

**FMM - IMK 24th CONFERENCE ON  
THE CORONA CRISIS: MACROECONOMIC IMPLICATIONS  
AND POLICIES FOR SUSTAINABLE RECOVERY**

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**SESSION ON "THE FED AND THE  
ECB IN UNCHARTERED WATERS"**

**Central Bank challenges and the  
revision of Monetary Frameworks**

**VÍTOR CONSTÂNCIO**

**28 October 2020**

# OUTLINE

I-

## OUTLINE

### I- WHAT UNCHARTERED WATERS?

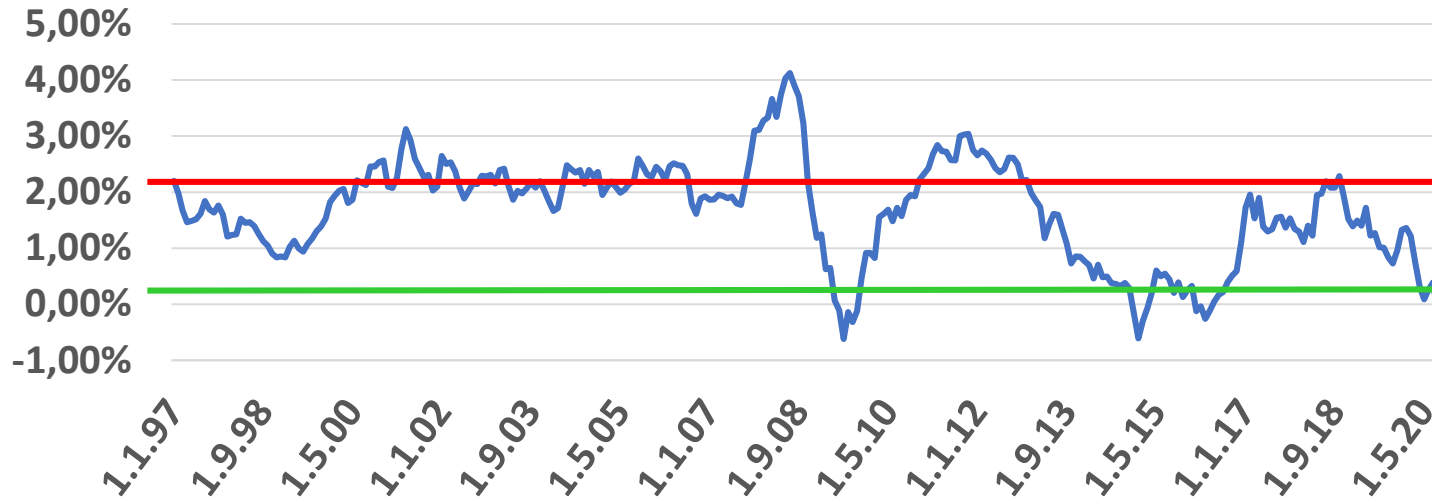
**Failure to achieve the inflation target and a sustained recovery, generating pressure to adopt bolder, controversial policies.**

