IN-DEPTH ANALYSIS

Requested by the ECON committee

Monetary Dialogue Papers, November 2021

The ECB's New Definition of Price Stability: Better but Short of Specifics

Policy Department for Economic, Scientific and Quality of Life Policies
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PE 695.473 - November 2021

EN

The ECB's New Definition of Price Stability: Better but Short of Specifics

Monetary Dialogue Papers
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Abstract

The new definition of price stability is a step in the right direction, even though the ECB could have gone further toward the Fed's average inflation targeting. This definition can become most helpful as the central bank navigates new uncertainties. Yet, the review does not deal with some daunting challenges that are already visible. It will need more than a few principles about price stability to deal with such issues as high and rising public debts, financial stability, or climate change.

This paper was provided by the Policy Department for Economic, Scientific and Quality of Life Policies at the request of the committee on Economic and Monetary Affairs (ECON) ahead of the Monetary Dialogue with the ECB President on 15 November 2021.

This document was requested by the European Parliament's committee on Economic and Monetary Affairs (ECON).

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Original: EN

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Manuscript completed: November 2021
Date of publication: November 2021

This document was prepared as part of a series on "The ECB's Revised Inflation Target", available on the internet at:
https://www.europarl.europa.eu/committees/en/econ/econ-policies/monetary-dialogue

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LIST OF ABBREVIATIONS

APP	Asset purchase programme
ECB	European Central Bank
ESCB	European System of Central Banks
EP	European Parliament
EU	European Union
GDP	Gross domestic product
HICP	Harmonised index of consumer prices
PEPP	Pandemic emergency purchase programme
QE	Quantitative easing

EXECUTIVE SUMMARY

- **The second strategy review of the European Central Bank (ECB) comes at a crucial juncture**. It follows three historical crises and it precedes a complex situation that could combine resurgent inflation, high public debts and the struggle against climate change.
- **The second review improves on the first review but not much**. Major lessons from the three crises are not fully drawn and the challenges that lie ahead are not well recognised.
- **The new definition of price stability has long been awaited**. It is now symmetric and it allows for temporary overshooting, as needed. It remains vague regarding the margin of tolerance and the time allowed for overshoots.
- **The other long-expected change is the recognition that financial stability is an objective**. However, it is presented as a pathway to the primary objective of price stability. There is no room for a trade-off.
- **The review is silent on the issue of lending in last resort**. Central banks are usually careful not to create a moral hazard by committing to lending in last resort, but they are known to keep the instrument on the ready. In order to have a ready instrument, the ECB must reach an understanding with member governments on procedures and liabilities.
- **A first likely challenge that the ECB could face is higher inflation**. There is no indication in the review of how it would deal with fiscal and financial dominance. The reassertion that price stability is paramount may be the answer.
- **A second potential challenge concerns the end of quantitative easing (QE)**. Does the ECB intend to shrink its balance sheet? There is no answer in the strategy review although it is an important issue given the size of public debts.
- **The third challenge is the upcoming struggle against climate change**. The review mentions the need to evaluate the associated risks but does not explain how it will deal with rising public expenditures and further increases in public debts.
- **These challenges imply a rise in uncertainty**. The new definition of price stability creates more room for manoeuvre. This may be a welcome reason for the vagueness of the definition. The increase in uncertainty should be borne primarily by the financial markets.
- **The rise in uncertainty also concerns the accountability process**. Monetary policy could become more uncertain as well, which stands to complicate the central bank's communication. The European Parliament could conduct its own review of the Monetary Dialogue.

1. INTRODUCTION

The strategy review intends to clarify how the European Central Bank (ECB) intends to deliver on price stability, its primary objective. From the start, the formulation of the inflation objective has been criticised for being imprecise, asymmetric and quite likely unachievable as stated. The new formulation is symmetric but even more imprecise, so it will be difficult to assess if it has been achieved.

The previous strategy review was conducted in 2003. Evaluating this review, Lars Svensson (2003) wrote:

> *"This evaluation can be seen as a response to the strong and almost unanimous criticism of the ECB's strategy from the ECB's outside observers and commentators, both academic and nonacademic. […] The ECB has missed an opportunity to thoroughly modernize its strategy, remove the ambiguity, and explicitly and transparently adopt flexible inflation targeting."*

Since then, without any formal review, the ECB has *de facto* adopted the flexible inflation targeting strategy. Almost twenty years later, it could have been hoped that the review would provide clarity and precision, but it is not the case.

