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.
“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?

<table>
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<tr>
<th>Event</th>
<th>Term Premium on 10-Year Treasury</th>
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<tr>
<td></td>
<td>Predicted Change (basis points)</td>
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<tr>
<td>FOMC Meeting (Sept. 2012)</td>
<td>-13</td>
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<td>FOMC Minutes (Oct. 2012)</td>
<td>-8</td>
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<td>FOMC Meeting (Dec. 2012)</td>
<td>-2</td>
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<td>JEC Testimony (May 2013)</td>
<td>-1</td>
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<td>FOMC Meeting (June 2013)</td>
<td>+1</td>
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“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, %)
“...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

[Graph showing headline inflation and core inflation from 2012 to 2019, with shaded area indicating the Asset Purchase Programme (APP) period from 2015 to 2017.]
QQE and Japan Core-Core Inflation

The chart illustrates the trend of BOJ Inflation Target and the range (2014 to 2019Q1) with specific labels indicating significant events such as the Start of QQE and the Start of YCC.
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.
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.
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.