

François Villeroy de Galhau: Five lessons learned for monetary policy from the latest years

Remarks by Mr François Villeroy de Galhau, Governor of the Bank of France, at the Paris School of Economics, in discussion with Olivier Blanchard, Paris, 28 June 2023.

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Looking at the last three years, which were rich in unexpected events, I would risk two general lessons, and three more technical ones:

1. The first is that we must remain modest, humble: monetary policy is not omnipotent; it cannot be the only game in town. And we must be nimble, able to react to surprises with agility.
2. That said, monetary policy was efficient in preventing deflation during Covid-while not creating the present inflation.
3. On a more technical note: we certainly should work with **less forward guidance**. I wouldn't throw it away completely but if we use it again in the future, forward guidance should be (i) state dependent and not calendar based except in the very short term (ii) indicative and not committing.
4. We should keep our **inflation target** of 2%. It served us well, explaining in part why inflation expectations remain rather well anchored; we shouldn't change it, while keeping in mind that the target is for the medium term.
5. **Transmission lags** are a key question, and we should dig more into this issue. In my view, transmission of monetary policy in this cycle is not weaker but **slower**, for three reasons:
 - The starting point: the balance sheet of corporates as well as of households was very strong after the exceptional Covid support;
 - Fixed rate mortgages have significantly increased in share, and are now predominant in many jurisdictions. It's nevertheless good news for financial stability;
 - The higher proportion of services in the economy, which are less directly sensitive to interest rates. Non-housing services now represent 49% of Core HICP basket in the euro area, compared with 41% in 2001.

In a [recent speech](#),¹ I suggested that the lag could be up to two years. Hence, "length" is still more important than "level", to quote the two dimensions mentioned by Christine Lagarde recently².

We stated in our last Monetary policy statement that "the key ECB interest rates will be brought to levels sufficiently restrictive to achieve a timely return of inflation to our 2% medium term target and will be kept at those levels as long as necessary". I think we are close to the former (levels), and should be now sufficiently patient on the latter (duration). In other words, as transmission is of the essence, so is the persistence of our monetary policy.

¹ Villeroy de Galhau, F., [*Monetary policy transmission: where do we stand?*](#), speech, 22 May 2023

² Lagarde, C., [*Breaking the persistence of inflation*](#), speech, 27 June 2023