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# Central Banks and Globalisation

Introduction to the 10th Bundesbank Spring Conference

(in cooperation with the IMFS)

in Eltville

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## 1 Introduction

Ladies and gentlemen, it is a pleasure for me to welcome you to the 10th Bundesbank spring conference, which has been organised in cooperation with the Institute for Monetary and Financial Stability (IMFS). And for those who have never been to our training centre before – welcome to our facilities here! I am sure you will like this location, not least because of its direct proximity to the Rhine and the picturesque town centre of Eltville.

The title of this spring conference is “Central Banks and Globalisation”. With regard to globalisation, I think it is quite justified to say that this term has been a key economic topic over the past ten years – and I don’t think this is going to change in the foreseeable future. Why is this so? Nowadays, there is almost no economic phenomenon that is not influenced – at least to a certain extent – by what we call “globalisation”. “Globalisation” seems to be everywhere – a search on Google yields more than 25 million hits.

Evidently, the process of globalisation has many different historical, political, social, and economic facets. Some of the economic facets – in particular, those that are of interest to central banks – are going to be covered over the course of the next two days, as highlighted in the conference programme. When looking at this programme, I am very pleased to see that – once again – we have been able to bring together many distinguished participants who are going to present the results of their recent research on globalisation-related



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issues. I hope or, more specifically, I am pretty sure that this conference will generate useful insights and that it will lead to a productive exchange of ideas and views among the participants.

In my remarks over the next 15 minutes or so, I shall cover some issues related to globalisation which are of particular importance to central bank policymakers. Therefore, after highlighting some basic characteristics with respect to globalisation, I shall focus on globalisation and inflation, leaving aside the important and interesting issue of globalisation and monetary policy.

In this context, the fundamental question is whether globalisation has altered the setting for central banks, in particular with a view to delivering price stability. My basic conclusion will be that globalisation has not changed the rules of the game for stability-oriented central banks.

## 2 Globalisation: basic characteristics

To start off, let me briefly restate some basic observations with respect to globalisation. Notwithstanding the widespread use of the term “globalisation”, there is neither a single definition of what globalisation actually means nor a single key figure for measuring its scale and evolution over time.

In my view, a useful working definition of the term “globalisation” is that, quite fundamentally, it describes the ongoing process of the international division of labour. In the wake of this process, the domestic markets for goods and services, as well as the labour markets, are becoming more and more interlinked and interdependent internationally.



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The process of globalisation has been evolving among developed countries for many decades now. Therefore, in contrast to what some observers might think, the current process of globalisation per se is neither new nor particularly unique. Rather, it is the logical outcome of efforts to further exploit the benefits of the division of labour on an international scale.

However, the pace of this process has been increasing rapidly for more than a decade now. Declining costs of telecommunication and transportation have been the main drivers of this development. There have, moreover, been considerable improvements in skill levels in many regions of the world as well as in the product quality of goods and services that are produced in formerly rather underdeveloped countries. Additionally, what has changed the face of globalisation is the fact that globalisation nowadays extends to a larger group of countries than in the past.

More and more countries which used to have rather closed economies have opened themselves to the world market. Thus, new players have entered on to the global stage and are becoming increasingly relevant economic powers and, as a result, competitors to established developed countries.

As a consequence, the process of globalisation is leading to a shift in weights in the global economy. This shift is nothing exceptional. In fact, it is a quite natural development, which simply reflects the continuously evolving global economic landscape. Let me now come to the subject of globalisation and inflation.

## 3 Globalisation and inflation

Speaking on globalisation and monetary policy at the current juncture, I feel tempted to refer to the famous song by Bob Dylan "The times they are a-changin". One verse has several great lines of advice for economists:

Come writers and critics
Who prophesize with your pen
…………………
And don't speak too soon
For the wheel's still in spin
…………………….
The loser now
Will be later to win
For the times they are a-changin'.

It is only some months ago that a lot of writers and critics "prophesized" that, in an era of globalisation, inflation is, and should not be, a cause for concern among monetary policy-makers. With the benefit of hindsight, though, they should have followed Bob Dylan's advice: "But don't speak too soon, for the wheel is still in spin", as inflation has reappeared on a global scale.

Moreover, in the face of the global financial turbulence of the past months, the debate in the media has switched from being about a "goldilocks environment" to the inherent risks of entering a period of perceived stagflation.

Considering that "the times they are a-changin'", as Bob Dylan put it, a medium- to longer-term perspective is of the essence. Taking such a medium-term view, I have always been one of the sceptics with regard to the "globalisation = low inflation"-paradigm, notwithstand-



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ing the fact that the notion of “more globalisation equals lower inflation” is shared by many observers – or was, at least, shared by them until a few months ago.

What is the underlying reason for this widespread assumption? Evidently, since the beginning of the 1990s, the ongoing advance of globalisation has coincided with a marked decline in inflation rates and inflation volatility worldwide. It is not surprising that a causal interpretation has been given to these parallel developments with increased globalisation being seen as the agent that has driven down inflation rates. And, indeed, over the past ten years, price rises in manufacturing imports in the euro area have been rather subdued, thus dampening – other things being equal – the increase in the overall consumer price index.

At first sight, this seems to support the view of “opportunistic disinflation” according to which globalisation has been a key factor in lowering inflation rates. However, the past few months, in particular, have shown that there are obvious reasons why many observers should have been more cautious before drawing such conclusions.

In fact, globalisation does not necessarily only have a dampening effect on inflation. To the contrary, the opposite might be the case as well; globalisation might be a major driver of inflationary pressures.

The reason for this is as follows: Increasing international competition, which is an element of today’s globalised world and tends to dampen inflationary pressure, cannot be separated from the globalisation related inflationary effect of higher energy and commodity prices. Both developments are driven by the same force, namely the integration of more and more countries into the world economy. Hence, both developments are the two sides of the same “globalisation coin”. Put differently: If one thinks about the price effects of globalisation, one



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should not only consider declining prices of textiles and electronics, but also bear in mind higher fuel and heating invoices.

It is difficult to estimate the net effect of these various terms-of-trade shocks on the overall price level in industrial countries. But, in my view, there is no reason to assume that the overall outcome has been one of a more benign inflation outlook.

Not least with this in mind, I have – as I mentioned earlier –always been quite sceptical about whether the story of globalisation adequately captures the aspects that are most important for explaining the decline in inflation rates. It is monetary policy that, over the medium to long term, pins down trend inflation. Central bankers ultimately have to do their job to deliver price stability.

The decline in trend inflation worldwide is therefore better explained by monetary policy in many countries being geared to price stability, which is enhanced by the increasing independence of central banks in achieving their goals.

Let me conclude as follows: In contrast to what was a widespread notion until a few months ago, there are no signs that globalisation has led to a more benign inflationary environment for central banks. In particular, in the current setting of heightened price pressure due to food and energy price increases, it is becoming obvious that globalisation does not necessarily produce tailwinds for a stability-oriented monetary policy. In fact, “headwinds induced by globalisation” are a better description of the drivers of today’s inflationary pressures.



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Thus, globalisation by no means reduces the need for a stability-oriented domestic monetary policy which is robust enough to deal with an ever-evolving environment. Generally, it is monetary policy that determines inflation in the medium to long run.

The fact that this idea has now become accepted in more and more countries worldwide is the key factor in explaining the global decline in inflation rates we have been observing over the past decades.

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