# Comments on monetary policy

## Communication to the Académie des Sciences Morales et Politiques[1] September 18, 2023

***Note written by Jacques de Larosière***

## Introduction

I would like to thank our President, a man who throughout his career has been a resolute defender of monetary stability, for choosing me to give you my views on monetary policy as it has been conducted in recent years.

The subject is a technical one, but it is of the utmost interest to our societies. The literature shows that in peacetime, inflation was considered by the populations surveyed to be the greatest danger, even before unemployment[2].

This is understandable: "money is the standard by which all things are given their value", as Montesquieu taught. How can we imagine that this standard could itself change value at any time?

Traditionally, since their emergence at the end of the 17th century, central banks have been entrusted with the task of ensuring currency stability.

For most of the 19th century, the major countries decided to base their currencies on the physical value of gold, a rare commodity that was easy to value and had a fairly stable market. Holders of banknotes issued by central banks could convert them into metal at any time. All currencies that played a key role in international trade were defined by a weight of gold. Since they were defined in the same way, they were easy to exchange. To ensure the stability of the system, currencies did not change the weight of gold that defined them: exchange parities were therefore fixed: no devaluation for mercantile purposes.

This system – which had ensured great international monetary stability and helped finance the Industrial Revolution – collapsed with the outbreak of war in 1914. Military expenditure had become so gigantic that it was illusory to continue pledging the issue of currency in gold. We resigned ourselves to issuing as much money as the continuation of hostilities demanded. This meant the end of stability and the rise of inflation.

After the Great War, attempts were made to restore the gold standard, but to no avail. The habit of financing ever-increasing public spending with debt, and the desire to win export market share through competitive[3] devaluations, explain this failure. The world had entered a regime of floating exchange rates.

At the end of the Second World War, the United States was determined to recreate a new world monetary order. This order took the form – under the name of the "Bretton Woods system" – of a regime of fixed exchange rates. Each currency was defined in relation to the dollar, which became the anchor of the system. But the dollar itself was subject to gold convertibility: foreign central banks that felt they held too many dollars could exchange them for gold with the American authorities.

As long as the United States had a balanced balance of payments, the system worked pretty much as it should. Currencies, defined in dollars, were bound by a certain discipline. They were only authorized to devalue with the agreement of the International Monetary Fund, which could thus impose its "conditionality".

But the Vietnam War at the end of the 60s destroyed the Bretton Woods system. The United States had decided not to finance the war by raising additional taxes, but by borrowing. However, because of rising military spending, the United States – whose indebtedness was growing rapidly – did not possess enough gold to ensure the convertibility of the dollar.

1. This speech has been slightly modified to take account of the main statistical developments in the last quarter of 2023.
2. After the Great War, inflation had become, in Keynes's eyes, "one of the most significant events in the economic history of the modern world". Quoted in: "The Currency of politics" by Stefan Eich, Princeton 2022.
3. It was the "beggar thy neighbor policy" that exacerbated geopolitical tensions in the 1930s.

The international monetary system collapsed in August 1971 with President Nixon's decision to end dollar convertibility.

This was followed by a more or less administered floating exchange rate regime. This "non-system" still governs us today, with no discipline whatsoever.

It is in this international context, which alone allows us to understand the subject, that I shall attempt to describe and assess the monetary policy followed for almost twenty years.

## 1. Monetary policy in recent years has been characterized by continuous stimulation. In so doing, it has led to the weakening of the financial system

Since the financial crisis of 2007-2008 – itself the result of excessive indebtedness – the monetary policy of the major central banks – which have followed the Fed's lead – has been consistently stimulative. Money creation had been "firing on all cylinders" for over 15 years, the advocates of the new policy, acknowledge.

Monetary policy over the last twenty years can be characterized as follows:

### 1.1 Key interest rates have been maintained at 0 and even lower in real terms for twenty years

This is shown in Chart 1

It shows that, apart from the 2007-2008 crisis, real key rates have been kept in negative territory for over twenty years.

In concrete terms, this means that a European buyer of Treasury bonds has had to pay a subsidy to the borrowing state in order to be allowed to lend to it.

This anomaly was not confined to short rates. It had spread across the entire yield curve. By 2020, 40% of European public debt had a negative nominal interest rate.

This incongruity – unique in history – insofar as it involved taxing savers who wanted to finance the economy – seemed normal and even desirable to many, including central bankers.

However, the paradox was considerable: when it comes to financing an economy and its productive investment, is it normal to punish the saver, *i.e.* the provider of capital?

### 1.2 Growth in money supply has continually outstripped that of the real economy

Chart 2 shows that growth in the most comprehensive monetary aggregate – M3 – has consistently exceeded that of the economy (GDP). This is true in both Europe and the USA.

Thus, between 2000 and 2019, M3 grew by 220% in the USA, compared with real GDP growth of 48.6% (the corresponding figures for the Eurozone are 172.5% and 28% respectively).

If we refer to "central bank money" (banknotes in circulation and reserves held by commercial banks with the Institut d'Emission), we see that for the majority of OECD countries, central bank money has risen from $2.5 trillion in 2006 to $25 trillion in 2022, a record increase of 900% in fifteen years.