In fact, the review can be seen as focused on the near-term challenge. Following three crises (global financial, euro area debt and COVID-19), the ECB is preparing to face a new situation with high public debts, potential inflationary tensions, asset prices reflecting expectations of near-zero interest rates and a multitude of possible structural changes predicted by the impact of the pandemic on trade or individual preferences regarding work, travel, consumption and more. It is entirely possible that the new world will resemble the old world, but uncertainty is much higher than it used to be. Accordingly, the ECB needs to be flexible in both its analyses and its strategy. This is difficult for an institution that used to project an image of steadiness.

This paper describes the conflicting demands put on the ECB. The financial markets and some observers ask for too much reassurance. Monetary economists want to see a carefully-redesigned inflation targeting strategy. Some worry about rising inflation while others are sure that the current surge is strictly temporary. Some are concerned that governments cannot absorb higher interest rates, others fear fiscal dominance. Climate change deepens all these debates. Faced with these demands, the ECB is recoiling, formally changing little and searching for flexibility by increasing ambiguity.

The paper starts with a brief review of the momentous events over the last decade. The euro area was shaken by three crises that were not supposed to happen. Several missteps occurred, which would suggest that the strategic review had many lessons to digest while also preparing the future. This overview opens the way to examining the strategy review in Section 3. The new definition of price stability finally recognises that the previous one was ill-conceived. It also provides some much needed flexibility in view of the forthcoming challenges. However, old sacred cows (the two-pillar strategy) survive while several important issues that will dominate the next few years are either ignored or imprecisely dealt with. Section 4 describes the challenges that lie ahead and what they mean for the ECB. The next sections briefly examine how the mounting level of uncertainty affects the ECB strategy and accountability. The last section offers conclusions.

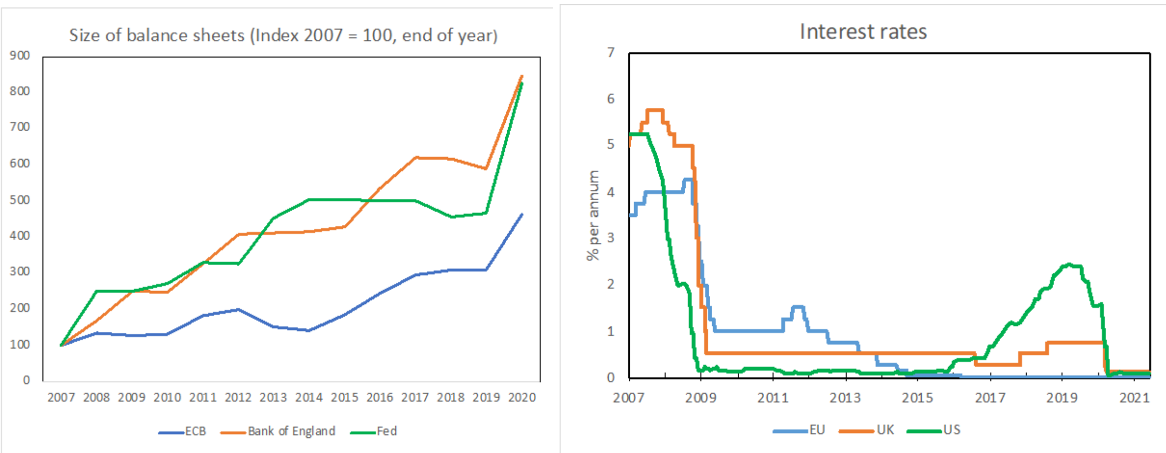
2. THREE CRISES LATER

2.1. Brief overview of the crises

The previous strategic review was mooted during the period of "great moderation", as it was called by Ben Bernanke, the former chair of the Fed. Growth and inflation were within the norms of the time and central banks were expected to keep it that way. These were easy times, when defining a monetary policy strategy was an exercise in fine tuning the inflation targeting strategy that had delivered the great moderation. Much excitement greeted details of no interest to non-specialists. Then three crises of historical proportions hit. In the event, the ECB's response has been marked by an abondance of policy mistakes because the review had not prepared the bank for the totally unexpected events that would follow.

