The Monetary Policy Consequences of COVID-19 was given on October 28, 2020 by Jean-Pierre Landau, M-RCBG research fellow and Associate Professor of Economics at SciencesPo-Paris. It was given as part of M-RCBG's weekly Business & Government Seminar Series.

John Haigh:

All right. Welcome, everybody. I'm John Haigh. I'm co-director of the Mossavar-Rahmani Center for Business and Government. We are extremely fortunate today. We have Jean-Pierre Landau with us and he is going to talk about monetary policy consequences of COVID-19. I will be very brief, and then I will turn it over to John-Pierre but I wanted you to know a little bit of his background. First of all, I think, I'm not sure he would put this at the top of his CV, but we put it at the top of his CV. He is a research fellow in Mossavar-Rahmani Center for Business and Government, and has been a senior fellow and research fellow for the past three years.

John Haigh:

He has a very distinguished career in Europe. He's an associate professor right now of economics at Sciences Po and teaches a couple of classes. He's teaching a couple classes now. He was a former senior official at the French Treasury and the French Central Bank, and served as a deputy governor of the Bank of France, executive director for France at the International Monetary Fund, the World Bank, the European Bank for Reconstruction and Development. He was under secretary of the Ministry of Finance in Paris, and has had a number of different roles in certain different capacities on the board of the Bank of International Settlements, in Basel, the G7, the G 20, deputy, and a member of the Financial Stability Board and its steering committee.

John Haigh:

He's also been a visiting professor at Johns Hopkins. He's co-author to The Euro and the Battle of Ideas with Markus Brunnermeier and Harold James, it was published by Princeton University Press. He clearly has extensive experience in monetary policy in international economics. And I'm going to turn it over to him. And thank you, Jean-Pierre, for joining us. We will try to allow time for questions at the end. Jean-Pierre has some slides he wants to go through, but we'll try to leave probably 20 minutes or so at the end for all of you to ask your questions. It is a webinar, so you can't I don't think go into the chat room. But if you put them into the Q&A box, we'll try and track them and make sure we get to them. And with that, Jean-Pierre, it's all yours.

Jean-Pierre Landau:

Thank you very much, John. I'm very happy to be back with the center even if it's on the virtual form. And I'm very grateful for the opportunity to be at the center as a research fellow, and very grateful for the kind introduction that you did. Without further ado, I'm going to share screen with you. There're a few slides I would like to show. Here they are. So I hope they are visible for everyone. The presentation I'm going to make is certainly neither an economic nor a fully policy presentation. I think we are in a period of deep uncertainty, nobody knows really how long this thing will last. Nobody knows how much resources will have been devoted to absorbing that kind of shock.

Jean-Pierre Landau:

And so what's best, I think, is to try and get us a framework to think about the issues, and to see how we can assess the various possibilities for the future rather than. And I'll start with that moment, which I like very much was during an April interview of the chief economist of the IMF, Gita Gopinath. And she was interviewed by Trevor Noah, the well-known TV host in the US. And he came up with this question about the crisis. Is there a point where money just runs out? That was a very interesting moment.

Jean-Pierre Landau:

She gave him a very robust answer about what all the IMF was doing to mitigate the impact of the crisis, especially in emerging economies. But she did not tell him what she could have told him, which is we can print as much money as we like. And the fact that she did not say that tells you that she may have thought that that would trigger concerns rather than switch concerns. The fact that we could print as much money as we like, may not have been in her view. I'm interpreting there, may not have been the kind of soothing answer that maybe Trevor Noah was looking for.

Jean-Pierre Landau:

And also, it's very interesting because that TV host, of course, is very attentive to public opinion. And as soon as April, people were getting worried, not only specialists, not only economists, not only fiscal experts, but a lot of people were getting worried about the amounts which were spent into facing this crisis. So that's the kind of question we'll try to answer today. At least not answer the key framework for thinking about how much debt we can incur and how much money we can print. Maybe three points, a quick look at the current situation.

Jean-Pierre Landau:

First, stylized description of what people think and how they react. And we'll see that there're two opposite various attitudes to the current challenges. And then maybe you'll deal with three questions on inflation, debt and the future of central banking. So the current situation, and most likely legacy of the crisis is not finished. Definitely not. We could describe it in four points.

Jean-Pierre Landau:

First, in all countries, we would have a jump in the ratio of debt to GDP. I would tell today, it's be around 20% in all European countries, and also in the US. So we'll come up, if everything goes well. We'll come out with debt to GDP ratio which will have jumped in a matter of one year of 20-25% of GDP. That's the first point.

Jean-Pierre Landau:

The second point is that all Central Banks will come out of this crisis with a very large balance sheet, 30-100% of GDP for Japan, 30-50% for all other advanced economy. This presentation mainly deals with advanced economy. And I have to apologize to people in the audience who may be coming from emerging economies. I'm not cognizant enough and I haven't looked closely enough to what's happening right now in the emerging world to make [inaudible 00:06:42] so I will concentrate on advanced economy.

