



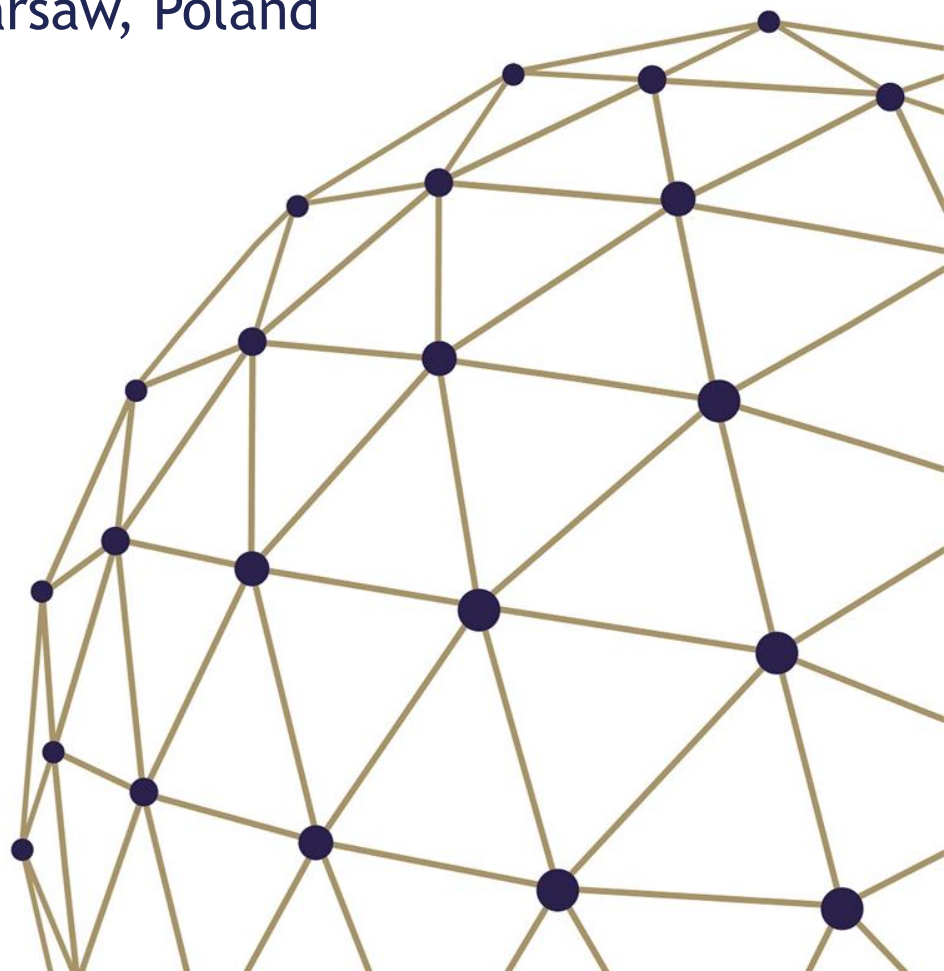
Central banks: unable to counteract lowflation?

