

Comments on
**“A Tale of Two Decades:
The ECB’s Monetary Policy at 20”**
by M. Rostagno et al.

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***These remarks solely reflect the views of the discussant
and should not be interpreted as reflecting the views of
any other person or institution.***

Lessons Learned Over Many Decades

- **Price stability** is crucial for sustaining economic growth and broad-based prosperity.
- The central bank is the **public institution** that is responsible for fostering price stability via the appropriate setting of monetary policy.
- The central bank must have the **tools** and **operational independence** to perform this task.
- The central bank must be **innovative** and **proactive** in identifying key risks and formulating contingency plans (*“stress tests for monetary policy”*).

Lessons Learned in Recent Years

- **Has the monetary toolbox been sufficient for fostering economic recovery & price stability?**
 - **NO**
- **Will the existing toolbox be adequate for mitigating the next severe adverse shock?**
 - **NO**
- **How can central banks fortify this toolbox?**
 - **Establish CBDC (central bank digital cash) and mitigate the ELB by imposing fees on large transfers between paper cash & CBDC.**

Federal Reserve Staff Analysis of QE

“Asset purchases...affect term premiums and thus longer-term interest rates primarily via their effect on private sector expectations of the future path of the stock of longer-term securities held by the Federal Reserve.”

Federal Reserve Board Staff Memo to FOMC, August 2012

“The balance sheet expansion lowers the path of the term premium on 10-year Treasury yields.”

Federal Reserve Board Staff Working Paper, January 2019

Was QE3 Helpful or Counterproductive?

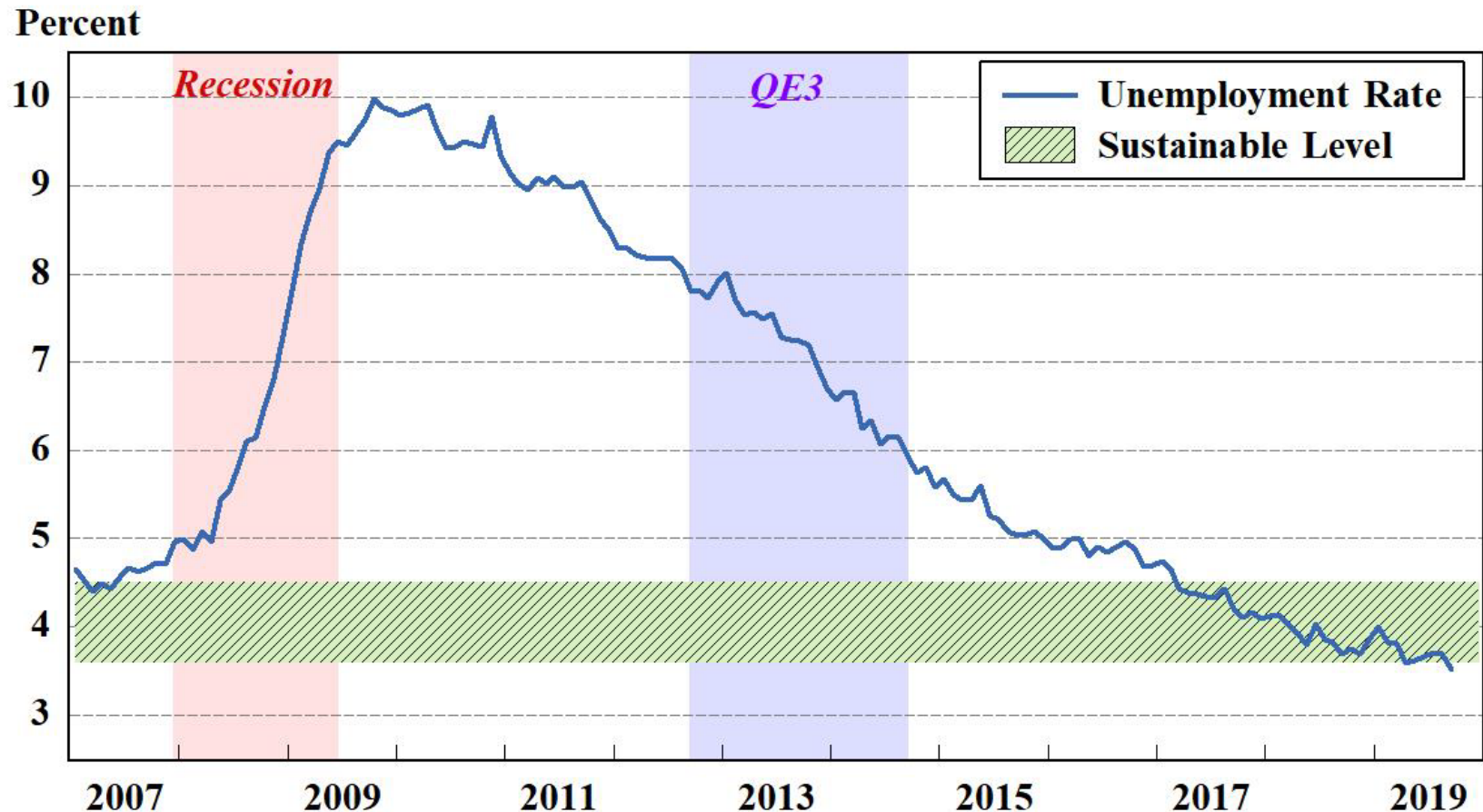
| <i>Event</i> | <i>Term Premium on 10-Year Treasury</i> | |
|--|--|--|
| | <i>Predicted Change (basis points)</i> | <i>Actual Change (FRBNY Measure)</i> |
| FOMC Meeting <i>(Sept. 2012)</i> | -13 | +17 |
| FOMC Minutes <i>(Oct. 2012)</i> | -8 | +15 |
| FOMC Meeting <i>(Dec. 2012)</i> | -2 | +11 |
| JEC Testimony <i>(May 2013)</i> | -1 | +11 |
| FOMC Meeting <i>(June 2013)</i> | +1 | +14 |

