

Invitation

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The natural interest rate: concept, measurement and monetary policy implications

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Abstract

Recent economic developments reinforce questions about what a new equilibrium in the global economy might look like. This is the case for both macroeconomic developments – how to interpret the continued weak global growth – and financial markets – how much stimulus near-zero interest rates provide, and how far policy rates in the United States and elsewhere have to rise during normalisation. Conceptually, the natural rate of interest could help answer these questions: it has traditionally been defined as the interest rate that would prevail when the economy is operating at potential and prices (inflation) are stable. Hence, knowing the level of the natural rate would allow central banks to assess how far current interest rates are from equilibrium. However, the natural rate is a multi-layered concept. Traditionally interpreted as a domestic macroeconomic equilibrium, in an open economy the natural rate can also be seen as representing a global macroeconomic equilibrium. In addition, the natural rate is unobservable and hence depends fundamentally on views about how the economy works. Various empirical approaches indicate that the natural rate has fallen in recent decades, although its current level may not be unprecedented.

Dubravko Mihaljek is Head of Macroeconomic Analysis in the Monetary and Economic Department of the Bank for International Settlements (BIS) in Basel. His main responsibility is drafting background notes for bimonthly Global Economy Meetings of central bank governors. Before joining the BIS in 1999, Dubravko Mihaljek was Economist and Senior Economist in Fiscal Affairs, European and Asian Departments of the IMF in Washington DC (1990–99); and Assistant Researcher at the Economics

Institute, Zagreb (1982–89). Studied economics at the University of Pittsburgh (PhD, 1990); University of Minnesota (MA, 1986); and University of Zagreb (Dipl oec, 1981). Currently on a sabbatical leave in the Economic Analysis Department of the Austrian National Bank.

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