Jean-Pierre Landau:

And in the advanced economy, the increase in the size of the Central Bank balance sheet over the last 10 years is absolutely spectacular. 10 years ago, before the great financial crisis of 2009, 2010, the balance sheet of the FED had the size of the few $10 billion, maybe 20,30, $40 billion. Now we're talking about seven-10 trillion dollars so 2000 times bigger. Same for the CB, same for the Bank of Japan. So we have those Central Banks who hold assets equivalent, which are very commensurate with the size of GDP.

Jean-Pierre Landau:

The third, of course, is that as a consequence of all the tools activism and unconventional monetary policy that those Central Bank deployed, a significant part of government debt is held by the Central Banks, and is going to be held by the Central Bank for the years to come, which would be deemed as a form of money of refinancing of the government. And finally, although the Central Banks are very active, although they keep the markets in check. Although they try to stabilize the market, we have an incipient instability in financial market.

Jean-Pierre Landau:

There was an episode which is widely commented in March 2020 where the US short-term Treasury market, which is the broader, largest, deepest, and most liquid financial market in the world, had a few days of big disruptions, which forced the FED to intervene and borrow around three or 400 billion of assets in a matter of a week or two weeks as possible. So this is the situation that we will inherit in advanced economy from the crisis.

Jean-Pierre Landau:

Here you have a few graphs which show just what I said, which are taken from a recent economic report by the BIS, the Bank for International Settlements. Two further comments about the situation right now, we've been there already. We've been there with huge debt to GDP ratio, and we've been there with huge minus interventions for the government but that was in war time or immediately after war time. This is no precedent in this time.

Jean-Pierre Landau:

And so again, this crisis occurred first, after another crisis which took place one decade ago. And second after a period where both interest rates and inflation were keeping at very, very low level. This despite all the efforts by the Central Banks to bring them up with monetary policy hitting what is called zero lower bound, meaning that interest rates policy rates were at zero and stuck there, despite the efforts of the Central Bank to bring them up.

Jean-Pierre Landau:

So there was already a sense that monetary policy was facing big challenges before the crisis occurred. And that the question which is a key question we have now of the relationship between monetary policy and fiscal policy was becoming extremely [inaudible 00:10:01]. When you look at how people or economists, analysts, observers, market participants, politicians react to that situation which again precedented in this time, you have...

Jean-Pierre Landau:

This is an overly stylized presentation. But you have basically two opposite approaches. A significant part of the opinion whether they're explicit in their concerns or not. And again [inaudible 00:10:32] was very representative about that. They feel and they predict that this will not end well, that the conjunction on the very high debt, and very high money growth and very large balance sheets of Central Bank is not going to end well. But I would say on the other side of the spectrum, you have a whole brand of opinion.

Jean-Pierre Landau:

We say, "Well, this is exactly the situation we've been advocating and predicating for decades. And this is an opportunity to create a new and necessary monetary regime, where financing of the government by the Central Bank and through money issuance would become a normal situation." And that's, of course, the modern monetary theory. And I will spend a few minutes talking about it, because it's well-known that it has a huge ego inside a large part of the democratic party today. And we are one week away from an election which may bring that to the forefront.

Jean-Pierre Landau:

So first trend of opinions would say the current conjunction of debt and money is unsustainable. And I suspect that if you ask market participants, analysts and great bank, investment bankers, they will tell you that. And the consensus wisdom in front of the situation would be, well, when there's excess debt, there are only two possible outcomes when we have too much public debt in the economy. The first one is inflation. So the authority inflate the debt away. And that would mean a big change in the current macroeconomic equilibrium in picture. And the second one is default. So the only big governments restructure or do not pay their debt.

Jean-Pierre Landau:

And the only... If you adopt that very pessimistic, but very historically realistic vision of the situation, something like I mean imminent most [inaudible 00:12:50] about that can hold up will certainly adopt as a vision, then your only question is, which one of those two undesirable outcome is the less undesirable? Should we inflate the debt or should we organize default? And those of you who come from emerging economy know exactly what I mean when the question is put on the table as a policy option, right?

Jean-Pierre Landau:

So if we take that pessimistic view, we see that the only question is, how should we organize ourselves in the perspective of either inflation or default? And of course, that pessimistic view, also lead people to immediately think on how to cut that experiment that we have now as short as possible, how to think about. And the code word is here, exit. How do we think about exiting the abnormal situation we are in? And how can we project and program for this exit. And at least in Europe, a few people not that many, but they are influential, in a way are starting to talk about the exit.

