

*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

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- **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

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- **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

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**“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>
<b>FOMC Meeting</b> <i>(Sept. 2012)</i>	<b>-13</b>	<b>+17</b>
<b>FOMC Minutes</b> <i>(Oct. 2012)</i>	<b>-8</b>	<b>+15</b>
<b>FOMC Meeting</b> <i>(Dec. 2012)</i>	<b>-2</b>	<b>+11</b>
<b>JEC Testimony</b> <i>(May 2013)</i>	<b>-1</b>	<b>+11</b>
<b>FOMC Meeting</b> <i>(June 2013)</i>	<b>+1</b>	<b>+14</b>

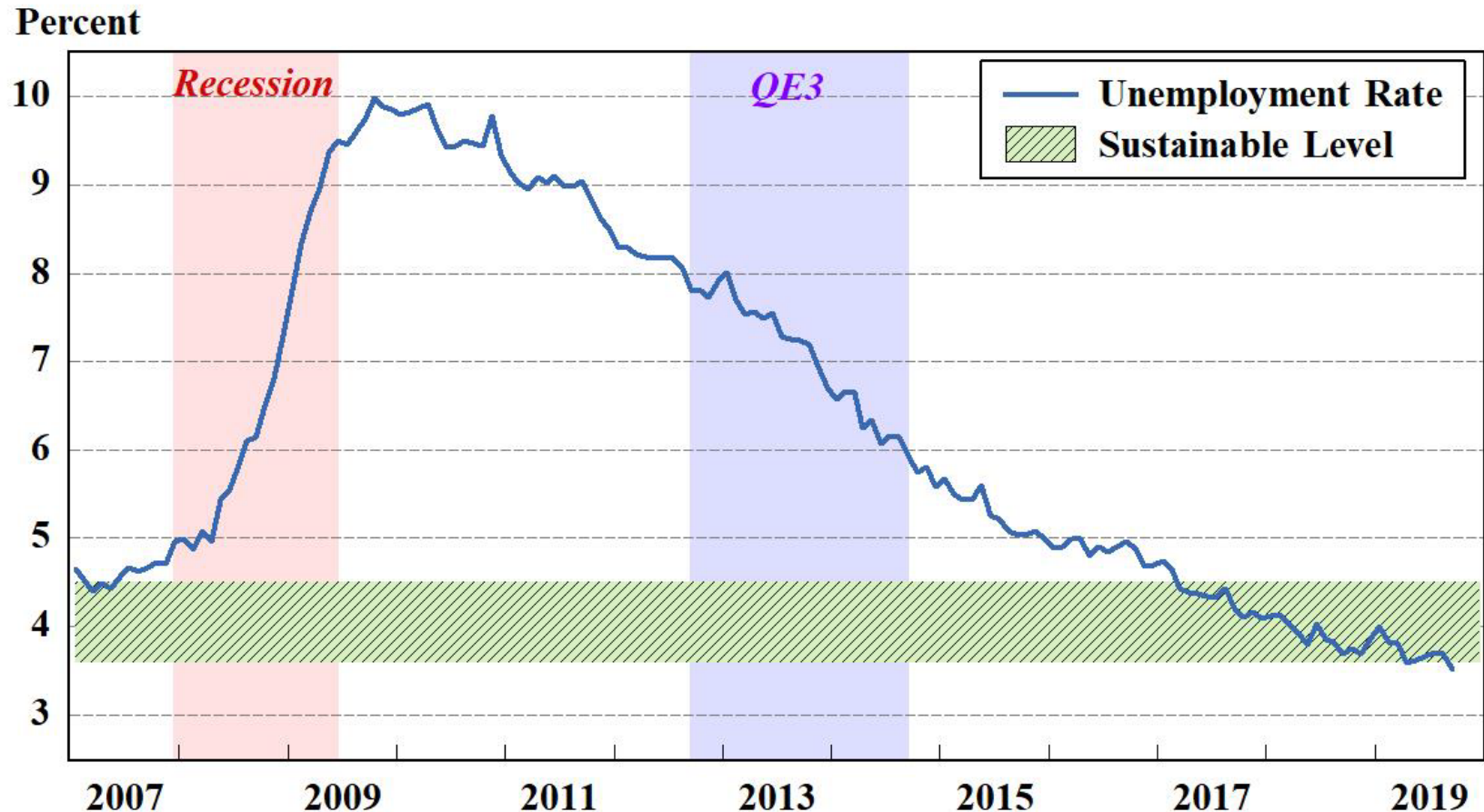
# U.S. Financial Market Narratives

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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.”**

