ECB Listens online survey
Positive Money Europe’s response

Section 1 – What does price stability mean for you?

The main contribution central banks can make to improving people’s welfare is to maintain price stability. You may have heard about our recent measures to help counter the economic impact of the coronavirus pandemic. These have the overall aim of keeping prices stable. If the rate of inflation (the rate at which consumer prices increase on average from one year to the next) is positive, low and stable, this situation is consistent with price stability. We currently aim at an inflation rate below, but close to, 2% over the medium term.

1.1 How do changes in general price levels affect you/your organisation and your members?

When inflation is low for a period of time, firms and households expect the inflation rate to remain low in the future, and they tend to respond by delaying their spending and investment decisions. Investors, foreseeing this decrease in demand and decrease in productive opportunities, then demand lower rates for borrowing. In turn, central banks provide accommodative borrowing rates in order to incentivize borrowing and investment. However, pushing commercial banks to expand the money supply requires central banks to be watchful of applying too much upward pressure to inflation.

As a response to the crisis, the ECB injected 2.6 trillion euros into the financial system through quantitative easing and lowered interest rates into negative territory, with the objective of stimulating lending and investment. Conventional monetary theory suggests that expansionary monetary policy can lead to increased inflation, but the empirical evidence shows that inflation has been decreasing, remaining persistently low for the past decade. Inflation has not reached the ECB’s target of “close to, but below, 2%” for the last 6 consecutive years.

While some structural and external factors are at play (covered in section 1.2), the ineffectiveness of the ECB’s policies to date is largely due to the inefficiency of the financial sector’s ability to “transmit” the borrowed funds to the real economy by issuing more loans to companies and households. Instead, they continue to circulate within the financial sector, leading to asset price increases and share buybacks.

In many ways, deflation currently poses more of a threat than inflation. Low expectations lead to low output, low investment and low growth, leading to a self reinforcing cycle. Some inflation is necessary to create a vibrant economy: higher inflation is beneficial for debtors as it lowers the value of their debt, making it easier to repay.

On the other hand, low inflation is discouraging demand for borrowing and investment by firms and households. The pandemic will in many ways exacerbate the current deflationary trend. Firms and households, expecting hard times ahead, will further delay their spending decisions or even increase precautionary savings and hoarding. Uncertainty and increasing unemployment will also continue to depress inflation.

Investors facing fewer productive investment opportunities will then have lower risk appetite, and therefore have no incentive to invest in the real economy. Instead, they direct investment borrowing back towards the central bank balance sheet, or reinvest them into FIRE (finance, insurance and real estate) sector firms, fuelling asset price bubbles.

Central banks have rightly been given the mandate of ensuring price stability. However the way to conduct monetary policy should not be set in stone. As with other policies, it needs to adapt to changing conditions. With their inflation target constantly undershooting, major central banks are revising their monetary policy strategies: the Federal Reserve announced that it will aim for flexible inflation targeting of 2% on average over the long-run, meaning that it will tolerate inflation above 2% for an extended period of time (Powell, 2020).

Recent research suggests that a monetary policy strategy focused on interest rate control faces inherent limitations in stimulating the economy because of agents' heterogeneity and disruptions in the flow of payments (Woodford, 2020). This finding strongly indicates a strategy focused on aggregate demand stabilization - including with direct and uniform money transfers to citizens and businesses - would almost certainly be a more effective response to the economic crisis provoked by the pandemic.

Given the immensely challenging environment faced by the Eurozone as a result of the pandemic, the ECB's strategic review is a timely and crucial exercise. We must ensure the ECB has the adequate policy strategy to fulfill its price stability mandate in the future.

To best achieve this, the ECB should join the ranks of central banks (such as the Federal Reserve and the Bank of Canada) that conduct a monetary policy strategy review every five years, and not restrict it to a one-time event.

1.2 Are you concerned about either deflation or inflation being too high?

From the inception of the ECB up to the financial crisis in 2008, the average inflation rate was 2%, while the core inflation (overall index excluding energy, food, alcohol and tobacco) averaged 1.8%. In the decade since the financial crisis, the average inflation was 1.3%, and the core inflation 1.1%. Then, in August 2020, core inflation reached a historically low level at 0.4%. The current ECB staff projections show that inflation will remain significantly lower than 2% until at least 2022.

