



Monetary policy beyond the Covid crisis

Letter submitted to
the President of the French Republic,
the President of the Senate and
the President of the National Assembly

by
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SUMMARY

With the emergence from the Covid crisis finally appearing to take shape, this *Letter* makes a first assessment of its economic impact. The shock in 2020 was unprecedented; the rebound in 2021-22 looks set to be similar in scale, and much stronger than anyone could have expected a year ago. But Europe is still underperforming the United States: this is as much a reflection of America's better specialisation, especially in digital technologies, as it is of the government's fiscal stimulus, which has certainly been massive, but is in part a response to the United States' specific weaknesses.

Inside the euro area, after suffering a bigger shock during the first lockdown, the French economy has since been outperforming its peers; it should see cumulative growth of around 10% over the two years of recovery, even if the Delta variant were to lead to the reintroduction of certain public health restrictions. However, the vaccine remains the best weapon to support economic activity, especially at the global level. Overall, the response adopted by French public authorities appears to have been the right one. The fiscal cushion, equivalent to over 8% of GDP in 2020 and half as much again in 2021, has, in average terms, preserved household purchasing power and corporate finances. The priority now is not to spend more, but to focus instead on the quality of the transformation plans – on a digital and ecological level, and above all with regard to skills. The strength of the recovery will be determined more by the supply side, and notably by firms' ability to recruit, than by demand. Of all the reforms France can make, the most crucial will be those that increase the size and quality of its labour supply: through training, a reduction in the underemployment of youth and of older workers, and an increase in incentives to work.

Eurosystem monetary policy, for its part, has helped to build a genuine "financing bridge", particularly for SMEs: in contrast with previous crises, lending volumes have increased this time round, while interest rates have remained very low. Over the period 2020-22, the European Central Bank (ECB) will thus have helped to safeguard 2 million jobs.

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Against this backdrop, we have engaged directly with the French public, to answer their questions on monetary policy. This initiative, entitled "*La Banque de France à votre écoute*" ("The Banque de France Listens"), is part of the ECB's strategic review which was concluded on 8 July. But it is also driven by a democratic imperative, and by a concern for economic efficiency. A monetary policy that is better understood will be better transmitted, including to households and firms.

We have conducted a survey, held 17 events – including one in each region of France – and reached an online audience of 260,000 French people. We have explained a lot, but also learnt a lot. And as a result

we have made a commitment, including at the level of the ECB, to communicate even more clearly.

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It is with the public's growing expectations in mind that we need to address the main issues for the future. Central banks cannot do everything; they have to make clear what they can, and therefore must do. The first challenge will of course be the emergence from the crisis. Past fears over the "disappearance of inflation" have given way to worries about its return. In Europe at least, the upward pressures on certain prices appear to be temporary, and inflation should come back towards 1.4% by 2023. As a result, once we have exited our exceptional anti-crisis programme (the pandemic emergency purchase programme or PEPP), the ECB will need to maintain a highly accommodative monetary policy using its powerful "quartet" of non-standard instruments. Our strategic review also clarifies that our 2% inflation target is symmetric, and can be temporarily exceeded.

Another challenge will be the problem of government debt, which the central bank can under no circumstances cancel. Reducing France's debt will therefore require a combination of three instruments: time; growth, amplified by reforms; and last, greater efficiency in our government expenditure, which is the highest in the advanced world. Our country should aim for a stabilisation of government expenditure in real terms, combined with stable taxation, in order to give economic agents visibility and confidence.

Our strategic review also underlines our reinforced commitment to the climate: central banks cannot replace other public policies in this respect, including the need for a fair carbon price. But we intend to act in the name of our mandate, by studying the effects of climate change in our economic projections, by publicly disclosing our climate-risk exposure and above all that of our counterparties, and by gradually "decarbonising" our balance sheet via the renewal of our operations. The ECB, together with the Banque de France, will be a world pioneer.

The Treaty, our solid foundation, entrusts us with a primary mandate of price stability, to guarantee confidence in our currency and foster sustainable growth. However, monetary policy also takes account of social challenges: it indirectly supports employment and thereby reduces income inequalities. The ECB keeps a close eye on rises in financial asset prices, through its enhanced supervision of financial stability. But the strategic review conducted by the Eurosystem is also an invitation to harness the full power of the single market, the Banking Union and the Capital Markets Union. In the post-pandemic world, the "firefighters" who effectively tackled the Covid crisis will need to pass the baton to the architects, so that we can finally strengthen the European Economic Union alongside the European Monetary Union.

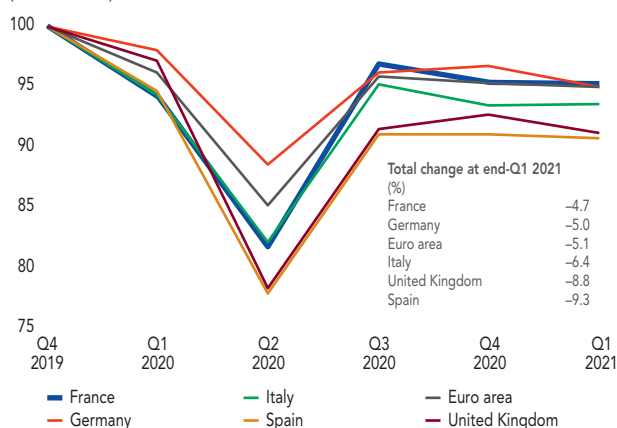
This “Letter” is traditionally the occasion to re-examine the main economic challenges of our time. After focusing on the 20th anniversary of the euro in 2019 and the Covid crisis in 2020, this year it centres on monetary policy in the crisis exit period. It falls within the framework of the strategic monetary policy review launched last year by Christine Lagarde alongside the Eurosystem and completed on 8 July, and which this year in France has taken the form of “*La Banque de France à votre écoute*” events (“The Banque de France Listens”).

“*La Banque de France à votre écoute*” has helped to establish an unprecedented dialogue with the general public. Never before has interest in the role of central banks been so great: monetary policy played a decisive role at the most critical moments of the pandemic, which in part explains the emergence of new demands. We now need to separate these into what is excessive and what is imperative: in other words, say exactly what central banks cannot do, but equally clearly, what they can and therefore must do. Our price stability objective shall, of course, remain our lodestar.

Our snapshot of the French and European economies after fifteen months of the health crisis confirms the brutality of the shock since March 2020, and the efficacy of the unparalleled fiscal and monetary support (1). Against this backdrop, public expectations regarding monetary policy have increased, and there is a strong need for clarity and explanation (2). It is with these expectations in mind that we will need to tackle the main challenges ahead, be it the gradual winding down of the exceptional programmes, or the more structural challenges of a social and environmental nature (3).

Chart 1 Change in GDP in Europe

(Q4 2019 = 100)



Sources: Eurostat, national statistical institutes.

A snapshot of the economy and an appraisal of the support measures fifteen months into the Covid crisis

1.1 France compared to the rest of Europe

The shock of the pandemic triggered the biggest economic **shock** ever seen in peacetime. Euro area GDP fell by 6.7% in 2020, with a drop of 11.6% alone in the second quarter of 2020. According to the Eurosystem’s June 2021 forecasts, euro area GDP is expected to come back to its fourth quarter 2019 level in the first three months of 2022. In 2020, France posted a bigger drop in GDP (–8.0%) than the rest of the euro area, but a smaller one than the United Kingdom (–9.8%). After experiencing a stronger shock in the first two quarters of 2020, during the first lockdown, our economy then rebounded sharply over the summer. At the end of March 2021, France, alongside Germany, had suffered a smaller loss of GDP since the start of the crisis than the other main euro area countries (see *Chart 1*).

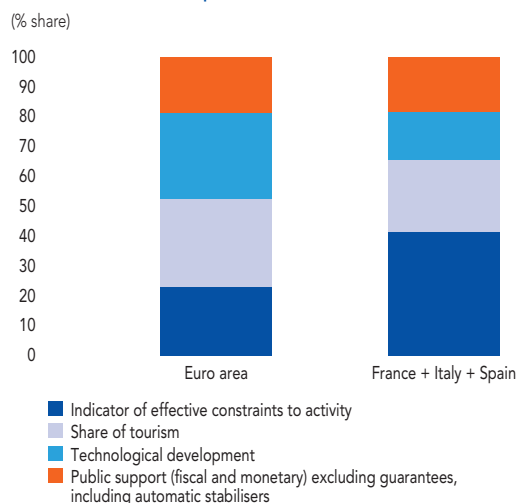
The massive use of the short-time work scheme¹ helped to cushion the social **shock**: there was a sharp reduction in working hours per capita, but the number of people in work fell to a much lesser extent than might have been feared given the scale of the contraction in activity (–1.0% in 2020). The unemployment rate remained almost stable. The short-time work schemes, the support measures for the most vulnerable households and the solidarity fund for the self-employed, all helped to shield French households’ purchasing power, which in fact increased by 0.2% on average compared with 2019.

1.2 Europe compared to the rest of the world

European leaders and citizens are facing a painful paradox. The 2008 financial crisis began in the United States and the Covid crisis in China, yet each time it has been Europe that has paid the biggest economic price.

¹ In April 2020, more than 18% of workers in the four largest euro area countries were placed on short-time work.