The financial crisis has forced central banks to accept that their mandate could not just be price stability. The need to also aim at financial stability surged as an urgent priority. In 2008, the ECB initially responded quickly by providing the financial markets with liquidity but then moved with much more caution than other central banks. As can be seen from the left-hand chart in Figure 1, the ECB did not really adopt the quantitative easing (QE) instrument, which it calls asset purchases programmes, until 2011, and on a much reduced scale compared to other major central banks. Furthermore, the right-hand chart indicates that it was also slow in lowering its interest rate, even mistakenly raising it in 2011. This low reactivity partly explains the next shock, the debt crisis that nearly destroyed the euro.

Figure 1: Non-standard policies



Source: ECB, FRED, Bank of England.

Unfortunately, the ECB's reaction to the debt crisis was equally slow and subdued. It took more than two years after the new crisis erupted until President Draghi uttered the historical "whatever it takes" statement. The statement came late, since the debt crisis had already spread from Greece to several countries. Arguably, had it been made at the outset, there would have no contagion beyond Greece and, probably no crisis [1].

In contrast, the response to the next crisis, created by the COVID-19 pandemic, has been both forceful and prompt. While it could not further cut the interest rate, which was at its effective lower bound, the ECB promptly expanded its bond purchases. Importantly, its pandemic emergency purchase programme (PEPP) amounts to a major innovation as it allows the ECB to buy national public bonds of the most exposed countries over and beyond the usual key that corresponds to country shares of the

[1] This point is developed in Eichengreen and Wyplosz (2016).

ECB capital. Indeed, from the point view of financial stability, it makes no sense to buy a lot of German bonds and just few Portuguese bonds. As a result of this move, there has been no threat of a renewed debt crisis and, more broadly, of financial instability, which would been disastrous in the midst of the pandemic.

2.2. Implications of the crisis for the strategy review

This brief overview of the crises shows that the ECB has found it difficult to move away from its focus on price stability even as the global financial crisis and the debt crisis presented the euro area with historical threats to financial stability and, more broadly, to the European economy. Somewhat reassuringly, by the time of the pandemic, the ECB had moved away from its narrow concerns[2]. These events matter for any assessment of the new strategy review, for five reasons.

First, the primary focus on price stability is explicitly stated in the Treaty that lays down the mandate of the ECB. This is probably why the bank finds it necessary to frame any decision, big or small, as justified "within the mandate". This litany may be seen as an indication that bold changes are impossible or, at best, that they must be limited in scope and carefully scripted. This has long led to small steps and therefore to slow moves, even in the teeth of a major crisis, and when reviewing the strategy in 2003.

Second, there is always room for interpreting any mandate. The evolution of monetary policy over the three crises has shown that "within the mandate" is not as highly constraining as sometimes asserted. In addition, the Treaty leaves the ECB free to define price stability, which indeed is one outcome of the second strategy review.

Third, because it may be interpreted in a wide variety of ways, adherence to the mandate is both of mostly symbolic importance and a source of high-level debates, both within and outside the ECB. Such debates can become very theoretical and detached from the practical issues that the central bank faces. The interventions of the German Constitutional Court are an example of such debates, which restrict sensible actions, including the adoption of a new review.

Fourth, the unique feature of the European monetary union is that it includes many independent states, each with its own history and idiosyncrasies. This opens up the possibility of disagreements along national lines, which have been frequently aired. These disagreements are bound to emerge when producing a formal document like the strategy review. Disagreements also exist in other major central banks, but they are not based on alleged national interests.

Fifth, crises offer opportunities to learn from successes and mistakes. However, evaluating the past requires a practical focus. Otherwise, it may only harden preconceptions along doctrinal and national lines. It may be reassuring that the pandemic crisis was well managed, but was it because one group dominated another, maybe against concessions on the strategic review then under way?

[2] It is fair to note that in 2008 most central banks were confident that inflation targeting was the definitive strategy, which required at most some fine tuning. Financial and debt crises were not considered issues relevant to the advanced economies.