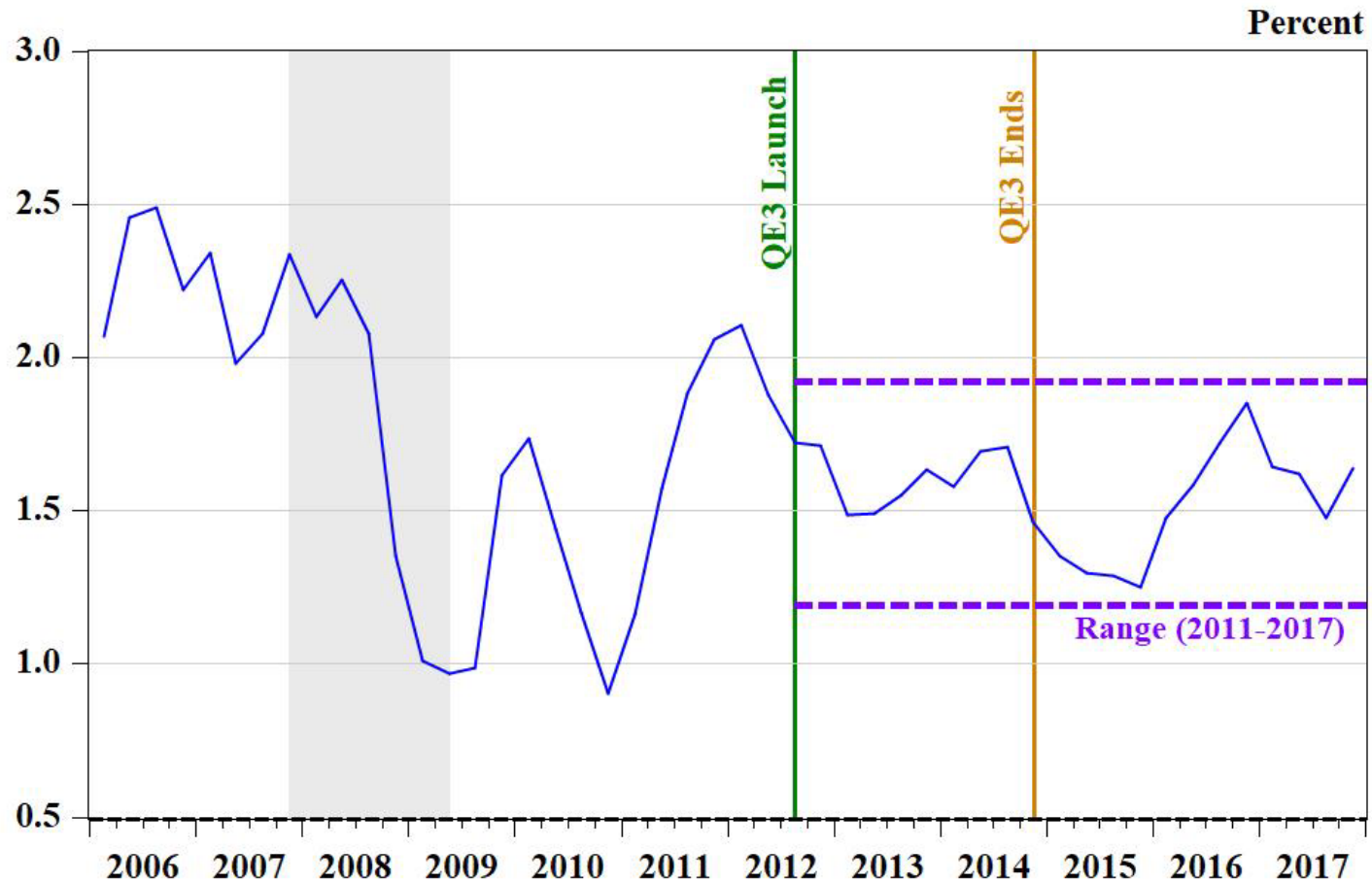
*Federal Reserve Bank of New York  
Survey of Primary Dealers  
June 2013*

