

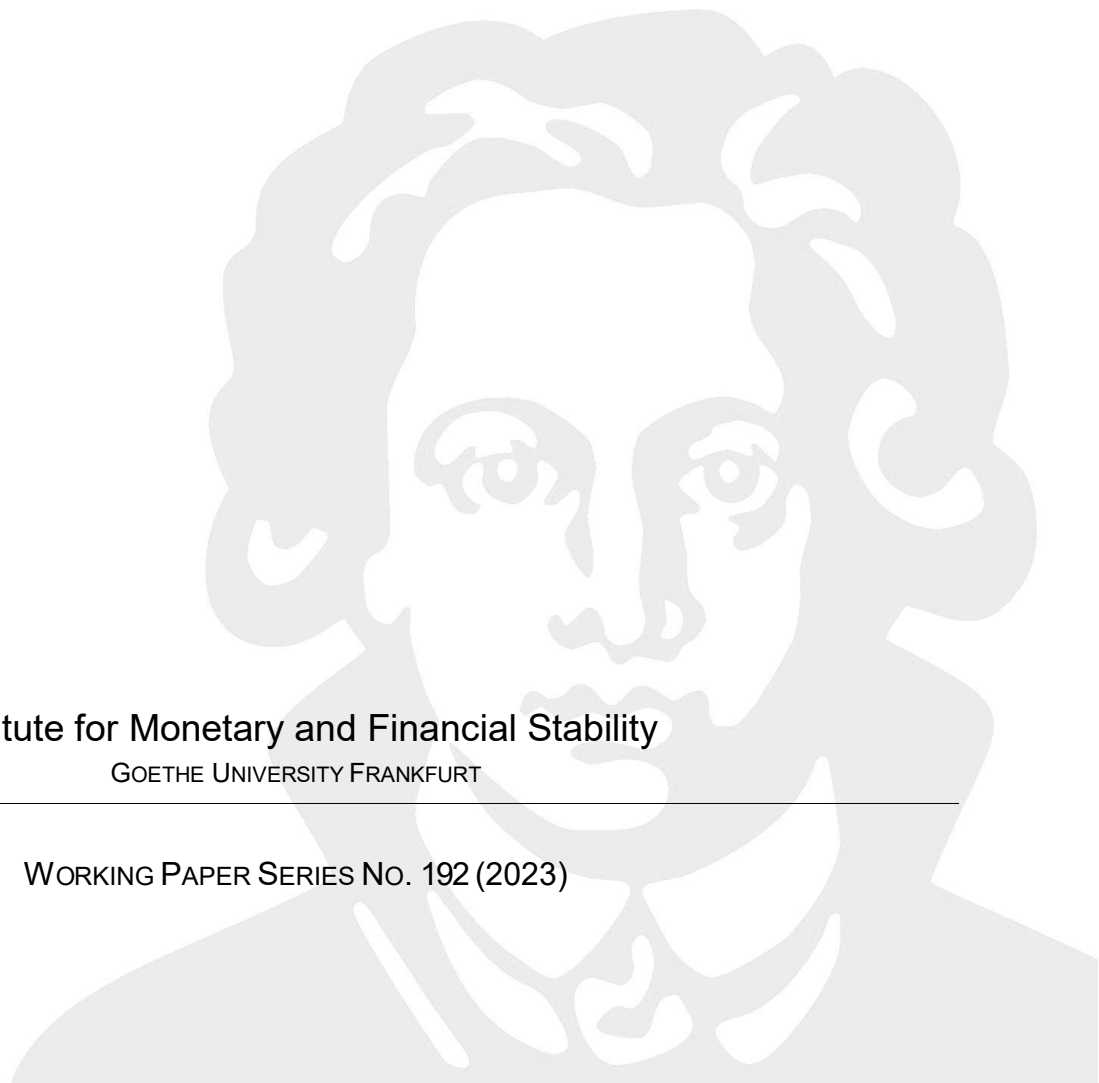
OTMAR ISSING

On the Importance of  
Central Banks Watchers

Institute for Monetary and Financial Stability  
GOETHE UNIVERSITY FRANKFURT

---

WORKING PAPER SERIES No. 192 (2023)



This Working Paper is issued under the auspices of the Institute for Monetary and Financial Stability (IMFS). Any opinions expressed here are those of the author(s) and not those of the IMFS. Research disseminated by the IMFS may include views on policy, but the IMFS itself takes no institutional policy positions.