Jean-Pierre Landau:

Now, on the opposite spectrum, you have people who say, "Well, this is a great opportunity. Actually, we've been advocating that for a long time. And this is a great opportunity to operate a change in the policy regime, which has been governing monetary policy and fiscal policy during the three or four last decade."[inaudible 00:14:32] And this would develop into two more technical points. The first one is that we have to get a close coordination between monetary and fiscal policy and close coordination between monetary and fiscal policy is the new normal.

Jean-Pierre Landau:

So the period of the last 20 years where there was that feeling that monetary policy was independent of fiscal policy and was operated independently of fiscal policy. That period is finished and it was actually parenthesis with full implication for Central Bank independence. And I remember, John, that we had this discussion in some meeting in senior research fellow and we had colleagues who were very extremely competent and well-informed, were supporting very much that thesis.

Jean-Pierre Landau:

And the second one is that we have no inhibition, we should have no inhibition towards monetary financing of public expenditure. And that sort of taboos which exists, especially in Europe toward monetary financing of the government should be dispensed with and dismissed. So let's look at those two issue a little bit more in detail. First, should coordination between fiscal and monetary policy become the new normal?

Jean-Pierre Landau:

Now, if we look at the instant, if you take a snapshot of the current situation, the answer is yes. Of course, we are in the situation, low inflation, low interest rates, zero interest rates, where fiscal policy has to take the brunt. And the biggest part of the task of keeping the economy afloat and relaunching the economy. This is a situation when there are few interest rates, where fiscal multipliers as the most effective, and where fiscal impulse is most effective when it is fully supported by monetary policy.

Jean-Pierre Landau:

So today, at the moment we speak, there is absolutely no doubt that there is a total convergence of objectives within the fiscal and the monetary side but the government is getting monetary authorities. And this is clearly apparent, when both in the US and the European Union, you have the central bankers calling for longer office collection and more immediate correction. Everybody remembers the statements by the FED chair over the last three weeks.

Jean-Pierre Landau:

So in the immediate future there's no doubt but of course in that school of thought, people said... Well, I'm not only talking about the situation we have now. I think these people think that closer fiscal monetary coordination is a natural situation and should be a natural situation for the future. And for some of them, so you have that very subtle, technical economic argument, which I'm not going to develop at length but if we a have question we can discuss it. That actually, the reason why monetary policy looked as it was dominant and independent over the last 30 years, is that fiscal policy were implicitly passive.

Jean-Pierre Landau:

They were following the lead of monetary policy. They were backing monetary policy in some way. And that backing gave the feeling that monetary policy could be conducted in the pendency of fiscal policy. But that is not according to the school of thought. That is not the reality. In reality, fiscal policy and monetary policy have always been intertwined.

Jean-Pierre Landau:

Here I have an equation, I'm not going to comment on it, but we can come back to it. And that couple of equation shows, formula, I should say, show the two situation which can exist at least in theory, monetary dominance, where the monetary authority sets the monetary stance in that very small stylized formulation. The monetary [inaudible 00:18:41] and the fiscal policy has to adjust by changing the surplus over time so that the equation stands.

Jean-Pierre Landau:

And we have fiscal dominance, we have the fiscal authority decide what they do, and the monetary policy adjust by actually monetizing whenever necessary, the fiscal deficit. So fiscal dominance, monetary dominance, two states of the world. And people who argue that closer coordination between fiscal and monetary policy should be the new normal, actually argue that we are going out of 30 years of optical monetary dominance, but maybe fiscal dominance should be part of our future.

Jean-Pierre Landau:

And implicitly of course, this theory jettisons Central Bank independence and accept at least the risk if not the reality of fiscal dominance in the future. And that's why we had active debate when it was mentioned during our research fellow team because I'm a person who is very attached to Central Bank independence so I was not prepared to yield on that ground. But that's, I think a lot, if not a dominant part of the market analyst and maybe you're going to be publishing things along those lines.

Jean-Pierre Landau:

Even going a little bit further or step further, looking at the situation right now, looking at very low and stable inflation, actually worrying low inflation is getting negative in some part of the area right now. It's close to zero almost everywhere in the advanced world. And we are creating an enormous amount of money, and there's no inflation. So a lot of people who've been advocating for monetary financing of the government are feeling vindicated today in that situation. And they argued that monetary financing should be bufFED and sometimes the essential part of the financing of governments.

Jean-Pierre Landau:

And this position has I would say, three dimensions. First one is a technical dimension. And just to mention it quickly, but again, we can discuss that later. When you have zero interest rate, money and short-term government bonds are basically the same instruments. They are, as we say, close substitute. So why should we focus on one source of finance rather than the other when actually they are both the same? So that's the technical dimension.