U.S. Financial Market Narratives

“Most primary dealers stated that **changes in perceptions or heightened uncertainty about the FOMC’s view of appropriate monetary policy were key factors that generated the rise in the 10-Treasury yield.”**

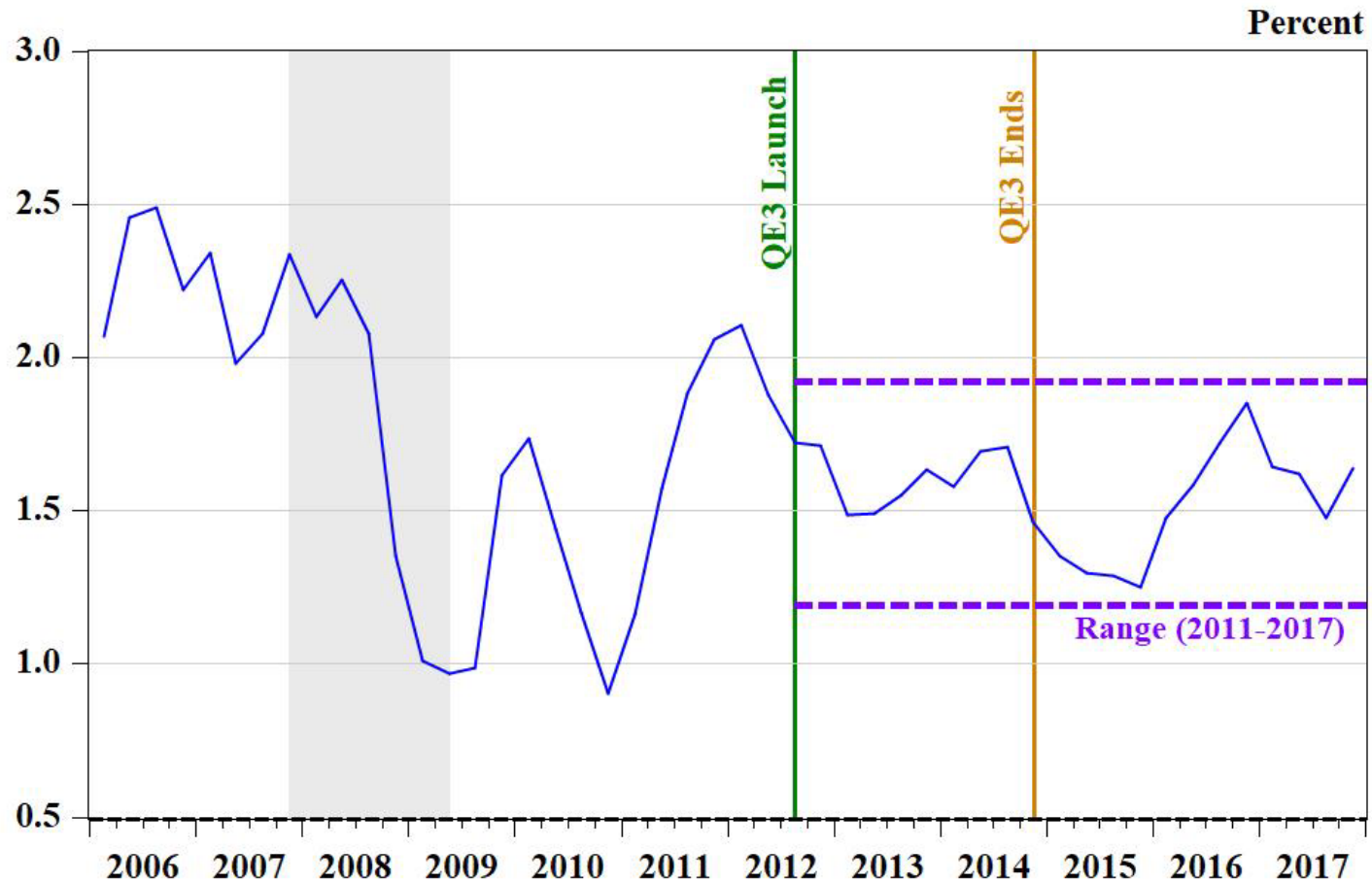
*Federal Reserve Bank of New York
Survey of Primary Dealers
June 2013*