The IMFS aims at raising public awareness of the importance of monetary and financial stability. Its main objective is the implementation of the “Project Monetary and Financial Stability” that is supported by the Foundation of Monetary and Financial Stability. The foundation was established on January 1, 2002 by federal law. Its endowment funds come from the sale of 1 DM gold coins in 2001 that were issued at the occasion of the euro cash introduction in memory of the D-Mark.

The IMFS Working Papers often represent preliminary or incomplete work, circulated to encourage discussion and comment. Citation and use of such a paper should take account of its provisional character.

## Institute for Monetary and Financial Stability

Goethe University Frankfurt

House of Finance

Theodor-W.-Adorno-Platz 3

D-60629 Frankfurt am Main

[www.imfs-frankfurt.de](http://www.imfs-frankfurt.de) | [info@imfs-frankfurt.de](mailto:info@imfs-frankfurt.de)

# **On the Importance of Central Bank Watchers**

**The SNB and its Watchers Conference**

**Bern, November 1, 2023**

**Otmar Issing**

**Center for Financial Studies**

## 1. Experience from the start of the ECB

In the course of monetary history, more precisely the age of paper currencies, it has been demonstrated that central bank independence, coupled with a suitably clear mandate, is the essential prerequisite for price stability.

Independence shields the central bank from political influence on its monetary policy decisions, but does not place it outside of the social order. Not least, independence obliges the central bank to use all available knowledge to design an adequate monetary policy to fulfil its mandate. Naturally, the central bank must foster dedicated contact with economic science for this purpose. This is achieved through a variety of channels, including continuous exchange with individual academics and relevant conferences. Of course, this necessarily entails openness to critical voices and a willingness to review and, if necessary, correct one's own position. Beyond this, is there still a need for a Watchers Conference?

This was the question facing the ECB, which had just been founded on 1 June, in the autumn of 1998. More precisely, this task fell to me, as a member of the Executive Board, responsible for the Directorates General Economics and Research. In all decision-making, I could rely on the support of President Wim Duisenberg. Support for the establishment of a Watchers Conference was a minor issue.

Rather than offering purely theoretical reflections on the benefits and drawbacks of a Watchers Conference, I will draw on my own experience in the following, which I believe provides general insights, despite certain aspects being unique to the ECB.

Although the ECB would only assume responsibility for the new currency, the euro, in January 1999, four organised groups had already formed in advance – besides various comments by individual academics and numerous journalists – and announced their intention to critically monitor the ECB’s monetary policy. The group, composed of prominent academics and working under the auspices of the Centre for Economic Policy Research (CEPR), published a critical paper titled “The ECB: Safe at Any Speed?” even before the euro was launched.<sup>1</sup>

Its verdict was short and scathing: “At present, it is both weak and unprepared” (p. XI). (This would be followed by other highly critical publications in the years to come).

How was the ECB (– how was I –) supposed to deal with this? Simply ignore it? The group was too prominent to ignore and had already garnered considerable public attention.

In any case, the new institution was surrounded by scepticism, sometimes to the point of malice. One argument was often brought into play. Here we had the ECB headquarters in Frankfurt, with just under 500 employees and no experience whatsoever, and on the other hand we had 11 national central banks, some of them quite powerful, with around 55,000 employees. How could a uniform monetary policy – one size must fit all – ever be introduced in this landscape?

I invited my colleagues from academia to an initial exchange of views. We could not exclude the other groups, of course, but time was far too short for separate meetings with all of them, especially during the particularly difficult

---

<sup>1</sup> Begg, D., De Grauwe, P., Giavazzi, F., Uhlig, H., Wyplosz, C., 30 Oct 1998 – The ECB: Safe at Any Speed? – Monitoring the European Central Bank 1, CEPR 1998.

early stages. I had also considered inviting all the groups collectively to the ECB, but I moved away from that idea and sought a “neutral ground” instead.

The Center for Financial Studies (CFS) in Frankfurt was the ideal choice, especially since I had been in close contact with its Director Axel Weber for a long time. Thus we were able to develop the concept for the first Watchers Conference together. The idea right from the outset was to have a very broad circle of participants, so alongside the four watchers groups there would be other academics, bank economists and members of the media. The ECB and its representatives would play an active role and engage in a lively exchange of views with the other participants.