Chart 2 Factors explaining the difference in size of the 2020 Covid shock in Europe and the United States



Sources: International Monetary Fund (*Fiscal Monitor*), World Bank, OECD, Oxford University, Google Mobility, Banque de France calculations.

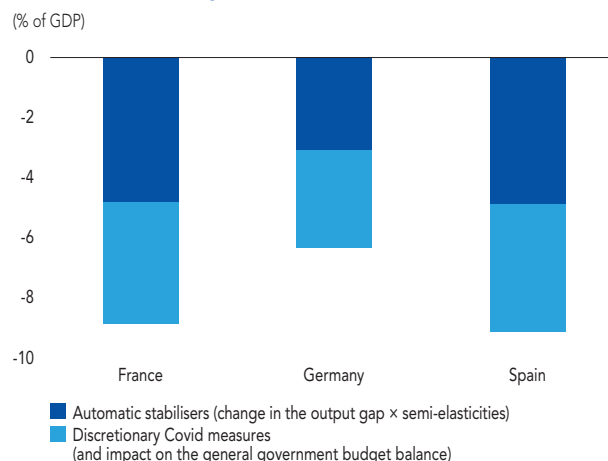
Notes: The indicator of effective constraints to activity is an average of an index of the stringency of the public health restrictions (*Stringency Index – Oxford*) and a synthetic index of movement to five categories of location.

The economic impact has so far been smaller in Asian economies, especially in China, which has in fact seen an expansion in its market shares. Overall, in 2020, China was the only major economy to post positive economic growth (2.3%).

In the United States, total Covid infections have been higher than in Europe. However, GDP has dropped by half as much as in the euro area (–3.5% in 2020) and by three times less than in the United Kingdom. A first explanation for this is that US governments – federal and state – placed fewer constraints on economic activity, and economic agents reduced their movement to a lesser extent. This explains more than 40% of the divergence with France, Spain and Italy (see *Chart 2*). Differences in specialisation also explain 40% of the divergence, as the United States is less reliant on tourism and more technologically advanced. The greater public (fiscal) support provided in the United States explains less than 20% of the difference.

Support for the economy should remain substantial in the United States in 2021 (at around 10% of GDP), essentially thanks to the stimulus plan adopted in March 2021 (Biden 1), which extends the emergency measures introduced in 2020. Its size (USD 1,900 billion) is considerable given that the recovery is already well underway in the United States. The administration has already proposed two additional stimulus plans; however, the Biden 2 and 3 plans (targeting

Chart 3 Automatic stabilisers and discretionary Covid measures in three large euro area countries in 2020



Source: Eurosystem (data as at 26 January 2021).

infrastructure and social measures respectively) still need to pass through Congress and will be revised downwards.

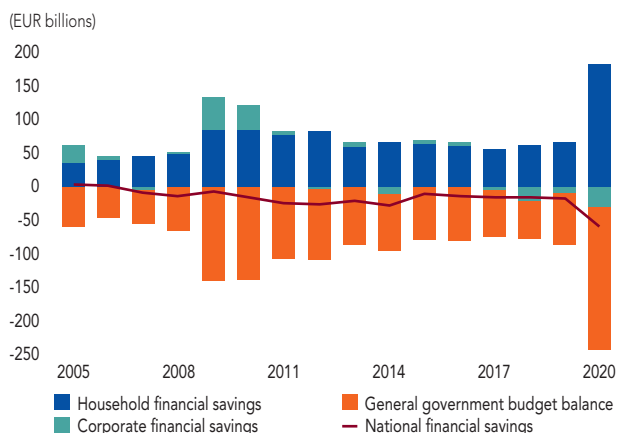
These plans address certain structural needs in the US economy – the poor state of existing infrastructure and insufficient social safety nets. Therefore, a straightforward comparison of the amount of fiscal stimulus in the United States and Europe has little meaning.

1.3 Strong and effective fiscal support in France and Europe

Faced with the shock of the Covid crisis, governments across Europe deployed strong fiscal responses to cushion the effects of a severe economic shock. In France, the discretionary fiscal response, that is the support measures excluding the provision of liquidity and automatic stabilisers, amounted to 4.1% of GDP in 2020, or around EUR 90 billion. This is in line with the euro area average (over 4% of GDP in 2020), and slightly higher than in Germany. In France, as in the other main euro area countries, if we add to this an estimate of the usual effect of automatic fiscal stabilisers, the total impact on the general government budget balance is almost twice as large² (see *Chart 3 above*).

Overall, and despite criticism that they were unduly aiding certain firms or, conversely, not doing enough, governments

Chart 4 National financial savings and counterparts in France



Sources: INSEE, national accounts.

in France and the other main euro area countries appear to have adopted an appropriate response. Their measures played a massive role in shielding households and firms from the Covid crisis. The huge outflow of government savings thus has its mirror opposite in a massive rise in household savings (see Chart 4), and a limited deterioration in firms' net borrowing position; but overall, France borrowed from the rest of the world in 2020, as reflected in the sharp widening of our external deficit.

With the public health restrictions continuing to drag on euro area economies at the start of 2021, governments responded by extending the existing support measures. On the whole, discretionary fiscal support should remain very high in 2021 (at around 4.4% of GDP in France, which appears to be in line with the euro area average). Around 1.1% of GDP of these measures will finance the recovery in France. Indeed, the initial emergency measures, to support demand and households, have been followed up with a "second leg", consisting of national and European recovery and reconstruction plans, which target the supply side and firms: in France this is the EUR 100 billion plan announced in September 2020, while at the European level, it is the EUR 750 billion Facility for Recovery and Resilience (FRR), the historic instrument announced by the European Union in July 2020 and that is starting to be rolled out in the summer of 2021.

A recovery now that will be played out on the supply side

France's rebound in 2021 looks set to be stronger than first expected: the Banque de France has regularly revised its growth forecast upwards, from 5% in December to 5½% in March, and then to 5¾% in June. Our most recent monthly economic survey, published at the start of July, confirms this trend, and any new public health restrictions triggered by the Delta variant are unlikely to affect it significantly. Indeed, the past phases of lockdown have impacted our economy to a diminishing extent, while the vaccine is creating an increasingly strong wall of defence. Provided we continue to make progress with the vaccine roll-out, this will be the most effective economic measure in the short term. This is even more true at the *global* level, and the IMF estimates the cost of vaccinating 40% of the world population in 2021 and 60% in 2022 at just USD 50 billion.³ Unfortunately, this call for action has had little effect, and many prefer instead to argue fruitlessly about the size of the European plans, which are deemed too small compared with the "Biden packages" (see above). We need to prioritise the **speed** of execution of these plans, together with their **quality**. The key is being able to target those needs that are most important for preparing the future: "Schumpeterian" transformation investments,⁴ in the digital and ecological transitions, and in skills.

The thing holding French growth back in mid-2021 is not a lack of government expenditure, but the re-emergence, already, of recruitment difficulties for 44% of firms.⁵ Of all the reforms France can make, the most crucial will be those that increase the size and quality of its labour supply: through training, a reduction in the underemployment of youth and of older workers, and an increase in incentives to work. The strength of the recovery will be determined more by the supply side than by demand, especially as the latter will be able to rely on households' "Covid savings" reserve, that could reach EUR 180 billion or 7% of GDP by the end of 2021. The success of the recovery does not therefore lie with additional government expenditure. Indeed, given the forecast strength of GDP growth (cumulative rise of more than 10% over 2021-22), the Covid "emergency spending" should be brought to a close by the end of this year. The "recovery" measures need to remain temporary, and should not include any new long-term spending commitments.

2 However, other developments also affected the general government budget balance, which in France "only" deteriorated by 7 percentage points of GDP between 2019 and 2020.

3 Agarwal (R.) and Gopinath (G.) (2021), "A proposal to end the Covid-19 pandemic", IMF, May.

4 Villeroy de Galhau (F.) (2020), "Quels remèdes au déficit d'investissement européen dans l'innovation ?", speech, May.

5 Banque de France (2021), *Update on business conditions in France at the start of July 2021*.

1.4 The Eurosystem’s monetary policy response

In response to an unprecedented crisis, and in parallel with the fiscal measures put in place by governments and by the European Union, Eurosystem monetary policy provided **rapid, strong and effective support**. From as early as March 2020, the Governing Council decided to implement two exceptional programmes: the first for agents that finance themselves via the banks, in other words households and most firms, including SMEs (the programme called targeted longer-term refinancing operations or TLTRO – more than EUR 1,800 billion drawn since June 2020); the second for those that finance themselves via the markets, in other words large corporations and states – the pandemic emergency purchase programme or PEPP, for which the envelope has now been raised to EUR 1,850 billion. The Eurosystem thus laid the foundations for a genuine “financing bridge”, to help economic agents traverse the crisis.