THE MORE LIKELY MEDIUM-TERM SCENARIO

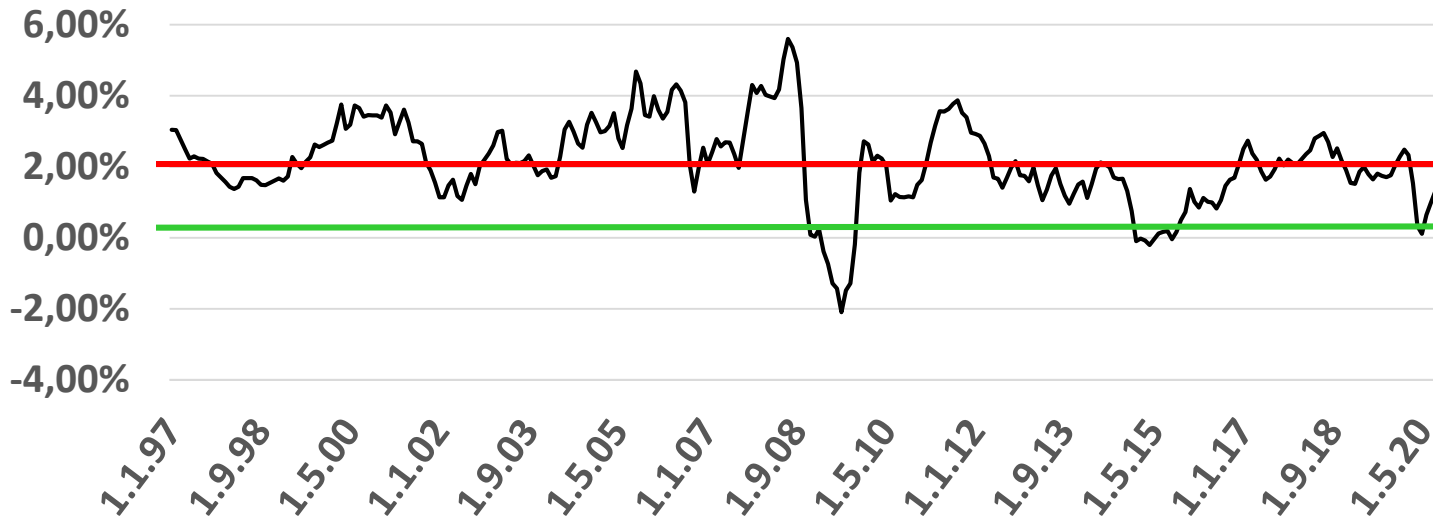
### III- BACKGROUND FEATURES TO THE MONETARY FRAMEWORKS REVISION

NEW MONETARY