Texte sur la politique monétaire

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Ce texte a été transmis par Jacques de Larosière le 26 novembre 2022 au Groupe des 30 afin qu'il prenne place dans les travaux menés par le Groupe de travail sur la politique monétaire.

Object : G30 Working group on Monetary policy

Dear Jacob,

The memo is, in my view, too piecemeal. It contains many valid points but it misses the main purpose of our exercise i.e. : to assess, in a comprehensive and coherent way ,the mistakes of monetary policy as it has been conducted over the last 20 years, as well as to explain the consequences of the fault lines and to propose a change of course.

I would suggest that the structure of the paper could follow the following lines :

1)What went wrong ?

2)What have been the consequences of such failures ?

3)How to redress the situation and to move forward ?

I.-What went wrong ?

1)The policy stance has been continuously accommodative. This cannot be accepted (even under the Keynes guidance)

This mistake can be substantiated by an analysis of monetary aggregates with the existing gauges (like the Taylor rule or the Johns Hopkins framework....)

2) Interest rates have been kept too low for too long

One should elaborate on the fact that , in real terms (the only ones that count)the Fed funds rates have been kept negative for 20 years !

3) The policy has thus been asymmetric : as soon as the economy showed slight signs of weakening, monetary policy was immediately loosened while it was more reluctantly tightened in case of a risk of overheating 4) The fear of deflation was overdone and was not based on objective facts (fall in prices never happened)

II.- What have been the consequences of such policies ?

1) Interest rates kept too low (even negative in nominal terms in the euro area) for long tend to blur market signals and produce serious economic distorsions.
Zombie companies receive a subsidy that allows them to survive despite the fact that they are uncompetitive .This weakens overall productivity .

2)The < liquidity trap >feared by Keynes is particularly acute in Europe but also elsewhere. Zero interest rates do not foster long term productive investment because the risks and duration of such investments are not remunerated anymore. This encourages savers to shift to liquid short term and riskless placements (bank notes, bank accounts...)to the detriment of longer term productive projects.

3)The huge credit boom (global credit jumped from 100 to 250 pc of GDP from 1970 to2020 i.e. an increase of 2,5 times in 50 years in real terms while GDP grew only by 80 pc during the same period) that was allowed by central banks weakened the financial system. Indebtedness has reached record levels in peace time which has made the system vulnerable. With the deterioration of the quality of credit the probability of crises has increased.

4) The fact that central banks turned a blind eye to the explosion of credit (while traditionally the survellance of credit has been an essential tool of monetary policy) is incomprehensible . It has led to the exacerbation of financial _-and real estate- prices. (75p.c. of the trebbling of net wealth observed in the global balance sheet over the last 20 years came from higher market valuations of < speculative > assets and only 25pc resulted in real investment and wages, as shown in the last Mc Kinsey Report). From a global perspective, the type of monetary policy that led to such an appalling situation should be stressed, all the more so because the < financialization > paradigm that has developped will not be able to finance, if it lasts, the ecological transition.

5) This surreptitious change in the financial paradigm and the primacy of higher valuations over production leads to strong social inequalities. This phenomenon is intrinsically the result of monetary policy (QE has been accompanied by higher asset prices that basically benefit 10 pc of the population)

III.-What to do?

1. Stop acting as if central banks could achieve everything as long as their policy is "non conventional".

2. Abandon the mistaken < inflation target >. This target has had dramatic consequences: I remember vividly having pleaded, in front of European central bankers, for a less accommodative policy at a moment of satisfactory growth. I was told by my interlocutors : < as long as we have not reached the < close to 2% > inflation target, we have no other choice but to continue our monetary stimulus >.

The target should have been conceived as a way of protecting us against inflation but not as a mechanistic rule to obtain an arbitrary higher figure that should never have been considered as the sole goal of monetary policy (that mistaken rule was pursued blindly and at the cost of weakening the whole financial system).

Central bankers did not want to understand that the actual inflation rate-1%- was lower than the target because of structural factors(ageing, globalization....) and that it was an equilibrium rate since it avoided deflation as well as hyperinflation.

3. Long term interest rates should not be determined by central banks QE has been used and abused to reduce artificially long-term yields while this should be the result of demand and supply on the financial markets.

4. A gradual, but determined ,return to a more traditional and sensible monetary policy

-Restore the oversight of credit expansion ;

-reintroduce symmetry in monetary policy and don't stimulate continuously ;

- don't give the market a form of free insurance against possible losses ; moral hazard has pleagued the system ,upset the risk-reward relation and encouraged short term speculation

- be more careful on the risk of fiscal dominance ; having created money to buy some 70 % of GDP in the EU, a central bank is getting so deeply involved in fiscal affairs that its independence is questionable ;

-central banks should refrain from the temptation of being < popular > and having too many goals (green, social inclusion....) which are not at the heart of their primary mission which should be monetary and financial stability

I believe the above remarks should be reflected in our report ;

Best wishes, Jacques