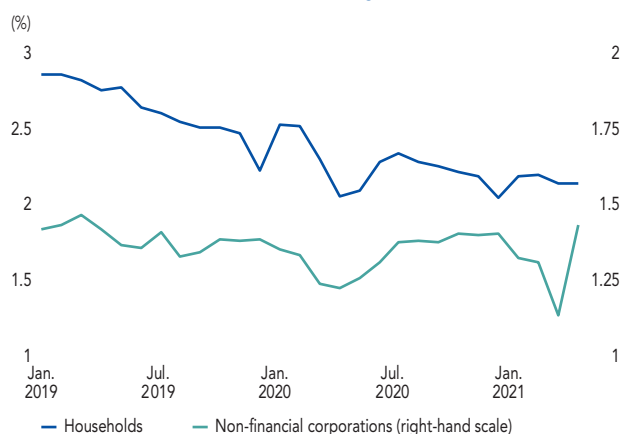
In doing this, we acted in the name of our price stability mandate. The Covid crisis has had a strong disinflationary impact: euro area inflation fell from 1.2% in 2019 to 0.3% in 2020. Monetary policy has delivered very concrete results: it has **maintained favourable financing conditions** in all economies and for all economic agents, including firms and households (see *Charts 5 and 6*). Unlike in previous crises, and especially that of 2008-09, interest rates have not increased and lending volumes have not fallen: on

the contrary, they have actually increased considerably in France, thanks to the success of the state-guaranteed loan scheme (SGLs, close to EUR 140 billion⁶). The stress in financial markets was quickly brought under control, allowing the banking and financial systems to function almost normally. Sovereign bond yields fell back sharply, and were back at pre-Covid levels by October 2020.

The efficacy of our instruments can be measured in the level of inflation, but also in growth and employment. According to ECB estimates,⁷ the monetary policy measures taken in 2020 should have a cumulative impact over 2020-22 of around 1% on inflation and 1.6% on GDP growth. Thanks to these measures, the euro area is expected to save around 2 million jobs over the same period. In the face of the disinflationary shock of the Covid crisis, there has thus been a **convergence between the objectives of price stability and of a rebound in activity**.

The Eurosystem has therefore **deployed a similar scale of firepower to the US Federal Reserve (Fed)**. Indeed, the increase in their respective balance sheets, which reflects their purchase volumes (see *Chart 7*), shows that the Eurosystem’s response, expressed as a percentage of GDP, has in fact been larger than the Fed’s (22% versus 16%). As a percentage of GDP, the Eurosystem’s total balance sheet is now nearly twice the size of the Fed’s. Euro area interest rates are among the lowest in the world: be they short or long-term, nominal or real – that is adjusted for inflation.

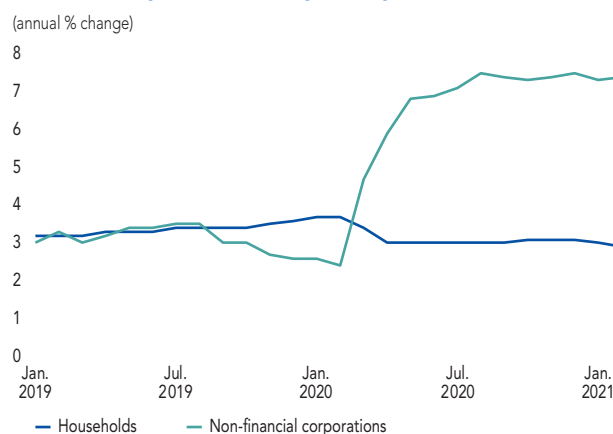
Chart 5 Interest rates on new lending in the euro area



Source: ECB.

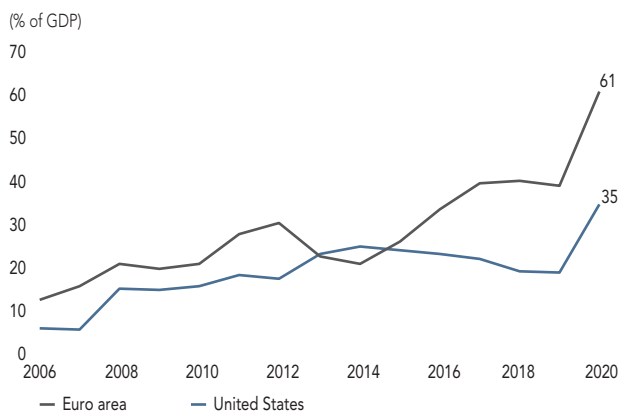
Note: The sharp decline in euro area interest rates in Q2 and Q3 2020 is due to the introduction of the state-guaranteed loan scheme.

Chart 6 Change in outstanding lending in the euro area



Source: ECB.

Chart 7 Change in Eurosystem and US Federal Reserve balance sheets



Sources: ECB, US Federal Reserve, Eurostat.

1.5 The Banque de France has stepped up its action to aid those most affected by the crisis

Beyond the realm of monetary policy, the Banque de France has also acted on various crucial fronts. Through its branch network, it has continued to **accompany households in financial difficulty**, by dealing with cases of overindebtedness. 2020 was atypical in that overindebtedness submissions initially dropped sharply as a result of the first lockdown, before returning to more usual levels as of the summer. Fortunately, however, this did not lead to a backlog of financial difficulties: in the first six months of 2021, the number of overindebtedness cases was nearly 15% lower than in the same period in 2019.

The Banque de France has also firmly supported **businesses**. Its National Credit Mediation service, which is present in each of France's departments, handled more than 14,000 cases in 2020 – 14 times more than in 2019 – of which a large majority concerned VSEs. It has thus helped to safeguard close to 80,000 jobs. As would be expected, applications for mediation fell sharply in 2021, to around 500 per month in the first quarter and less than 300 per month more recently. Thanks to its VSE-SME correspondents in each department, the Banque de France has also assisted more than 13,000 firms since 16 March 2020.

The *Autorité de contrôle prudentiel et de résolution* (ACPR – Prudential Supervision and Resolution Authority) has also reinforced its **supervision of the financial health of banks and insurers**. With their solvency already strengthened by the Basel regulations, French banks were this time at the heart of the solutions and not the cause of

this extra-financial crisis. French and European supervisors encouraged banks to use their countercyclical buffers and flexibilities to absorb this exceptional shock and maintain their ability to finance the real economy.

2

What the French public tells us about monetary policy

Over the past thirty years, the way central banks communicate has changed radically. They have moved from a form of communication that was limited and very technical, to a much more open one.⁸ As regards monetary policy, the challenge is now to move from *transparency* towards experts and markets, to *clarity* towards different and wider audiences.

This transformation is of course driven by a democratic imperative: public accountability is the counterpart of central bank independence.⁹ Since the creation of the euro, each year, the President of the ECB is heard four times by the European Parliament and gives eight press conferences; and since 2015, the ECB systematically publishes an account of its monetary policy meetings. The Banque de France is heard very regularly by Parliament (32 times in 2020, including five hearings for the Governor) to report on its actions; it explains its surveys and economic analyses to the French public both on its website and through the media.

6 Ministry for the Economy and Finance, situation as at 25 June 2021.

7 Presentation by Isabel Schnabel for GDP and inflation (webinar in German: "Die Geldpolitik der EZB in der Corona-Krise", 14 April 2021). The employment effect has been deduced using the elasticities proposed by Hartmann (P.) and Smets (F.) (2018) in "The first twenty years of the European Central Bank: monetary policy", *ECB Working Paper Series*, No. 2219.

8 Blinder (A. S.) (2008), *The quiet revolution: central banking goes modern*, Yale University Press.

9 Trichet (J.-C.) (2005), "Communication, transparency and the ECB's monetary policy", speech at the International Frankfurt Business Journalists Club, January.

SOME EXAMPLES OF OUR COMMUNICATION ACTIONS

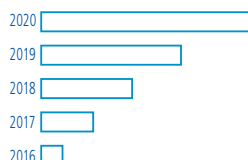
INCREASED OUTREACH
IN TRADITIONAL
AND DIGITAL MEDIA



13,138
media
mentions

+27%
vs 2019

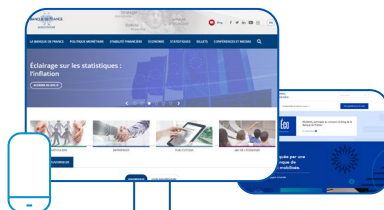
SOCIAL MEDIA **ENGAGEMENT**



over **132,000** LinkedIn
subscriptions

over **798,000** YouTube
views in a year

**DISSEMINATION OF CONTENT
AND SERVICES**
TO ALL AUDIENCES
IN THE DIGITAL ECOSYSTEM



over **5.2 MILLION**
visits

including 1 million views of the pages
on *Covid-19 and the economy*,
the keys to understanding,
uploaded in April 2020

In the framework of the strategy review of monetary policy, we also organised two meetings with the Finance Committees of the National Assembly and the Senate for an open and informal exchange of views on monetary policy, in May and June 2021 respectively. Three topics were raised in particular during these discussions:

- (i) the ECB's **mandate** regarding the determination of our inflation target and our ability to fight global warming;
- (ii) the **conditions for exiting the crisis**, with strong concerns expressed about the public debt, and the situation of companies;
- (iii) risks to **financial stability** and the possible overvaluation of financial assets, which could be linked to negative interest rates and non-standard Eurosystem instruments.