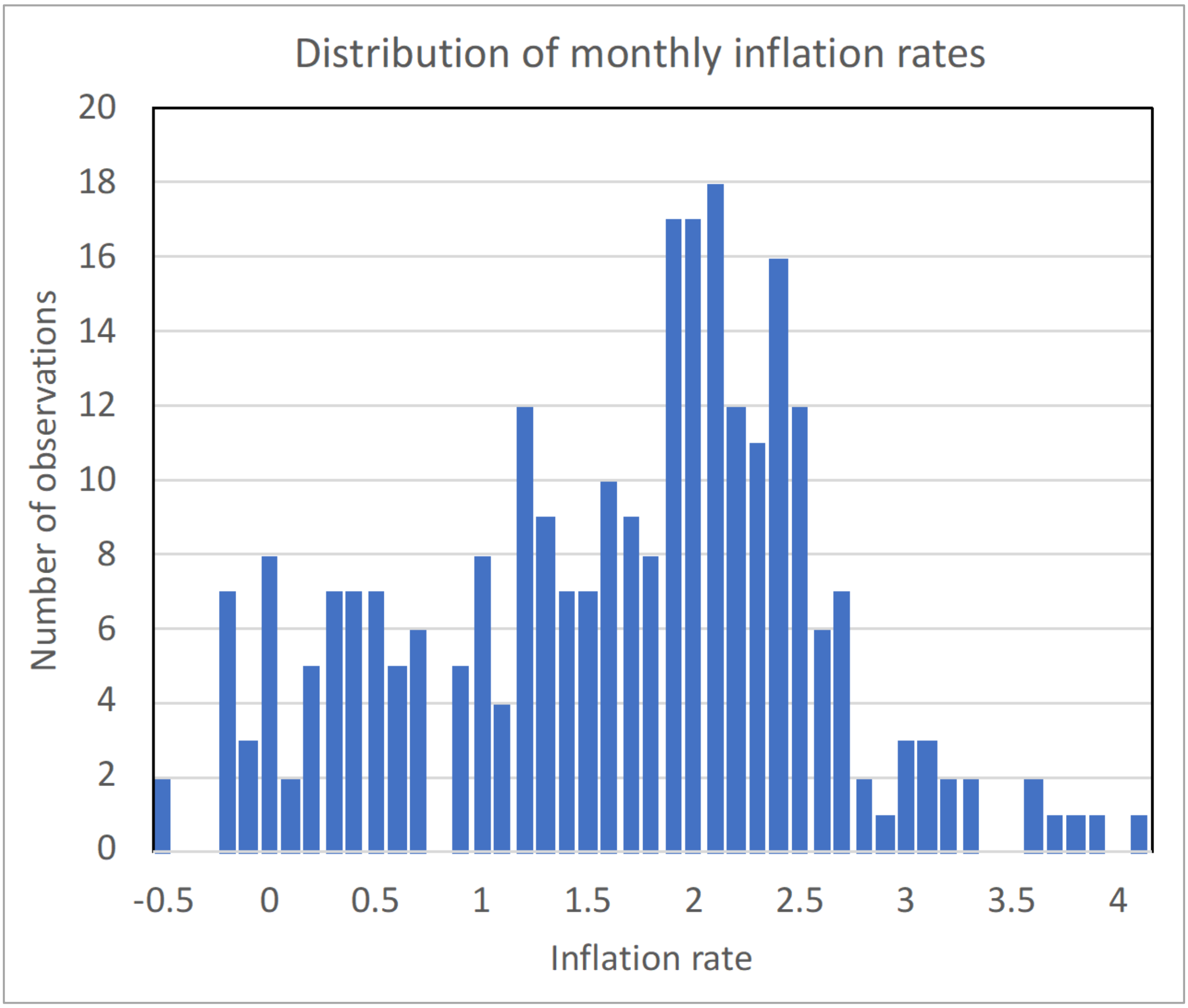
3. THE STRATEGIC REVIEW

3.1. The new definition of price stability

The main step forward is to replace the previous inflation goal of "below but close to 2 %" with a symmetric 2 % objective to be achieved in the medium run. This change had been very widely advocated ever since the ECB offered its definition of price stability. Critics complained about the asymmetric ("below 2 %") and ambiguous ("close to 2 %") definition. The ECB argued that it was merely a definition, not an objective, and therefore it did not have to be an operational guide. It was never clear how a central bank tasked with price stability could have another objective than its definition of price stability.

Unsurprisingly, the outcome reflects the ambiguity of the definition and its impact. Figure 2 presents the distribution of monthly inflation rates since January 1999, measured over the last 12 months. The most frequently observed range is between 1.9 % and 2.1 %, which is symmetric around 2 %. However, the distribution is highly asymmetric. About 40 % of the rates are less than 1.5 %.

Figure 2: Frequency distribution of monthly inflation rates – January 1999-September 2021 (price increases over previous 12 months)



Source: ECB.

