Introduction to the Policy Forum: Macroeconomic Policies after the Global Financial Crisis

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This issue of the Policy Forum focuses on a theme that has dominated the policy-makers' agenda since the global financial crisis: how to conduct monetary and fiscal policies in a low interest rate environment.

The real natural interest rate, often referred to as r^* , is a reference rate for monetary policy-makers. Such an unobservable rate, which is the one the economy would be at in absence of nominal rigidities, is a crucial component of an interest rate gap that is key to understanding how monetary policy affects aggregate demand. The gap can be formalised as $r - r^*$, where r is the real interest rate influenced by the nominal policy rate directly managed by a central bank and the inflation rate prevailing in the economy. Suppose a negative shock hits the economic system and opens a recession, which leads to a deflationary phase. How can a central bank trigger a recovery? The typical move is that of lowering the nominal interest rate in order to drive the real interest rate r below r^* , therefore opening a negative real interest rate gap. Such a negative gap should have consumers intertemporally substitute future consumption with current consumption, therefore stimulating contemporaneous aggregate demand. The same should happen with investment due to a higher value of discounted future profits because of a lower market discount rate. In this way, output and inflation should go back to the pre-shock level.

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This textbook transmission mechanism is, however, in danger if r^* is low. At that point, engineering a negative real interest rate gap $r - r^*$ becomes complicated because to have $r < r^*$ the nominal interest rate has to be set to very low values. However, the presence of the zero lower bound on nominal interest rates works against aggressive expansionary monetary policy moves. Crucial questions are: what is the level of r^* after the crisis? What to do if it is very low?

These and related questions were tackled during the Macroeconomic Policy Meeting organised by the Macroeconomic Unit of the Melbourne Institute on 5–6 October 2017. The workshop featured 11 papers covering a broad spectrum of economic dimensions, including, among others, trade policies, unconventional monetary policies, macro-economic policies in the presence of heterogeneous agents, monetary policy and private debt, monetary policy uncertainty, and macroprudential policies. Alejandro Justiniano (Federal Reserve Bank of Chicago) offered a keynote lecture on mortgages and monetary policy, while Marc Giannoni (Federal Reserve Bank of Dallas) gave a talk on the natural real interest rate, during which he presented estimates of such a rate for the United States. Bottom line: r^* is very low, a finding that some recent literature associates with many other industrialised countries.

In light of what is written above, policy-makers' concerns for the 'new normal' characterised by a low r^* are not a surprise. Thus it is quite timely that the Melbourne Institute workshop also proposed a panel discussion involving Bruce Preston (University of Melbourne), Guy Debelle (Reserve Bank of Australia), Anella Munro (Reserve Bank of New Zealand) and Nigel Ray (Australian Treasury) on 'Macroeconomic Policies after the Global Financial Crisis'. The discussion triggered a very fruitful interaction with the audience—composed of academics and economists working in a variety of policy circles—on what policy-makers could have done in the recent past to avoid the great recession and what they could do now to avoid falling back to it.

The workshop, sponsored by the Reserve Bank of Australia, Reserve Bank of New Zealand, the Australian Treasury, the Department of Economics of the University of Melbourne and the Melbourne Institute, represented an excellent example of a successful interaction between academia and policy-making institutions on a relevant theme such as uncertainty. This issue of the Policy Forum elaborates on some of the elements that emerged during the workshop. The piece 'Macroeconomic Policies in a Low Interest Rate Environment: Back to Keynes?', written by Guay Lim, Giovanni Pellegrino and me, offers a brief overview of some of the papers that have recently documented a decline in r^* at an international level, discusses the possible reasons behind this and proposes an analysis of the consequences of such a situation for the design of monetary and fiscal policies. In 'Measuring Uncertainty and its Impact on a Small Open Economy', Lucy Greig, Amy Rice, Tugrul Vehbi and Benjamin Wong develop an index of macroeconomic uncertainty for New Zealand and show that policy-makers should also monitor the evolution of uncertainty because of its effects on the economic system. Finally, 'Towards Understanding Macrofinancial Impacts of LVR Policy in New Zealand: A General Equilibrium Perspective', written by Martin Fukac, Lucy Greig, and Daniel Snethlage, completes the set of

policies currently discussed among macroeconomists by proposing an investigation into macroprudential policies in New Zealand.

These three papers cover hot topics, and they blend very nicely in this special issue. It was a pleasure to read them and contribute to one of them. I feel privileged I was in the position of managing such an informative issue of the Policy Forum. I believe these three contributions will receive a warm welcome from academics and economists working for policy institutions in Australia and around the world.

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