Admittedly, these figures must be interpreted with caution, as the relationship between money creation and inflation is complex and non-linear (the velocity of circulation, as well as the irregularity of economic agents' need for money, are difficult to model). But the continuity and scale of this "excess" of money should, at the very least, have prompted to question the wisdom of such a policy… Traditionally, growth in financing was proportional to growth in the economy. Over the past 20 years,

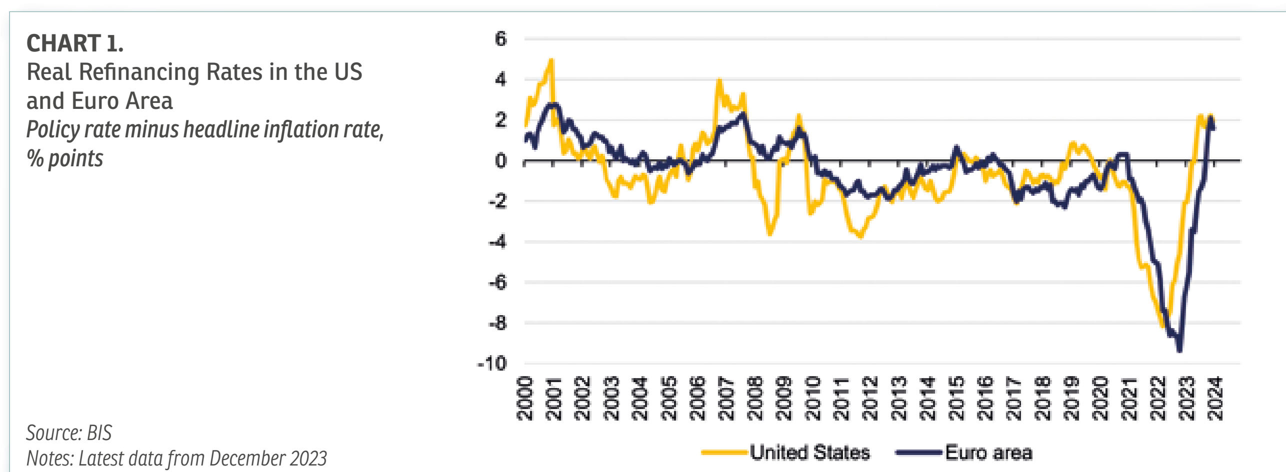



**CHART 1.**
Real Refinancing Rates in the US and Euro Area
*Policy rate minus headline inflation rate, % points*

*Source: BIS*
*Notes: Latest data from December 2023*

**CHART 2.**
Monetary expansion has continuously exceeded GDP growth.
M3 Growth Rate Against Real GDP growth rate, % annual change

*Source : OECD*
*Last data from Q3-2023*

this link has disappeared: financing now exceeds economic needs.

In 1568, the French economist Jean Bodin posed the quantitative equation for money, which was taken up much later by Milton Friedman and American economists. He demonstrated that if the creation of money exceeded the economy's financing needs for too long, inflation would eventually set in. This thesis has never been contradicted in the long run.

### 1.3 Monetary policy was conducted asymmetrically

Detailed examination shows that monetary policy was continually stimulative:

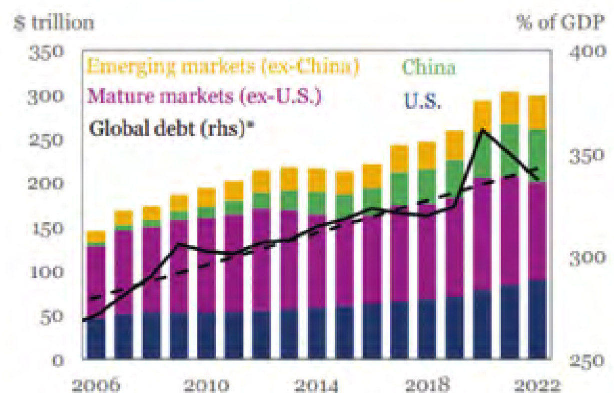
- very stimulative at the slightest sign of economic slowdown,
- without becoming truly restrictive in the event of overheating.

Yet we know that an anti-inflationary monetary policy must take account of the economic cycle, alternating phases of easing and tightening according to the economic situation.

### 1.4 Low-interest monetary policy has contributed to massive debt growth in advanced countries

Chart 3 from the Institute of International Finance (IIF) shows that global debt has literally exploded over the past 17 years. Between 2006 and 2022, global debt (financial + non-financial) doubled in value, rising from $150 trillion in 2006 to around $300 trillion by the end of 2022.

**CHART 3.**
Global debt has soared



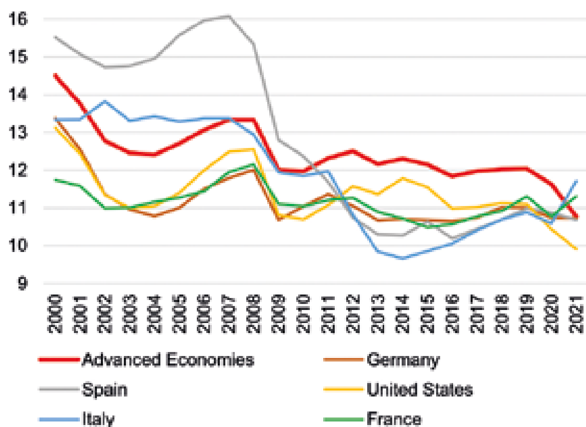

*Source : Institute of International Finance*
*Notes: as of Q4 2022; * the dotted line indicates the trend over the pre-Covid-19 period*

According to BIS figures – which, unlike the IIF, exclude debt issued by financial organizations – global debt has risen in real terms :

- in the USA, from 186.8% of GDP in 2000 to 255.6% in 2022 (*i.e.* +36%).
- in the Eurozone, from 198.1% in 2000 to 250.9% in 2022 (*i.e.* +26.6%).
- This explosion in debt concerns all economic agents:
  - Governments have seen their debt soar in real terms:
  USA: 48% of GDP in 2000 to 112% in 2022 (+130%)
  Euro: 69% of GDP in 2000 to 92% in 2022, *i.e.* +33%.
  - During the same period, private non-financial companies and households saw their debt rise, particularly in Europe:
  USA: from 135% to 152% of GDP (+12%)
  Euro: from 126 to 162% of GDP, *i.e.* +28%.