Jean-Pierre Landau:

There is an economic dimension decided that once you have exhausted all conventional and unconventional tools to support the economy and try to push inflation a little bit up. There is the so called helicopter money situation, where the Central Bank basically distributes cash or something which is close to cash directly to households and cooperates. And it has been hard with a lot of elaboration and sometimes veracity that it may be an appropriate tool to fight deflation, if deflation were to materialize or to avoid the risk of deflation if it were to become too hard.

Jean-Pierre Landau:

And in the last year, I think the former chair of the FED, Ben Bernanke has come out with a column which examines the pros and cons of helicopter money, and does not dismiss the whole idea altogether, while pointing at these technical difficulties and all that. And then you have a whole political economy dimension through the emergence and... Not emergence, because they've been there for 20 years, but for the revitalization of the Modern Monetary Theory, which as I said, has been espoused by a significant part of the most, I would say leftist part of the democratic party. And they play a big influence in elaborating the economic policy if and when the democrat candidates becomes president of the United States.

Jean-Pierre Landau:

So what does the Modern Monetary Theory say? It says that... Those two bullet points on these slides are absolutely true and unchallengeable. The bullet points of the next slide are a matter of discussion. So the two things which are absolutely true and unchallengeable is that the sovereign state can issue money in unlimited quantities, and that it can impose the use of money and transaction by asking that taxes be paid in that money and that public debt should be paid back in that money. So, that is absolutely true. This is synthetic expedition, or what is called State Theory of Money. The sovereign can make sure that it issues money and that money is used.

Jean-Pierre Landau:

And second more technically, when you look at the detailed operations of the Treasury, and this is not always well explained by the supporters of the Modern Monetary Theory, but it's true. Every time the government spends $1, they create $1 on that, every time they borrow or tax $1 that is $1 of money. This is technically two. So those two close link between the government and money are economically and technically true.

Jean-Pierre Landau:

On that on, the supporters of Modern Monetary Theory tells us where there's no problem, then why don't we finance routinely the government functions of money? And that's where under surfaced do focus on the deficit. The question of the deficit of the budget is wrong. And you know that one of the major supporter of the theory who is Stephanie Kelton has just published a book which seems to be bestseller which is called the Deficit Myth. Money can be regulated by raising or lowering taxes and therefore, you don't have to worry about the deficit. You just cover the deficit by printing money.

Jean-Pierre Landau:

What are the assumption which must be true, and may not be true for this theory to hold? First, implicitly, they said that money and debt are equivalent and substitute. And today it's true, but it's not always true. And they are very close in that to one other theory, which is fiscal theory of the price level which I will not describe it, we can discuss it.

Jean-Pierre Landau:

In my view, the main weakness is on second bullet point, right. There is an implicit assumption on money demand and the fact that people are willing to hold money in unlimited quantity, because if the government issues money to finance its expenditure, that means people have to hold that money. And I used to say, and I think it's a very important distinction, the government can force you to use money in transaction, they cannot force you to hold money, at least in a liberal, democratic, non-financial request society. And so my big question for the Modern Monetary Theory, what if people don't want to hold the money that the government is issuing in large quantities, and we know what's going to happen then. It's going to happen that people will try to exchange money versus goods, and there will be inflation.

Jean-Pierre Landau:

So that risk of inflation due to a change in the demand of money is in my view severely underestimated by the Modern Monetary Theory, which has a theory of inflation, which is much more of Keynesian one, there is no inflation as long as we are very far away from full employment. So mixed diagnostic, it's certainly a theory which is attractive today because we have huge unemployment and low inflation.

Jean-Pierre Landau:

So maybe today, if I have to defend the modern Theory of money, I would say, "Yes. Well, today we don't have any inhibitions toward monetary financing, whatever the legal framework, whatever [inaudible 00:27:23] may not be technically justified." But we have to think about the future we have creating a lot of money. What if in the future, people don't want to hold that money again, and this is an issue that I will come back to.

Jean-Pierre Landau:

Actually, my point here, and maybe this is the only slide where I would send a personal message. My point here is that both approaches are making actually the same mistake, but in a symmetric way. They both pretend to come with a vision, which is consistent for today and for the future. So the alarmists would say, "The future is dim, therefore we should be very careful today." And the money allocation, today we can issue money so there's no problem for the future. Both approaches are wrong.

Jean-Pierre Landau:

And my deep conviction and I'm pretty sure that policymaker share it either they're explicit about is that what is needed today, and what is needed tomorrow are actually two very opposite things. We need to be as permissive as possible today because the situation calls for it. But we need to be very careful tomorrow, not to destroy the foundation of what has done [inaudible 00:28:41]. And this case of schizophrenia between what we must do today and what we must care for tomorrow is the most difficult thing to manage.

Jean-Pierre Landau:

And I must confess, I don't have a full fledged vision of solution of how it should be done, but I am convinced that this is the way to go forward. And those people who are too alarmist, and if they express this alarm isn't too strong, they will create concern that will impede the efficiency of the response to that. And those people who are too opportunist and think we can do anything we like today, they will risk destabilizing the policy frameworks which we will need in the future to operate in a more normal macroeconomic situation.