It is clear that low inflation and deflation currently pose a far greater threat than inflation.

First, low inflation is not anymore a temporary phenomenon: deeper structural changes are contributing to persistent low inflation, and have increasingly disrupted conventional inflationary dynamics over the past two decades. Those structural causes of low inflation include economic uncertainty, the slowing of global trade, and labour market fragmentation (which induces a reduction of labor bargaining power), along with the disruption caused by technological innovations such as artificial intelligence and automation.

Second, the lack of supportive fiscal policy in the Eurozone is holding the inflation rate low. Unlike at the beginning of the euro crisis, the pandemic crisis comes at a time when euro area governments - some more than others - are highly indebted, meaning some countries have less room for fiscal expansion. In the future, undue emphasis on the perceived dangers of higher government debt could lead politicians to rush into painful and senseless austerity policies. A moderate level of inflation would lessen the cost of public debt service, which would support a smoother recovery.

Third, and most importantly, ever since the global financial crisis of 2008, central banks have been conducting deeply accommodative monetary policies with consistent rate cuts and massive amounts of liquidity injected into the economy in the form of quantitative easing. In contrast with conventional monetary theory, which would have predicted a surge in the inflation rate, the transmission mechanism of monetary policy has been muted.

Given the above mentioned factors, the ECB should consider adopting a new policy framework targeting a higher inflation level, including different options such as price-level targeting (that is, allowing inflation to overshoot for a period of time to make up for the missed 2% target), or even nominal GDP targeting, which would reduce the risk of recession. Those proposals have many merits, and therefore need to be discussed openly and considered seriously.

Unlike other central banks, the ECB is a special case since it functions as a central bank to 19 member states and there is a significant heterogeneity between them. Lowering the inflation target would systematically increase the risk of having a positive average inflation while letting a few individual countries go into deflation. For that reason, the ECB's inflation target should certainly be higher rather than lower.

Whatever option is chosen, the new inflation target will not be credible if the ECB does not accompany this change with the adoption of better policy instruments to reach this target. Indeed, as we pointed above, the ECB's existing tools are increasingly ineffective at increasing inflation and stimulating growth in sustainable sectors of the economy.

The pandemic crisis and the strategic review initiated by the ECB opens the door for major reflections on helicopter money or "QE for the People" as a policy tool.

Helicopter money would increase demand and jumpstart the economic recovery through so-called "helicopter money". The ECB would create money and send it directly to the public in the form of unilateral transfers to citizens, without increasing the levels of debt. Helicopter money would greatly improve the transmission channel of monetary policy because the ECB could channel money directly into the economy, circumventing the slow and uncertain process of spurring more bank lending.

Boosting the purchasing power of the population by direct transfers is more likely to push inflation closer to 2%, with even a moderate risk of overshooting the target. But given the current risks of economic depression and price deflation, this would be an overall benefit for the economy, as a larger inflation rate would also facilitate the deleveraging of public and private debt.

A coordinated approach between member states, the ECB and the EU institutions - particularly the European Parliament - is necessary to secure a higher degree of political ownership and democratic legitimacy in deciding how helicopter money should be allocated (Jourdan, 2020).

1.3 For which types of goods and services do you feel the effects of price changes most?

Housing prices and asset prices are almost constantly going up since the inception of the Euro.

1.4 When you think about inflation, how relevant do you find the increase in the cost of housing?

Housing prices are particularly relevant for the ECB's monetary policy and for people's purchasing power and perception of the inflation dynamics. It is very odd that the Eurozone's HICP index does not properly incorporate housing price developments as the corresponding indices of other major central banks do.

HICP is the main indicator which the ECB uses to adjust its monetary policy, and how the bank's performance is likely to be evaluated by citizens and the public. The fact that the ECB's inflation metrics significantly underweigh one of the main consumption items of European households' budget ultimately means the inflation index does a poor job in reflecting households' purchasing power, or at least operates a dangerous discrepancy. This may negatively affect how people perceive the performance of the ECB in delivering price stability.