More specifically, in the first half of 2021, the dialogue conducted with the public within the framework of "*La Banque de France à votre écoute*" provided us with a better understanding of the expectations of the French public with regard to our monetary policy mission. In total, we organised 17 meetings and events particularly through our nationwide branch network. We were in contact online at 7 July with almost 260,000 French citizens – including 145,000 young people – and we collected more than 600 questions directly from them. We also included a CSA survey of 5,000 people, and a representative panel of 30 citizens.

2.1 "*La Banque de France à votre écoute*": feedback on our meetings with the French public

"*La Banque de France à votre écoute*" aims to address a paradox: support for the euro is set to reach an all-time high in 2021, with 79% of Europeans (and 70% of the French)

LA BANQUE DE FRANCE à votre écoute !



National event
of 8 February

10,000 live
over **100,000** replay¹



Consultation of deputies and senators

6 May and 16 June
(unprecedented in the Eurosystem)



Exchange with young people

of 30 June – Interview with the Governor by Cyrus North

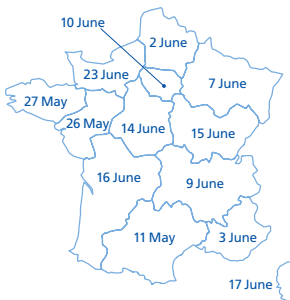
over **145,000** views
See video²



Total number of questions asked

over **600**

IN REGIONS



Total regional audiences
live + replay

over **12,000**
See replays³

Three complementary sources for gathering the opinions of our fellow citizens:

- The Eurobarometer, a biannual survey of citizens in the 19 euro area countries, which has measured support for the euro and the European Central Bank since 1999.
- A survey conducted in January 2021 by the CSA Institute by telephone among 5,000 French people on their knowledge of monetary policy and the level of prices.
- A representative panel of 30 citizens surveyed online for one week on their perception of central bank action before and after receiving educational material on monetary policy action.

¹ <https://www.banque-france.fr/la-banque-de-france-votre-ecoute>

² <https://www.youtube.com/>

³ <https://www.banque-france.fr/>

in favour, according to the latest Eurobarometer.¹⁰ Yet, confidence in the ECB is only 46% in the euro area and 40% in France.

A little-known policy, which nevertheless interests the French public

This divergence can no doubt be explained by the fact that the euro is a concrete reality, while the exact role of central banks is still not very well known by the public. Everyone can recognise how much the euro facilitates payments, both in daily life and across borders. Knowledge of the ECB, however, is a matter for specialists. According to the Eurobarometer,¹¹ while 86% of Europeans and

83% of French people have heard of the ECB, only 28% of Europeans (and 20% of French people) have a clear understanding of its mandate. As regards monetary policy, 53% of French people surveyed by CSA in January 2021 said they were not at all familiar with monetary policy. This lack of awareness is neither a new phenomenon nor specific to France.¹²

¹⁰ Eurobarometer, European Commission, May 2021.

¹¹ ECB, *Studies* (in progress).

¹² For example, this was already the case in the Netherlands and Austria ten years ago. Cf. Van der Cruysen (C.A.) and Eijffinger (S.C.) (2010),

"From actual to perceived transparency: the case of the European Central Bank", *Journal of Economic Psychology*, Vol. 31, No. 3, pp. 388-399 for the Netherlands, and Rumler (F.) and Valderrama (M.T.) (2020), "Inflation literacy and inflation expectations: evidence from Austrian household survey data", *Economic Modelling*, Vol. 87, pp. 8-23 for Austria.

In France, an analysis of the responses to our CSA survey shows that the majority of respondents who claim to know about monetary policy are men, with at least a high school diploma and earning more than EUR 2,000 per month.¹³ But beyond these socio-economic characteristics, awareness of current economic issues, such as debt dynamics, is also a major factor in the understanding of monetary policy. By raising the French public's awareness of economic and financial issues, monetary policy can therefore be better understood. We observed this with the citizen's panel by collecting their opinions *before and after* the presentation of some basic concepts, using accessible and educational tools.

Many questions about inflation

Logically, inflation-related topics are one of the main areas of concerns in our meetings (16% of the all questions). The CSA survey also shows that almost half (43%) of French people believe that prices have risen by more than 2% in the last year, whereas inflation was only 0.5% in 2020.

This flawed perception of actual inflation is a challenge for all major central banks. This challenge is similar in the United States and in other European countries.¹⁴ However, the CSA survey shows that respondents are 10% more likely to know the level of inflation for the year if they have a basic knowledge of monetary policy.

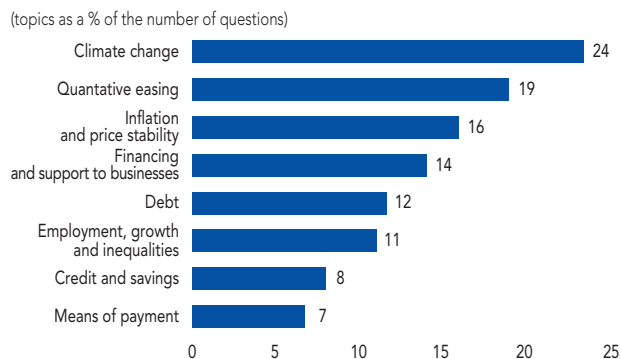
One of the most common issues raised during our listening exercises was **for the cost of housing to be better taken into account**, particularly for owner-occupiers. It is therefore rightly one of the topics discussed in the strategic review of monetary policy.

Beyond price stability, other important concerns were expressed by our fellow citizens

The fact that our consultation took place during the pandemic led the French public to express their concerns about the country's economic situation. Indeed, 84% say they are worried about the economic situation and 76% about the level of public debt.

They also questioned what other objectives the ECB should pursue in addition to the stability of the economy and the financial system. Climate change for example accounts for 24% of the questions asked at the meetings (see Chart 8).

Chart 8 The questions the French public asked the Banque de France

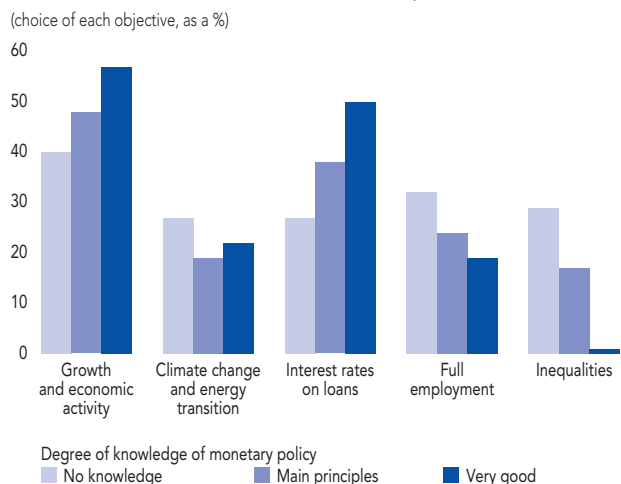


Source: Banque de France.

Note: Questions asked (425 at 28 June) at "La Banque de France à votre écoute" events. The total exceeds 100% as 17% of questions cover two topics and 4% of questions three topics (e.g. questions on the role of monetary policy in the fight against climate change).

Inequalities are major concerns for 29% of the French public, according to the CSA poll, but are not necessarily for them an issue for monetary policy to address. Inequality only accounts for 8% of the questions asked, and respondents who are better versed in monetary policy do not think that the central bank should consider it an objective (see Chart 9).

Chart 9 Perception of objectives that the central bank could pursue in addition to price stability, according to the degree of knowledge of monetary policy



Sources: CSA survey, Banque de France estimates.

Note: The question asked "In addition to its main price stability objective, what, in your opinion, are the two main objectives that the European Central Bank and national central banks (like the Banque de France) should pursue?"

Box 1

WHAT DID WE LEARN FROM WHAT THE FIFTY OR SO PARTICIPANTS REPRESENTING CIVIL SOCIETY (TEACHERS, FAMILY ASSOCIATIONS, BUSINESS LEADERS, BANKERS, STUDENTS) WHO SPOKE AT OUR MEETINGS?

“Explain to us, but first hear us”

In times of crisis, the demand for explanations of economic mechanisms is increasing, but there is also a strong demand for concrete ways of linking the information received to everyday concerns. The actions carried out within our mission of providing financial education to the public (games, etc.) are therefore all the more important.

The central bank is perceived as being very present during the crisis

While the instruments of monetary policy are very poorly known, its impact on the level of interest rates and on lending conditions were often mentioned. The panellists also regularly cited the economic environment and our forecasts, which can help to reduce the level of uncertainty. However, there are very wide-ranging expectations that go beyond our missions: repayment of state-guaranteed loans, public support after the crisis, the cost of housing, commodity prices, hiring difficulties and the need for training are recurrent concerns.

The Banque de France’s commitment to the most vulnerable populations

This commitment addresses real concerns: support for overindebted persons, banking inclusion and caps on bank charges are subjects that have been regularly raised.

The questions asked at the event organised for the young public were largely associated with the topics outlined above. However, the issues related to cryptoassets – including bitcoin – and more broadly to digital currencies, attracted much more interest.

2.2 How to communicate more clearly and effectively on monetary policy

In addition to the essential aspect of democratic accountability, the objective of clarity is also a matter of **economic efficiency**. A better understood monetary policy will be better relayed to all economic players, including households and businesses. And will thus be more effective. The Banque de France is therefore going to undertake a series of concrete actions to **strengthen its communication** based on three commitments:

- Measuring inflation expectations of SMEs and households;
- Meeting and interviewing the French public more regularly;
- Continuously adapting our materials and making them increasingly accessible.