The second change in strategy is probably richer of consequences. The new strategy "implies a transitory period in which inflation is moderately above target". The ECB now accepts to temporarily overshoot the 2 % target. This statement is a welcome step as it should help facing the coming challenges presented below. However, the statement is vague. It does not specify any limit to inflation nor how long an overshoot will be acceptable.

Without saying so, the ECB almost follows the US Federal Reserve's own new average inflation targeting (AIT) strategy. Almost, though. While the Fed wants to be judged on average inflation over an unstated duration – for which it has been rightly criticised – the ECB aims all the time at 2 %, only accepting temporary deviations. This may seem like neat picking, but it is not. The merit of the Fed's strategy is to get close to price *level* targeting. If the Fed is successful, you can anticipate price levels over the long run to move along a 2 % growth trend, which provides a high degree of precision, because bygones are not meant to be bygones. In the case of the ECB, the strategy is much less precise, creating a significantly larger level of long-run uncertainty. This uncertainty is not only affecting firms and possibly households, it also is likely to impact long-term interest rates.

3.2. Financial stability

The ECB now takes responsibility for financial stability, a crucial missing element of the previous review (and of the mandate). But its justification, that "financial stability is a precondition for price stability" is embarrassing. It shows that a key lesson from the crises is deliberately being ignored. In recent years, along with major central banks, the ECB has adopted the nonstandard quantitative easing instrument, expanding its balance sheet to stabilise the financial markets. But it has always insisted that its aim was to bring inflation up to its definition of price stability. This formulation perhaps explains the limited use of QE displayed in Figure 1. Evidence that QE has a powerful effect on financial markets but no discernible macroeconomic (on growth and inflation) effect notwithstanding, the ECB seems unwilling to recognise the true purpose of its own actions. This is not innocuous.

As explained in Wyplosz (2021), this view stands to hamper the need to normalise its policies in the coming years. If QE is a powerful macroeconomic instrument, the ECB will need to wait until inflation is back to its 2 % objective to tamper and, quite possibly, to shrink its balance sheet. As Figure 1 shows, it missed that opportunity before the pandemic crisis. It was left with no room to maneuver when it became needed.

Furthermore, the statement rules out any trade-off between price and financial stability. On the one hand, the review opens up the door to such a trade-off through the redefined medium term orientation and the insistence on proportionality and side effects. On the other hand, financial stability is systematically presented as secondary to price stability. In the end, the review does not spell out a clear strategy on a most important issue. What will the ECB do in the event that financial stability is under threat while inflation is above 2 %? It would be a major mistake to refrain from adopting policies that stand to stabilise the financial markets, and let a financial crisis erupt, simply because the justification articulated in the strategic review does not warrant expanding the money supply in these circumstances.

3.3. Banking system stability

The ECB is now in charge of bank supervision and shares responsibility for bank resolution with national authorities, leaving the euro area with a cumbersome process to be activated in case of emergency. It might be argued that clarifying the framework lies outside the strategy review since it is not for the ECB alone to decide. However, the review could acknowledge the importance of the issue.

In recent years, macroprudential policies have become an increasingly important part of the overall monetary policy framework. In the euro area, this instrument remains in the hands of national central banks. Yet, financial stability is unlikely to be preserved in the monetary union if one country faces acute instability. As with lending in last resort and bank resolution, potential transfers among member countries complicate the search for an agreement. The ECB could, and should, have an important say in how these policies are designed and implemented at the national level. Various possibilities exist, none is mentioned.

3.4. Lending in last resort

Whether they like it or not, central banks must be prepared to act as lenders in last resort to governments and banks. They usually refrain from creating the impression that they will automatically use this instrument in case of need, because they do not want to create the moral hazard of encouraging governments and banks to adopt risky policies in the expectations that they will be bailed out if they face acute hardship. The ECB's reluctance is no exception, but the absence of any reference to this responsibility in the strategic review is worrisome.

During the global financial and public debt crises, it did end up carrying out this responsibility, but late and with all sorts of potentially harmful safeguards. This issue is particularly controversial in the euro area because it includes different countries. Depending on how its structured, lending in last resort may lead to significant transfers among member countries. This is one additional reason for the ECB to undertake preparations. It needs to develop instruments that minimise the moral hazard and avoid losses. It also must negotiate with member country governments how eventual losses can be apportioned. Such preparations are unlikely if the ECB does not accept this responsibility.

