Thomas Jordan: Monetary policy and government debt – different perspectives

Summary of a speech by Mr Thomas Jordan, Member of the Governing Board of the Swiss National Bank, at the 13th Zermatter Symposium, Zermatt, 28 August 2007.

The complete speech can be found in German on the Swiss National Bank's website (www.snb.ch).

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The effects of fiscal and monetary policy overlap. Fiscal policy can have a cyclical effect, while monetary policy can also generate income for the government. However, theory and practise have shown that, first and foremost, monetary policy must be used to ensure price stability and – to a limited extent – to dampen economic fluctuations. The principal aim of fiscal policy, however, must be to ensure that the national budget is financed as efficiently as possible. When government debt levels are high and budget deficits get out of hand, they pose a significant threat to a monetary policy that is geared to stability. Misusing monetary policy as an instrument of fiscal policy inevitably leads to a loss of purchasing power. Many episodes of high inflation have come about, ultimately, as the result of funding requirements on the part of the state. Nowadays, the independence of many central banks shields them – to a large extent – from the fiscal greed of politicians. Nevertheless, time and time again, when government finances have fallen into disarray, central banks have been seen to come under political pressure. From a monetary viewpoint, however, government debt is not entirely unwelcome. On the contrary, government debt is a vital ingredient of modern monetary policy. A liquid market for government bonds is a prerequisite for a modern and efficient financial market. Functioning financial markets, in turn, are necessary for an efficient monetary policy: a liquid market for governments bonds enhances the efficiency of the monetary transmission mechanism. Yields on government bonds and indicators derived from these yields are an important source of information for the monetary policy decision making process. Finally, in implementing government policy, government bonds serve as collateral. Sound government finances are a prerequisite for the long-term success of monetary policy and for maintaining price stability. However, healthy government finances do not necessarily imply zero government debt. For the functioning of financial markets and an efficient monetary policy, a liquid market for government bonds is a considerable advantage.