Did QE3 Accelerate the U.S. Recovery?



Sources: BLS, NBER, FOMC (as of September 2019).

Did QE3 Affect U.S. Core PCE Inflation?



Source: U.S. Bureau of Economic Analysis (4-quarter chg, %)

ECB Staff Analysis of the APP

“...no event studies [in the eurozone] were available to pin down the effects...So, staff had to **borrow from the recent Fed experience with its second round of QE**... appropriately rescaled to the size of the euro area debt market and fed into a suite of **macroeconometric models**.”

“The package matured into a unified policy strategy in which the features of each instrument were **perfected, integrated, and finely calibrated** to achieve mutually complementary effects.”

Rostagno et al. (2019), p.242 & 250

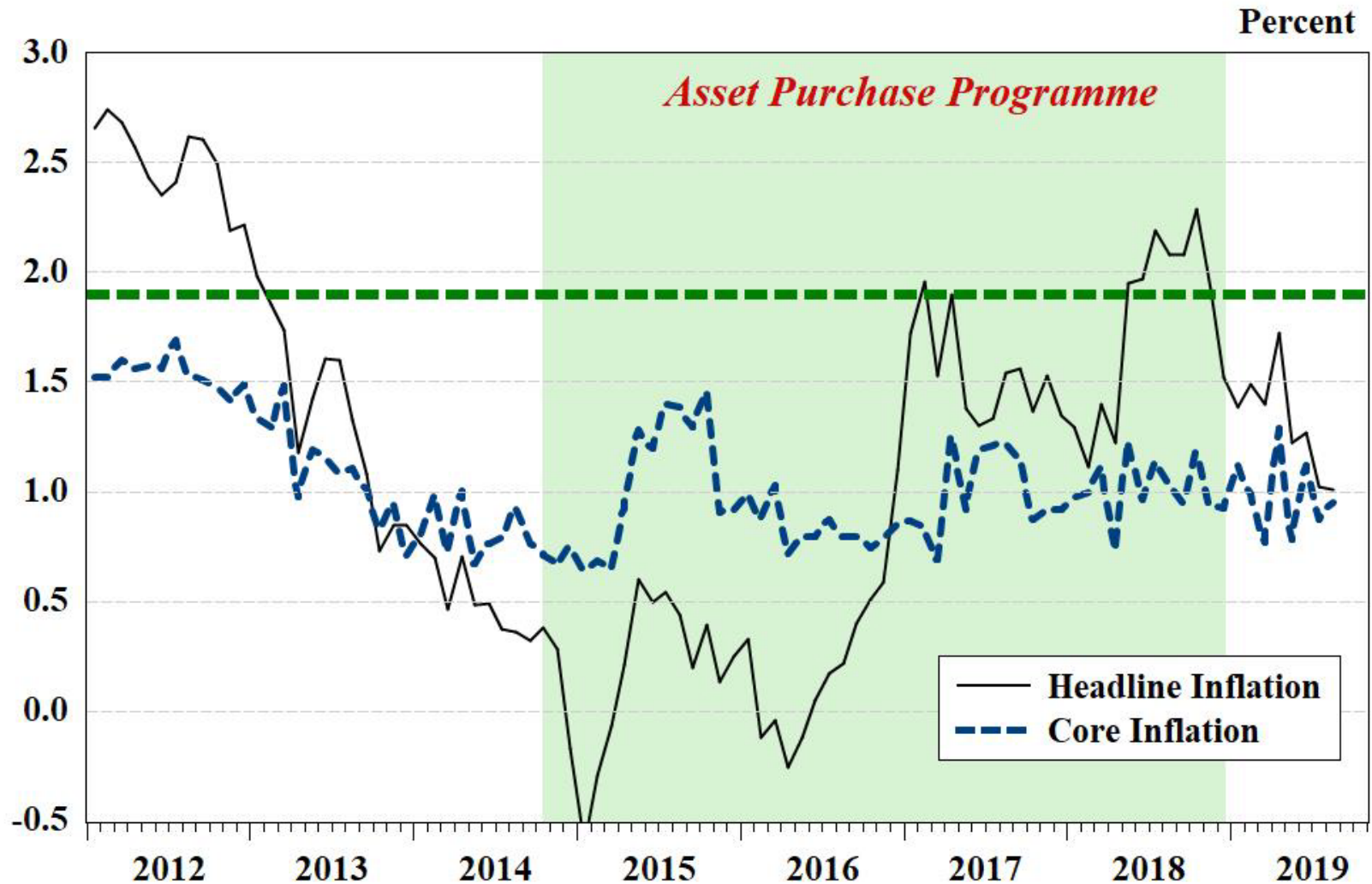
Eurozone Financial Market Narratives

“Markets were underwhelmed by the Dec. 2015 decisions...[which] led to a sharp re-pricing in the EONIA forward market and a back-up in longer term yields across the curve.”

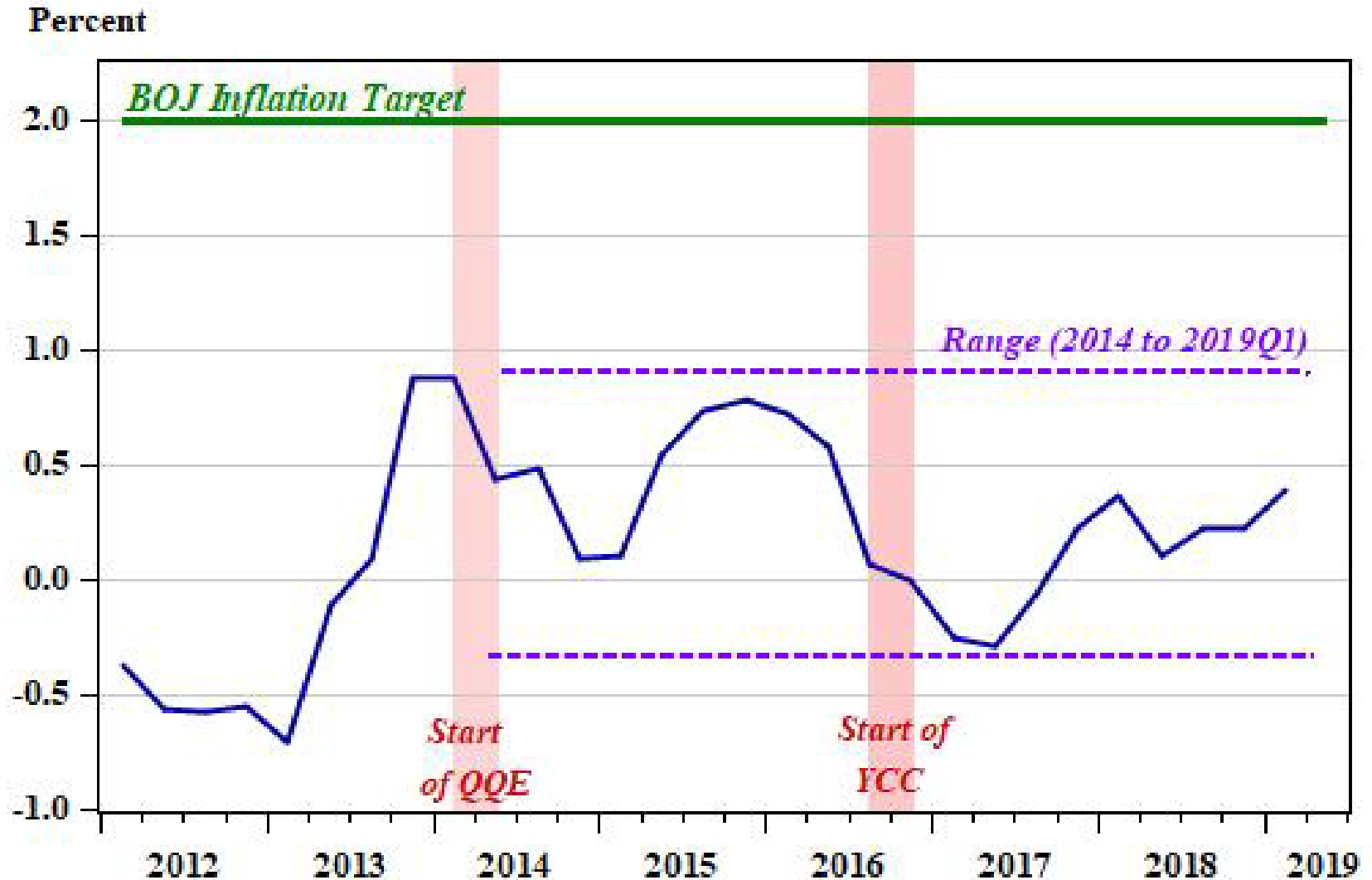
“Beyond the immediate market response,... trading [in eurozone financial markets] became dominated by a general risk-off sentiment.”