Jean-Pierre Landau:

So I would say we should use all the policy space today and the policy space today is enormous, because we don't have inflation. So we can do almost everything. But we should use it in a way which does not destroy the world system, and does not create instability for the future. That's very difficult, easier said than done. But we will see how it can be approached for three questions. I have only seven minutes left. Is that correct? Yeah, so I'll go very fast.

Jean-Pierre Landau:

Inflation, nobody knows. Nobody knows what is going to become. We don't really understand why it was so low over the last decade. We are reasonably sure it's not a problem in the next 18 to 24 months, unless something very, very dramatic happens in the world in terms of strategy tensions or something like that. So no inflationary problem for the next, I would say 24 months. And actually, as you know, in most country, it's not expected that we get back to the GDP level of 2019 before the middle of 2020, 2023. So any kind of output gap may not be resolved before 2023. No reason why inflation should stop. We cannot exclude a traumatic event but I don't mention it there.

Jean-Pierre Landau:

Management is very strong. People are willing to hold money, they are willing to hold debt, they are willing to hold safe assets. But what about the future? Should we aim at higher inflation, here I would make a distinction. In a way, Central Banks are aiming at higher inflation. They want to raise inflation higher than it is now. And part of the recent review of the FED is to say, "Well, we adopt average inflation targeting which means that we can go a little bit higher than 2% for a few years." The official motive, of course, is to get multi policy more stimulative, to get real interest rates more negative, access early of course, five or six years of inflation at 3% might help wipe out part of the debt which has been accumulated. So it's not a bad idea.

Jean-Pierre Landau:

The question, of course, is that there's a difference between high inflation and accelerating inflation. And accelerating inflation is something nobody wants because, of course, you don't know when it starts to accelerate, when it will stop and then you get to levels which are very, very disruptive for the economy. So again, a very difficult balancing act between getting higher inflation and preventing accelerating inflation, especially if people start expecting that the fiscal authorities will push the Central Bank to be more permissive than they should do.

Jean-Pierre Landau:

Second point, debt sustainability. The debate has been marked by a major contribution by Olivier Blanchard who's the former chief economist of the IMF, former professor at MIT, who published a great paper a year and a half ago. And that paper is basic on the simple idea. We are in a period where the interest rate is lower than the growth rate in real time. So intuitively, when the interest rate is lower than the growth rate, the debt to GDP ratio diminishes. The debt grows slower than the GDP and so the debt diminishes. So this is a situation where debt sustainability is not by itself a problem. And we can live with a higher debt to GDP ratio, because it will stabilize or even reduce as long as interest rate is lower than the growth rate.

Jean-Pierre Landau:

That is true. That is of course absolutely true. We've three caveats. First, some countries have a primary deficit, which is a deficit which you run before you're paying interest rates so after you pay interest rates you have even a bigger secondary deficit. And that of course, change the world dynamic. This is the case of many European countries including mine. And so if you have to have... including to the charge of interest, if you have to include a primary deficit, the whole stability of the system might not be the same.

Jean-Pierre Landau:

Second, the reasoning of Russia is true for, "safe countries", but as many emerging and even European countries know, not everybody is safe, not everybody safe. And a lot of countries have to pay risk premium in the form of [inaudible 00:34:26] spread on the market. And that spread may bring the interest rates well able the growth rate and make their debt unsustainable. And the debt markets have their own dynamic. And even if rationally the debt should be deemed as sustainable, there maybe liquidity squeezes, there may be liquidity events, there may be what economists call multiple equilibrium as the one we checked...

Jean-Pierre Landau:

There may be liquidity incidents as the one which occurred in March for the Treasury. And that, of course, every time that occurs, that pushes interest rates up. And so that instability is there, it may create cycle of... I've represented one here, I'm not going to elaborate on it but it may be that the perfectly solvent government has difficulties to rollover to finance and to borrow.

Jean-Pierre Landau:

One of the main task of major Central Bank in the world is to prevent that. And it has been recognized for almost centuries, that Central Banks have a duty to stabilize the government's debt market and avoid a seizure and liquidity squeezes on those markets but this thing can be okay. So even if the interest rates is lower than the growth rate, it's not going to be for most governments on the planet an easy time in the future. This is what I said.

Jean-Pierre Landau:

And my conclusion on that and how I would advocate that, including for my own government, I'm amazed that we don't do anymore. This is the moment to issue long-term debt, all government to issue massively long-term debt. You can issue long-term debt for very, very low, even zero interest rates, in some cases, negative interest rate at 10 or 15 years. If you have long-term debts, you don't have to refinance it. You are less dependent on the whims of the markets, you are less dependent of the possible liquidity events on the debt market. So, if I'm not sure that... I don't have many certainties in the current circumstances but I'm pretty sure that issuing long-term debt is a very, very good move for most of the government.