POLICY FRAMEWORK (for the ECB)

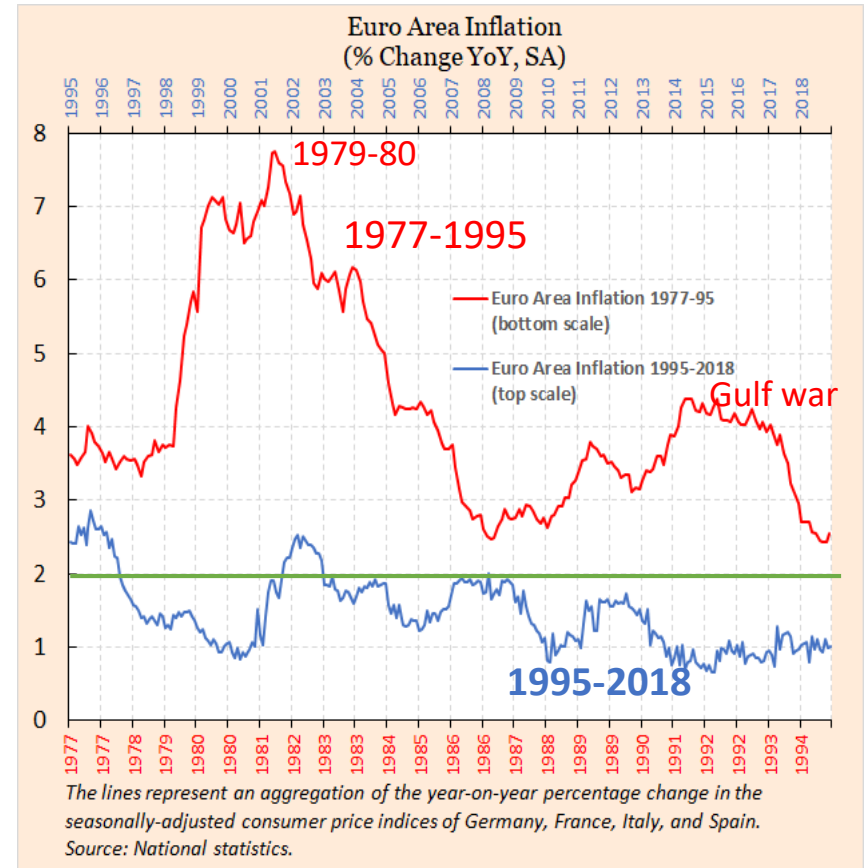
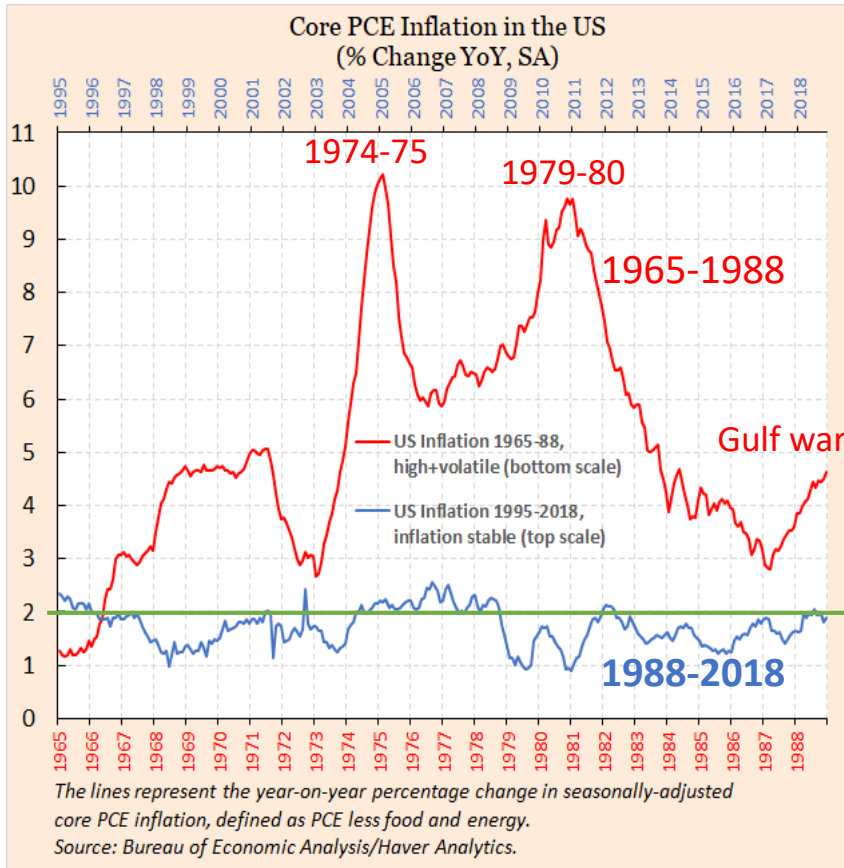
**Euro Area Inflation (1997-Aug 2020)**