Moverover, inclusion of housing prices in HICP would greatly assist with the evaluation of the transmission channel of monetary policy for better credit guidance. Indeed, credit for housing purchases forms 43.5% of loans (CEPS, 2018) by banks, and is therefore a major contributor to the ECB monetary policy transmission mechanism.

Furthermore, loans for housing represent the most obvious way in which commercial banks' money creation contributes to the building up of wealth inequality and unequal access to credit (Turner and Ryan-Collins, 2019). By potentially inducing a disproportionate effect on housing prices, the ECB may in effect be contributing to increasing inequality of wealth. Awareness of this risk must be carefully incorporated into the ECB's overarching analysis and policymaking framework.

The way that housing prices are currently under-reflected within the HICP index is highly concerning, especially as rent or mortgage payments are often the biggest expense of households.

While we are aware of the conceptual and practical difficulties identified by the European Commission with adopting this change (for example, the lack of monthly housing data in the eurozone), those are not viable excuses for further inaction, especially after 20 years of adhering to a flawed status quo.

Section 2 – What are your organisation's expectations and concerns?

We conduct monetary policy to make sure that the euro holds its value over time. To make our monetary policy as effective as possible, we want to better understand your expectations, as well as your economic concerns.

2.1 What economic concerns are you/your organisation and your members facing?

In the aftermath of the last Eurozone financial crisis, high levels of public debt are a major concern for citizens, as more public debt is likely to become a disproportionate burden for future generations. A discussion around debt finance and intergenerational justice is necessary, and as a solution, financing fiscal policy in other ways than conventional bond issuance must be considered.

The rise of inequality is also a major concern. While an overwhelming growing literature shows an accelerating growth of income and wealth inequality, we are witnessing near zero public action to address the problem in a systematic way, through adequate redistributive policies. Central banks are not immune to this problem, as their policies also contribute to the problem. In particular, quantitative easing policies do cause a rather uniform and direct increase in the value of financial assets - which are mostly owned by the richest individuals - while the lowest income groups have benefited only indirectly, and to a lesser extent, from a moderate decrease in unemployment. Even this small gain has been largely offset by stagnating wages, growing precarity, and poor working conditions.

Furthermore, climate change poses a major challenge to the economy, public health and the financial system. Central bank policy is not exclusively concerned with climate change because of its systemic risk to the financial sector resulting from asset price valuations (‘stranded assets’). Moreover, climate change poses a far greater risk of impacting a central bank’s ability to meet its mandate, as inflationary and deflationary risks will be more severe as shocks (commodity price shocks, productivity shocks, policy shocks) intensify in frequency and depth, making the job of the central bank that much harder. Therefore, the ECB needs to prioritize climate change as part of its core (price stability) mandate, as well as within the secondary objectives of the Union as a whole.

2.2 How have changing economic conditions affected you in the last decade and especially in the current economic crisis caused by the coronavirus pandemic?

On the employee side, large and persistent increases in part-time employment, fixed and short-term contracts, underemployment and related factors are contributing to the rise of the ‘precariat’, especially amongst the young people.

On the employer side, increasing automation and technological change means that factories and companies can achieve the same (if not increased) levels of productivity and profit with fewer workers. This in turn weakens the bargaining power of employees. Stagnating wages then reinforce deflationary tendencies. This is not only a phenomenon in Europe, but across the developed world, happening against the backdrop of slowing global output and growth.

Unemployment, while decreasing pre-pandemic, is likely to increase substantially in the near future due to lay-offs and bankruptcies. Moreover, not only unemployment, but also underemployment is a major concern, both contributing to increased inequality.

Lack of wage growth in the eurozone as a whole and in some countries in particular (for example, Germany) is a growing challenge. This is perpetuated by the low level of public investment, more of which is needed to effectively mobilize capital where necessary.

The COVID-19 pandemic will exacerbate the debilitating effects of debt-deflation.

2.3 How do low interest rates and monetary policy in general affect you/your organisation, your members and the overall economy?

Since 2015, the ECB policies have belatedly helped the Eurozone economy to get out of the deadly spiral of the Eurozone sovereign debt crisis. In particular, the quantitative easing policy has reduced government bond yields and reduced spreads across countries. The induced reduction in cost of government borrowing is in principle beneficial for taxpayers and public policy, however this windfall has been largely offset by overstrict fiscal rules. The stagnating low level of public investment is a blatant illustration of that.