Márton Nagy

Deputy Governor, Magyar Nemzeti Bank

CoFEE conference, Warsaw, Poland

14th October 2016

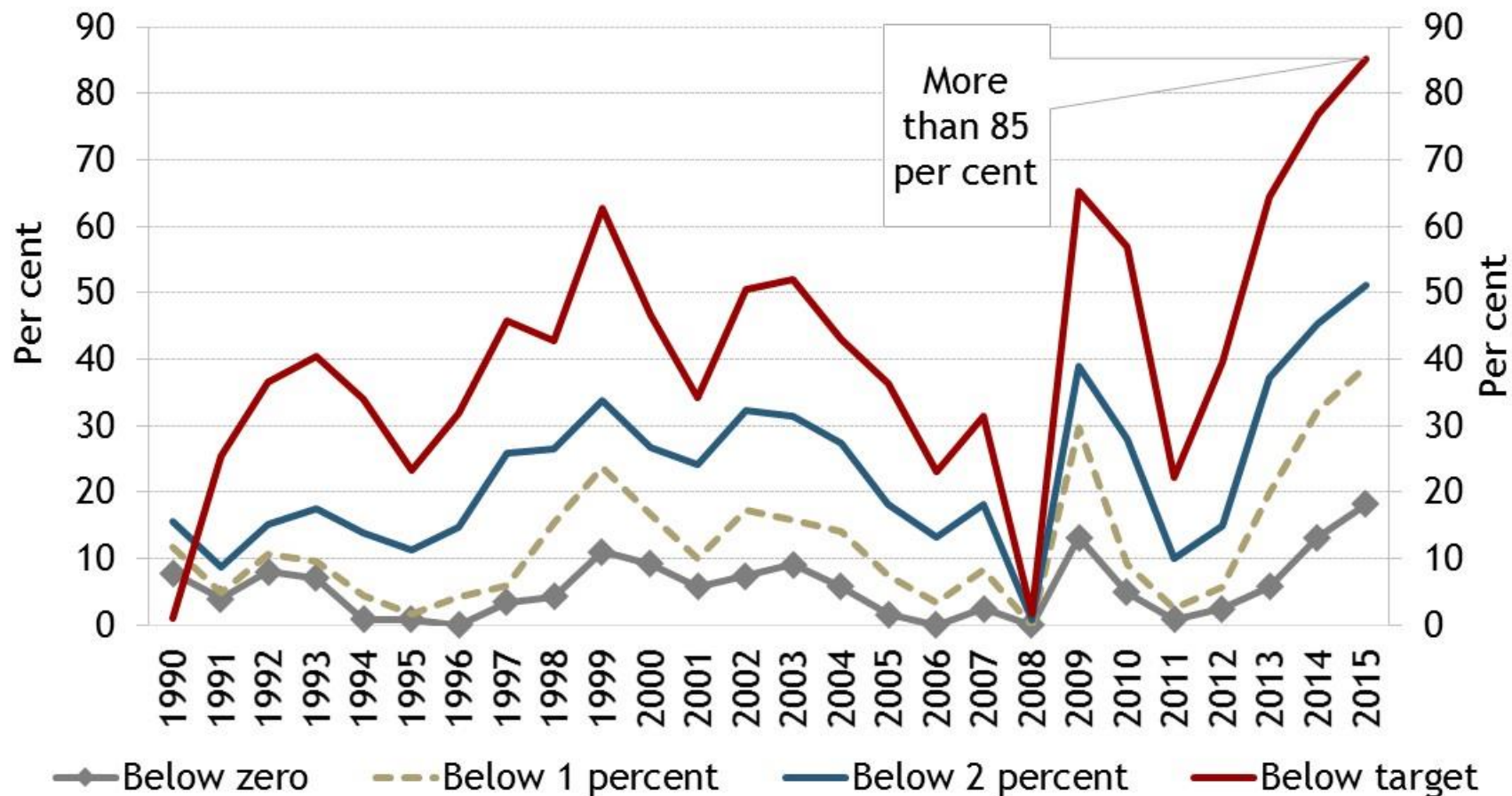


ISSUE 1

Will we ever reach the inflation target, or the permanently lowflation will be the new norm?



A large number of countries are currently facing low inflation or even deflation



Share of countries with low inflation



The permanently lowflation will be the new norm?

Pros

- Aging and declining population
- Increase in the sensitivity of inflation expectations to downside inflation surprises
- Perception that monetary policy is constrained and may be less effective in bringing inflation back to targets
- Globalization and technological developments help to reduce production costs

Cons

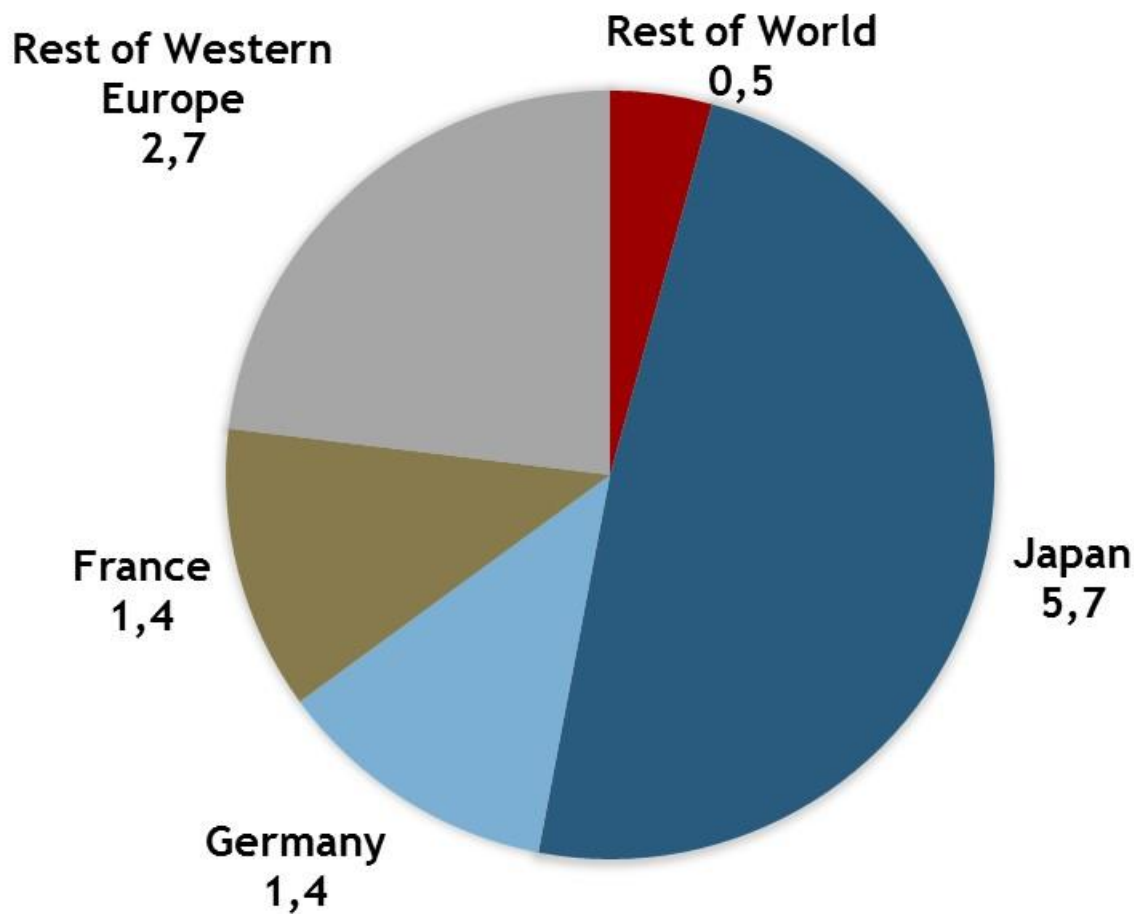
- Slowly recovering commodity prices
- Gradually diminishing economic slack
- There is no strong evidence that the slope of Phillips curve has declined
- Picking up in wage dynamics
- Surge in lending