**US Inflation (1997-Aug 2020)**

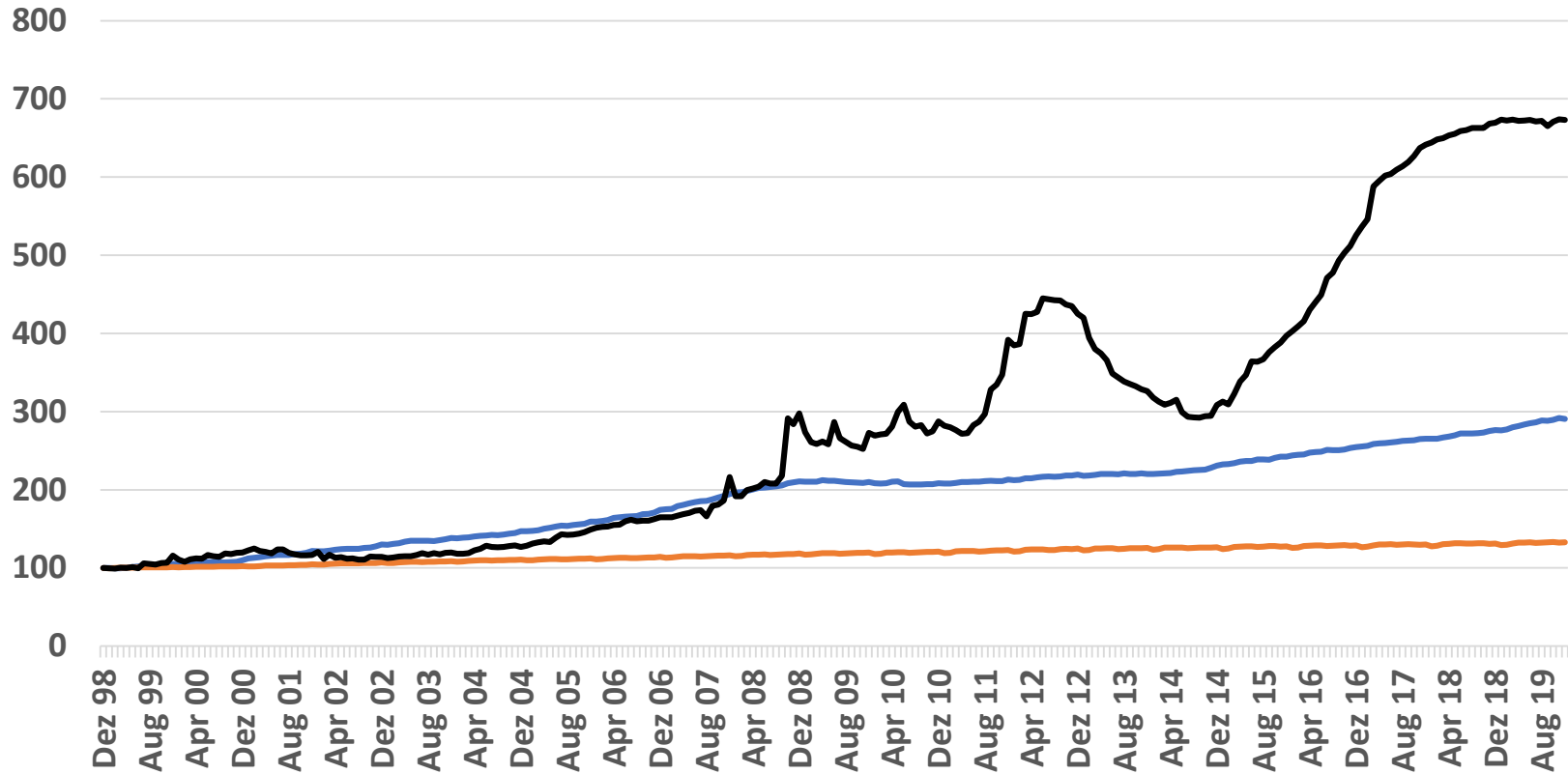


# Long period of low inflation and entrenched inflation expectations.



Source: FT

## Euro Area



2007 to 2018				
	Total balance-sheet	Monetary Base	M3 or M2	Inflation
<b>ECB</b>	<b>211%</b>	<b>201%</b>	<b>50%</b>	<b>14%</b>
<b>FED</b>	<b>320%</b>	<b>309%</b>	<b>105%</b>	<b>22%</b>

## OUTLINE

### I- WHAT UNCHARTERED WATERS?

**. Financial instability and crisis linked with financial exuberance empowered by a permanent CBs “policy-put” and insufficient regulation.**

**3. Catastrophic scenarios: High inflation and the “ debt trap”.**

THE MORE LIKELY MEDIUM-TERM SCENARIO

### III- BACKGROUND FEATURES TO THE MONETARY FRAMEWORKS REVISION

NEW MONETARY POLICY FRAMEWORK (for the ECB)

# Sovereign debt has reached historic levels

General government debt as a % of GDP



Aggregate series based on constant sample of 25 advanced and 27 emerging economies, weighted by GDP in purchasing power parity terms Source: IMF

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## OUTLINE

### I- WHAT UNCHARTERED WATERS?

#### **THE MORE LIKELY MEDIUM-TERM SCENARIO**

- 1. No high inflation. The failure of grand theories of inflation and “long-term” models.**
- 2. A sluggish recovery in a scarred economy by capital and labour hysteresis; Possible some price-spikes but no sustained high inflation; Macro policies in expansionary mode for a “high pressure economy” ; More important policies: Fiscal policy, Regulation and supply-side industrial policies for a green project.**