3.5. The two pillars

The logic of the two pillars of analysis, economic and monetary, has been doubtful from the start. The strategic review makes progress in two directions. First, it explicitly abandons the notion of cross-checking, which really meant that each pillar on its own provides information on the variables of interest to the central bank. Cross-checking really reflected long-resolved debates pitting inflation targeting against monetary aggregate targeting. The new strategy now accepts the notion of general equilibrium, which relies on an integrated framework of analysis.

The second progress is summarised in the redenomination of the monetary pillar into "monetary and financial analysis". This change acknowledges that the path from money policy to the economy (including growth, inflation and employment) transits in an important way through the financial markets. This may seem obvious, but it was not in the 2003 review, which relied on primitive and mechanical links.

Still, once it is agreed that both pillars must be integrated into a general equilibrium framework of analysis, there is no need to keep them explicitly apart. It is surprising that this relic of a distant past has survived in the review. It may reflect the ECB's internal organisation into specific departments. If that is the case, it would seem preferable to adjust the organisation structure to the task. Alternatively, it may reflect lingering disagreements within the Governing Council or among the staff. In the end, the survival of the two pillars is most likely inconsequential in view of the adoption of the general equilibrium approach.

4. THE NEW CHALLENGES

Navigating three major crises in a few years constitutes a major, unprecedented challenge. Over the two first crises, most governments have been relatively subdued in their macroeconomic interventions, leaving the central banks as the first, and often only, line of defence. The situation has been reversed during the pandemic because the situation unambiguously required fiscal policy actions – sanitary, public support – that lie far from the competencies of central banks. Although they have continued to forcefully deploy their nonstandard tools, central banks have been more efficient in eliminating the risks of financial instability. Assuming that COVID-19 becomes "only" a normal sickness, the return to normality will bring the central banks to the fore. They will face a set of unprecedented challenges. A natural question is whether the strategy review is well-adapted to this new situation.

4.1. Inflation and public debts

In many countries, public debts now reach levels (in percentage of GDP) unseen outside postwar times. Historically, high debts have been reduced by long-lasting primary budget surpluses, or defaults, or inflation. Inflation is often presented as the easy way out (Aizenman and Marion, 2009; Blanchard et al., 2010). This would only be possible if the ECB were to change its focus on, or its definition of price stability.

The strategy review may be interpreted as a signal in this direction. The symmetry of the new definition and the comment that above target inflation can be accepted for a while could indicate a willingness to let inflation rise. These changes can even indicate that the ECB accepts *ex ante* to provide fiscal space to member governments as the euro area exits a very troubled decade, both economically and politically. In that view, fiscal dominance is back.

Assuming that this is indeed the ECB's intention, we need to examine whether inflation can work as intended. Reviewing two centuries of high debts, Eichengreen et al. (2019) observe that inflation was used to reduce debts in only two periods. After WW1, a few countries (including Hungary, France and Germany) eliminated their debts through inflation, but this was inflation of the hyperinflation variety (not quite in France), which is not acceptable now, for good reasons. After WW2, moderate inflation was indeed the instrument of choice. However, this was only possible because of financial repression through heavy-handed regulations – allowing governments to control interest rates directly or indirectly – alongside capital controls. In addition, public debts were mostly privately held.

This is not the current situation. Although nothing is impossible, it is hard to imagine that financial repression is an option that governments will be willing to contemplate, even if they have high debts. This is largely precluded in the euro area or, at least, it would require unanimity. Lower-debt member countries are most certain to veto such moves, including imposing capital controls.

In recent weeks, inflation has risen, but the ECB keeps saying that this is temporary. As long as it convinces the markets, interest rates are not likely to rise much, especially medium- and long-term rates. If inflation at 3 % only lasts one year, public debts are reduced in similar proportions[3], which is too small to make a significant impact. If inflation is longer-lasting, the question is how the ECB will react.

The strategy review commits the ECB to keeping inflation around 2 %. This is the answer. If inflation becomes entrenched, because wages rise to catch up on prices, the ECB will need to lift the interest rate. That would shrink the fiscal space and possibly trigger concerns about large public debts. It would

[3] The actual impact is more complicated to evaluate.

also hurt the financial markets. The price of existing bonds, public and private, would fall. Stock prices are currently very high because they assume that interest rates will stay low for a long period of times. They are also kept low by central banks' nonstandard policies that effectively manage the yield curve. Higher interest rates would trigger a re-pricing of shares as the "old world" of low rates would give way to the "new world" of higher rates. This would threaten financial stability. At this stage, the financial markets seem to believe that the ECB would take this risk lightly and would limit increases in interest rates, in effect accepting more inflation than it wishes.