**CHART 4.**
Productive investment has declined

Non- Residential Investments in Advanced economies, % of GDP




*Sources: OECD, IMF Staff Calculations*
*Notes: Advanced economies = Australia, Canada, France, Germany, Italy, Japan, Korea, Spain, United Kingdom, United States ; the series include government and corporate investment*

the case. The debt indicator no longer even appears on the dashboard of our central bankers. And yet, the spectacular explosion in credit (100% between 2006 and 2022) should, at the very least, have triggered a reaction of concern... But it didn't.

Has productive investment at least benefited from low interest rates? Unfortunately, the answer is no.

Zero interest rates may have encouraged indebtedness, but not productive investment.

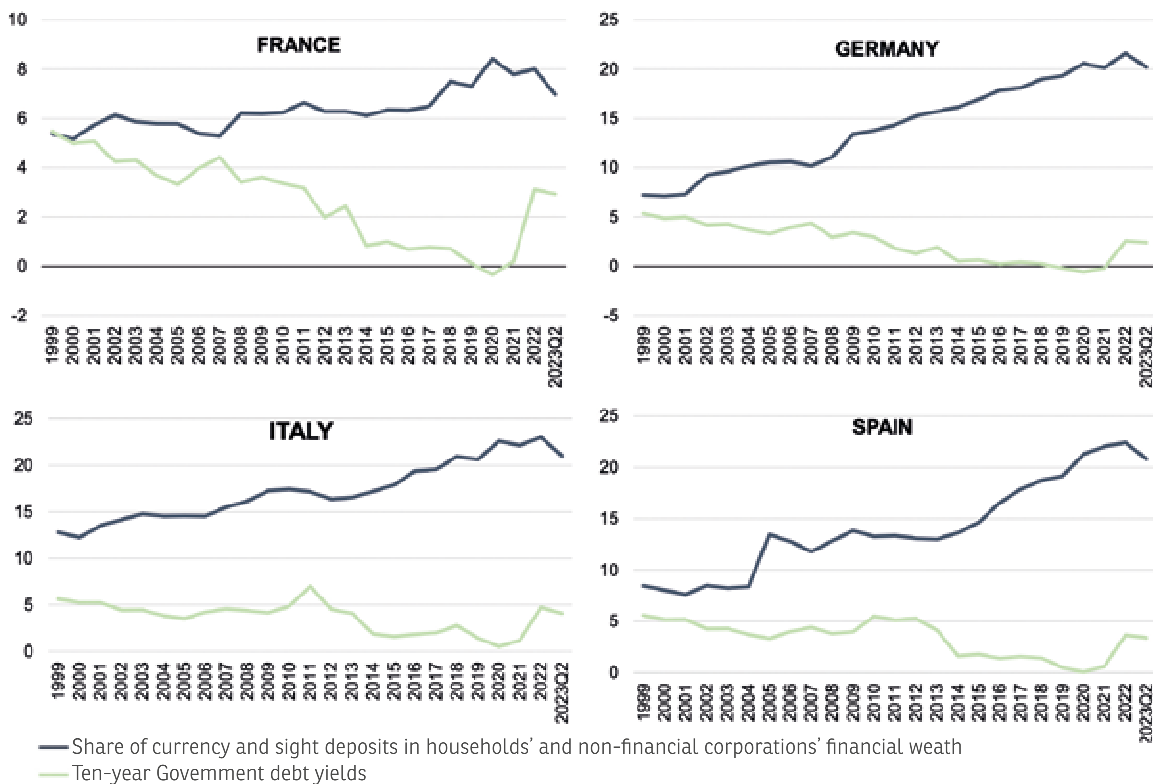
Chart 4 shows that, in the advanced countries, capital invested in productive (non-residential) assets declined by 2.5% of GDP over the twenty years of zero interest rates. This is unique for a global economy that is supposed to be growing.

Part of the explanation lies in monetary policy.

Keynes warned us that the "liquidity trap" is not conducive to long-term productive investment. Faced with the absence of a return on savings, economic agents rationally prefer to remain liquid, and not commit to risky long-term investments with no prospect of gain. Chart 5 below shows that, in fact, the purely liquid portion of European household savings has literally soared to the detriment of long-term productive investments.

**CHART 5.**
Savings are increasingly liquid

Evolution of the liquid assets of economic agents as proportion of financial wealth and interest rates and government bonds




*Sources : Eurostat, Refinitiv Eikon, OEE (Observatoire de l'Epargne Européenne)*

4. The IMF taught that the deterioration of a country's current account balance depended on the evolution of "net domestic assets", *i.e.* the variation in credit to the economy and the government.

**CHART 6.**
Volumes of Share buybacks have doubled in the US since 2011

Share buybacks by non-financial corporations (USD billions)

*Sources: S&P Global Market Intelligence, via AGEFI*

It had also become more attractive for a company to take on low-cost debt to buy back its shares than to invest for the long term. Hence the explosion in "share buy backs" (*see Chart 6*).

### 1.5 Central bank balance sheets have reached levels unseen in the past, at least in peacetime

Given that – as shown above – key interest rates have been kept at zero – or even in negative territory – for twenty years, central banks have faced an arithmetic challenge.

Since nominal interest rates could not fall much below zero (there is, in fact, a common-sense limit to the "repression" exerted on savings), central banks came up with the idea of compensating for the rigidity of the zero limit by transferring their stimulating action from the fall in rates – now blocked – to the growth of money creation. This was the way they imagined to restore "room" for manoeuvre to monetary policy. After 2008, this became known as "quantitative easing". To ensure that monetary policy was properly transmitted, the idea was to create virtually unlimited amounts of money. To turn the zero lower bound, central banks bought financial securities, mainly bonds, on the market. These purchases were financed by money creation. By buying back securities from market players, liquidity was increased. And it was thought that this liquidity would encourage banks to finance investment. So did productive investment at least benefit from these low rates? The answer is negative, as shown above (*see Graph 4*).

Buying (or selling) securities has always been part of the central banks' arsenal. It's one of the classic ways of influencing financial market liquidity and avoiding very short-term crises.