At the invitation of the CFS, the first Watchers Conference was held in Frankfurt on 17 June 1999. The programme essentially consisted of an exchange of views between representatives of the watchers groups and me. The watchers were united in the view that the strategy announced by the ECB in October 1998 was not a promising blueprint for a successful monetary policy. Nevertheless, fundamental differences of opinion emerged between the groups. While the majority criticised the two-pillar strategy as such and in particular the prominent role of monetary factors, the representative of one group argued in favour of monetary targeting. These opposing positions made my line of argumentation considerably easier.

Besides the fundamental, theory-based discussion, I was keen to draw the critics’ attention to the special situation of the ECB and the extreme uncertainty associated with it. The data pool on which we had to base our monetary policy decisions was absolutely dire. Aside from monetary variables, we had no reliable data to work with at all. To give just one example: Eurostat’s unemployment data for the euro area were an aggregate of the figures from the

respective national statistics, which were compiled with time lags of between 3 and 9 months (!). For one thing, there were no historical data series available. With no ability to compare with the past, it was virtually impossible to correctly assess the significance of the current absolute figures. In their criticism that the ECB attached too much weight to survey results, it became apparent that the watchers lacked any grasp of the extent to which the European Monetary Union represented terra incognita for the new central bank. However, the ECB could not ignore the extreme uncertainty, not only about the data but also about the appropriate model (or models) to apply. Monetary policy was comparable to a boat that could only take its final shape at sea, when already in full sail.<sup>2</sup>

This is not the place to discuss the merits and problems of the ECB's strategy. In any case, I was able to point out that on the basis of this strategy, and with its prior announcement, we had evidently convinced the public and the markets, stabilised inflation expectations and thus gained credibility right from the outset. The available data told a clear story. In the transition from national currencies to the euro, in the ECB's assumption of monetary policy responsibility from the national central banks, perhaps the biggest regime change in monetary history, there are no breaks in the data for long-term interest rates, for example, to name just one important indicator. The critics had little to offer in response to this "success argument", except to say that the problems of the ECB's strategy would become apparent in time. In this context, the following anecdote is also significant in my estimation. Olivier Blanchard gave a dinner speech at the Sintra meeting on the occasion of the ECB's 20th anniversary – and Mario Draghi's upcoming departure – in which he dismissed

---

<sup>2</sup> Issing, O., *Monetary Policy in uncharted territory*, in: O. Issing, V. Gaspar, O. Tristani and D. Vestin, *Imperfect Knowledge and Monetary Policy*, Cambridge 2005.

the strategy chosen by the ECB in 1998 as entirely unsuitable. In a conversation two days later, I pointed out to him the undeniable success at the start and asked him to confirm whether he believes that some kind of “miracle” made this success possible in spite of such an unsuitable strategy. He could not offer me any real answer.

I mention this anecdote because, as a central banker, I have found myself in similar discussions with economic academics on a number of occasions. I will return to this later.

## 2. The onward development

In the course of the following years, the programme of the Watchers Conference was widened significantly incorporating current developments in the central bank policy landscape and the number of participants expanded considerably. However, monetary policy always remained at the heart of proceedings. My role, until I reached the end of my term in 2006, was to explain the ECB’s policy and engage in dialogue with the watchers.

Having some concerns about how things would proceed after my departure from the Executive Board of the ECB, I was able to convince President Trichet to open the next conference with a speech. This has now become tradition and is enough even in isolation to ensure that the event receives a great deal of attention. As a result of high demand, a limit on the number of participants had to be introduced a long time ago. The Watchers Conference has become a firm fixture in the calendar of important events and, with virtual and hybrid formats, has also survived the pandemic period. For years, Volker Wieland, Chairman



of the Institute for Monetary and Financial Stability (IMFS) at Goethe University Frankfurt and previously long-serving Director of the CFS, has acted as organiser and spiritus rector of the conference.

### 3. Experience of the Watchers Conferences

The Watchers Conference has now existed for almost 25 years. Even after stepping down from the ECB Executive Board, I have attended (almost) every edition. In the following I offer my assessment of the conference, which is understandably based primarily on the first eight years.

#### a) From the central bank perspective

During my tenure, I maintained a lively exchange of views with numerous economic academics from all over the world. The ECB, which became upon its founding the world's second most important central bank, attracted the utmost interest, so there was certainly no shortage of attendees. In addition, contact with members of the media and financial market participants came with the territory.