Measuring inflation expectations of SMEs and households

Through their behaviour, all economic players contribute to the effectiveness of monetary policy. For example, in times of economic recession, if the public is confident that inflation will remain around the 2% target, this helps to avoid a deflationary spiral. According to a study by the Banque de France, it is primarily a correct perception of *changes* in inflation rather than expert knowledge of its *level* that leads to changes in consumption.¹⁵ In particular,

¹³ The analysis of the typical profile of the French respondent claiming to be familiar with monetary policy was based on the analysis of individual responses to the question “In general, how familiar do you feel you are with monetary policy issues, including the primary objective of the ECB and NCBs?” with three response options: “Not at all”, “The main principles”, “Very well”. In order to construct a typical profile, we study each response in relation to the individuals’ socio-economic characteristics and on their answers to the other questions in the survey, such as the main economic

challenges of the moment, their personal concerns or their assessment of monetary policy.

¹⁴ Coibion (O.), Gorodnichenko (Y.), Kumar (S.) and Pedemonte (M.) (2020), “Inflation expectations as a policy tool?”, *NBER Working Papers*, No. 24788, June.

¹⁵ Andrade (P.), Gautier (E.) and Mengus (E.) (2021), “What matters in households’ inflation expectations?”, *CESifo Working Papers*, No. 9005, April (revised version – old version: Banque de France, *Working Paper*, No. 770, June 2020).

when interest rates are low, if economic players expect prices to rise moderately, this stimulates consumption and investment and helps to stabilise the economy.

In order to better steer monetary policy decisions, the Banque de France will measure, on a quarterly basis, the opinion of business leaders on the future level and developments of prices and wages. After a test phase conducted in 2020 in the Hauts-de-France and Provence-Alpes-Côte d'Azur regions, the questionnaire will be made available to all 8,500 business leaders surveyed in the framework of our Monthly Business Survey during the coming winter. In parallel, the ECB will conduct a survey on inflation and its developments among households in five European countries, including 2,000 French households.

Meet and talk to the French public more regularly

In order to enhance the public's confidence, regular dialogue and a proactive educational approach are needed to help our citizens better understand monetary policy transmission mechanisms. In turn, these meetings with the French public considerably enrich our expertise in the specific issues raised at the grassroots level. From this point of view, these exchanges constitute a strategic sharing exercise that goes well beyond specific communication campaigns.

The "La Banque de France à votre écoute" meetings will be repeated each year online, under the title "Annual monetary policy meetings". They will always be combined with a survey of a representative sample of 5,000 French citizens. The "20 years of euro cash" will be the focus of the 2022 edition.

Continuously adapt our materials and make them increasingly accessible

Our communication materials are important tools in our strategy to engage with the general public. They will be redesigned to be more accessible, educational and innovative.

A. More accessible materials in terms of content and presentation

We will promote, in clear language, the close links between the Banque de France's tasks and the daily lives of the French people, particularly when our experts speak. We will also ensure that our extensive teaching materials ("*ABC de l'économie*",¹⁶ "*The keys of the economy*"¹⁷) on monetary policy are catalogued, by topic, in a single resource bank.

B. More educational materials for all audiences

We will involve more routinely the less expert audiences – non-specialist workers or young people and students. For example, with the *Cité de l'économie* in Paris, Citéco, an adapted – and free – programme of conferences will be designed for young people and students on the topic: "monetary policy and you".

C. More innovative materials

All our events will be organised in a dual format (face-to-face and online) in order to attract the greatest number of people. We will also make systematic use of new communication media and tools (infographics, videos, podcasts, etc.) to enhance our messages.

Far from being limited to the Banque de France alone, this approach of greater openness and improved accessibility must be pursued by the Eurosystem as a whole. In this respect, the ECB will need to provide the general public with a better understanding of its monetary policy decisions and strategy. After each monetary policy meeting of the Governing Council, a simpler and more accessible language, accompanied by more interactive content and visuals, will make it possible to enhance the understanding and, ultimately, the effectiveness of our measures, through the Monetary Policy Statement.

The major issues ahead, addressed in particular in the framework of the strategy review

The Covid-19 crisis has increased general public's expectations of central banks. We are honoured by these unprecedented expectations, which reflect the confidence of citizens who benefit directly from the measures taken by the Eurosystem, but it is also essential to speak the truth when it comes to the risk of excessive expectations. This is the aim of the strategy review, whose conclusions were presented by Christine Lagarde on 8 July.

Our first challenge is the gradual exit from the exceptional measures and the debate on a possible return to inflation (3.1): the ECB will maintain an accommodative monetary policy for as long as necessary. Nevertheless, the question of government debt will have to be addressed. But beyond the Covid-19 crisis, central banks can now take better account of both the environmental and social dimensions (3.2).

3.1 How to gradually exit from exceptional measures?

In a recovery surrounded by uncertainty, one thing is certain: the gradual exit from the exceptional measures must be guided by a single lodestar, our inflation objective. Inflation is once again being hotly debated: in the space of a few months, the decade-old debate about the structural weakness of "missing inflation" has shifted to fears of a return of excessive inflation. The two extremes need to be examined.

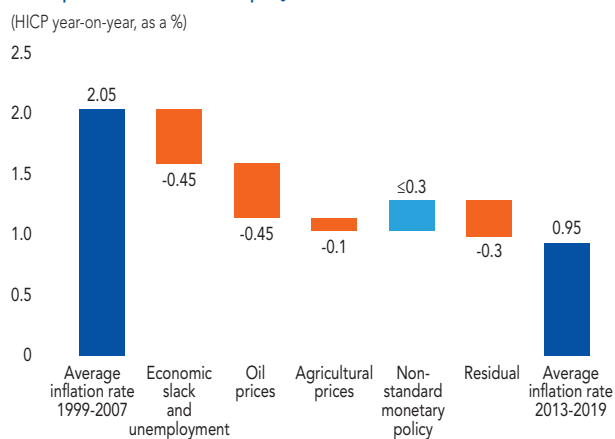
From a lack of inflation to the return of inflation?

As a central bank, we must first explain the past inflation path. The "disappearance of inflation" – or rather its significant reduction – has been a global phenomenon. Inflation in the euro area fell from an average of 2.1% over the 1999-2007 period to an average of 1.0% over the 2013-19 period. In the United States, inflation (as measured by the PCE¹⁸ index) fell by a similar 0.8%, from 2.2% to 1.4% between the two periods.

According to a study by the Banque de France,¹⁹ in the euro area, two factors explain most of the gap between the observed level of inflation and our target: the

weakness of the economy and falling oil prices. Indeed, the Great Recession and the sovereign debt crisis had a lasting downward impact on demand and employment between 2008 and 2012 and hence on prices. The sharp decline in oil prices after 2014 brought down both directly the energy component of consumer prices, and indirectly the production costs of non-energy goods and services. Non-standard monetary policy has helped to limit these disinflationary effects. Without this policy, average annual inflation would have been about 0.3 percentage point lower between 2014 and 2019. This leaves an unexplained part of the fall in inflation which represents at most 0.3 percentage point on average since 2013, and which can be attributed to structural causes: globalisation, digitalisation, changes in wage negotiations, etc. (see Chart 10).

Chart 10 Breakdown of the decline in average euro area inflation between 1999-2007 and 2013-2019 (Phillips curve with unemployment rate)



Source: Banque de France (Bulletin No. 234/7).

Note: Values are rounded to 0.05.

However, since the beginning of 2021, some have started to fear a return of inflation: it has risen significantly (from -0.3% in December 2020 to 1.9% in June 2021 in the euro area and from 0% to 1.9% in France), but this should not be over-interpreted. Admittedly, supply difficulties are real and are particularly acute for certain raw materials. For instance, in June 2021, the rebound in energy prices

16 <https://abc-economie.banque-france.fr/en>

17 <https://www.citeco.fr/en> – Section: The keys of the economy.

18 Personal consumption expenditures price index.

19 Diev (P.), Kalantzis (Y.), Lalliard (A.) and Mogliani (M.) (2021), "What explains the persistent weakness of euro area inflation since 2013?", *Banque de France Bulletin*, No. 234/7.

(12.5% year-on-year in the euro area) following that of petroleum products, alone accounts for over half of the change in the Harmonised Index of Consumer Prices (HICP) year-on-year (1.9%). In industry and construction in France, 50 to 60% of all businesses now report supply difficulties, from wood to semi-conductors. Nevertheless, judging from the last two decades, these “bottlenecks” are usually temporary, and businesses tend to absorb these price peaks by squeezing their margins. Core inflation in the euro area (excluding food and energy) remained for its part at 0.9% in June, after 0.2% in December. Moreover, the return of VAT to its normal rate in Germany, accounts for almost 0.4 percentage point of this rise.

Overall, these probably temporary effects should not lead to significant wage increases. They do not change the generally disinflationary nature of the health crisis. Inflation in the euro area should remain low, at 1.4%, in 2023:²⁰ there is therefore no risk of a lasting return to inflation in the euro area today. The situation may be different in the United States, where inflation hit 5% in May (again with many temporary factors), and where some economists are concerned that the economy is overheating.