### III- BACKGROUND FEATURES TO THE MONETARY FRAMEWORKS REVISION

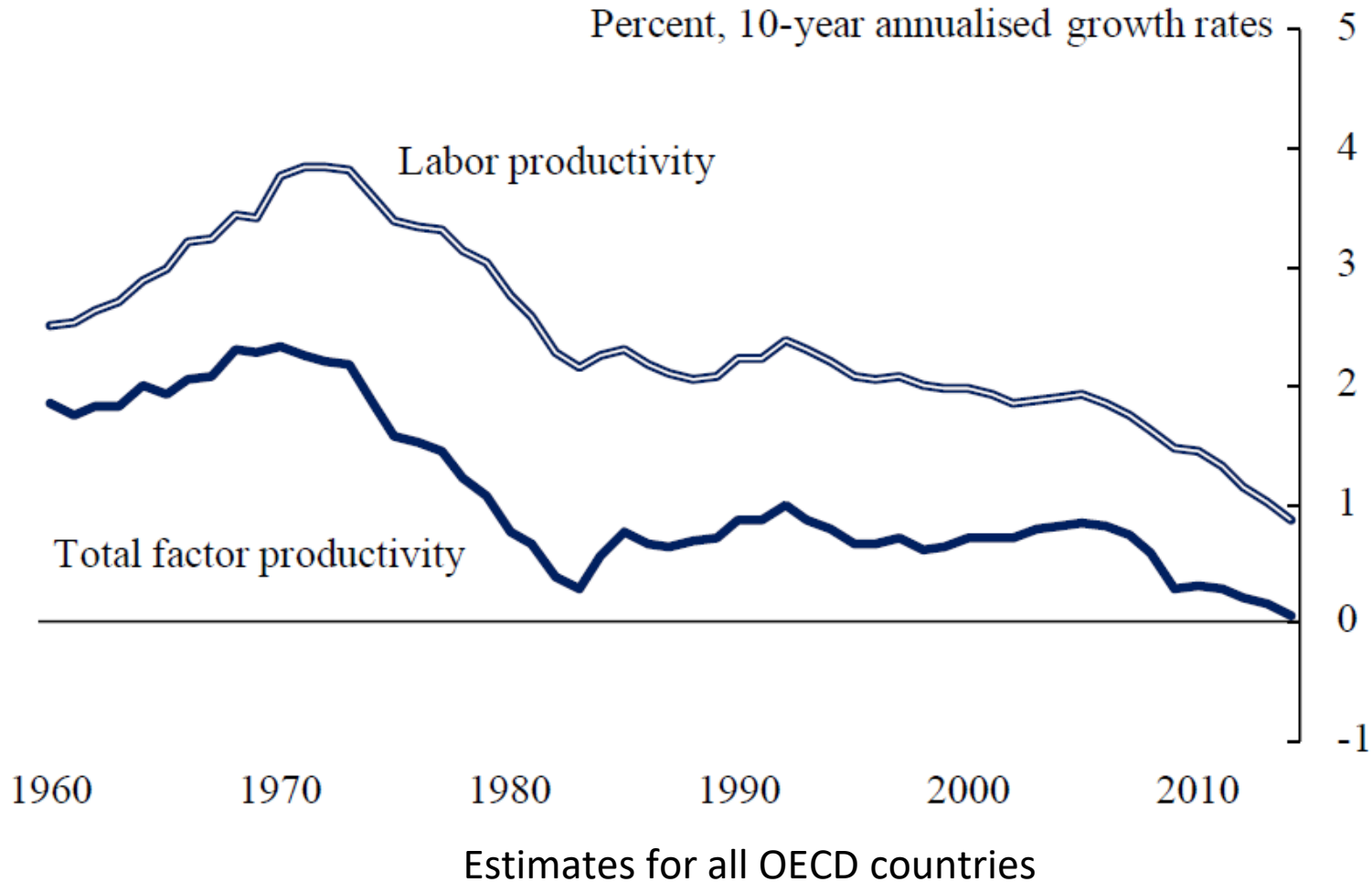
#### NEW MONETARY POLICY FRAMEWORK (for the ECB)

# OUTLINE

I-

# Slow recovery: slow productivity growth

Figure 16: Trend productivity and TFP growth in advanced economies



Source: Summers, L. and L. Rachel (2019) "On Falling Neutral Real Rates, Fiscal Policy, and the Risk of Secular Stagnation" Brookings PEA, March 2019

## OUTLINE

### **NEW MONETARY POLICY FRAMEWORK (for the ECB)**

- 1. Objective function: Flexible average inflation targeting (FAIT)**
- 2. Objective function: Explicit recognition of a mandate to ensure homogenous monetary policy transmission across member States.**
- 3. Objective function: No explicit financial stability goals assigned to monetary policy, but claim macroprudential tools for that purpose.**
- 4. Instruments: No further use of negative policy rates; use of forward guidance and QE, commensurate to keeping low market rates but not necessarily shifting down further the whole yield curve. Very gradual balance-sheet shrinking (when possible), without going back to a lean, small one in order to keep a floor system of monetary policy implementation and to help financial stability.**
- 5. Instruments: Active use of liquidity provision to banks at special rates, conditional on credit-supply behaviour.**