# 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, %)**



# ECB Staff Analysis of the APP

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“...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

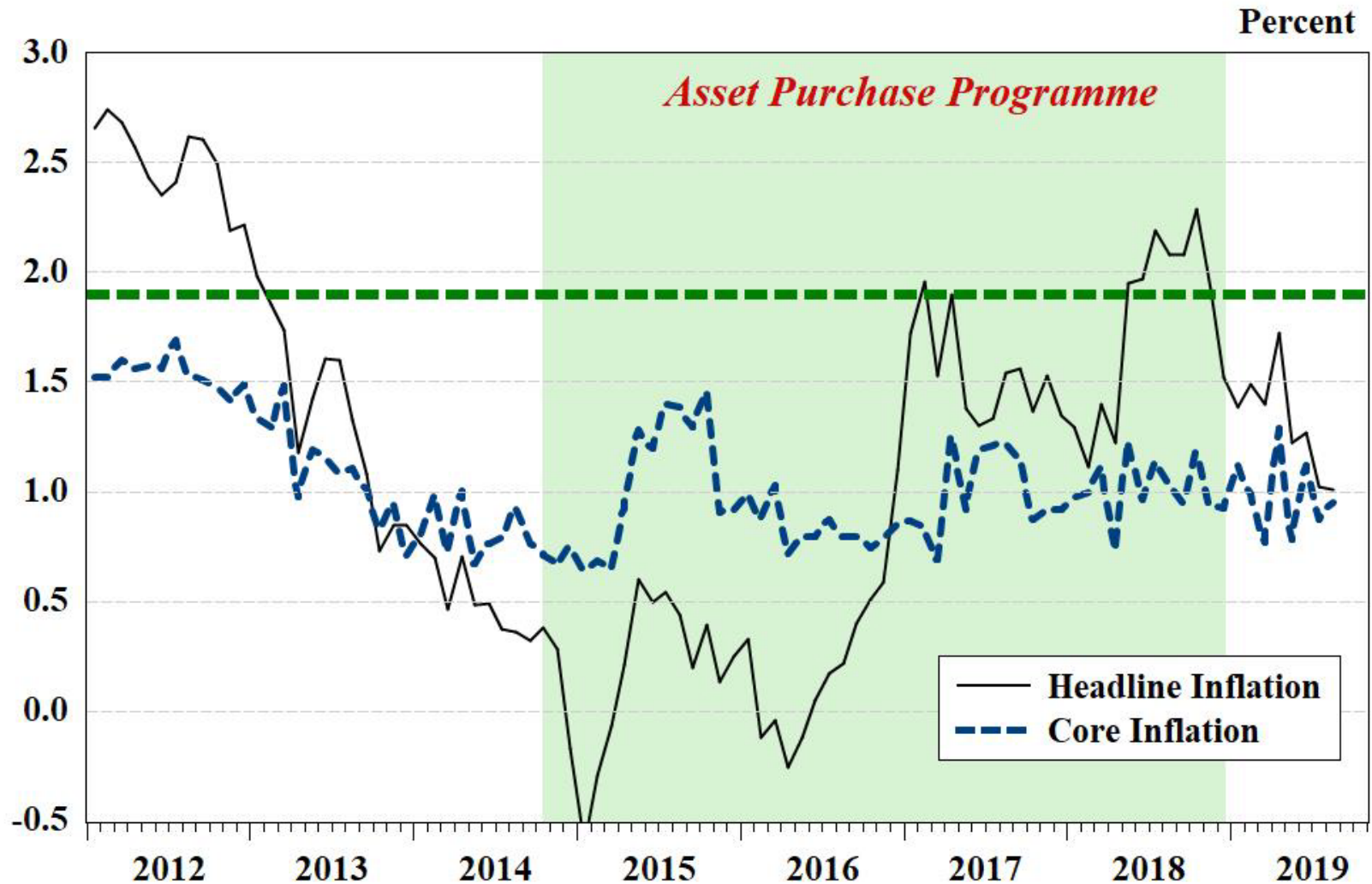
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**“Markets were underwhelmed by the Dec. 2015 decisions...[which] led to a sharp re-pricing in the EONIA forward market and a back-up in longer term yields across the curve.”**