Yet what was unique about the Watchers Conference was the opportunity to hold a public exchange of views with all the aforementioned groups present. Especially in the early days, this presented the chance to explain the ECB's policy. By engaging with the critics, I was able to clear up many a misunderstanding on the spot, so to speak – and this generally held true in the

period that followed. In most cases, stimulated by points raised by the critics, I continued to discuss certain aspects with my experts at the ECB after the end of the conference. The result usually influenced our policy in one way or another, most often confirming our course.

The ECB was confronted with the accusation that it lacked transparency from the very beginning. This is not a discussion I can address here. However, the critics completely overlooked the fact that the ECB, through the Watchers Conference, gave insights into its policy that were unique in the central banking world. This important contribution to the frequently voiced demand for transparency should not be underestimated.

#### b) Academia

Engaging with academia is an important challenge for any central bank. Especially for someone like me, who comes from academia, this requirement was a top priority. As such, it was the main focus of the Watchers Conference from the very beginning – and has remained so to this day.

To sum up a whole body of experience in a nutshell: I learned a tremendous amount from this exchange of views, whether critical or encouraging.

However, it would be wrong to conceal some rather negative experiences. Academics often submitted contributions that had long been known from their publications and that lacked any direct relation to the concrete issue at hand. I would like to explain this problem in more detail using what strikes me as a blatant example. Of course, I had known for a long time that prominent members of academia thought little of our two-pillar strategy, and were

generally just as sceptical about the consideration of monetary factors. The sometimes aggressively stated demand was that the ECB should join the mainstream of inflation targeting. To one of these critics, who had identified problems in our strategy which were not totally different from mine, I asked the simple question: If we opt for inflation targeting, we must be able to rely on the inflation forecast. Quite apart from the lack of experience with appropriate models for the euro area, which had just been created, what is to be done about the disastrous situation with data? Among other examples, I pointed to significant differences in the output gap estimates of the IMF, the OECD, the European Commission and our own first estimate. I asked him which one we should choose. I never received an answer. This did not prevent this colleague – like many others- from continuing to vehemently criticise the ECB strategy and to call for the introduction of inflation targeting. (Incidentally, it should be mentioned that a few years later the current output estimates of the time were revised considerably, in some cases even the sign had changed!)

This example can certainly be seen as representative of many ECB critics. I have frequently encountered, well beyond my term of office, academics who made little effort to update their positions, which are well known from the literature, to the issue at hand at the Watchers Conference.

Lastly, there are said to be some academics who base the degree of their criticism on the impact it will have on the attention by the public, which leads them to take extreme positions

c) The markets and media

Financial industry economists and media representatives have always been among the target group of “The ECB and Its Watchers” Conference. The reasons are obvious. Monetary policy measures have a direct impact on actors in the financial sector, whose reactions crucially determine the transmission mechanism and thus the efficiency of monetary policy. On the other hand, it is important for the central bank to correctly anticipate how the markets will respond. Therefore, an interplay developed between the central bank and the markets at the conference.

When it comes to communication, the central bank faces the difficulty of multiple layers of recipients. The ECB Watchers Conference offered a unique opportunity to address representatives of academia, the markets and the media all at the same time. The central bank primarily reaches the public via the media, which makes media reception a crucial factor. We therefore tried to actively involve the media representatives as well as informing them about our policy. At the 2003 conference, for example, a special panel was devoted to the topic “The Press as ECB Watchers”.

The particular challenge for the ECB – besides the diversity of the euro area, with different experiences and languages in the individual countries – was to reach out to international media. On the global level a hardly solvable problem lies in the dominance of one newspaper.

While the press conferences following the Governing Council meetings have arguably become the most important instrument of the ECB’s communication on current monetary policy, the Watchers Conference continues to provide the opportunity for dialogue on the strategy and other more fundamental issues.

#### 4. Conclusion

In the following, I will attempt to summarise in a few theses the experience gained from over 20 years of the ECB Watchers Conference.

- 1) The agenda of the conference should focus on concrete problems of monetary policy and related areas.
- 2) The central bank should actively participate and be open to a free exchange of views.
- 3) The central bank should discuss the results of the conference internally and, if necessary, consider changes in its policy. On the other hand, it might also see a confirmation of its strategy and policy – anything but a minor aspect.
- 4) Top representatives from academia should be invited as watchers. Great emphasis should also be placed on the consideration of different directions. The same applies to representatives of the markets and the media.
- 5) After several events, the contributions of the academics should be critically reviewed by an external reviewer. To exploit the disciplinary effect, this “watching of the watchers” should be announced in advance.
- 6) With the right format and a suitable selection of watchers, such a conference can play an important role in the success of the central bank and its reputation.

