

Trichet and Bernanke differ on strategy

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By Ralph Atkins in Frankfurt

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Transatlantic differences over monetary strategy erupted into the open on Friday as the European Central Bank sought to modernise its policy of relying on money supply measures as an inflation early-warning system.

Jean-Claude Trichet, ECB president, used a Frankfurt conference to stress the importance of indicators such as M3, the broad money supply measure.

But in contrast, Ben Bernanke, US Federal Reserve chairman, said a heavy reliance on money supply measures "would seem to be unwise in the US context," although money growth data might still offer important signals about future economic developments.

Mr Trichet refused to comment on whether differences between the US and European economies justified a different approach to the use of money supply data. But he acknowledged the need for monetary analysis to become more sophisticated, taking into account financial innovation.

Lucas Papademos, ECB vice-president, signalled that at least some on the bank's governing council would like to merge the monetary component and the ECB's more general economic analysis into a single "fat pillar" of analysis and revealed that preliminary work that could lead to such a project was already under way at the ECB. "But this will be a larger pillar in which money will continue to play a prominent role in guiding our monetary policy decision making," he said.

The ECB's "monetary pillar," largely inherited from Germany's Bundesbank, is controversial among economists because of confusion about the implications of money supply for inflation. At the ECB-hosted conference, prominent officials from the Frankfurt institution made clear that they saw significant scope for refinements. Recent fast growth in M3 and in credit figures has encouraged speculation that the ECB will continue lifting interest rates further in 2007, after an expected quarter percentage point rise in its main rate to 3.5 per cent in December, even though inflation is currently within the central bank's definition of price stability – a rate "below but close" to 2 per cent.

ECB research presented at the conference was open about the shortcomings of the bank's monetary analysis in its eight-year history.

Mr Trichet said the monetary analysis had been instrumental in the ECB's decision to start raising interest rates in December 2005. At the time many economists and politicians feared its actions were premature given the uncertainties then about the eurozone's economic outlook. "Without our thorough monetary analysis, we could have been in danger of falling behind the curve," he said.

Mr Bernanke pointed to larger methodological problems in the US. "The rapid pace of financial innovation in the US has been an important reason for the instability of the relationships between monetary aggregates and other macroeconomic variables."

Changes in payment technologies and individuals' behaviour had meant usage of different kinds of accounts "have at times shifted rapidly and unpredictably".

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