How likely is it, then, that the ECB accepts the combination of fiscal and financial dominance? The strategy review is clear: financial stability is not an objective, only a mean to achieve price stability. Consequently, the ECB is committed to resist the temptation of letting inflation rise long enough to curb public debts, assuming that it is feasible.

The contrast between current financial market beliefs and the statement of the strategy review that "it is important for monetary policy to respond forcefully to large, sustained deviations of inflation from the target in either direction" is puzzling. It is reminding of early September 2008 when the markets were warning of an impending crisis unless the authorities bail out the most troubled banks. The US Treasury refused to bail out Lehman Brothers, the bank collapsed, and the crisis erupted. Then, with the support of the Fed, the Treasury bailed out the largest banks and more.

4.2. QE and public debts

A proper assessment of the costs and sustainability of public debts has to go beyond the observed levels of gross debts. First, the proper concept should be the net, not the gross debt. Gross debts are known with a high level of accuracy but not net debts since it requires evaluating the values of public assets, which is arduous. The International Monetary Fund (IMF) undertakes these calculations, which are at best indicative. Table 1 shows the results for a few euro area countries, looking at the ratios to gross domestic product (GDP). The differences are limited and not reliable. On the other hand, the gross debt data ignores public commitments, such as the very sizeable loans provided to firms during the Covid-19crisis. For better or worse, we use gross debts.

Table 1: Gross and Net Public Debts (% of GDP) - 2021, selected euro area countries

	Gross debt	Net debt
Belgium	113.4	99.6
France	115.8	103.3
Germany	72.5	54.4
Italy	154.8	142.2
Portugal	130.8	121.8
Spain	120.2	104.5

Source: World Economic Outlook, IMF.

More important is the proportion of the debts held by the Eurosystem as the result of QE. As Table 2 shows, at the end of 2020, about 22 % of gross public debts were held that way. By the end of 2021, this proportion is likely to be significantly higher due to PEPP. It is often noted that this is irrelevant for the public sector, which includes the central bank. The argument is that the central bank receives interest for the debts that it holds, but it must pay interests on the corresponding amounts deposited by the banks from which the debt was bought. The only benefit for the public sector is the difference between the interest paid to the central bank by the Treasury and the interest paid by the central bank to banks, and the difference is negligible. This is true of course, but it misses two important points. First, the central bank can pay the interest by creating new money, that is borrowing again from the banks, a process that is limitless. Second, the risk of a debt crisis is reduced. Indeed, the "debt" of the central bank is not perceived as a risk. It may become a source of inflation, but that is a much less pressing issue than a run on public bonds.

Table 2: Public debts held by the Eurosystem's central banks
(% of total gross debt, end of 2020)

Austria	21.4
Belgium	16.0
Finland	21.8
France	17.8
Germany	22.5
Ireland	25.0
Italy	21.6
Netherlands	24.3
Portugal	18.5
Spain	23.3

Source: Sovereign investor base estimates by Arslanalp and Tsuda (2014), updated on line.

The upshot is that, through QE, the Eurosystem is effectively retiring a significant share of public debts. If it paid no interest to banks, the charge of that part of the debt would be nil[4]. Thus, the effective indebtedness of governments is significantly lower than what is shown in Table 2. Reversing QE will involve re-injecting public bonds into the financial markets, which will eliminate some of the protective effect of large-scale central bank holding of public debts.

This is why the ECB could raise its interest rates before it considers reducing its balance sheet, as argued in Wyplosz (2021). Unfortunately, this important issue is not mentioned in the strategy review.

4.3. Climate change and public debts

One way or another, governments will have to massively increase public spending to fulfill their commitments to reduce carbon emissions. In theory, this would be unnecessary if they agreed on a carbon tax whose rate would be steadily rising. An alternative is the generalisation of increasingly expensive pollution permits. Indeed, these measures would provide governments with revenues that they could and should spend in two ways: compensating the part of the population which would be seriously hurt by the tax and providing subsidies that support the transition to zero carbon (transport, R&D, electricity network and storage, insulation of buildings, etc.). Absent government revenues from this most efficient approach, public spending will have to rise by large amounts.