ISSUE 2

A possible solution:
negative interest rates.
Harm or benefit?



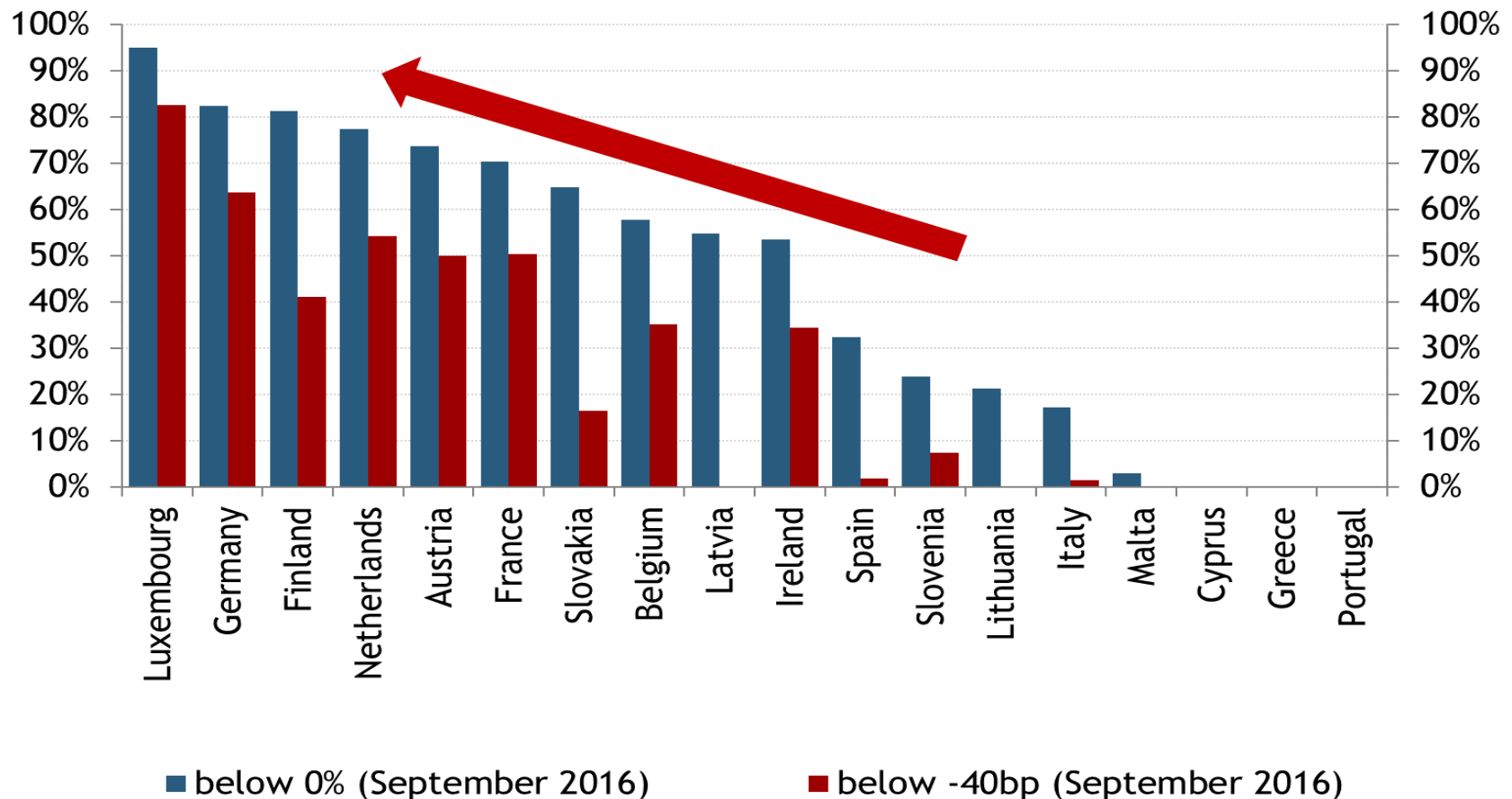
Public debt with negative yields increased to 12 trillion USD