Jean-Pierre Landau:

One quick word of Central Bank independence, you clearly see that both intellectually, politically, financially, the Central Banks are finding themselves in a much more challenging situation than they were 10 years ago. I think independence is the key to the balance that I mentioned between being very agile and very permissive in the short-run, and keeping the framework robust in the long-run. But it's going to be difficult when you hold a large part of government debt.

Jean-Pierre Landau:

The condition for pressuring the Central Bank to keep supporting the government debt market is going to be very, very strong, very strong. They will have risk in their balance sheet, they are piling up risk in their balance sheet. And those risks are quasi-feel scared risk and they take great care of mentioning that they are not fiscal agents that even if they take risks for the sake of monetary policy, it's not [inaudible 00:37:56] to take risk. And you have that wonderful sentence by Jerome Powell like a month or two months ago, which he keeps repeating with good reason, "We are lending not spending. We conduct a monetary policy. We don't conduct a fiscal policy," but still.

Jean-Pierre Landau:

And last but not least, there is either an obligation or a willingness by Central Banks to diversify their task and their mission which sometimes is called dismissively mission creep. So of course, they are very active now in [inaudible 00:38:32] market. So there may be a temptation to high and allocate credit, which is not their job. Their job is to stabilize the economy. They don't have a hole for allocating resources, they don't have a mandate for that. And of course, in the current circumstance, where concerns about the climate change are extremely high and everybody looking for ways to act more, this is civilian term insurance, some Central Bank including the European Central Bank are considering whether they should be more active into that and contribute to the [inaudible 00:39:10] and in finance. With very good motives, that would put them into again, something which is different from their traditional subdivision hole and some people amongst them actually think their legitimacy could be put at risk and their independence could be put in danger. But that's an open debate. That's a very open debate.

Jean-Pierre Landau:

That's one of the fascinating question that we have to face now. Independence with scalability, independence with what may be legitimate aspiration of the society, and keeping their framework robust to make sure that they can absorb the possible shocks in the future, which would allow them to be very agile in the present. John, I think I almost kept the time limit that you mentioned. I've been very fast and sometimes very vague, but I'd be very happy to answer questions.

John Haigh:

We will open it up to questions, you can put them into the Q&A box, and we will try and track them. And I will take the liberty as monitoring, asking a few questions myself to start things off. So one of our colleagues, Larry Summers has written extensively about something called structural stagnation. And structural stagnation was basically a belief that the real interest rate, our star they call it the neutral interest rate has declined significantly. And there are a lot of reasons people can debate and discuss why that's the case, but partially a reduction in aggregate demand. And so it's very hard to stimulate the economy. That occurred prior to COVID.

John Haigh:

And so I guess, as I start to think, and I don't claim to be a macro economists, you're much more knowledgeable than I am. So I'm happy to listen and learn. But it seems to me that there's a question about whether he's right, and what the impact is of COVID on that belief, because one of your concerns is that your options was to inflate, basically out of the debt situation in the future. But if you're really suffering from structural stagnation, how can you inflate the economy even if you wanted to? And it seems to me that Central Banks have been having some difficulty even getting inflation up and prior to COVID. I'm just trying to square that circle a bit. And I don't know if you can help me think about that.

Jean-Pierre Landau:

First point, I think at the beginning in intuition, the theory developed by Larry Summers is absolutely illuminating. And for me, it's been a revelation of what we're going through. And I would encourage everybody to watch his improvisation in November 2013. And a seminar in the IMF with no notes, no paper, nothing. And for 15 minutes he starts developing a hypothesis. It's absolutely fascinating. I think he's right, I think he's right.

Jean-Pierre Landau:

So basically, if our star, if the real equilibrium interest rate is low, there's nothing that monetary policy can do about it. Because the only thing that monetary policy can try and do is not having its own policy rate above ourselves. Because if you have it, this is the [inaudible 00:42:45] thing, then you contribute to further depression. But to bring our star up, you have to just save and you have to invest because our style is basically the equilibrium between saving and investment. And if the private sector is not ready to invest, or is ready to save too much, which is the case for many reason, then the public sector has to do it. And this is a very strong case for public infrastructure spending. And you remember one of the sentences he came up with, everybody talks about Kennedy Airport, which is the worst airport in the world. But when we say we should repair it, they say, "No, it's not the moment." Well, if it's not the moment, now.

John Haigh:

Now's the moment.