But that's not what this was about. It was about flooding the economy with money creation on the pretext that the inflation target ("just under 2%") had not been met.

**Chart 7 (*see next page*) shows that securities purchased by the ECB have literally exploded:**

- The ECB's balance sheet has grown from 1 trillion euros in 2006 to 8.2 trillion in 2022[5] (+720%).
- Cumulative purchases represented up to 70% of Eurozone GDP.

Chart 8 shows that, for the Fed, securities purchased and on its balance sheet rose from \$1 trillion in 2006 to \$8.9 trillion in mid-2022 (its peak): an increase of 910%.

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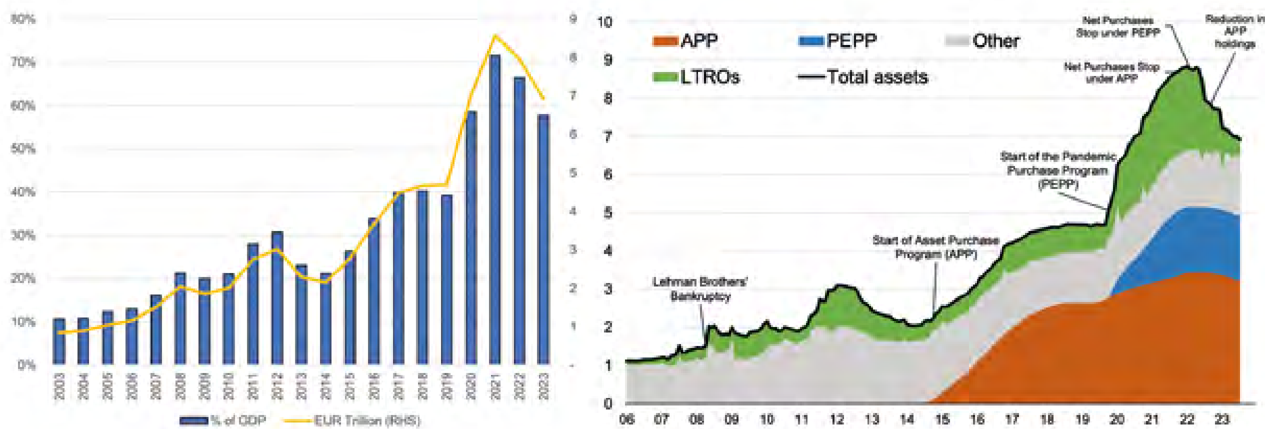
These are the facts: unbridled monetary stimulation that continued until 2022. What were the consequences?

I will summarize them as follows:

1. **The exponential growth of indebtedness has led to the vulnerability of the financial system**, increasing the probability of debtor defaults and, by the same token, fostering financial crises.
2. **"Short-termism" has invaded the financial system**
   Since long-term financing of productive investments was virtually non-remunerative, investors were driven to hold on to their cash or to make short, speculative investments.
3. Central banks' purchases of abysmal quantities of securities on the market contributed to an **unprecedented financial** bubble: stocks, bonds and real estate saw their value soar far beyond "fundamentals".

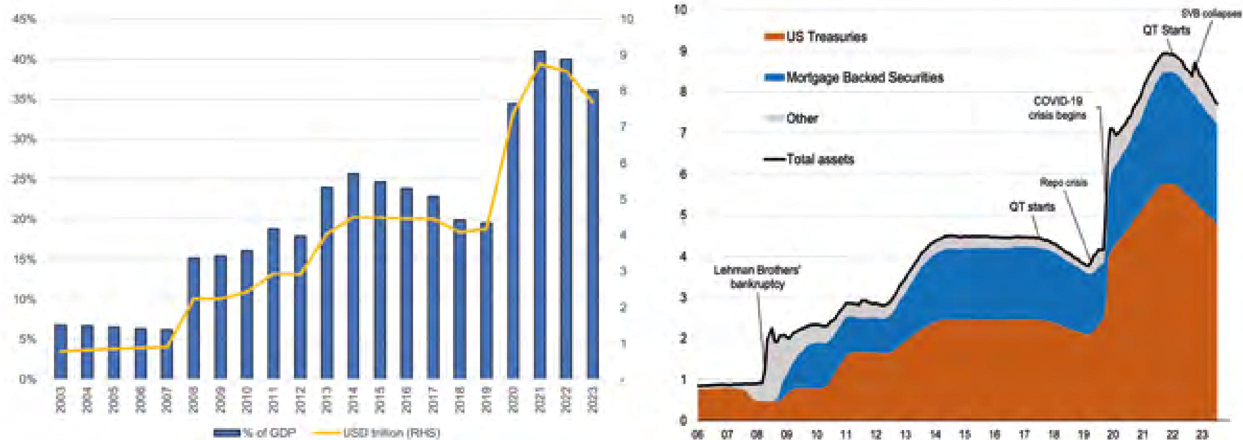
5. The increase in the balance sheet is also due to LTROs (long-term refinancing operations) (24% of the balance sheet in 2022). These facilities provided commercial banks with long-term loans at attractive rates.

**CHART 7.**
Eurosystem balance sheet soared (from 1 to 8 trillion euros)




*Source : ECB*
*Last observation from 31 December 2023*

**CHART 8.**
Similar development for the Federal Reserve




*Source : Federal Reserve*
*Last data from 31 December 2023*

But trees never grow taller than the sky, and sooner or later the markets turn around and the crisis begins.

4. Many companies benefited from very low interest rates, which enabled them to survive. But when rates rise with inflation, these "zombie" companies are threatened, as their subsidies disappear and the value of the securities they hold plummets. These companies account for an estimated 16% of all companies in advanced countries. This phenomenon would have contributed to reducing the productivity of the productive sector insofar as it had slowed the development of the most dynamic firms (*see Chart 9*).