Global debt with negative yields by regions in September 2016
(in USD trn)



Significant share of government bonds in the euro area yielding below -40bp



Share of government bonds in the euro area yielding below -40bp and 0 per cent (September 2016)



The drawbacks of negative interest rates can outweigh the benefits in the current monetary system

Pros

- Lower real interest rates increase aggregate demand
 - Rising price level
 - Rising real GDP

Cons

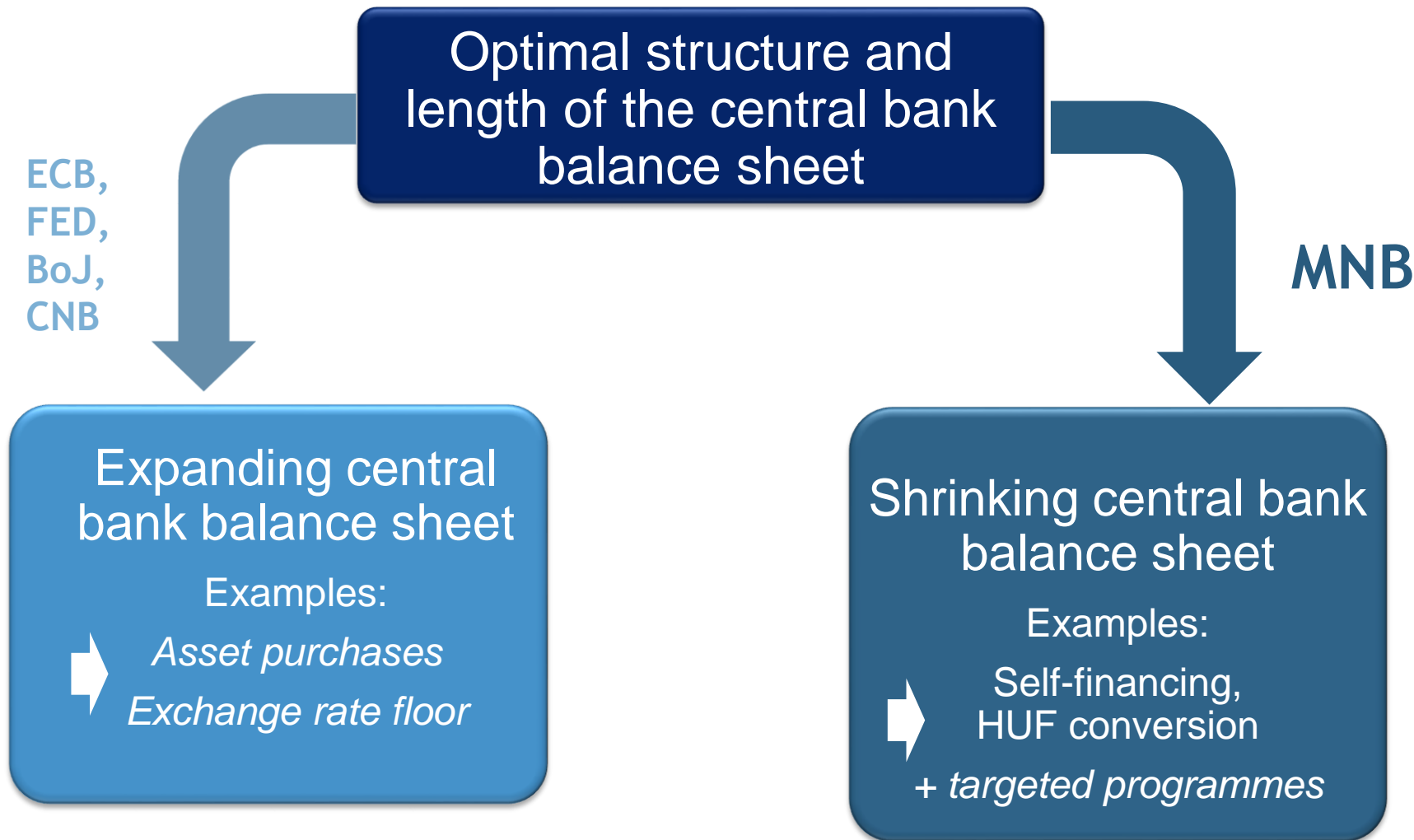
- Potential problems with the transmission mechanism
- May create asset price bubbles
- Banks' profitability can deteriorate
- Uncertain whether *real* interest rates fall

ISSUE 3

Central banks' balance sheets are getting into the focus. Comprehensive quantitative easing or targeted programmes?

