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Comment on Brunnermeier and Goodhart

Bruegel Monetary Policy Workshop, Brussels, January 18th, 2016
Main issues tackled:

(i) troubles in restoring inflation to target / difficulty in creating inflation

(ii) central bank independence.
Troubles in restoring inflation to target / difficulty in creating inflation

- **proximate cause**: breakdown of relationship between base money and inside money / money creation impaired;

- **root cause**: serious tensions in various sectors / impairments to their balance sheets.

**Implication for monetary analysis**: focus on weakest chains / bottlenecks.
Question: UMP solution or source of problems?

- **Majority view**: solution, even if not perfect;

- **Minority view**: source of problems.
Could UMP solidify bottlenecks?

- delays in restructuring;
- heightened uncertainty;
- deleveraging by viable firms;
- reach for liquidity buffers
Sluggish recovery by historical standards not because of slack but because of stagnant productivity

GDP path in the US after the Great Recession compared to previous recoveries

Utilization of capital and labour in the US after the Great Recession compared to previous recoveries

TFP path in the US after the Great Recession compared to previous recoveries

Source: IE NBP
Productivity stagnant because of non viable firms being kept afloat

Insolvencies vs. interest payments

Productivity dispersion

Source: Forbes (2015)
Could UMP solidify bottlenecks?

- delays in restructuring;
- heightened uncertainty;
- deleveraging by viable firms;
- reach for liquidity buffers
Threats to central bank’s independence:

- Inability or unwillingness of fiscal authorities to control long-run expenditure to GDP ratio;
- Inability or unwillingness of financial sector to absorb losses;
- Interest rate risk and credit risk linked to expanded balance sheets;
- Macro-pru
Appropriate central bank’s response to a crisis most likely would call for both:

- preventing the collapse of the financial sector and
- promoting post-crisis restructuring.

The second condition could require establishment of an effective lower bound clearly above zero.
In the case of BoE 2% was the effective lower bound until 2009

Source: Bank of England
We protect the value of money