Unless governments raise revenues by other means than a carbon tax or pollution permits, it is difficult to imagine how the budget deficits will not increase very significantly. This will make it impossible to

[4] Currently, the Eurosystem pays a negative interest rate and interest on some public bonds is also negative, although somewhat less so than the interest paid by the Eurosystem. In other countries, the bonds carry positive rates.

stabilise public debts at their currently high levels. These increasingly large public expenditures will also make fiscal policies expansionary, which will strengthen inflationary pressure.

In its strategy review, the ECB writes:

> *"The Governing Council is committed – within the ECB's mandate – to ensuring that the Eurosystem fully takes into account the implications of climate change and the carbon transition for monetary policy and central banking. […] The Governing Council will adapt the design of its monetary policy operational framework in relation to disclosures, risk assessment, corporate sector asset purchases and the collateral framework."*

This statement points toward being alert on the financial risks that the transition may create for its own asset holdings. While it mentions "the implications of climate change and the carbon transition for monetary policy and central banking", it says nothing precise about the impact on public debts and inflation.

5. POLICY UNCERTAINTY

Crises may have rather short-term impacts, but they leave a legacy. Since the global financial crisis, interest rates have been historically low and much-needed financial regulatory changes have altered the traditional channels of transmission of monetary policy, which made it apparently impossible for central banks to bring inflation rates up to the stated objectives. The euro area debt crisis has been followed by important institutional changes (the Banking Union, partial centralisation of financial supervision). Undoubtedly, the COVID-19 crisis will also leave its mark. All along these crises, public debts have risen. As a result, economic uncertainty has grown larger, and will continue to remain high as the result of climate change and its daunting policy challenges. Importantly, the political landscape has grown in complexity: nearly everywhere, the old dominating parties have shrunk while polarisation has grown.

Facing more uncertainty, monetary policy itself is bound to become more uncertain. One challenge faced by the strategy review was how to cope with uncertainty. The ECB cleaned up its outdated definition of price stability, which called for more precision, while seeking more flexibility, which makes policy more uncertain. It also acknowledged its responsibility for financial stability but subjecting it to the price stability objective provides neither clarity nor flexibility. Its brief statement fails to come to grip with an essential issue: its relationship to the financial markets.

The financial markets understandably require less policy uncertainty. However, quite often, the ECB is rightfully unsure of its next move. It should then say so. Indeed, a key function of financial markets is to deal with uncertainty. The ECB has no responsibility to reduce policy uncertainty if that requires a commitment that it will follow a course of action while it is not sure that it will do so. It can well describe its options and share its doubts, leaving it to the markets to face the resulting uncertainty. This is a proper allocation of tasks. It could lead to periodic jitters in the financial markets, with no serious consequences for the economy itself.

6. ACCOUNTABILITY

The rising uncertainty also matters for the ECB accountability. Much like with the financial markets, the central bank should not seek to project an amount of knowledge that it does not possess. Accountability calls for openness, not for commitments. The European Parliament's (EP) responsibility is not to try and tie the ECB to a course of actions. Rather it is to verify that the ECB is fully aware of the risks that lie ahead and has worked out adequate contingency plans.

Now that the ECB has completed its strategy review, it could be helpful for the EP to conduct its own review of the Monetary Dialogue. This should lead to renegotiating with the ECB the conduct of the dialogue. It would have to cover the formalities of the process, but also the range of issues to be covered. The ECB's own review now includes considerations of financial stability and climate change, which could be explicitly included in an adjusted Monetary Dialogue (by the way, this title lacks any reference to the legal requirement that the ECB be accountable to the EP). The EP could also review its own procedures. A key improvement would be to limit the number of interventions and to allow for more follow-up questions (a real dialogue) between those who intervene and the Chairperson of the ECB. The briefing papers include a wealth of detailed analyses that could be used to conduct precise discussions, which could go beyond the currently pre-determined topics.

7. CONCLUSION

The new definition of price stability is a step in the right direction, even though the ECB could have gone further toward the Fed's average inflation targeting. This definition can become most helpful as the central bank navigates new uncertainties. Yet, the review does not deal with some daunting challenges that are already visible. It will need more than a few principles about price stability to deal with such issues as high and rising public debts, financial stability, or climate change.

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This paper was provided by the Policy Department for Economic, Scientific and Quality of Life Policies at the request of the committee on Economic and Monetary Affairs (ECON) ahead of the Monetary Dialogue with the ECB President on 15 November 2021.

PE 695.473
IP/A/ECON/2021-51

PDF ISBN 978-92-846-8685-8 | doi:10.2861/96976 | QA-01-21-390-EN-N