“Withdrawal of supportive measures, shifting policy options must be done in an anticipated way, with sufficient transparency and good communication”

Introductory comments of Prof Danuta Hübner to monetary policy discussion.

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During the first year of pandemic-induced turmoil, the monetary policy has achieved results. But it was not on its own. And we must admit that fiscal policy did not have another choice and the monetary policy supported it.

A good mix between monetary and fiscal policies will be needed in the years ahead. At certain moment there might be a shift needed, with regard to which policy will fit better the driving seat. The choice cannot be made today but it will matter strongly.

When we navigate through the reflection on the monetary policy choices and actions in the EU, we must bear in mind the fact that this policy operates in a jurisdiction where there is no common fiscal policy. There are no common European safe assets. Sovereign spreads continue in spite of ECB purchases and transmission of monetary policy is asymmetric across countries producing differentiated fiscal costs.

ECB has now more responsibilities. But it also has more instruments. The number and range of ECB instruments has increased enormously in the last decade. It is not at all clear whether we should see them as alternative or complementary to conventional tools. Or whether this toolbox is closed.

There is knowledge and experience pointing to the observation that channels of monetary policy transmission can be impaired due to many factors, including market imperfections, but also persistent low inflation, negative rates environment or

segmentation across EU.
We see asymmetric effects of monetary policy in different states. And it is not at all clear whether these differentiation of impact implies only some unused potential of monetary policy here and there or the dysfunctional, transmission channels can as well generate unintended consequences of monetary instruments. Indeed, there seems to be limited knowledge about how diversity and fragmentation of banks, firms, households, companies affects the monetary policy transmission channels. There seems to be limited evidence on how effective transmission mechanism was in transmitting the accommodative impulses.

Probably many experts would agree that after so many years using unconventional monetary policy measures has become a new normal.
So I think it is absolutely legitimate today to ask what is the current consensus on monetary policy, including new responsibilities of central banks in addition to monetary policy.

Looking anew at monetary policy, we see not only that there are many more tools banks can use. In some jurisdictions we clearly see further movements in this direction but also their balance sheets are unprecedentedly large.

Long term strategic priorities will bring in the years to come a number of new issues into the regulatory space, resulting in new risks, in particular related to technology, climate and health. There are views expressed already at his stage pointing to the need of more capital in central banks to absorb those new risks.

So there is a question, whether it is at all legitimate to consider the current situation as exceptional? Will we see the ECB converging to central banks of other jurisdictions? Can ECB cap domestic spreads to eliminate fragmentation and disparities in fiscal costs? This question seems to be already put for discussion. How can it be operationalized?

Can we discuss monetary policy without looking at the fiscal, especially in the time when public debt is of unprecedented size and here to stay for a relatively long period. With the ECB more present in the market, with the fiscal footprint of monetary policy getting larger, the ECB will have to keep backstopping very large public debts in the time when fiscal policy will become increasingly sectorial in recovery, tailored to the specifics of sectors.
While many observers envisage fiscal policy in recovery to be in the driving seat what should be the function of the monetary policy? Its mission is not accomplished.

What will monetary policy role being an aggregate instrument be further down the road. Even if the main burden is put on fiscal policy, monetary policy will have to continue with its expansionary tools. Fiscal dominance will be back in town. The policy will also have to start getting ready for next recession bringing interest rates up while keeping public debt asset on its balance sheet.

The ECB cannot be left without ammunition to prevent that pandemic recession will morph into another crisis.

Indeed, large public debt must be supported by low interest rates. Choosing the right moment to move toward more restrictive monetary policy will be a sophisticated policy choice burdened with uncertainty. With large debt being a legacy this may lead to a scenario of fiscal dominance where expansionary monetary policy can be the only way to alleviate debt burden.
Whatever the timeline, withdrawal of supportive measures, shifting policy options must be done in an anticipated way, with sufficient transparency and good communication.

This brings me to this rather new strand in the ECB communication, when we hear that the ECB will not tolerate any increase in long term bond yields which would in reality have effect of tightening monetary policy. Most likely achieving it requires acceleration of bond purchases. This might be the beginning of targeting the long term rates and raise the question of whether it could become an alternative to QE, mass bond buying or even forward guidance. In other jurisdiction, in particular in the US and Japan, this trend is already in place.

But do we have any long term bond yield to target? Can it be the bond linked to funding recovery and resilience investment? If we assume that supportive measures for years to come will aim at shifting from supporting survival toward supporting long term reforms, restructuring, resilience building, we stay in the realm of support for supply side of the economy.

The question is whether the ECB can involve in helping to sustain demand through its policies or we should rather leave fiscal policy to do in this regard whatever it takes?

It is interesting to see in this context that the ECB is in listening mode and launches consumer surveys asking people about inflation, housing, labour market, consumption. What will it do with the results of such surveys? Can monetary policy move toward achieving distributional targets or is it rather government's accountability issue?

It would seem rational to expect that the ECB cannot ignore the approaches to monetary policy in other jurisdictions. There is visible innovating approach by central banks in other jurisdictions. We see moves toward new regimes, revamping goals and tools in the US, Japan, UK. I already mentioned the issue of yield capping or moving toward influencing long term interest rates more actively. We see the Bank of England allowing HMG to use its balance sheet to directly finance its fiscal measures without going through issuing bonds. Are global bench mark being developed?

Of course the ECB has departed a decade ago from simply moving short interest rate up and down. Today in addition to the new current monetary policy consensus, the question is whether it has reached its limits with regard to unconventional measures and is its unconventional toolkit a closed one.