# Is monetary policy less effective when interest rates are persistently low?

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# Summary of the paper (I)

**Main message**

1. Interest rates in advanced economies have been persistently low for about a decade.

2. The low rates of the recent past have reflected central banks' unprecedented monetary easing to counteract the negative effects of the financial and sovereign crises.

3. Still, output has not returned to its pre-recession path; actual and expected inflation still disappointing.

4. *Monetary policy effectiveness is hindered in a low interest rate environment.*

# Summary of the paper (II)

**Sources of monetary policy weakness when rates are low**

- Headwinds:
  - impaired borrowers and lenders balance sheets;
  - misallocations;
  - uncertainty.
- Non-linearities:
  - banks' profitability and lending;
  - changes in consumption and saving behaviours;
  - impact of confidence on expectations.

Extensive empirical evidence supporting these channels (around 100 papers in bibliography!)

# Identification

- Causal relationship between low-interest rates and low effectiveness of monetary policy is not clear.

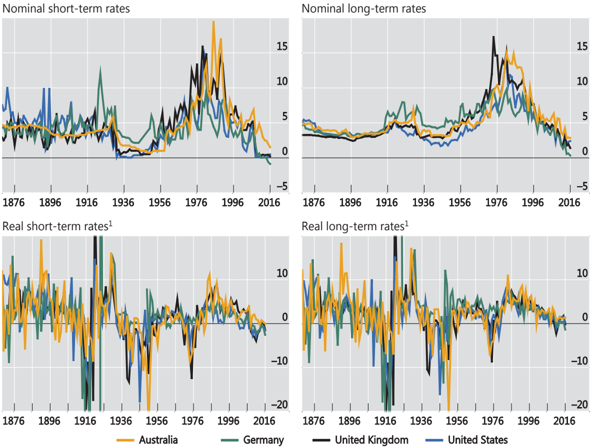
- Most of the sources of low monetary effectivness analyzed in the paper (e.g. impaired balance-sheet, uncertainty, loss of confidence) are not necessarily linked with interest rates level...

- ...actually, taking the (depressed) economic environment as given, their negative effects are likely to be even stronger and/or last for longer when rates are high:
  - higher cost of debt increases time of recovery from balance sheet recession;
  - low inflation increases the real burden of debt;
  - debt deflation mechanisms (Fisher, 1933).

- Confusion between the true cause (e.g. balance-sheet impairment) and an illusory cause (low interest rates)?

# Decline in short & long term interest rates

Paper claims that low interest rates are due to recent ultra accommodative monetary policy. What about complementary explanations?



# A good diagnosis is half the cure

What lies behind current low level of low interest rates? Many possible complementary and intertwined causes... (Ferrero and Neri, 2017)

- Financial cycle, balance-sheet recession, debt overhang (BIS view, Rogoff,...)
- Secular stagnation (Summers, Gordon,...). Many determinants:
  - adverse demographic developments;
  - reduced pace of innovation;
  - changes in propensity to invest/save;
  - safe assets shortage;
  - increased inequality;
  - ...

Distentangling causes requires an encompassing model. Very difficult task (Busetti; Mojon; Thwaites;...)!

# Policy implications

1. Current monetary policy: does (supposed) limited effectiveness requires greater accommodation? How?
   - even more negative rates?
   - increase reliance on asset purchases, i.e. larger balance sheet?
   - strengthen forward guidance?

2. Implications for monetary policy in possible "new normal": inflation target, size central banks' balance sheet,...

3. Interactions between monetary, fiscal, macroprudential and structural policies.

# Specific comments

Some suggestions on current version of the paper:

- weaken link between effectiveness of monetary policy and level of interest rates; also evidence on decreasing effects of QE not fully convincing;
- more clarity on the pros & cons of low rates in an environment characterized by debt overhang, resources misallocation, zombie lending & lack of confidence;
- low interest rates and banks: take into account also positive medium-term effects of monetary policy on the economy;
- some inconsistencies with assessment of monetary policy effectiveness: very effective at the height of a crisis and less effective afterwards when constraints (e.g. balance sheet impairments) should be looser.

# Conclusions

- Very interesting and thought provoking paper. Challenges surrounding this topic are massive!
- My feeling is that the issue of the effectiveness of monetary policy when rates are low remains open.
- Hard to deny that structural factors played a role.
- Approaches that encompass different views are extremely useful.