Jean-Pierre Landau:

Now's the moment. And then he has a development in the region the Charles River [inaudible 00:43:38]. I think everybody should read it. It's really nice. In that perspective, the way you finance... I'm not sure he's taken a stance on how this program expenditure should be financed. Whether it's money or borrowing, I think but it's a second order of magnitude as compared to the main concern that we don't have enough spending or investment in the economy. And of course, now we have a very big negative demand shock on the economy. So in a way that transform even the necessity for spending.

Jean-Pierre Landau:

Let's say we have a democratic president next year. One thing I'm sure is that there will be... I'm reasonably sure that there will be an increase in spending, and especially in funding structure. How that will be finance, how that will be decided to be financed is other questions but the first order of importance is, of course, yes. Stimulate aggregate spending, and stimulate investment. I think from that point, I'm very much inspired by what Larry Summers said.

John Haigh:

So I'm going to continue asking questions unless somebody puts something into the chat box or the Q&A box. So I struggle with this question of how much independence Central Banks should have. On one hand, I completely understand that you want to remove them to some extent, from political pressures, and enable them to focus on what they need to focus on in the stability of the economic system. On the other hand, some coordination with fiscal policy seems to me to lead to more rational outcomes potentially. And I'll give you a specific example. It's a simple one, one of my students a few years ago wrote a paper on this, which turned out to be very influential. But the example was... It's a relatively simple example. And he calculated out the cost, if you will.

John Haigh:

So the Federal Reserve in the United States decides that it wants to stimulate the economy and so it takes up monetary policy actions to try to lower the interest rate and stimulate the economy. The US Treasury, on the other hand, looks and says, "Fantastic. The interest rate is lower, we should borrow more." And so they go in, and they suck up some of the capacity that the FEDeral Reserve has created. And the impact of the FEDeral Reserve's policy is diminished but the United States government has borrowed money at favorable interest rates. Is there an opportunity to coordinate in a way that's productive, and manages that tension? I'm conflicted, because Central Banks are highly independent institutions in a democratic context. Do you have thoughts on how to think about that kind of problem?

Jean-Pierre Landau:

Oh, I have I think an economic comment of what you made, and then maybe a personal comment, which is personal. On what you said, of course, I think any central banker would accept that independence is not isolation. And the example that you mentioned were basically the debt management policy how he later contradicts what the monetary policy is doing is one example of this, right? So you have two independent authorities, the fiscal one and the monetary one, they manage basically the same balance sheet. So it's a very strong situation where you have two authorities managing the same balance sheet, and the example that you mentioned is exactly that. So they don't have to be isolated.

Jean-Pierre Landau:

I think the FED chairman in many, many times had mentioned that they were having regular weekly breakfast with the Secretary of the Treasury. They didn't think it would impede their independence. So independence is not isolation. And if two independent authorities are not acting with a minimum of exchanges and trying to share what objectives they are pursuing and what kind of intervention are visible, yeah of course, it's a very bad situation. And the situation you described is a typical example of that.

Jean-Pierre Landau:

My second point, yes. I think the one thing which could really derail the... Let me give you a bad scenario for the economy. I don't think I'm not... But let me give you a bad scenario. I mean, you have a huge amount of money in the hands now of the private sector, and they're willing to keep that money. But as I said, the demand for money may be unstable, and nobody can force you to hold money. I mean, one of the drivers of the demand for money is inflation expectation.

Jean-Pierre Landau:

So let's say that inflation expectations start to raise for some reason. That's a scenario which unlucky but not zero probability. And the velocity of money starts to increase, then you start to have some push for inflation up movement, then we should think that the Central Bank should react if we are above its target, right? If we already averaged two, 3% and that happens, right? But of course, if it's perceived, two years before, that it will not react, because of the fiscal problems, it could cause the government, then those expectation will grow much faster. They're a lot. I mean, this is the unpleasant monetary arithmetic of [inaudible 00:49:40]. So if we want people to have a stable management today, we must make sure that they don't expect that the Central Bank will yield tomorrow, which is a very difficult trick, right?

John Haigh:

Right.

Jean-Pierre Landau:

If they don't expect the Central Bank will yield tomorrow, then the Central Bank can do whatever it's like today. That's what I'm saying. And I think it's a... Now, last remark, I think Central Bank should be fully independent in the narrow field of their mandate. These are not elected officials, these are unelected officials. So there should not be entrusted in my view, but that's a personal review. They shouldn't be entrusted to decide implicitly, or explicitly which kind of cooperate will be financed and which kind of cooperate will not be financed. Which kind of bonds will be deemed “green enough” so that they can buy it. And which kind will not be deemed “green enough” so that they don't buy it. This is not a joke. This is allocation of resources and allocation of resources should be done by the government. So if the government want them to do this, they should give them an explicit mandate. So it's very important.

They should be fully independent, in the narrow objective of their mandate, which is to get to price stability and maximum employment in the US.