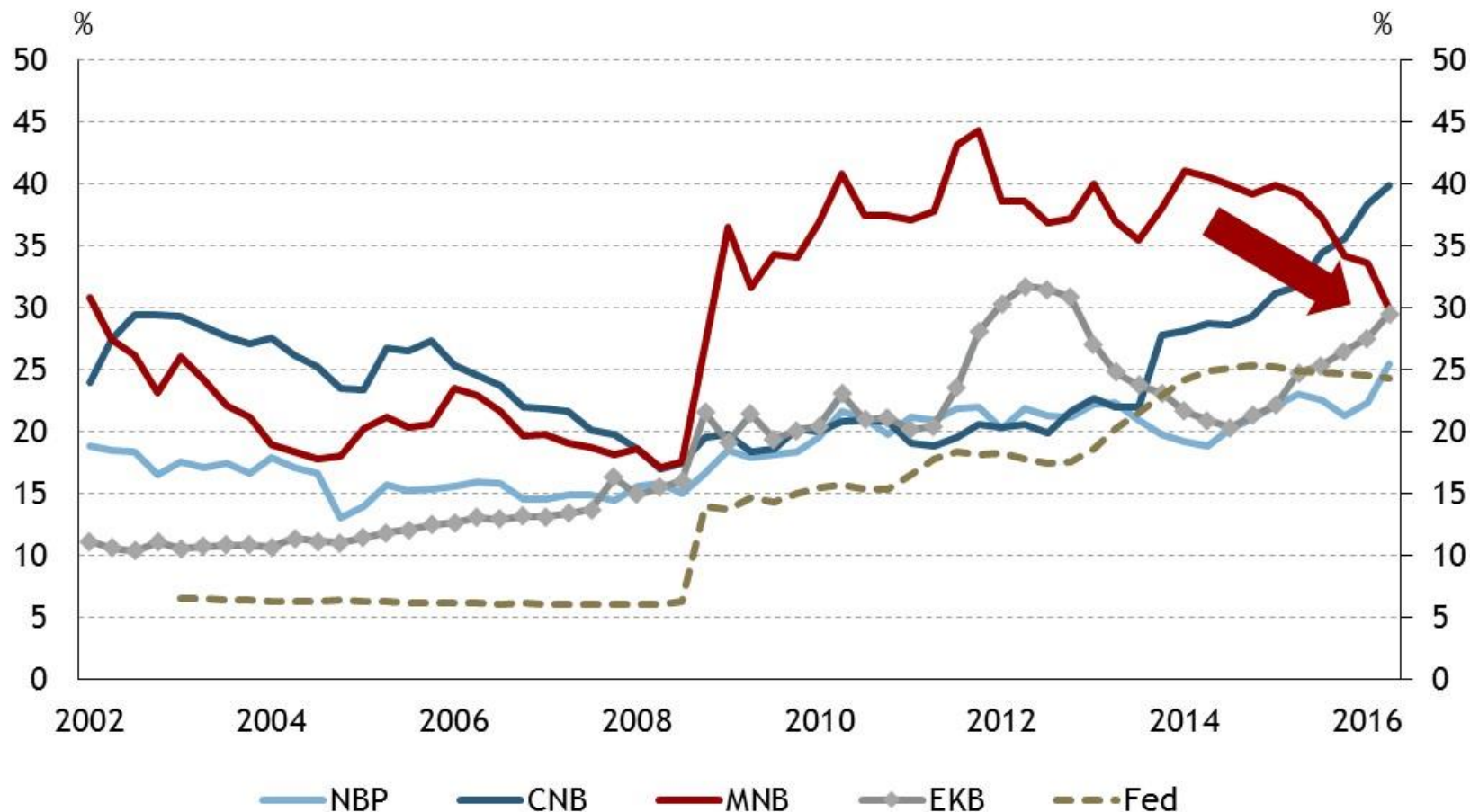


Different approaches to implement monetary policy





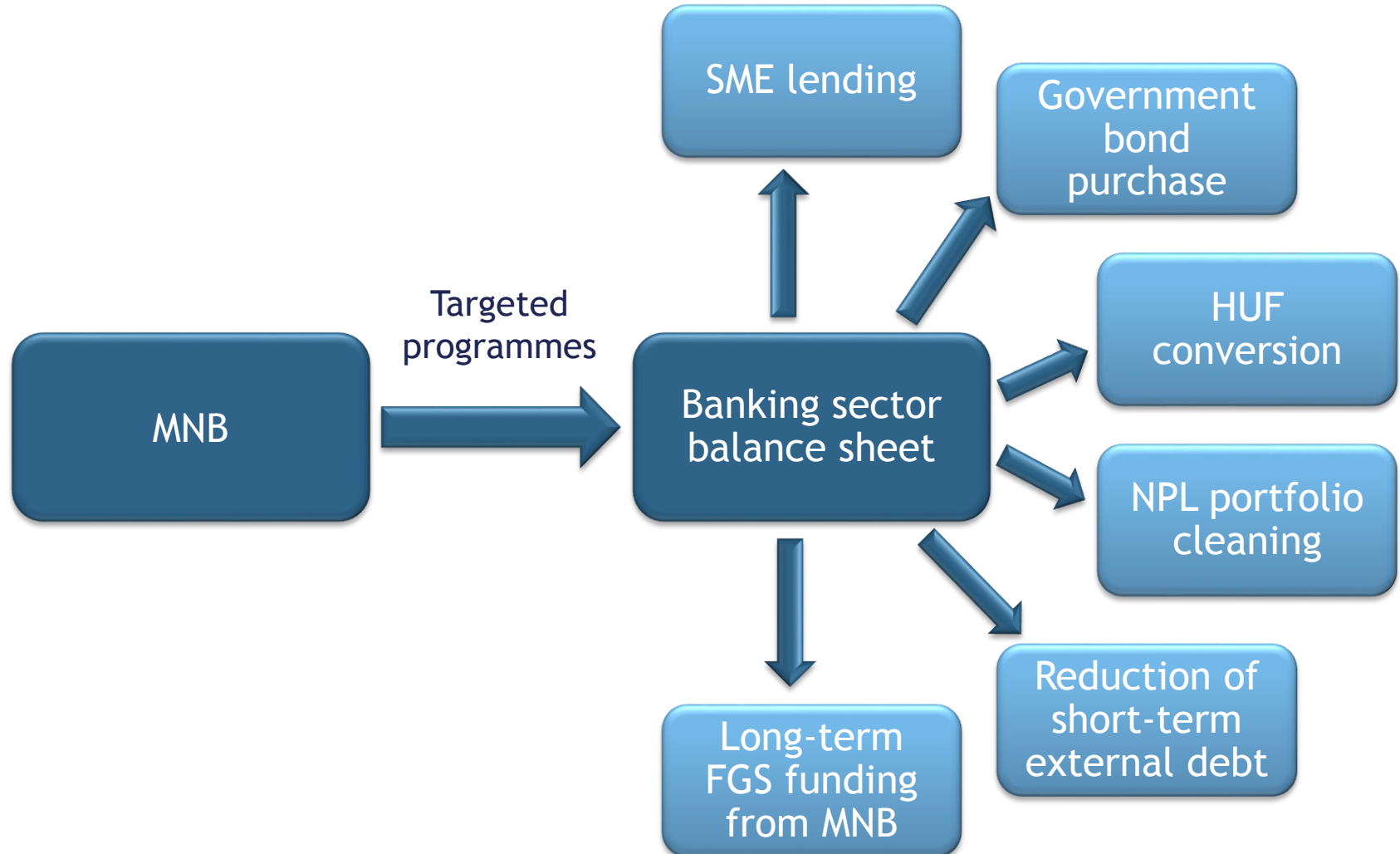
The MNB has eased monetary conditions while reducing its balance sheet



Central bank balance sheet length relative to GDP



The MNB's programmes have influenced the economy through the balance sheet of the banking sector





Targeted programmes can reduce credit spreads but they usually entail transfers to certain sectors

Advantages of comprehensive quantitative easing

- Smaller interest expenses of the government (*ceteris paribus*)
- Smaller rollover risk at the consolidated government level
- No transfer to any given sectors in the private economy (unlike in the case of most targeted programmes)

