

## 3 Questions: Roberto Rigobon on world markets

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World markets produced a roller-coaster ride for investors in August. *MIT News* recently spoke to international economics expert Roberto Rigobon to hear his views about the chaos investors have been facing. Rigobon is the Society of Sloan Fellows Professor of Management at the MIT Sloan School of Management, and a founder of MIT's Billion Prices Project, an innovative real-time inflation tracker.

**Q.** The month of August was seemingly the most volatile in world markets since the financial crisis that peaked in 2008 and extended into 2009. What strikes you as noteworthy about the market activity we have just seen?

**A.** I have learned five things. One, markets and consumers have been growing impatient with the lack of success of economic policy, and the volatility is a kind of disenchantment with that. The political discussion in the United States was far more damaging and immature than anyone ever expected.

Second, I was extraordinarily surprised by the actions of the European Central Bank (ECB), in a good sense. For a long time they had been signaling that they were not going to buy sovereign debt, they didn't want to participate in resolving the fiscal issues in Europe — then suddenly they started buying sovereign debt from countries on the periphery, in the Mediterranean. Most of the analysts that have been looking at Europe were saying that was the only solution.

Third, the central bank in the United States is taking the right approach. I think the Federal Reserve has implicitly decided it has to try to rescue the economy. The cost of that is going to be inflation, but it's more important to employ people than to protect inflation from moving from 2 to 4 percent. I think we can all live with 4 percent inflation for a while, but 10 percent of the population cannot live without jobs. So I think the Fed finally decided that [fiscal policy, controlled by the White House and Congress] will never get its act together. I'm optimistic on that ground.

My last two lessons are about reforms. The only way we are going to get out successfully from this lackluster recovery is with reforms, and the only place doing that is Europe as opposed to the United States, and that's very surprising. European countries like Spain are working to pass constitutional reforms to fix their fiscal nightmares. In the [United States](#), we need financial reforms. With the banking reform [bill], still nobody knows how it's going to be implemented. I mean, it's been three years since the crisis. What is happening? So it's no wonder why we're still not lending. In the end there's no new investment, no new companies and no new jobs.

Q. You say the Fed has signaled it wants to be more active. But what can it do at this point to help kick-start growth?

A. What the Fed should do is similar to what the ECB did: They should go out and start buying assets. So if banks are willing to lend to companies that will create new jobs, the Fed will provide implicit backing. The market is not willing to lend, but there are investment opportunities out there — we have good ideas, new sources of exports, new products we could be building, but nobody will do it. That's more or less what happened in Europe. My sense with the Fed discussion is they have realized there are no more bullets coming from the Treasury, and there will be very little from Congress. I'm reacting to [the Fed's]

rhetoric. By buying debt instruments from the financial system, as if we were in the middle of the crisis, hopefully that will be enough to start reactivating the economy. By the way, the central bank has done a superb job in the last three years. Our crisis could have been much worse if it weren't for the actions of the Fed.

Q. As far as inflation goes, MIT's own Olivier Blanchard, as chief economist of the International Monetary Fund, suggested in early 2010 that the central bank could change its inflation target from 2 percent to 4 percent (which could be more conducive to growth). That proposal got a mixed reaction. But you just indicated that higher inflation, at least temporarily, would be acceptable. Are people more receptive to the idea now?

A. I agree it's not the end of the world to move from 2 percent inflation to 4 percent inflation. It's different when you announce that, as opposed to using the "Britney Spears Theorem." Let me explain. There are two ways of getting 4 percent inflation. One is saying you want to deliver 4 percent. Another is saying you are protecting against inflation, but that suddenly we have 4 percent. And you say, "Oops, I did it again." That's the Britney Spears part. It's way more effective to say your long-term goal is 2 percent. If I change the long-term target to 4 percent, it might affect bond prices and expectations. I want bond markets to know it's going to be 2 percent in the long term, but it won't be 2 percent next month, and in the short run, because we're going through this process, so I will allow it to get higher.

If that means 4 percent for six months, or 3 percent for nine months, nobody knows for sure. But I think everybody who is not too attached to ideology will agree with Olivier that it would be healthy to free that target. I mean, in Europe, it's 1 percent. You have to be kidding me. Now it's very interesting, because the Germans have an objective of 1 percent, and they have had 2 percent [inflation](#) for six months. So they

are doing the Britney Spears thing. In Britain the target is 2 percent, and since February the rate has been 4 percent.

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