5. **The extreme financialization** we have achieved (it should be noted that 75% of the rise in the global balance sheet over the last 20 years has been due to increases in speculative valuations, rather than increases in added value[6]) has privileged the 10% of the population most able to benefit from it.
   In a world where salaries are tending to stagnate, we can measure **the aggravation of social inequalities** resulting from such "two-speed finance" and its political consequences.

6. Finally, the fact that **interest rates have been very low** for a long time is **hardly an incentive for governments to undertake the necessary structural reforms**. It's so easy to borrow cheaply!

I would add that the policy of quantitative easing (QE) has led central banks to hold a very large share of public debt.

In total, as shown in Charts 10.a and 10.b, the Eurosystem held one-third of the Eurozone public debt in June 2023.

6. See my book: "Putting an end to the reign of financial illusion" Odile Jacob 2022.

**CHART 9.**
The share of zombie firms has risen from 4% to 16%
Share of zombie firms in listed Non-Financial Companies across advanced economies, %

*Sources: CGFS Working Group calculations, Datastream Worldscope*
*Notes: Across 14 advanced economies, zombie firms defined as firms with both an interest coverage ratio of less than 1 and a Tobin's q below the median firm in the sector over two years. To be declassified as a zombie firm, an ICR larger than one or a Tobin's q above the sector median over two years is required. Zombie share is the ratio of zombie firms to all firms*

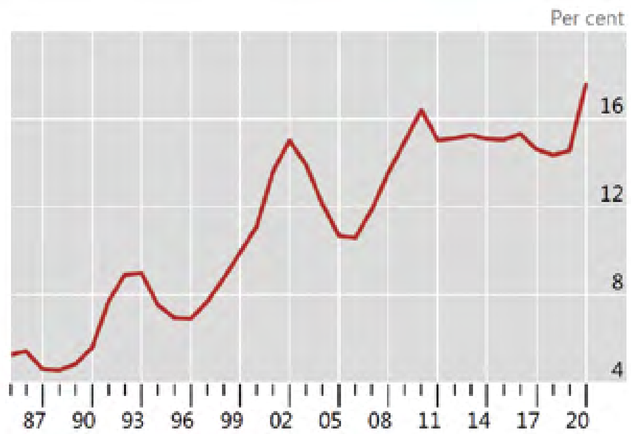
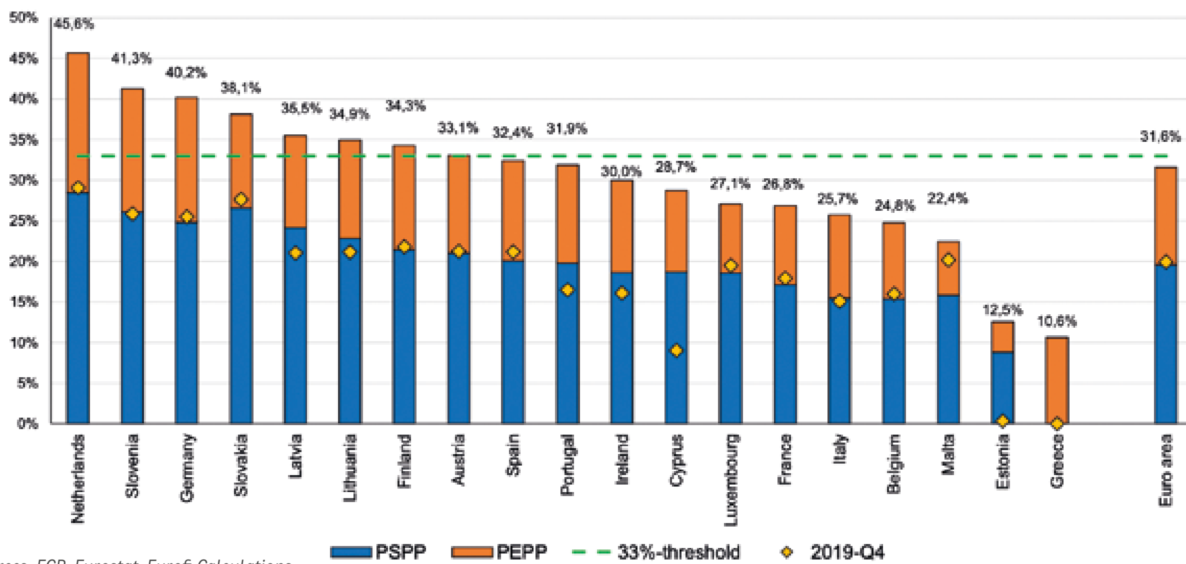
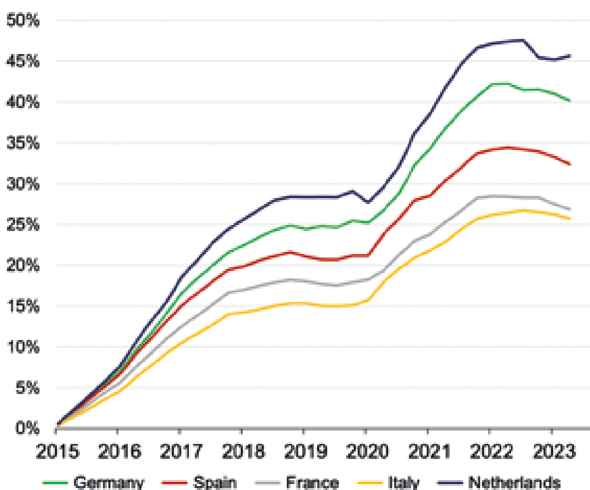



**CHART 10.a**
The Eurosystem holds a third of Euro area government debt
Share of Government Debt held by the Eurosystem as of June 2023, %




*Sources: ECB, Eurostat, Eurofi Calculations*

**CHART 10.b**
The Eurosystem holds a third of Euro area government debt
Share of public debt held by the Eurosystem




*Sources : ECB, Eurostat, Eurofi Calculations*
*Last observation from 2023-Q2*

## 2. Why and how did we get here?

There is no denying that monetary policy has had some positive results. The most undisputed is the reaction of central banks to financial crises. Their rapid intervention and firepower have twice prevented the collapse of the financial system.