## IMFS WORKING PAPER SERIES

### *Recent Issues*

<b>191 / 2023</b>	Anh H. Le	Climate Change and Carbon Policy: A Story of Optimal Green Macroprudential and Capital Flow Management
<b>190 / 2023</b>	Athanasios Orphanides	The Forward Guidance Trap
<b>189 / 2023</b>	Alexander Meyer-Gohde Mary Tzaawa-Krenzler	Sticky information and the Taylor principle
<b>188 / 2023</b>	Daniel Stempel Johannes Zahner	Whose Inflation Rates Matter Most? A DSGE Model and Machine Learning Approach to Monetary Policy in the Euro Area
<b>187 / 2023</b>	Alexander Dück Anh H. Le	Transition Risk Uncertainty and Robust Optimal Monetary Policy
<b>186 / 2023</b>	Gerhard Rösl Franz Seitz	Uncertainty, Politics, and Crises: The Case for Cash
<b>185 / 2023</b>	Andrea Gubitz Karl-Heinz Tödter Gerhard Ziebarth	Zum Problem inflationsbedingter Liquiditätsrestriktionen bei der Immobilienfinanzierung
<b>184 / 2023</b>	Moritz Grebe Sinem Kandemir Peter Tillmann	Uncertainty about the War in Ukraine: Measurement and Effects on the German Business Cycle
<b>183 / 2023</b>	Balint Tatar	Has the Reaction Function of the European Central Bank Changed Over Time?
<b>182 / 2023</b>	Alexander Meyer-Gohde	Solving Linear DSGE Models with Bernoulli Iterations
<b>181 / 2023</b>	Brian Fabo Martina Jančoková Elisabeth Kempf Luboš Pástor	Fifty Shades of QE: Robust Evidence
<b>180 / 2023</b>	Alexander Dück Fabio Verona	Monetary policy rules: model uncertainty meets design limits
<b>179 / 2023</b>	Josefine Quast Maik Wolters	The Federal Reserve's Output Gap: The Unreliability of Real-Time Reliability Tests
<b>178 / 2023</b>	David Finck Peter Tillmann	The Macroeconomic Effects of Global Supply Chain Disruptions

<b>177 / 2022</b>	Gregor Boehl	Ensemble MCMC Sampling for Robust Bayesian Inference
<b>176 / 2022</b>	Michael D. Bauer Carolin Pflueger Adi Sunderam	Perceptions about Monetary Policy
<b>175 / 2022</b>	Alexander Meyer-Gohde Ekaterina Shabalina	Estimation and Forecasting Using Mixed-Frequency DSGE Models
<b>174 / 2022</b>	Alexander Meyer-Gohde Johanna Saecker	Solving linear DSGE models with Newton methods
<b>173 / 2022</b>	Helmut Siekmann	Zur Verfassungsmäßigkeit der Veranschlagung Globaler Minderausgaben
<b>172 / 2022</b>	Helmut Siekmann	Inflation, price stability, and monetary policy – on the legality of inflation targeting by the Eurosystem
<b>171 / 2022</b>	Veronika Grimm Lukas Nöh Volker Wieland	Government bond rates and interest expenditures of large euro area member states: A scenario analysis
<b>170 / 2022</b>	Jens Weidmann	A new age of uncertainty? Implications for monetary policy
<b>169 / 2022</b>	Moritz Grebe Peter Tillmann	Household Expectations and Dissent Among Policymakers
<b>168 / 2022</b>	Lena Dräger Michael J. Lamla Damjan Pfajfar	How to Limit the Spillover from an Inflation Surge to Inflation Expectations?
<b>167 / 2022</b>	Gerhard Rösli Franz Seitz	On the Stabilizing Role of Cash for Societies
<b>166 / 2022</b>	Eva Berger Sylwia Bialek Niklas Garnadt Veronika Grimm Lars Othér Leonard Salzmänn Monika Schnitzer Achim Truger Volker Wieland	A potential sudden stop of energy imports from Russia: Effects on energy security and economic output in Germany and the EU
<b>165 / 2022</b>	Michael D. Bauer Eric T. Swansson	A Reassessment of Monetary Policy Surprises and High-Frequency Identification
<b>164 / 2021</b>	Thomas Jost Karl-Heinz Tödter	Reducing sovereign debt levels in the post-Covid Eurozone with a simple deficit rule