On the private sector side, not everyone benefits equally from low interest rates and unconventional monetary policy. Quantitative easing leads to asset price bubbles (increase in equity prices) and rising housing prices. By pushing asset prices up, quantitative easing has increased the wealth of top percentiles of households, a finding that is confirmed by Bank of England research (BoE, 2018) and by the ECB (Annual report, 2016). It is no surprise that cheap credit disproportionately benefits those in the higher end of the income and wealth distribution.

It is essential that the ECB should acknowledge their actions with regard to social and distributional impact and consider more seriously their consequences. Instead, the ECB continues to shift the responsibility of tackling inequality to the domain of fiscal policy. The fact that QE exacerbates inequality is a direct result of ECB policy, therefore it is the responsibility of the ECB to tackle as well.

The ECB could implement alternative policies that would contribute to its price stability objective while not increasing inequality. Implementing helicopter money would boost consumption and ease the debt burden of households at the bottom end of the distribution. It is a bold proposal, but when it comes to designing technically convoluted programs such as Outright Monetary

Transaction (OMT), Targeted Long-Term Refinancing Operations (TLTROs), Corporate Sector Purchase Programme (CSPP), Covered Bond Purchase Programme 1,2,3 (CBPPs) and negative interest rates, they can equally think seriously about adopting more citizen-friendly and inequality-reducing measures.

Helicopter money as a policy option is a far cost-friendly option, than central bank measures to be deployed in case of the total collapse in aggregate demand, arguably a real risk in the post-pandemic world.

Section 3 - what other topics matter to your organisation?

The ECB's main task, its "primary objective", is to maintain price stability in the euro area. However, once price stability is guaranteed, it is the ECB's task to support the general economic policies of the European Union. These include, for example, the sustainable development of Europe based on balanced economic growth, a highly competitive social market economy aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment.

3.1 Do you think the ECB should give more or less attention to these other considerations and why?

Most central banks in the world have a "dual mandate" with employment or growth considered to be an objective equally important to price stability. The ECB is an exception to this rule, with price stability being the predominant objective subject to which the ECB shall support EU objectives.

In the past, the ECB has disappointingly undertaken very few initiatives that address its secondary objectives. Sometimes the ECB even contradicts them: consider the case of the Corporate Sector Purchase Programme (CSPP), which disproportionately benefits high-carbon sectors at the expense of the EU's environmental protection objective. The CSPP directly influences prices, increasing debt issuance by polluters and sends a false and damaging signal that high polluters' assets are low risk.

In the first decade of the ECB's existence, the credible threat of inflation was often used as a convenient excuse for not taking action on the secondary mandate. But the fact that inflation is structurally very low has effectively removed this excuse for inaction.

A more profound obstacle is arguably that secondary objectives are too broadly defined and subject to various possible interpretations. There are also trade-offs between focusing on some of them (for example, environmental protection may sometimes conflict with productivity maximisation within a market economy). This vagueness indicates that the ECB would need to make a discretionary judgement over which secondary objective it should focus on more than the others, possibly at the expense of its democratic legitimacy.

Instead of leaving discretionary power to the ECB to act or not act on those secondary mandates, a formal inter-institutional process should be established in order to prioritize and specify those objectives over the medium term, in alignment with the EU's current priorities. This process could be led by the European Parliament, including through a formal vote.

If such a process was carried out today, there is little doubt that the fight against climate change would stand out as one of the most important EU objectives on which the ECB would be required to act.

3.2 Are there other issues not mentioned above that you think the ECB should be concerned with when setting its policies?

As explained above, the possible secondary objectives for the ECB defined in Article 3 TEU are rather broad, leaving a lot of room for the ECB to take action. However a greater explicit emphasis on social justice and the need to reduce income and wealth inequality and overall poverty would be a welcome specification to the current stipulations.

Inequality and poverty are not only undermining social and democratic cohesion of our society, they also hamper the functioning of monetary policy. When great disparities exist between income groups, it becomes more complex for the ECB to get its "one size fits all" policies transmitted in the real economy. For example, a high level of poverty induces disruptions in the flow of payments in the economy, and decreases the bargaining power of labor, which makes the economy less resilient and more fragile during downturns. Greater inequality also induces that segments of society have a very varying level of access to credit, with low-income groups generally facing greater borrowing constraints.