Faced with inflation below our target, it is our duty to maintain an accommodative monetary policy to support economic activity.

In order to be better understood by economic players (see Part 2), **clarifying our 2% inflation target** is also a key element of our strategy review. The decisions published on 8 July enhance three interrelated characteristics. Our inflation target is now:

- **More simple:** the previous definition mentioned a target of “close to, but below, 2%”.²¹ Like most other central banks (United States, Japan, United Kingdom), the ECB now pursues an inflation target of 2%;
- **Symmetric:** our objective is a target, not a ceiling. The Eurosystem could, going forward, accept inflation slightly and temporarily above 2%, without necessarily changing its monetary policy stance. This will help anchor inflation expectations lastingly at 2%;

Euro area inflation forecasts

(%)

	2021	2022	2023
Inflation	1.9	1.5	1.4
Inflation excluding energy and food	1.1	1.3	1.4

Source: ECB Eurosystem, *Macroeconomic projections for the euro area*, June 2021.

- **Medium-term:** we assess inflation over a sufficiently long period of time, beyond temporary inflation variations. However, the ECB does not wish to go as far as the “flexible average inflation targeting” adopted by the Fed in August 2020: this raises many calibration questions and imposes excessive constraints.

Inflation is still not at the level we would like it to return to, i.e. 2% in the medium term. And it is thus in the name of our price stability mandate that we will continue our net purchases under the PEPP (see Part 1.4), at least until March 2022. If these purchases were to stop thereafter, our monetary policy would nevertheless remain very accommodative, well beyond that date and for as long as necessary, thanks to a **quartet of very powerful “non-standard” measures:** (i) negative interest rates; (ii) intentions to clarify that interest rates will be kept at a low level (forward guidance); (iii) securities purchases under the asset purchase programme (APP), in place since 2015; and (iv) the provision of liquidity to banks (TLTRO) to finance the economy.

Our four non-standard measures were set up long before the Covid-19 crisis, and will last long after it. Created in response to the structural decline in interest rates, in a context of population ageing and lower investment, non-standard measures are particularly useful to address the obstacle of the effective lower bound (ELB). Within this quartet, two measures act on current and future short-term rates: negative rates and forward guidance. Two measures focus more on the central bank’s balance sheet and have an impact on the quantity of liquidity and on long-term rates: TLTROs and asset purchases. The combination of these instruments is particularly effective in maintaining favourable financing conditions, with positive effects on growth, prices and employment.

Asset purchases are a powerful tool for which we still have leeway if necessary. Reinvestments under the PEPP will remain significant and net purchases under the APP will continue, with the possibility of adapting their terms and increasing their flexibility if necessary. The forward guidance on keeping rates low for long should be enhanced, in line with the symmetric nature of our objective.

20 ECB Eurosystem (2021), *Macroeconomic projections for the euro area*, June.

21 ECB (2003), *The ECB’s monetary policy strategy*, May.

Box 2

MAIN CONCLUSIONS OF THE EUROSYSTEM'S STRATEGY REVIEW

The main conclusions of this review launched in January 2020, and unanimously approved by the Governing Council members, were published on 8 July 2021¹ and may be summarised in six key points.

1. A symmetric inflation target of 2% over the medium term

Price stability in the euro area is now defined as an inflation target of 2% over the medium term. This new formulation clarifies the previous target, which since 2003 had been defined as an inflation rate “close to, but below, 2%”. This objective is symmetric, which means that the ECB is concerned both about negative and positive deviations.

2. Inclusion of owner-occupied housing costs in the HICP

The Harmonised Index of Consumer Prices (HICP) remains the appropriate price measure for the objective of price stability, but it should be extended to include “owner-occupied” housing costs. The Governing Council has therefore asked the European statistical agencies to develop a measure of inflation that will better take into account housing costs in the coming years.

3. Climate change

Climate change has profound implications for price stability (*see Part 3.2*). The Eurosystem has therefore embarked on an ambitious action plan to properly integrate the implications of climate factors for monetary policy and to adapt the operational framework accordingly.

4. Financial stability

ECB decisions will now be based on a broader assessment of the effects of monetary policy on the stability of the financial system. Financial stability will thus be fully integrated into the ECB's analytical framework, which now includes two components: (i) economic analysis; and (ii) monetary and financial analysis, which replaces the former “monetary pillar”.

5. Communication with the public

The communication of monetary policy decisions will be clearer and more educational, thanks in particular to the simplification of the statements made following Governing Council meetings and to the use of visual content aimed at the general public. The listening activities, hosted this year in the euro area, will become a permanent feature of the Eurosystem's communication with the general public.

6. Commitment to conduct regular strategy reviews

The Governing Council will review its monetary policy strategy more regularly. A first review is expected to take place in 2025.

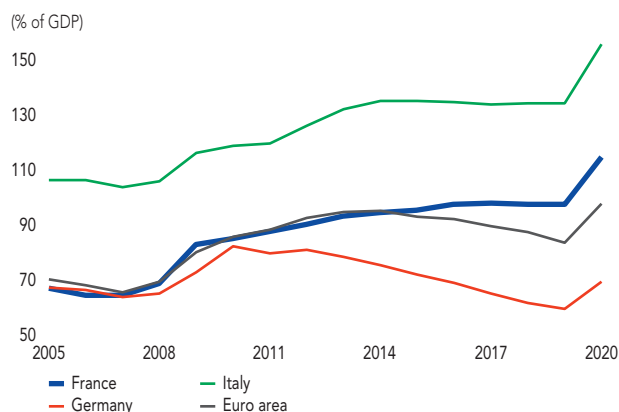
1. <https://www.ecb.europa.eu/en>

How to address the issue of government debt build-up

The issue of government debt is rightly of concern to our fellow citizens. The debt accumulated in the past together with the exceptional – and fully justified – measures to support activity during the Covid-19 crisis have led to historically high levels of debt.

All countries experienced a relatively similar size shock to their government debt ratios in 2020 (see *Chart 11*). The difference stems from the earlier period: Italy and France entered the Covid-19 crisis with much higher levels of government debt (130% and 100% of GDP respectively) than the euro area average – notably Germany.

Chart 11 Government debt ratios of the main euro area countries



Sources: Eurostat, national accounts.

Debt cancellation is not an option

Some claim that cancelling the debt held by the Banque de France and the Eurosystem would be a solution. That is not the case. A debt cannot be cancelled; it can be rolled over at maturity, but this is never automatic. And the lender will only roll it over if it has confidence in the sustainability of that debt. A lender, private or public, which is not reimbursed, will not lend.

The cancellation of this debt would lead to the monetary financing of public deficits, the prohibition of which is one of the founding pillars of the agreement creating the euro. But assuming the Banque de France were to cancel the debts it currently holds (more than EUR 600 billion of French government securities at end-May 2021), it would book an equivalent loss on its balance sheet, and,

given that the state is its only shareholder, the country's collective wealth would be reduced by the same amount. Moreover, if, like some people are requesting, the central bank committed to never raising interest rates, then that would trigger a potentially uncontrollable inflationary spiral.

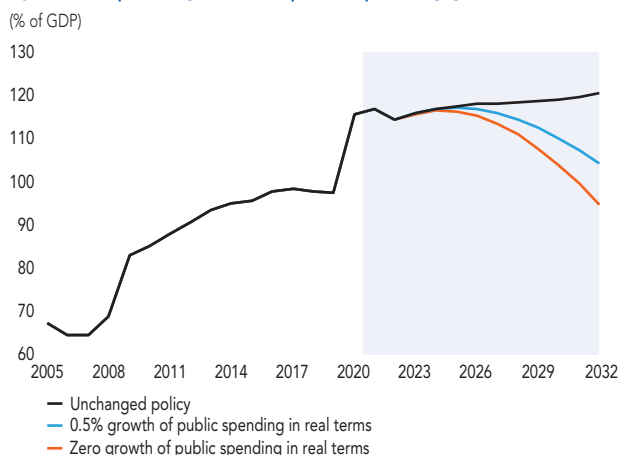
Thus, the Eurosystem cannot and should not work a monetary miracle, either legally or, above all, from a fiduciary perspective: any suspicion of "fiscal dominance" would lead to monetary mistrust, to a loss of confidence in the value of money, as observed in the past (like in Germany or Poland in the interwar years, or in Israel at the start of the 1980s), and recently in certain emerging market economies (Argentina, Lebanon and Turkey). Whenever a currency is devalued, it is the poorest who suffer the most.

The problems of government debt sustainability cannot therefore be solved by monetary policy. It is true that today the monetary and fiscal objectives are perfectly aligned. However, conflicts of objectives between fiscal and monetary policies could arise in the future, should inflation rise excessively. There is, indeed, no silver bullet for this economic policy adjustment. But the rules for both policies, and in particular when exiting exceptional measures, must be as **predictable** as possible ex ante. For monetary policy, the strategy review and forward guidance provide this clarification. For fiscal policy, it is advisable to keep the rules, but to revise them: there should be no complacent departure from the principle of the Stability Pact, nor the traditionalist obsession with the current procedures. The definition of sustainable debt has evolved since Maastricht, particularly as a result of the sharp fall in interest rates: but it is essential to anchor quantified benchmarks, such as the government expenditure growth rule and the deficit threshold to stabilise debt.²²

What is a credible path to debt reduction?