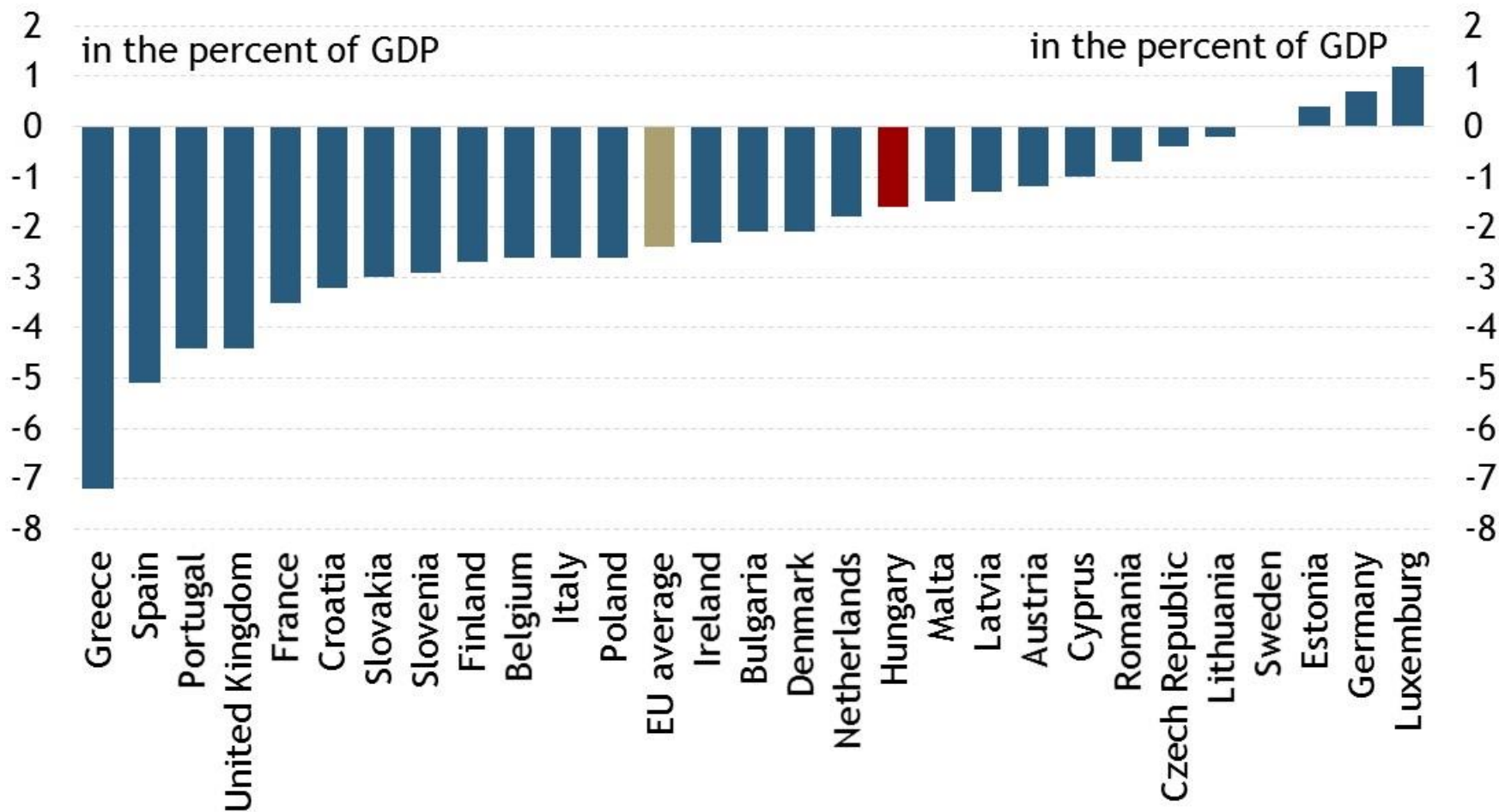
Advantages of targeted programmes

- Country-specific financial tensions can be managed
- The CB can improve the transmission mechanism in a targeted way
- Can cope with complex challenges (CHF households loans)
- CB balance sheet is not increasing

ISSUE 4

Optimal economic policy mix -
cooperation of fiscal, monetary
and prudential policy

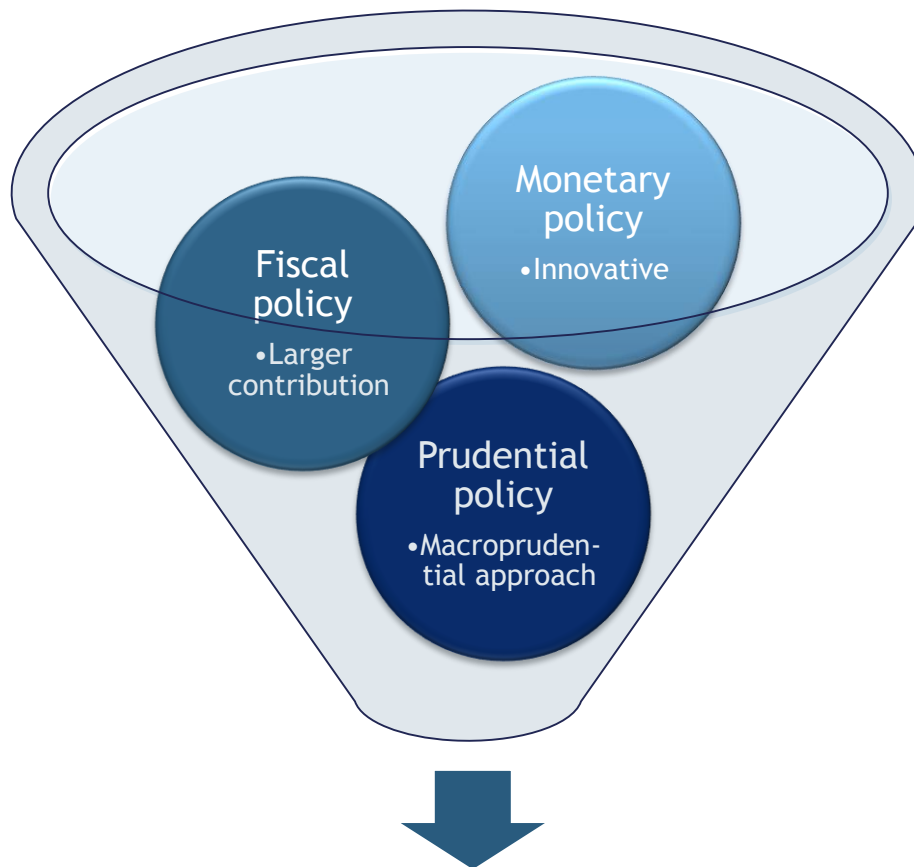
Most EU countries' budget deficit is below the Maastricht criterion