By extension, the ECB should be given a stronger role in supporting financial inclusion, for example by introducing a digital euro system where all citizens could be provided with a free of charge bank account at the custody of national central banks. This proposal would also protect the sovereignty and security of the EU's payment system.

Finally, at the operational level, the ECB should strive to support diversity within its staff and at board level. Gender diversity is important in leadership is important given the implications for how institutional decisions are made. Balanced teams are likely to be informed by a more varied set of views which is important especially when it comes to the financial sector.

Except for ECB President Christine Lagarde and Executive Board Member Isabel Schnabel, the composition of the ECB Governing Council is male. A more comprehensive approach to monetary policy can be expected from a central bank committee that benefits from a variety of perspectives. Improving gender balance is one mechanism that can offer this, as academic studies in behavioural economics highlight men and women's different attitudes to economic policies. This is not to say an organisation's success is derived solely from having more women on the board. Instead, better gender balance expands the range of available views, which serves to enhance the decision-making process. The ECB subsequently introduced gender targets in 2013 with the aim of raising the share of women in management positions to 35% by 2019 (ECB, 2018).

The ECB as a European institution should reflect not only gender, but it needs to be intersectionally representative of Europe beyond gender, in ethnicity, political views and professional and academic backgrounds. The more diverse the ECB board is, the more perspectives it will benefit from.

3.3 How will climate change have an impact on you/your organisation, your members and the economy?

The speed at which we now need to transition to a low carbon economy presents a number of systemic risks to the financial system, with the potential to wipe out trillions of Euros worth of assets. The risks of inaction are far greater. Far from being Paris-aligned, our financial markets are set to fund a 4℃ temperature rise and have not priced in the catastrophic risks associated with climate change. If not addressed, climate change will lead to huge disruptions for millions of people, including rising unemployment and increasing sanitary and energy precarity.

While the primary responsibility for climate policy will continue to rest with governments, alongside the European Commission, the ECB has a vital role to play. Both the European Parliament and the ECB itself have acknowledged that the ECB is bound by the Paris Agreement, which includes “making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development”. The European Parliament insisted in early 2020 that this should be reflected in its policies, while respecting its mandate and independence.

The ECB must align its asset purchasing programmes and collateral frameworks with the Paris Climate Agreement to support the low carbon transition. The carbon bias in QE and collateral frameworks creates better financing conditions — an implicit subsidy — for fossil fuel sectors and the corporations.

Furthermore, the ECB needs to align its refinancing operations for the banking sector with the Paris Agreement to encourage more sustainable bank lending and close the green investment gap. In this regard, ECB’s TLTROs could open bids for 10-year-long TLTROs at a very low interest rate on the condition that banks increase their volume of green loans (such as loans for housing energy renovation or renewables). This mechanism would create a huge incentive for banks to offer cheaper green loans to customers and provide a further incentive to banks to support the low-carbon transition.

Leading members of the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) have called for senior managers at private financial institutions to be assigned personal responsibility for ensuring that relevant information is communicated to their investors and shareholders. The same principle should apply to the ECB, whereby it should regularly report climate related risks and other relevant information not to shareholders, but to the general public to whom it serves. This engagement can take place through European parliament, via existing platforms such as the Economic and Monetary affairs committee.

The ECB should also integrate climate-related risks into financial supervision. It will permit policy makers and the general public to monitor the progress of the banking sector in aligning with the

Paris Agreement, and assess the scope of the prudential measures that are necessary to increase the resilience of the financial system to climate risks.

4. How can we best communicate with your organisation?

We know that understanding how monetary policy works helps people make decisions about how to spend, save, invest or borrow money. We would like to find out how successful we have been in explaining what we do and why we do it.

4.1 To what extent do you feel well informed about the ECB/your national central bank, for example, concerning the recent measures taken in response to the coronavirus crisis?

Central banks in the Eurozone have largely improved how much they communicate to the wider public, as demonstrated during the pandemic crisis with numerous public and media interventions. Over the past few years, the ECB has also greatly improved its online presence, for example with providing useful "explainers" for citizens.