But we must not forget that the crises (particularly that of 2008 and the euro in 2010) were largely provoked or encouraged by excessive indebtedness, which in turn was strongly reinforced by the actions of central banks.

Nevertheless, the asymmetrical nature of monetary policy, the fact that real key rates were held at zero for 20 years, the gigantic scale of quantitative easing, the lack of interest in the quantitative theory of money, the unprecedented level of indebtedness... are all deviations that are difficult to understand and justify.

**CHART 11.**
Long-term interest rates have been falling for one hundred and twenty years
Estimated natural interest rate (R*) for the United States and Eurozone, %

*Source : "Measuring the Natural rate of Interest after Covid-19", by Kathryn Holston, Thomas Laubach, and John C. Williams, Federal Reserve Bank of New York Staff Reports, no. 1063, June 2023*

In any case, central banks felt they had to act freely in an "unconventional" – but, in fact, extremely dangerous way. The fact remains that they had made a formal commitment to limit inflation to "just under 2%". This commitment was not kept. Inflation rose again in 2021 to over 10% after years of moderation. It still stands at 5%.

This fact needs to be explained if we are to learn from it. It must not be denied or treated lightly.

So let us try to understand the ancient origins of these trends.

Three facts seem important.

1. **The memory of the Great Depression of 1929** has left its mark on people's minds. In the eyes of Keynes and his followers, a deep economic crisis accompanied by an explosion in unemployment was incompatible with a tightening of monetary policy.
   In fact, the monetary policy followed in 1929 had only exacerbated the economic crisis. It was therefore necessary to completely rethink the data and our understanding of the problem. It was then that the New Deal, the stimulation of demand through budgetary spending and major public works were implemented by the Roosevelt Administration.
   The results were spectacular, and Keynesianism took hold in the monetary sphere too. Lowering interest rates to encourage investment became a recognized instrument of macroeconomic management.
   Since then, the fear of deflation (*i.e.* a fall in prices likely to lead to depression) has become a haunting feature of economic thinking (although at no time over the past 20 years have we slipped into deflation).
2. This belief in the virtues – and inevitability – of monetary stimulus **was reinforced by the theory of weakening secular growth** (Robert Gordon[7]). According to this theory, the world is engaged in a long-term process of very low economic growth for structural reasons. The fundamental reasons lie in the aging of the population and the correlative slowdown in technological innovation and productivity gains. As societies of older people consume and invest relatively little, while continuing to save, there is a "savings glut" in relation to the – declining – financing needs of the economy. This has two consequences:
   - The downward trend in "natural" interest rates resulting from these excess savings helps to explain the long-term downward trend in "real interest rates", which may well continue once inflation has dissipated.
   - Hence the need for monetary policy to adapt to this evolution.
   But we must also recognize that forecasting models for long-term interest rates are extremely uncertain. In particular, they depend on how major environmental investments are financed, and on future trends in public spending.
3. The third explanatory factor is linked to **the absence of a genuine international monetary system**.
   Since the collapse of the Bretton Woods system, relations between currencies – and exchange rate interventions – are random and no longer respond to a common macroeconomic discipline imposed and controlled by the system. As a result, players are primarily concerned with their exports, and adjust their exchange rates accordingly. Recourse to borrowing to "cure" their exchange rate has become normal. The resulting indebtedness goes a long way towards explaining the system's structural imbalances.

7. The Rise and Fall of American growth, *Princeton University Press* 2016.

## 3. How to get out of it?

### 3.1 The difficulty of getting out of a trap we have unconsciously created is often a sign of the inadequacy of the policy we are following

Clearly, today's traps are huge.

- By raising interest rates to combat inflation, central banks are making the right decision. But in doing so, they are causing a collapse in fixed-income assets with low yields. The debt crisis is then compounded by a market crisis. Californian banks were unable to withstand the shock: as customers watched the collapse of Silicon Valley Bank's balance sheet assets, they began to withdraw their deposits, and the bank, now bankrupt, was bailed out by the state, which guaranteed all deposits (thus recreating the "moral hazard" that had flourished in the wake of the 2008 crisis and is one of the evils of our time).

What had we learned?

- Raising interest rates in times of inflation is wise. But the governments that benefited from QE will now have to pay positive rates to service their debt.
- A "soft landing" for advanced economies is desirable, but not guaranteed. The risk of a hard landing has not been completely ruled out.

Will central banks allow rates to rise as much as necessary to beat inflation, or will they take account of the effects of rising spreads on highly indebted countries ("fiscal dominance")?

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Finally, the above analysis calls for an answer to the question "what to do?"

I'll outline the following points in this regard:

1. **It is vital to beat inflation**, the tax that hits the poorest.

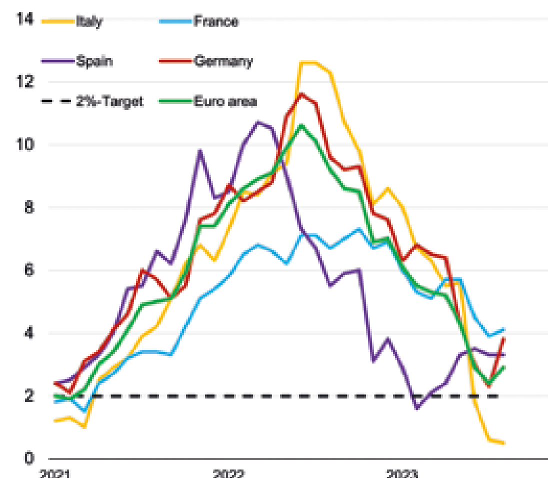
As early as spring 2021, before the invasion of Ukraine (which dates back to February 2022), inflation had re-emerged, as shown in graph 12.

