



*Reflections on monetary policy in the euro area
at the current juncture*

**Address by the Deputy Governor of the Bank of Italy
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Bank of Italy workshop on
“Unconventional monetary policy: effectiveness and risks”

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It is a pleasure to welcome you to the Banca d'Italia for this one-day workshop on 'Unconventional monetary policy: effectiveness and risks'. I understand that you have a full agenda, with nine dense and thought-provoking papers packed into a single day. I will keep my remarks very brief.

Your discussions today are sure to be policy-relevant and timely. The Governing Council of the ECB has repeatedly asserted, most recently yesterday, that the asset purchase programme (APP) will continue at the current pace of purchases until at least March 2017, or possibly beyond if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with its target. Properly measuring the effects of the APP is therefore a priority for the euro area monetary policymakers.

The Eurosystem's expanded APP has been in place for almost two years, exerting clear and sizeable downward pressure on government bond and other financial asset yields; these, in turn, have had favourable effects on private sector financing conditions.

Monetary policy on its own cannot produce growth. It can, however, create favourable conditions for a cyclical upturn; it may facilitate the adoption of other measures, such as structural reforms, by limiting the negative short-run impact that is sometime associated with them.

As a joint outcome of the APP and the other extraordinarily expansionary measures recently adopted by the Eurosystem, the cost of bank loans is now historically low and, even more importantly, the dispersion of lending rates across countries is once again close to the levels prevailing in the pre-crisis period. This helps to preserve the integrity of the monetary union. Still, almost ten years after the onset of the financial crisis and five years after the start of the sovereign debt crisis, the slack in the euro-area economy persists.

A number of questions are being raised on the functioning of the expansionary measures recently adopted by the Eurosystem. How does the transmission mechanism work when the economy is at the lower bound of the interest rates? Might the working of those measures be impaired after some time? What are the interactions with other developments, such as commodity prices, financial regulation, legacy assets in banking, and conditions in the world economy? Could specific monetary policy measures adopted by the ECB weaken the transmission mechanism by negatively affecting banks'

profits and capital accumulation and hence lower the incentives for banks to engage in lending activities?

Many factors are at work, and disentangling the impact of the APP from that of other measures is of capital importance in informing the monetary policymakers' decisions. Yet, it is no easy task; and that is why solid, in-depth analysis, looking at these issues from different angles and with different tools, is surely needed. The first part of today's workshop will provide several interesting papers which attempt at doing that.

The second half will deal with another question that is being asked in the monetary policy debate, namely whether the current, extraordinarily expansionary monetary policy stance is inducing excessive risk-taking and thereby possibly igniting tomorrow's financial crises.

Low interest rates and yields make investors inclined to search-for-yield and embark on riskier investment strategies. Up to a point, this is not an unintended consequence of the current monetary policy measures, but actually part of the hoped-for transmission mechanism. Portfolio rebalancing is a key component of the mechanism that is expected to transmit the APP to the real economy.

It is conceivable, however, that this may eventually go too far and the amount of risk-taking induced by the Eurosystem's monetary policy exceeds what is optimal and results in more costs than benefits. I do not think there is any evidence that this is happening so far at the aggregate level. There are localized tensions, particularly in the property market in certain member states; these need to be tackled, and are being tackled, by macroprudential measures.

Opinions on the respective roles of monetary policy and macro prudential tools differ, as is perhaps natural given that macro-prudential policy is still in its infancy; more research on these topics is therefore welcome.

Looking at today's impressive collection of papers, I have no doubt that the workshop will go a long way towards providing us with answers to many of the questions I listed. I very much look forward to hearing about your findings and the outcome of your discussions.

Before the presentations begin, I would like to thank all those that contributed to this workshop, both from the Banca d'Italia and from other national central banks of

ESCB or academia. I wish you all a most successful workshop, and a pleasant stay in Rome and at the Banca d'Italia.