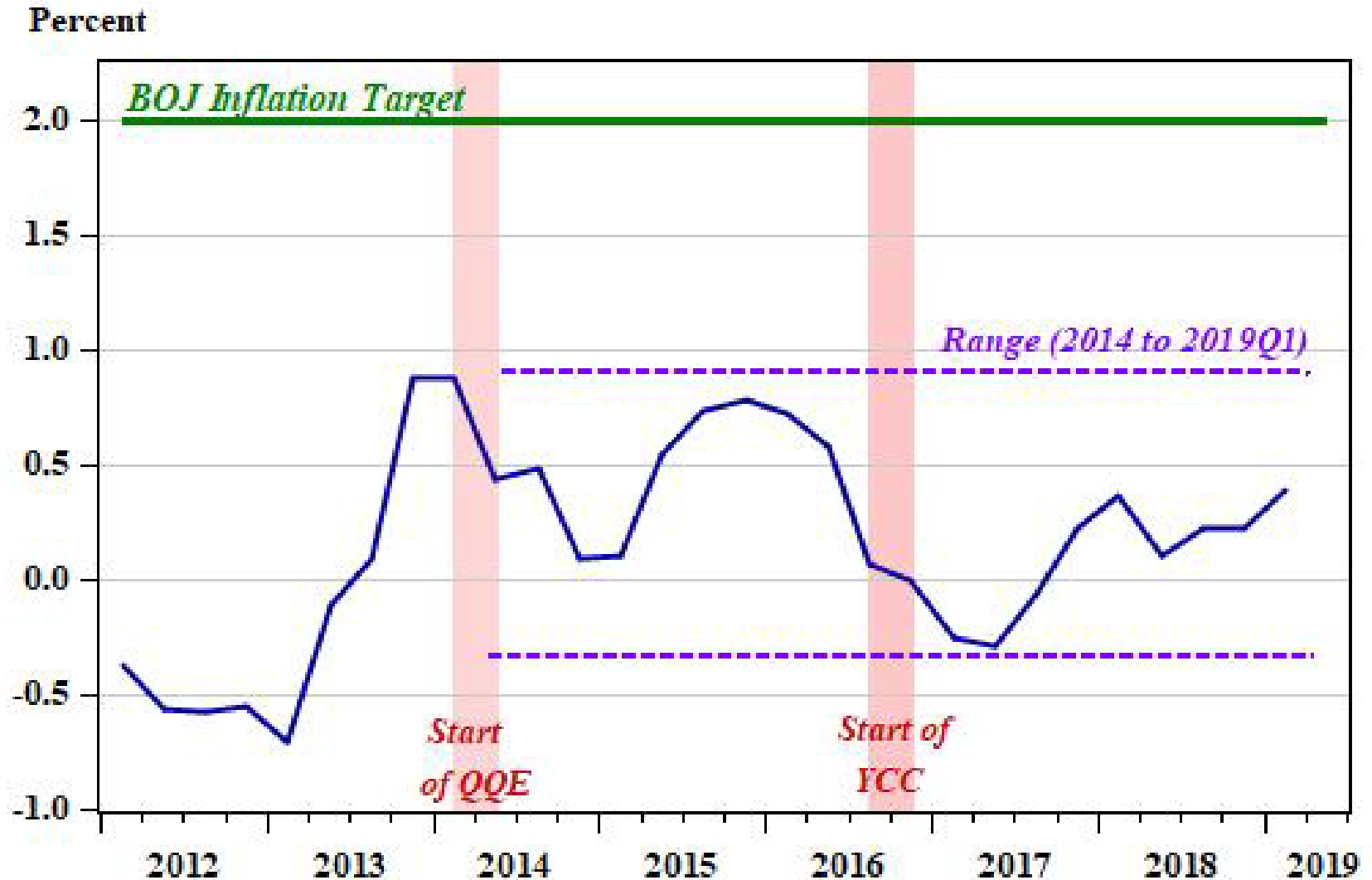
**“Beyond the immediate market response,... trading [in eurozone financial markets] became dominated by a general risk-off sentiment.”**

*Rostagno et al. (2019), p.254*

# The APP and Eurozone Inflation



# QQE and Japan Core-Core Inflation



# Overall Assessment of QE

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- 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

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- **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)*

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- **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

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- **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

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- 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

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- 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

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- 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.