John Haigh:

So we have some questions that have come in. And I'm going to just start at the top and we'll work through them. First one, when you suggest we issue long-term debt, in the case of the US, what is the potential market for 30 or 50 year bond? As you know, the maturity schedule of treasuries is very front-loaded. Can the market primary purchasers of Treasury support 10s of hundreds of billions or more of 30 plus year debt?

Jean-Pierre Landau:

Okay. The comment I made was partly irresponsible. And I was aware I was making that because I discussed that with my colleagues from the Debt Management Agency in Paris, and they tell me exactly the same kind of things that you just mentioned. So the reason why governments do not issue longer-term debt is because their debt management agency tell them it's going to be difficult and costly. And this is the kind of reasoning that you mentioned. And that's true. That's true.

Jean-Pierre Landau:

And I think it's a job of a debt management in [inaudible 00:52:10] to tell the government, "If you do that, it's going to cost you half, I don't know 50, 25 basis points." My point there is that we should have a thinking as citizens of whether we should... I mean, you were mentioning derivative in the private conversation to protect us from the future, whether paying today 50 basis points more to protect us from further financial accident down the road maybe good.

Jean-Pierre Landau:

So I acknowledge it's more of a concern for European governments than the US government for various reasons but that is something that should be considered. And we should protect people. We will live in 10, 15 years, will be active then from... We should think whether it's not a good way to protect them from financial instability, even if you have to pay a little more.

John Haigh:

All right, the next question, there is an argument that the question, at least in the immediate future is not debt sustainability in an environment with zero interest rates, but whether you can finance the debt, i.e pay the interest rates, which is zero currently, and if you are a large developed country, you can indefinitely roll over the debt that the debt will never really need to be paid? I'm not sure I fully understand. You probably understand better than I do. But, yeah.

Jean-Pierre Landau:

Of course, you can roll over the debt. But what is the debt crisis?

John Haigh:

Elaborate.

Jean-Pierre Landau:

I mean, an acute debt crisis is a situation where you cannot roll over the debt at all. And that happens. I think people in emerging economies know that. But significantly serious debt crisis is where you can roll it over, but at a very higher interest rate. That is the link with the previous question. Today you can borrow zero, so why don't you use that possibility to protect you from the fact that maybe in five years we will go at a more expensive rate.

Jean-Pierre Landau:

So if you borrow five years today, you pocket a very small interest rates, of course, you pay zero interest rate. [inaudible 00:54:26] the roll over risk, which is described by your second questions in five years. If you borrow 15 years, you pay a little bit more expensive to them, significantly not actually because the markets are [inaudible 00:54:38] and are supported by the Central Bank. But you don't have the roll over risk in five years, and you eliminate the risk that you have to pay higher interest rates in five years. So the two questions actually complement each other very well.

John Haigh:

They do. Okay, this is the last question in the box. And we're approaching close to time. What are the highest likelihood events that could spur inflation higher, even if they're low [inaudible 00:55:01] in relative terms. What keeps you up at night, in terms of potential inflation expectations?

Jean-Pierre Landau:

I think if we have to think of a scenario which would trigger inflation concern in next two, three years, it has to come from the supply side of the economy. It cannot come from the demand side of the economy, because the demand side of the economy is going to be very, very dis inflationary. So what could make a supply shock possible in the next two, four years? Well, a big geopolitical event, which would disrupt all supplies in many parts of the economy, that's a possibility. Totally disruption for similar reason of supply chain, so we could have shortages of some goods we are considering as essential in our life. And the COVID itself is both a demand shock, but it's primarily a supply shock, right? We cannot produce anymore. And a lot of people three, four months ago would have expected that inflation would have grown, would have been higher, would have increased more quickly because of that supply shock.

Jean-Pierre Landau:

I would say my general concern would be if we have inflation in the next two, four years, it will come from the supply side, either for physical disruption or strategic disruption. Now, what's interesting is what happened after that. And there's no doubt, I would say operational book in the Central Bank will tell you if you have a supply shock. You just look at the expectation. If the expectation don't move, you don't act, but if they move you act, right. So the big question is what the expectation would do in that case, and if expectations start to grow up, then with a huge amount of money balances around the world, I think Central Bank should start acting. But that's a big series of significant negative supply shock and [inaudible 00:57:12] expectation.

John Haigh:

So terrific. So, we've managed to end pretty close to the time. It is a little after 5:00. I just want to say thank you so much to Jean-Pierre. As usual, I always learn a lot in our conversations and appreciate it. Thank you so much for taking the time to do this. And I'd like to thank all of our listeners and participants. And I hope you have a good evening. Enjoy the situation, even though... At least in Boston and Cambridge it's overcast and raining and cold. But hopefully, you're all going to enjoy your evening. So thank you very much. And we'll talk again soon. Jean-Pierre, thank you.

Jean-Pierre Landau:

Thank you for the opportunity, John. Thank you. Bye-bye.