However, there is a lot of ambiguity and inconsistency in communication. For example, there is a contradiction in some of the Governing council members explaining that the ECB is effectively providing huge amounts of liquidity while at the same time insisting on the notions such as "fiscal space", "debt sustainability" and that all debts have to be repaid. These seemingly contradicting messages are confusing people and contributing to the build up of austerity bias in fiscal policy making.

4.2 How could the ECB/the Eurosystem improve the way it explains the benefits of price stability and the risks of inflation being too high or too low?

In the past decades, central banks have focused their communications on explaining the dangers of overly high inflation, but they have done much less to explain the risks of deflation or low-inflation. This has resulted in a misunderstanding of the justifications for the ECB policies and a more polarized debate about them.

The ECB should adopt a more open and honest approach to explaining the dynamics of money creation, including the role of private banks in the process. When they do engage on this matter, central bankers tend to focus on emphasizing the risks and limitations of money creation instead of also pointing to its necessity for the well functioning of the economy. This biased perspective does not contribute to the general understanding of monetary policy.

The presence of the ECB in member states should be boosted and improved, as well as transparency. To this end, hearings in the national parliaments involving members of the executive board of the ECB and of the national central banks should take place. Hearings with the national parliament should be public, at disposal of citizens. The Monetary Dialogue, in this context, still plays a meaningful role.

The European Parliament should have more power when it comes to appointment of executive board members. There should be a balanced list of candidates determined by the European Council.

4.3 What could we do to improve your understanding of the decisions we take and how they affect you?

Firstly, better transparency in how decisions are made would also contribute to a greater understanding of the ECB's policies and the trade-offs they often involve. In this respect, the public would deserve access to detailed transcripts and voting records of the Governing Council meetings with a reasonable delay of up to three years, instead of the current 30 year period. In addition, the "accounts" that are currently provided are insubstantial, and should be more detailed.

Second, the ECB and national central banks should communicate more openly and honestly about the key function they play in the economy: the management of the money supply by overseeing money creation by commercial banks. The current communication obfuscates the functioning of monetary policy by focusing on how the ECB policies are affecting market conditions, with little attention given to whether and how this is ultimately transmitted in the real economy by credit creation by commercial banks, and the direct effects of this process on the economy.

Instead of obfuscating their policy messages, the ECB should seek to adopt simpler language, in particular to explain and discuss the merits of money creation and the various ways this is affecting the economy.

Third, to get its messages across, the ECB should also seek to multiply the channels through which they communicate, going outside the usual channels such as the press conference, which mostly reaches the financial press.

Alongside more interaction with national parliaments, central banks in the Eurozone should seek to engage with civil society stakeholders, for example by hosting an annual forum with NGOs in each country. Eurosystem governors should also seek to engage further in bilateral meetings with civil society stakeholders, as they currently represent a very tiny fraction of meetings disclosed in official governors diaries.

More public consultations could be organized by the ECB as well, in particular to get feedback on the design and effect of its monetary policies from a diverse range of stakeholders and not just financial market participants. The ECB could also seek ways to consult with civil society when defining its research agenda, in order to ensure that the ample research efforts of central banks are more responsive to citizens' concerns and criticism, and less subject to institutional biases and groupthink.

About Positive Money Europe

Positive Money Europe is a not-for-profit research and campaigning organisation aiming to make the European Economic and Monetary Union support a fair, democratic and sustainable economy. We scrutinize the European Central Bank and work with parliamentarians, NGOs and academics to develop policy proposals to reform the Eurozone. Positive Money Europe was set up by Positive Money, a UK non-profit founded in 2010. Positive Money Europe was launched in February 2018 following the success of the campaign “Quantitative Easing for the People’. Positive Money Europe has an office in Brussels and is a registered interest group in the European Commission‘s transparency register.

Positive Money Europe
Rue Ducale 67, 1000 Brussels, Belgium
ASBL N° 0718.859.377

www.positivemoney.eu
info@positivemoney.eu
Phone: +32 2880449
@PositiveMoneyEU
facebook.com/PositiveMoneyEurope

First published September 2020

Download:

This document is available to download as a free PDF at: positivemoney.eu