

Thomas Laubach – A world-class economist and a dear friend

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Across the OECD, Thomas' family and friends are in our thoughts.



Photo source: "Der einflussreiche Deutsche im Hintergrund der Fed", Handelsblatt, 9 April 2018

Rarely does an economist have the opportunity to exert a direct influence on policymaking and contribute to better outcomes. Thomas Laubach did just that during his 23-year

tenure in the Federal Reserve system, where he rose to the key position of Director of Monetary Affairs and directly advised Chairwoman Janet Yellen and Chairman Jerome Powell. Known worldwide for his innovative work on the natural rate of interest – famously labelled “R-star” – he was also the author and co-author of over twenty articles published in key academic journals. His 2003 piece with John Williams, “Measuring the natural rate of interest”, was quoted no less than 1100 times (Google scholar) and his 1998 book with Ben Bernanke, Frederic Mishkin and Adam Posen on “*Inflation targeting: lessons from international experience*” received almost 3000 quotations.

Thomas was also a close friend of the OECD. He spent two years in the OECD Economics Department, in 2003-05, as part of a long-standing programme where the Federal Reserve dispatches one their promising researchers to Paris, with mutual benefits for both institutions. There, he worked on two OECD countries – the largest economy (United States) and the smallest one (Iceland). Thomas was passionate about both, and his intellectual contributions continued to resonate in Reykjavik for many years. His unfailing kindness, collegiality and equanimity, to borrow Jay Powell’s words, won him many good friends in Paris. Back at the Fed, he remained involved with the OECD, notably as a regular and key participant in working groups, including the small but influential network of “Monetary Experts”, which has been recognized as a key platform to exchange views on the latest in monetary economics. A loyal friend, he stayed in touch with many of his former OECD colleagues.

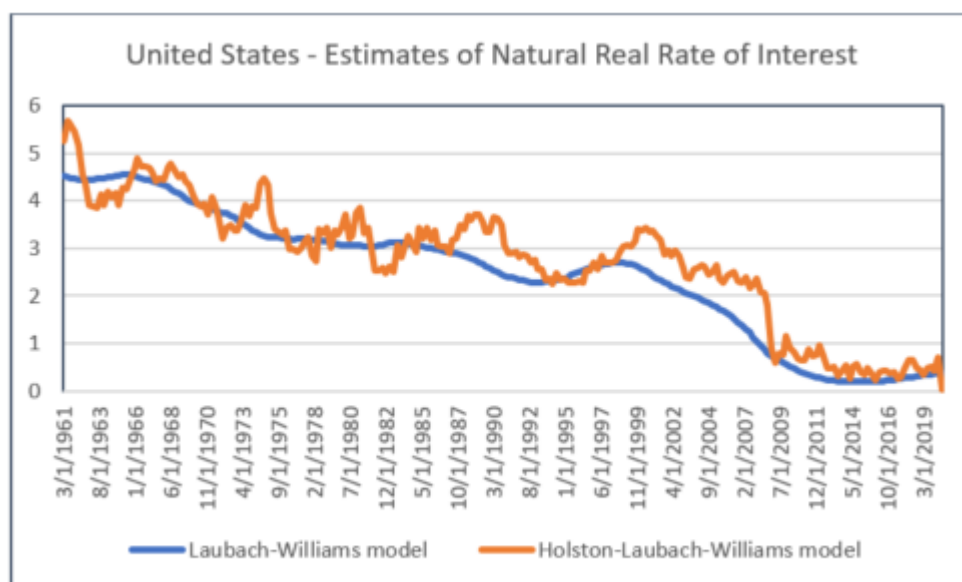
Born in Germany in 1965, Thomas graduated from the University of Bonn before embarking on one of his countless transatlantic trips. At Princeton University, he started to work with then Professor Ben Bernanke, who supervised his PhD in Economics, which led to their investigation of the international experience with inflation targeting. Thomas stayed close to

Ben Bernanke and their joint efforts eventually led to the Federal Reserve adopting in 2012 a long-run inflation objective of 2% as a new framework to anchor inflation expectations. After a brief stint at the Federal Reserve Branch of Kansas City, Thomas joined the Board of Governors in Washington DC, where he published his important work on the natural rate of interest.

The idea of a neutral interest rate was already present in John Taylor's monetary policy rule as the interest rate that should prevail when the economy is operating at potential with stable inflation. However, there was no consensus on how to estimate it. Together with John Williams, now President of the New York Fed, Thomas elaborated a methodology to estimate a time-varying natural rate of interest, depending on the trend growth rate of output. It used the Kalman filter to jointly estimate the natural rate of interest, potential output, and trend growth. The Laubach-Williams model ("LW R-star") found the estimated natural rate of interest to have varied substantially over time in the United States. This turned out to be an important insight because R-star was previously assumed to be stable, with different monetary policy implications. This work was extended in 2017, together with Kathryn Holston (Holston-Laubach-Williams, "HLW R-star"), this time covering several countries.

Thomas's most influential insight was to show that the natural rate of interest in real terms has declined dramatically over the past four decades – and indeed has remained close to zero since the global financial crisis (see the figure below). Explanations for this decline include "shifts in demographics, a slowdown in trend productivity growth, and global factors affecting real interest rates" (Holston, Laubach and Williams, 2017). Estimates produced for other countries have shown similar declines close to the zero bound, thus leading to the conclusion that global factors have played a crucial role in shaping natural rates of interest. Without doubt, such

findings played a crucial role in convincing central bankers in OECD countries that they should not hesitate to cut interest rates to historical lows and maintain them there, while conducting asset purchases to circumvent the zero-lower bound.



Source: Federal Reserve Bank of New York (2-sided LW model).

On top of his heavy responsibilities as Director of Monetary Affairs since 2015, Thomas continued his research work and remained an influential thinker, helping to modernize the Federal Reserve's policy framework. Most recently, and a few days before passing, he published a "FEDS Note" with several co-authors that provides the backbone behind the important reform announced by Chairman Powell at the 2020 Jackson Hole Symposium, namely the clarification that the inflation target is "symmetrical" and that the Fed will be flexible in seeking full employment given uncertainties about the natural rate of unemployment – compounded by the COVID-19 crisis – and the flatter Phillips curve (Altig et al., 2020).

While he spent most of his career in Washington DC, Thomas never forgot his native country. Returning to Germany during 2008-12, he held the position of Professor and Chair of Macroeconomics at the Goethe University of Frankfurt, where many PhD students benefited from his wisdom and friendly

advice. Thomas will be sorely missed on both sides of the Atlantic Ocean, but his intellectual contributions will continue to thrive for a long time.

References: Holston, Kathryn, Thomas Laubach and John C. Williams (2017), "Measuring the Natural Rate of Interest: International Trends and Determinants", *Journal of International Economics*, vol. 108, Supplement 1, pp. S59-S75.

Altig, David, Jeff Fuhrer, Marc P. Giannoni and Thomas Laubach (2020), "The Federal Reserve's Review of Its Monetary Policy Framework: A Roadmap", *FEDS Notes*, Washington DC: Board of Governors of the Federal Reserve System, August 27, 2020.