In this context, the debt issue should indeed be debated, but in a different way. It would be hazardous to base our public finance strategy on lastingly low interest rates. Under the assumption of unchanged policies, with potential growth of around 1.1% – a conservative assumption – and a growth rate of public spending in real terms of around 1.1%, which would be close to the trend over the past ten years, we would barely manage to stabilise our government debt at this high level over the next decade (see *Chart 12*); this would be a dangerous strategy given the risk of a new exogenous economic crisis or a rise in interest rates.

Chart 12 Projected government debt/GDP ratio in France by 2032 depending on three public spending growth scenarios



Sources: INSEE up until 2020, then Banque de France projections.

In order to write a better scenario, it is absolutely essential to combine three levers, none of which taken separately is sufficient:

- First, we will need **time**: we must only start to lower our debt ratio once we are economically out of the Covid-19 crisis, i.e. after 2022, and adopt a ten-year strategy;
- Second, **growth** – which will be all the stronger as our country continues to conduct reforms – is a key determinant of debt financing: it is necessary, but not sufficient.
- The third lever is indeed **a better control of our public spending, which is the highest in Europe and even in all developed countries** (see Chart 13).

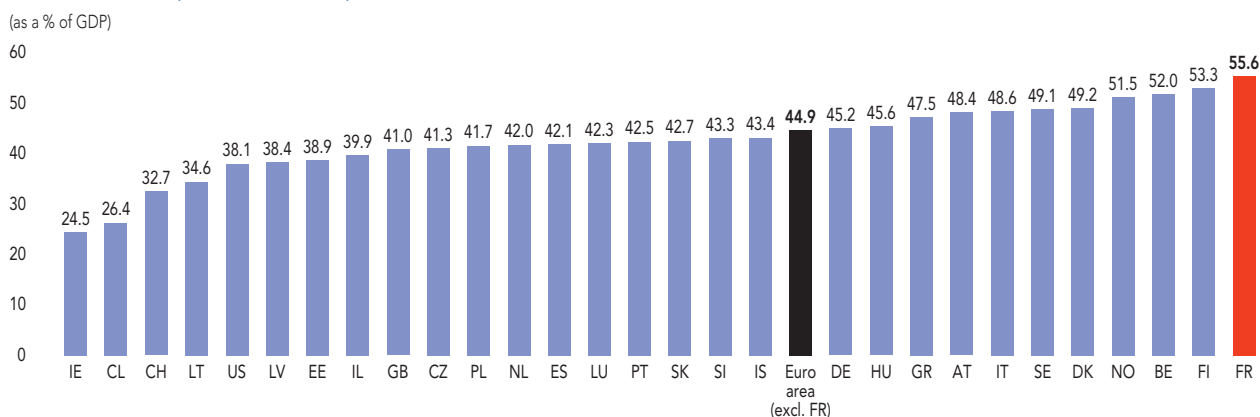
Many people, having repeatedly heard about this control, no longer believe it to be possible, while others fear “austerity”. This is not the issue. Our aim is to achieve a **dual stability**, that of taxation – by avoiding tax increases, but also tax cuts that we do not have the means to finance – and that of total public spending in real terms. Over the last ten years, our spending in real terms has continued to grow by an average of 1.1% per year. Lowering this growth rate to 0.5%, or even achieving stability – zero growth – would be compatible with maintaining our European social model. This is an ambitious yet achievable objective: many of our European neighbours have achieved it, notably Germany, with an average spending growth rate of 0.4% in real terms for an average GDP growth rate of 1.6% between 2003 and 2007.

Bringing real spending growth down to 0.5% per year would lower the debt to close to 105% of GDP, representing a 10 percentage points drop in ten years (see Chart 12), and France would begin to reduce its debt in 2026. As for the stability programme presented last April, it provides for a “spending growth limit” of 0.7%.²³ What is most important, however, is that the targets set are actually achieved, which our country has unfortunately never been able to do in a lasting manner. The target that will be set is, of course, a matter for democratic debate, not for central banks. But, then, respecting it will be key for our country’s credibility in Europe. This new target would also be compatible with the financing of the most productive public expenditures,

²² Villeroy de Galhau (F.) (2021), “What fiscal policies beyond monetary policy support?”, speech, April.

²³ According to the government’s stability programme, annual growth is expected to average 0.7% from 2023, based on potential growth of 1.35%, compared with 1.1% in our scenario.

Chart 13 Public spending in 2019 (pre-Covid)



Sources: OECD, Eurostat.

and notably those for young people, including education and training, as well as research, which have a positive effect on long-term growth. Unfortunately, this essential debate on the **quality** of spending is the blind spot in our budget debate, despite the explanations provided, in particular by the French *Cour des comptes*.²⁴

3.2 More structural challenges: how to better integrate both the environmental and social dimensions?

One of the novelties of our strategy review is to integrate a major dimension for our fellow citizens: the fight against climate change. However, to be credible, this commitment must be carried out in accordance with our mandate, and it must take into account the social dimension, to promote employment and address inequalities.

Central banks' commitment to the fight against climate change

Central banks' commitment to the climate cause may seem obvious today. But it was not a given five years ago, and few issues have been marked by such a rapid and massive change of mindset, and such action. At the Banque de France and now within the Eurosystem, we are driven by a simple but strong ambition: to do everything we can to support and complete the collective action in the fight against climate change. The ECB was the first central bank to include this fight in its strategy review. By taking climate change into account, we are neither faced with "mission creep", nor are we upholding a militant conviction or following a passing fad. It is an imperative: climate change is already a factor of financial risks, and is affecting our ability to achieve price stability, our primary objective. Climate change shocks may cause both upward pressure on prices and a slowdown in activity.

Central banks cannot do everything: there is no alternative to an appropriate carbon price and therefore, let's face it, a carbon tax in some form.²⁵ But we can do a lot. The Banque de France has been leading the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) since it was launched in Paris in December 2017. This network – which has already achieved a great deal in the field of banking and insurance supervision – now counts close to 100 members, including the US Federal Reserve and the People's Bank of China. The Banque de France was also the first central bank in the Eurosystem to publish a full report on its responsible investment policy in 2019; we have committed to exiting coal altogether by 2024.

That leaves the greening of monetary policy itself: this is our next "frontier". The Eurosystem's very accommodating monetary policy already contributes to the financing of the climate transition, thanks to very low interest rates and abundant liquidity. Greening central banks' action is therefore not a question of further easing monetary policy but of recalibrating its tools. The strategy review makes a clear commitment to action around three priorities:

- We first need to further our understanding and **modelling** of the effects of climate change, not only on prices but also on growth, and with much longer time horizons than usual. Much progress has already been made, notably under the impetus of the NGFS, which draws up climate and economic scenarios. However, a great deal of methodological work remains to be carried out, in particular to examine in greater depth the impact of the energy sector on economic dynamics. From this point of view, the Banque de France and the ACPR have, for the first time this year, tested the resilience of French financial institutions to climate scenarios for 2050;²⁶
- Our climate ambition will also require greater **transparency** for all our counterparties, not only financial but also corporate, for collateral as well as for securities purchase programmes. To do this, the Eurosystem will have to require that issuers publish their climate risk exposures according to a metric to be harmonised. However, neither in Europe, nor even in France, are we currently able to compare – and therefore correctly assess – the heterogeneous data published by financial institutions and companies. From this point of view, data standardisation and the proposal for a Corporate Sustainability Reporting Directive are battles that we need to fight now, with a strong presence of Europe and its values;
- Finally and most importantly, we will have to gradually decarbonise the ECB's balance sheet via our **very monetary policy operations** and concretely reduce our climate risk. The Eurosystem will adapt the valuation of all its corporate assets, whether they are held on the central bank's balance sheet (purchases) or used as collateral.²⁷ Non-financial corporations are indeed the most carbon-intensive players, and those for which we have the most climate data. A time-dynamic and sectoral assessment of their decarbonisation commitments is more of an incentive than a logic of exclusion, and would avoid blindly "punishing" all emitters in carbon-intensive sectors.

Central banks' action to promote employment and address inequalities

Some have long advocated a “dual mandate” for the ECB: it should aim at ensuring both price stability and full employment, following the example of the US Federal Reserve. Making such a change to the Treaties would be difficult, but also hardly necessary: in practical terms, reaching the inflation target on the one hand, and sustainable full employment on the other most often converge. This economic relationship is reflected in the “Phillips curve” that the central bank follows closely: excessively high unemployment leads to downward pressure on wages and excessively low prices. The “slope” of this curve – the strength of the relationship between prices and employment – is a matter for debate, but there is no doubt about its direction.

The rise in inequalities has become a major economic and social issue. It is one of the main keys for understanding the democratic crisis. On the economic front, international institutions, in particular the OECD and the IMF have made the clear observation that excessive inequalities reduce economies' long-term growth potential.