Central banks began by denying the seriousness of the phenomenon:

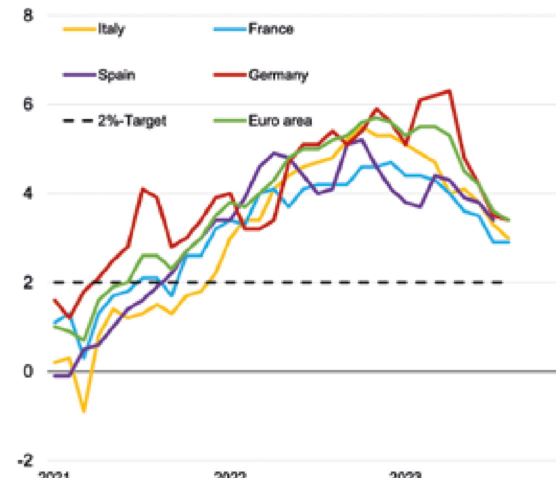
- It was due, we were told, exclusively to external factors (rising energy and food commodity prices, as well as the failure of international production chains).
- Inflation, for these reasons, was expected to be transitory, and would have disappeared by the end of 2022.
- Central bankers therefore saw no need to tighten monetary policy... which remained unchanged (ECB securities purchases continued despite rapidly rising inflation[8]).

**CHART 12.**
Core inflation remains an issue in the Eurozone

12.a : Headline inflation



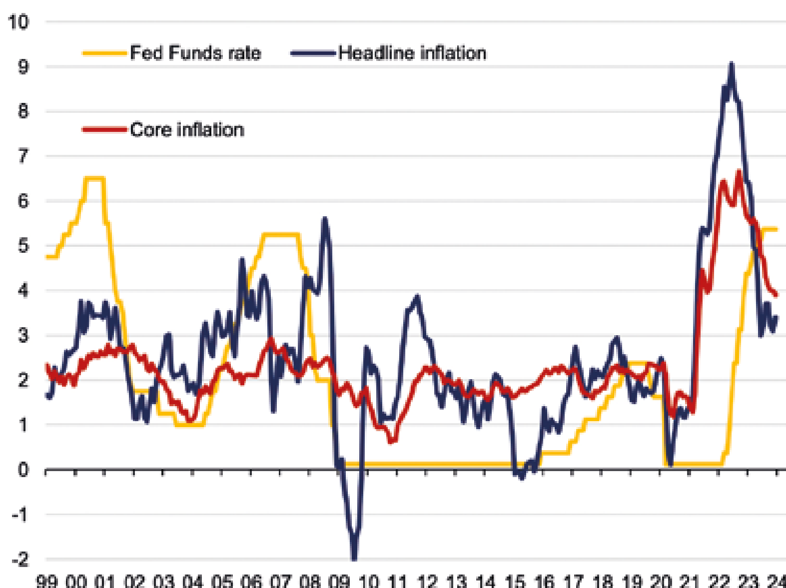

12.b : Core Inflation




*Source : Eurostat*
*Last data from December 2023, except for Spanish core inflation which dates from November 2023*

8. Instead of looking at the very sharp rise in inflation in monthly terms, central bankers took comfort in the fact that one-year statistics do not allow us to understand the very powerful dynamic recent rise in inflation in the first few months.

**CHART 13.**
US core inflation remains high
Fed funds rate versus headline inflation in the United States




*Source : Federal Reserve*
*Last observation from December 2023*

**TABLE 1.**
Evolution of real policy rates since 2019

| | | Nominal policy rate, % | YoY Headline inflation, % (i) | YoY Core inflation, % (ii) | Real policy rate (deflated by (i)), ppts | Real policy rate (deflated by (ii)), ppts |
|---|---|---|---|---|---|---|
| United States | déc-19 | 1,6 | 2,3 | 2,2 | -0,7 | -0,6 |
| | janv-21 | 0,1 | 1,4 | 1,4 | -1,3 | -1,3 |
| | janv-22 | 0,1 | 7,5 | 6,0 | -7,4 | -5,9 |
| | janv-23 | 4,4 | 6,4 | 5,6 | -2,0 | -1,2 |
| | déc-23 | 5,4 | 3,4 | 3,9 | 2,0 | 1,5 |
| Euro area | déc-19 | 0,0 | 1,3 | 1,3 | -1,3 | -1,3 |
| | janv-21 | 0,0 | 0,9 | 1,4 | -0,9 | -1,4 |
| | janv-22 | 0,0 | 5,1 | 2,3 | -5,1 | -2,3 |
| | janv-23 | 2,5 | 8,6 | 5,3 | -6,1 | -2,8 |
| | déc-23 | 4,5 | 2,9 | 3,4 | 1,6 | 1,1 |

*Sources : BIS, Eurostat, OECD*
*YoY = year-on-year ; ppts = percentage points*

- In a system where the central model is based on inflation **expectations** (by definition uncertain) "anchored at 2%" over the long term, and not on the factual evolution of statistical data, there is a strong likelihood of not anticipating a resurgence in inflation. Inflation needs to be monitored as closely as possible, and not in terms of reassuringly uncertain expectations.

The following table gives an idea of how low key rates are in real terms.

Real policy interest rates were below 0 in the Eurozone until August 2023. In truth, the implicit message from central banks was still: "you can borrow at rates close to zero"[9].

In December 2023, real policy rates in the Euro area stood at 1,6%. This recent return to positive territory follows several years of negative real interest rate policy.

What have we learned?

2. **What can we make of the reduction in central bank balance sheets?**

They have begun to deflate, albeit very moderately

- Fed: balance sheet reduction has begun: but half of this reduction has been offset by the bailout of US banks which had not protected themselves against the risk of rising interest rates.
- As for the ECB, it is very timidly embarking on QT (quantitative tightening).

How far should we go, and at what pace, in deflating central bank balance sheets? This is not the place to discuss the issue in detail, but the importance of the problem should not be underestimated. The legacy of monetary stimulus continues to be present, and reflects the stock of assets held by central banks.

