Jörg Asmussen: The costs and benefits of unorthodox monetary policy

Speech by Mr Jörg Asmussen, Member of the Executive Board of the European Central Bank, at the European Conference 2013, organised by UBS, London, 12 November 2013.

* * *

Ladies and Gentlemen,

It's a great pleasure to participate in this panel on unorthodox monetary policy.

I admit that for central bankers 'unorthodox' is not the preferred attribute to describe our policy actions.

Unorthodoxy means deviating from established behavioural patterns. It means departing from the received body of technical knowledge. It means forgetting about rules.

All of this violates one key consensus principle in the economics profession: namely, that monetary policy should be based on a predictable course of action with a clearly communicated policy objective.

Such clarity and predictability allows economic actors to form expectations about future monetary policy and to anchor their expectation around the price stability objective of the central bank. This ensures central banks' ability to appropriately steer monetary conditions to ensure a stable macroeconomic outlook with price stability and balanced growth.

So did we forget this crucial lesson?

The answer is: no.

In fact, when talking about "unorthodox" monetary policy, we have to clearly distinguish between two different dimensions of monetary policy, the objective and the instruments.

As to the dimension of the policy objective, the ECB pursues price stability, defined as positive inflation rates below 2 per cent. In its pursuit of the objective, and within that range, the Governing Council has clarified that it will aim for inflation rates below but close to 2%.

This quantification of our objective was the anchor of all our policy actions before the crisis; it has remained the anchor during the current crisis; and it will remain the anchor as the euro area economy proceeds towards recovery.

Accordingly, we have clearly followed the orthodox prescription of a predictable and steady monetary policy with regard to our objective.

The second dimension is the toolkit by which central banks seek to meet their objectives.

Along this dimension, the ECB – like many other central banks – has indeed left the well-trodden paths – for good reasons.

Indeed, it was necessary because the scale and complexity of challenges during this crisis fundamentally impacted the way monetary policy transmits through the economy and, hence, threatened to overwhelm our standard toolkit. In particular, amidst financial turbulence, our standard monetary policy lost some potency in steering money market rates. And these rates are of prime importance not only for the refinancing costs of the banking sector, but for the pricing of loans to households and firms and, hence, crucially determine the wider financing conditions in the economy.

This doesn't mean that our standard toolkit played no role in our crisis response: confronted with downside risks to price stability after the Lehman collapse, we swiftly cut our main policy rates to record lows.

But further action was necessary to confront impairments to monetary policy transmission. Here, three measures have taken a prominent role.

First, we provided term-funding support to euro area banks through long-term refinancing operations. This measure avoided a major credit crunch when interbank lending dried up.

Second, we removed unwarranted and self-reinforcing fears of euro breakup by announcing Outright Monetary Transactions. This measure mitigated major impairments in monetary policy transmission when sovereign bond spreads spiralled to fundamentally unjustified levels.

Third, we provided more explicit communication on the likely future orientation of our key monetary policy rates, including on the deposit facility, through forward guidance. This measure aligned market expectations more closely with our policy intentions when disturbances from within and outside the euro area interfered with our monetary policy stance.

Especially in extraordinary situations when, for example, policy rates are at, or close to, their effective lower bound, or when the normal channels of monetary policy transmission are impaired, or when there is exceptional uncertainty on the state of the economy, there is extra value in making central bank communication more explicit.

So do these rather non-standard monetary policy measures mean the ECB has become more unorthodox during the crisis?

Again, the answer is: no.

We have employed non-standard – not un-orthodox – monetary policy instruments precisely for the reason to achieve our orthodox monetary policy objective of price stability. In fact, the described challenges to the conduct of monetary policy during the crisis have required a more expanded set of tools to fulfil our price stability mandate.

Hence, they were an expression rather than a renunciation of our predictable monetary policy strategy with a medium-term orientation.

Vice versa, the anchor established through our price stability objective has allowed us to tailor our toolkit to the challenges at hand – without unanchoring inflation expectations.

Going forward, we must ensure that our policies continue to complement the adjustment in the euro area economy. At the same time, it must be clear that they are no substitute for structural adjustment.

For the banking system, the upcoming Asset Quality Review and Stress Test will be a crucial catalyst in this regard.

First, the AQR will foster transparency by providing a realistic assessment of the balance sheet situation in euro area banks.

Second, in the specific cases deemed necessary, the AQR will induce balance sheets repair by prescribing certain adjustment measures to individual banks.

And third, as a result of the first two, the AQR will foster confidence in the banks among all the major stakeholders.

Overall, these measures will help to restore confidence, contribute to integration and stability and therefore support a normal functioning of the banking system and monetary policy transmission. The goals of Single Supervisory Mechanism will, therefore, crucially complement our monetary policy objectives.