While “primary” inequalities – before redistribution – have increased in all developed countries since the 1980s, income inequalities have considerably diminished thanks to European social systems.²⁸ In France, after taking account of redistribution, economic inequalities have thus remained stable. In the long term, however, the health crisis could have negative consequences for young people and the least qualified. In particular, educational inequalities have been considerably exacerbated: children from the most disadvantaged backgrounds are those for whom the negative impact of the pandemic on the acquisition of knowledge will have been the strongest.²⁹

The issue of inequalities is among the main concerns of the French, but not necessarily among those they attribute to monetary policy (see Part 2). However, **inequalities are strongly linked to employment, and unemployment of course, but also to the rise in the value of financial assets and even the risk of “bubbles”**. International organisations – the BIS,³⁰ the IMF³¹ – have recently made this a focus of their research on monetary policy. Are these different elements part of the mandate, the **objectives**, of monetary policy; and what are the **effects** of monetary policy on these three variables?

The link with the ECB's mandate

Without prejudice to the primary objective – price stability –, the Treaties attribute at least two other “secondary” objectives to the ECB: “to support the general economic policies in the Union”, which contributes, among other objectives, to a “social market economy, aiming at full employment and social progress”; and “stability of the financial system”. These objectives are presented as “secondary” because other economic and prudential policies appear more capable of achieving them. Structural policies have a more direct impact on employment, and “macroprudential” policy on financial stability.

Fiscal and tax policy must remain the principal tool for addressing inequalities because it is, by nature, more targeted than monetary policy and is politically more legitimate with respect to issues of redistribution. This is particularly true in Europe, thanks to our social model. In particular, given the risk of growing inequalities related to the level of education, both for young people and for low-skilled workers, apprenticeship and vocational training are essential tools.

However, monetary policy can and must take these issues into account within its mandate. First, in the long run, price stability is a necessary condition for achieving full employment. Second, thanks to its medium-term inflation target, the ECB has a certain flexibility to avoid undesirable excessive fluctuations in employment and financial variables, if necessary. Finally, since it has a wide range of non-standard measures at its disposal, it can choose those that have the best properties in terms of meeting its “secondary” objectives, with the same impact on inflation.

24 Cour des comptes (2021), *Une stratégie de finances publiques pour la sortie de crise*, June.

25 The excellent report by Jean Tirole and Olivier Blanchard, submitted at the end of June 2021, makes a strong case for overall coherence and against false illusions.

26 Autorité de contrôle prudentiel et de résolution (2020), *Les principaux résultats de l'exercice pilote climatique 2020*.

27 Villeroy de Galhau (F.) (2021), “The role of central banks in the greening of the economy”, speech, February.

28 Dossche (M.), Slačálek (J.) and Wolswijk (G.) (2021), “Monetary policy and inequality”, *ECB Economic Bulletin*, No. 2, pp. 84-103.

29 Stantcheva (S.) (2021), “Inequalities in the times of a pandemic”, *Economic Policy*.

30 Bank for International Settlements (2021), *Annual Economic Report*, June.

31 Forthcoming publication of a working paper by Bonifacio et al. (2021)

The effects of monetary policy on inequalities

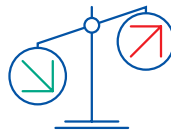
As regards the **effects**, by pursuing its price stability mandate, the central bank contributes over the long term to reducing income and wealth inequalities.³² The decline in inflation since the 1980s has better preserved the purchasing power and wealth of the poorest.

The question is posed in renewed terms with the accommodative monetary policy conducted since the 2007 crisis. This policy has helped to reduce **income** inequalities mainly through increased **employment**.³³

MONETARY POLICY AND INEQUALITIES

The objective of monetary policy is to maintain price stability and preserve purchasing power, not to reduce inequalities, which is essentially the purpose of fiscal and structural policies.

While monetary policy may have mixed effects on inequalities, its overall economic effect is to the benefit of the lowest-income households.



**EFFECTS THAT HELP
REDUCE INEQUALITIES**

over **3 million**
jobs created

Lower rates boost employment: 3 million of the 11 million jobs created between 2013 and 2019 are attributable to the ECB's monetary policy



A lower cost of credit benefits all categories of households, especially the youngest



**EFFECTS LIKELY
TO INCREASE INEQUALITIES**

Increase in the price of higher-risk financial assets, which tend to be held by high-income households, but decrease in financial income from interest rate investments, which tend to be held by medium and high-income households



Increase in the price of real estate assets, which tend to be held by medium and high-income households



**

From 2013 to 2019, over 11 million jobs were created in the euro area, of which 3 million thanks to monetary policy.³⁴ This job creation has essentially benefited young people and low-income households, and conversely, the lower returns on savings has mostly affected the most privileged. For the euro area as a whole, the significant effects of monetary policy on employment and labour income are leading to an overall reduction in income inequalities.

As regards **wealth**, the effects are mixed and more complex to analyse. Unquestionably, the fall in interest rates is one of the factors behind the rise in property and equity prices. However, this increase in prices is benefiting all homeowners, who represent more than half of all households in the euro area, some of whom have been able to become homeowners thanks to lower interest rates.³⁵

Better monitoring financial stability

The question of wealth inequalities is linked to another debate on the risks of overvaluing financial and real estate assets: highly accommodative monetary policies and abundant liquidity tend to foster “bubbles” which could themselves generate future financial crises. The Eurosystem already assesses twice a year the financial cycles and vulnerabilities in the markets (or in financial institutions) through the ECB’s *Financial Stability Review*³⁶ and the Banque de France’s *Assessment of Risks to the French Financial System*.³⁷ In France, this monitoring is the remit of the “High Council for Financial Stability”, set up in 2013 and chaired by the Minister of Finance, which has recently taken measures to prevent risks of overindebtedness related to real estate credit. Vigilance is required in order to strengthen the financial system’s resilience in the face of rising indebtedness and the development of “non-banks”, without, however, concluding that there is a global systemic risk.

However, the ECB will now better address financial stability issues by replacing its traditional “monetary pillar” with a monetary *and financial* analysis. This analysis will be able to take account of indicators relating to corporate and household debt, and to equity and real estate prices. This will promote the proportionality of our measures, a more thorough monitoring of the monetary policy transmission mechanisms, and a better hedging of financial risks.

In the face of the pandemic, the Eurosystem has once again demonstrated its firm determination to support the economy of the euro area. It has acted in complete independence, but in full concert with governments. Beyond the emergency phase, we must now also prepare for the future. This goal is at the heart of the strategy review. Our action will be more **understandable** to the general public, with a still central but **clearer** inflation target and a more **comprehensive** scope of intervention on climate and financial stability.

This severe crisis has also brought to light our ability to resist together, in France and in Europe. The founding Treaty of the euro – of which we will be celebrating the 30th anniversary – continues to be the firm anchor of this action. There is no need to amend it, but it is essential to follow through on its objective: Monetary Union must be completed by a stronger Economic Union. After the “firefighters”, who were effective in addressing the Covid-19 crisis, it is now time for the architects to step in: Europe must finally unlock the full potential of its single market, of the Banking Union, and of the Capital Markets Union, to better invest its abundant savings. To the mechanical weight of the European economy in the world, we must add power. And to resilience during the crisis, we must now add European reform. Europe and the euro have a history of making progress in times of crisis: this time they have yet to learn the lessons of the post-pandemic period. In this endeavor, the European Central Bank and the Banque de France will be fully committed, as part of their mission, to serving Europeans.

François Villeroy de Galhau

32 Carstens (A.) (2021), “Central banks and inequality”, speech, Bank for International Settlements, May.

33 Lenza (M.) and Slacalek (J.) (2018), “How does monetary policy affect income and wealth inequality? Evidence from quantitative easing in the euro area”, *ECB Working Paper Series*, No. 2190, October.

34 Hartmann (P.) and Smets (F.) (2018), art. cit.

35 Garbinti (B.) and Savignac (F.) (2018), “The role of real estate in euro area wealth inequality: lessons from the Household Finance and Consumption Survey”, *Rue de la Banque*, No. 55, January.

36 ECB (2021), *Financial Stability Review*, May.

37 Banque de France (2021), *Assessment of Risks to the French Financial System*, June.

APPENDIX

CONSTRUCTION OF TEXTUAL ANALYSIS QUESTION CATEGORIES

The textual analysis presents the topics of the questions asked during the various “*La Banque de France à votre écoute*” events. The questions were asked either directly via the broadcast platform or on the Facebook Live or YouTube pages of each event.

The thematic classification is based on a supervised textual analysis technique for 425 questions asked. A word counting algorithm was used to identify the frequency of different words used. We then constructed eight registers of vocabulary specific to each issue, according to the following breakdown.

Topic	Question including the root at least once
Climate	climate, green, ecological, environ-, fossil, pollution, emergency, planet, coal, gas, responsible, organic
Inflation and price stability	inflation, prices, real estate, housing
Money creation	monetary policy, creation, money, liquidity, PEPP
Debt	debt, repay-, default, cancel-, indebtedness
Business support and financing	support, financing, aid, SGL, guarantee, SME, VSE, crowdfunding, cash, Bercy
Means of payment	blockchain, payment, euro, crypto, bitcoin
Credit and savings	savings, loan, credit, negative, remuneration
Employment, growth and inequalities	investment, growth, unemployment, full employment, wage, employee, inequality, young, household, stock market, bubble, poor, destitute, over-indebted, wealth



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