9. The weakness of spreads (sovereign & corporate), virtually unchanged since the start of the rate hike, shows that monetary policy may not be perceived as restrictive enough.

These amounts (in money stocks) are still gigantic and contribute to market liquidity.

Specialists believe that this problem must be tackled, and scenarios are currently being developed by the ECB.

But will central banks dare, despite their independence, to tackle the problem vigorously and face up to the risk of rising rates?

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By way of conclusion, I would like to make the following points:

1 Monetary policy should not be – as it has been for over 15 years – "the only game in town".

Yet there is too much of a tendency to systematically turn to monetary policy to deal with structural problems, and in particular the drifting budget deficits. These problems can only be solved by structural action, since the aim is to increase productive supply, not demand.

2 Monetary policy, in its quest for permanent stimulation, has too often sought to be "popular":

a. By creating money,

b. By keeping interest rates at zero,

c. By multiplying targets (green, social, crypto currencies...) when the role of the central bank should be to concentrate on one essential objective, that of currency stability.

3 **The way in which the 2% inflation target has been used has been highly questionable.** An inflation target should be conceived as a ceiling: "no more than 2% inflation per year".

But it was used as a target. How many times have I heard officials justify monetary stimulus at times when a more measured policy would obviously have been in order, by saying: "We haven't reached the 2%. We need to wait until this figure is respected before thinking about tightening".

But there is no point in getting carried away with money creation in order to reach the arbitrary figure of 2%. At the time, structural factors were keeping equilibrium inflation at around 1%, which was satisfactory; there was no reason to intensify money creation in order to push inflation up to the sacrosanct figure of 2%.

4 **All in all, monetary policy was guided by a doctrinaire view.** The aim was to force interest rates to 0, whereas it was essential to let the capital market find its equilibrium rates.

But meddling in the administrative setting of medium – and long-term interest rates means that central banks are entering the political arena of resource allocation. Creating price distortions in the market in order to "do the right thing" and "redistribute better" is the domain of politics, not the role of a central bank[10].

With QE, monetary policy has sunk into the depths of the budgetary problem. It is a dangerous position for a central bank – such as the ECB – to hold 33% of the public debt of the countries under its jurisdiction. The risk of "fiscal dominance" is there.

Finally, a dose of humility seems in order.

By taking care of everything, we end up believing that this is reasonable.

But an institution that respects itself and its public must :

a. Accept that it doesn't know everything and doesn't do everything systematically,

b. Be cautious about the temptation of "unconventional" imagination,

c. We must not confuse good governance (we have never seen so many learned and ineffective reports on monetary stability and guidance on interest rate policy) with good policy (which, although essential, has largely failed).

In short, we need to get monetary policy back on its feet, based on facts and experience, and defined with a degree of independence that is desirable but should never be a pretext for persevering in error.

In a world governed today by the financial cycle, it's time for central banks to take care of the stability of financial systems, avoid creating speculative bubbles, moderate indebtedness and stop focusing exclusively and at all costs on the objective of inflation, to the detriment of financial stability[11].

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Finally, a word on the political aspect of the question.

With the emergence of inflation and the social dangers it entails, Hayek said in a lecture in 1975: "We must find a way to protect money from politics[12]".

10. "For a reason that has to do with the unrivalled strength of personal motivations, the market economy, based on the engine of competition, is more efficient than systems where, instead of setting the rules of the game, public authority claims to guide the player's hand. But the excessive inequality of income that the system generates, the existence of externalities and non-market values that are ignored by market mechanisms, the preservation of long-term interests that are difficult for players to calculate – all these are problems. And, assuming that these problems can be adequately controlled, competition must be allowed to work. (Marcel Boiteux, "Concurrence et service public", Sciences de la Société 42/1997, p.9-10).

11. See the remarkable article by William White, former advisor to the BIS : "Why the Monetary Policy framework in advanced countries needs fundamental reform" Institute for New Economics Thinking) August 2023.

12. Quoted in "The Currency of Politics" by Stefan Eich.

In its time, the gold standard had succeeded. Money was "depoliticized" by the introduction of an international discipline (convertibility into gold) which, in principle, eluded politicians.

The gold standard had led to adjustments and sacrifices that would otherwise have been dictated by political choices (or non-choices).

But Hayek was not listened to.

In the wake of the failure to deal with inflation in the 1970s, we came to advocate the statutory independence of central banks as a means of immunizing "monetary stability" from political temptations. But there are several reasons why the results of central bank independence have been disappointing.

Firstly, the "financialization" of the system, which led to the market becoming king, and the extraordinary freedom to borrow over the past 40 years, have weakened the international monetary discipline that should have been sought. This evolution (the multiplication of "false rights" according to Jacques Rueff) has led to a weakening of the system and the appearance of unprecedented financial bubbles, themselves harbingers of inflation.

Secondly, the way in which "inflation targeting" was applied, which consisted in raising the level of inflation through money creation on the pretext that a higher arbitrary figure had not been reached, when bubbles and the danger of inflation were just around the corner, was a manifest error.

When the ECB buys financial securities, it is, by definition, running a risk, which is that of the intrinsic value and duration (interest-rate risk) of these securities.

If the Central Bank has miscalculated its risk (by underestimating inflation or forcing rates to 0 while financial bubbles are inflating), it is preparing for a crisis.

In the ascending phase of QE, governments were happy with the fall in rates and the rise in Treasury securities. But as soon as inflation reappeared and rates had to be raised, governments began to worry: borrowing would cost them more, and they would have to make up the central banks' deficits (through recapitalization) and suffer the consequences of rising interest rates.

In reality, the concept of central bank independence had been largely emptied of its substance: the watchword was to create ever more money through purchases of public debt securities, without paying any attention to the resulting growing fiscal and financial dependence, which ended up devouring the very notion of financial stability.