General government balance in the EU countries in 2015



The harmony of economic policy branches is needed



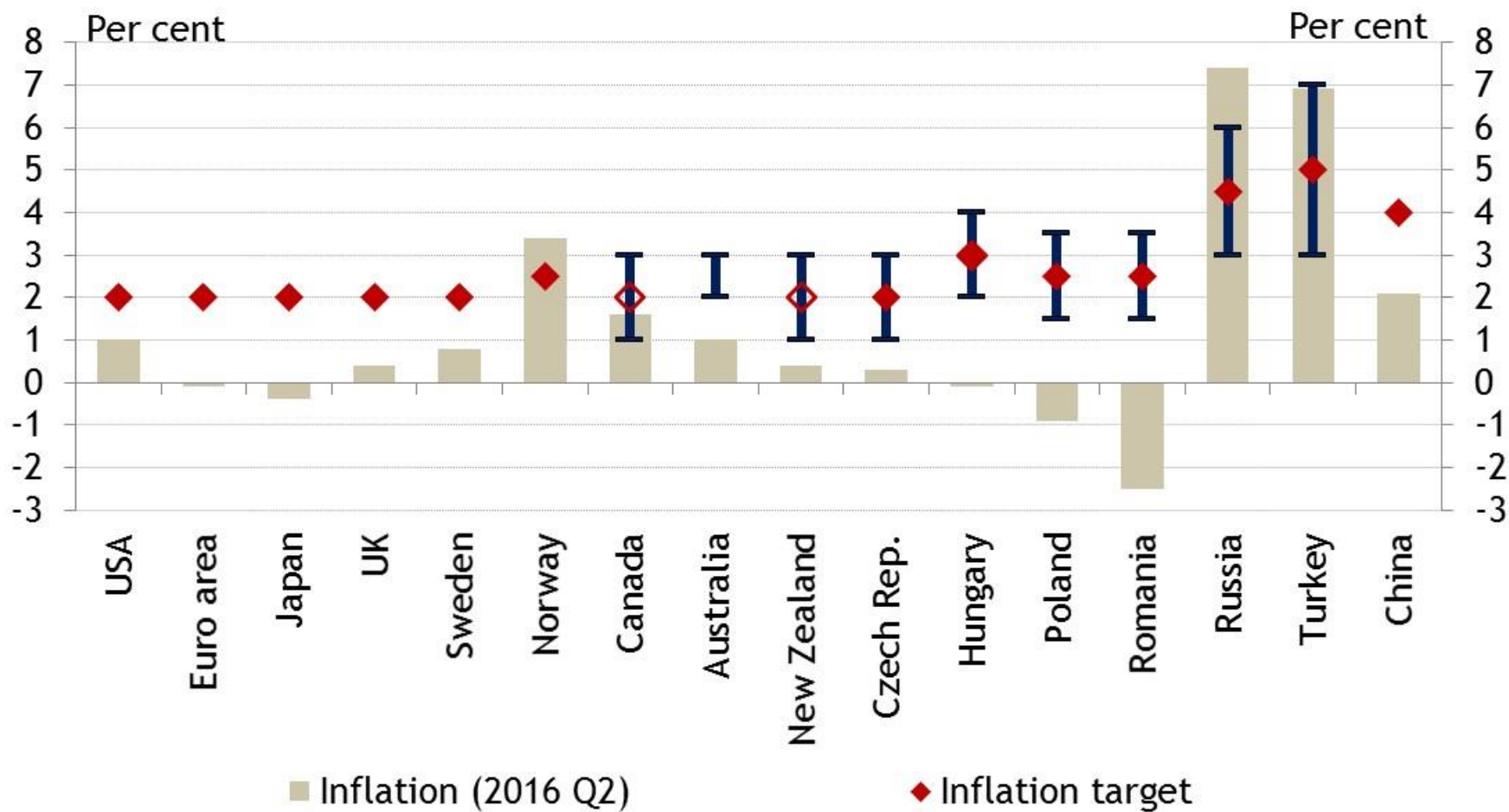
Optimal economic policy mix

ISSUE 5

The future of Inflation targeting



Inflation is below central bank targets in most IT countries



Inflation targets in central banks and actual inflation



Although making monetary policy has become more difficult, IT still seems to be the least worst option

Three pillars of controlling inflation at a low cost

Ability to control inflation

- Transmission mechanism is a black box
- Zero lower bound on nominal interest rates

Willingness to control inflation

- Several goals can be problematic

Transparency

- Steering expectations

Thank you for your kind attention!