Rostagno et al. (2019), p.254

The APP and Eurozone Inflation



QQE and Japan Core-Core Inflation



Overall Assessment of QE

- In periods of **elevated financial stress**, the central bank can play a **crucial role** in serving as the lender-of-last resort (*Bagehot 1873*).
 - During the 2008-09 financial crisis, the Fed's actions – including QE1 – were effective.
- By contrast, **when financial strains have subsided**, balance sheet actions are likely to have **little or no impact** on the macroeconomy (*Modigliani & Miller 1958, Woodford 2012*).
- Indeed, an opaque QE program may even be **counterproductive** (*Levin & Loungani 2019*).

Fundamental Goals of the Monetary System

- **An efficient medium of exchange** for economic & financial transactions.
- **A secure store of value** with essentially the same rate of return as other risk-free assets.
- **A stable unit of account** that facilitates the decisions & plans of households and firms.
- The monetary system should be particularly convenient and efficient for **less-sophisticated families and small businesses.**

The Bordo-Levin Proposal

(see 2018 Hoover e-book & 2019 NBER WP)

- **An account-based system of digital cash can provide an efficient medium of exchange.**
- **Public-private partnerships between the central bank and commercial banks will foster innovation, preserve privacy, and promote financial stability.**
- **The interest rate on digital cash can serve as the primary tool of monetary policy.**
- **The central bank can foster true price stability & more rapid economic recovery from shocks.**

Key Elements of Our Proposal

- **Individuals & businesses should remain free to use paper cash or private payments.**
- **Fees should be imposed on large transfers between digital cash and paper cash, thereby curtailing arbitrage and eliminating the ELB.**
- **Moderate amounts of digital cash balances should be exempt from negative interest rates.**
- **Thus, the central bank could respond to severe adverse shocks while ensuring that no implicit taxes or fees would be imposed on ordinary households and small businesses.**

Fostering Macroeconomic Stability

- By eliminating the ELB, there will no longer be a compelling rationale for targeting a positive inflation rate (*the “inflation buffer”*).
- The central bank can foster **true price stability**, i.e., zero average inflation of consumer prices.
- The interest rate on digital cash can serve as the primary tool of monetary policy, even in responding to severe adverse shocks.
- This framework will enable monetary policy to be more **systematic, transparent, and effective**.

Fostering Financial Stability

- In a financial crisis, cutting the digital cash interest rate below zero would **prevent runs** from other assets into digital cash.
- A temporary surge in risk spreads would be reflected in a lower risk-free rate, **insulating the nonfinancial economy** from the crisis.
- **A relatively steep yield curve would foster bank lending and rapid recovery**, in contrast to unconventional tools that flatten the yield curve and hence induce imprudent behavior in conjunction with a sluggish recovery.

Conclusion

- The monetary toolbox must be sufficient to foster **price stability**.
- Conventional interest rate adjustments are **constrained** by the ELB, while asset purchases and forward guidance are relatively **ineffectual**.
- **CBDC** can enhance all aspects of the monetary system and strengthen the efficacy of the central bank's toolbox.
- Central banks should **act promptly** to foster the implementation of digital cash.