



MONETARY AND FISCAL POLICY IN THE EURO AREA SYNERGIES AND CHALLENGES

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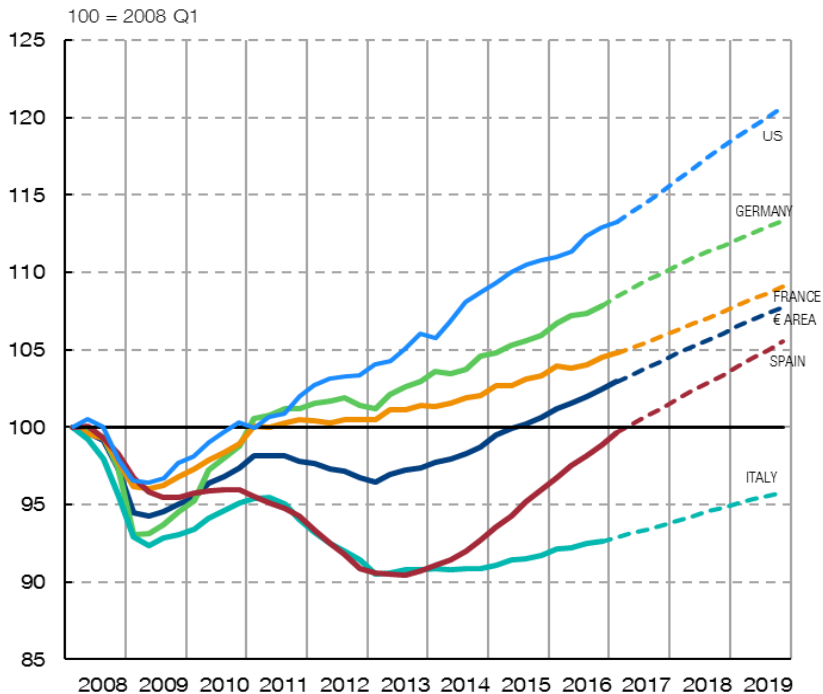
Bolivia, 8-9 June 2017

ECONOMIC SITUATION IN THE EURO AREA

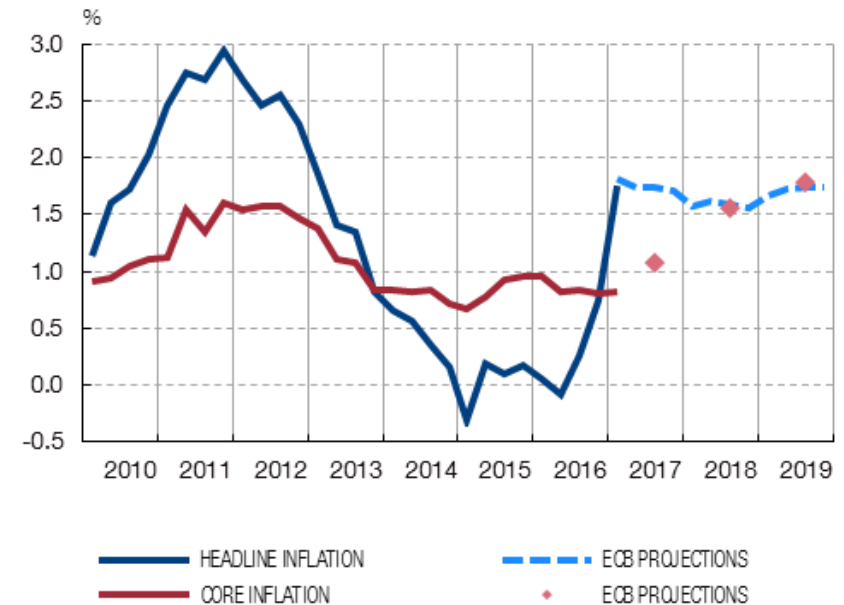


- The economic recovery in the Euro Area is firming and broadening across sectors and countries. But the Euro Area remains confronted with a scenario of very slow convergence of inflation towards the medium term objective (2%) and significant uncertainty (geopolitical tensions, Brexit, elections).
- This macroeconomic outlook remains largely dependent on the ECB's monetary stimulus.
- In this context, there has emerged a debate about the role fiscal policy should play in supporting the economic recovery

**EURO AREA GDP
SINCE 2008**



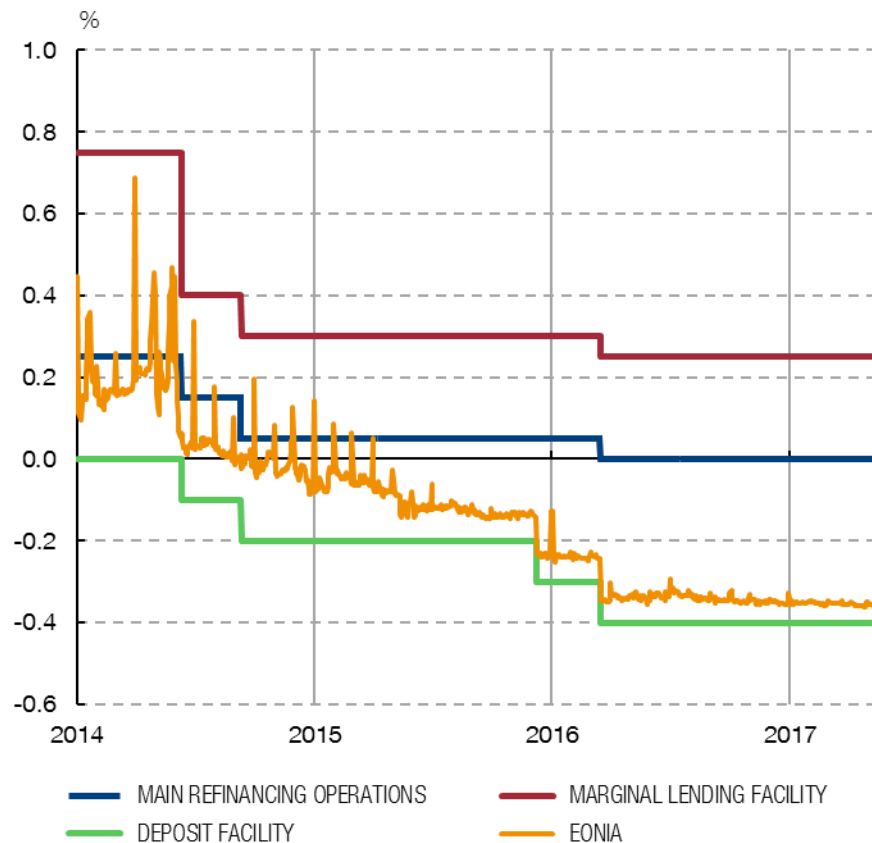
INFLATION



STRONGLY EXPANSIONARY MONETARY POLICY OF THE ECB TO SAFEGUARD THE PRIMARY OBJECTIVE OF PRICE STABILITY (I)



EONIA AND ECB INTEREST RATES



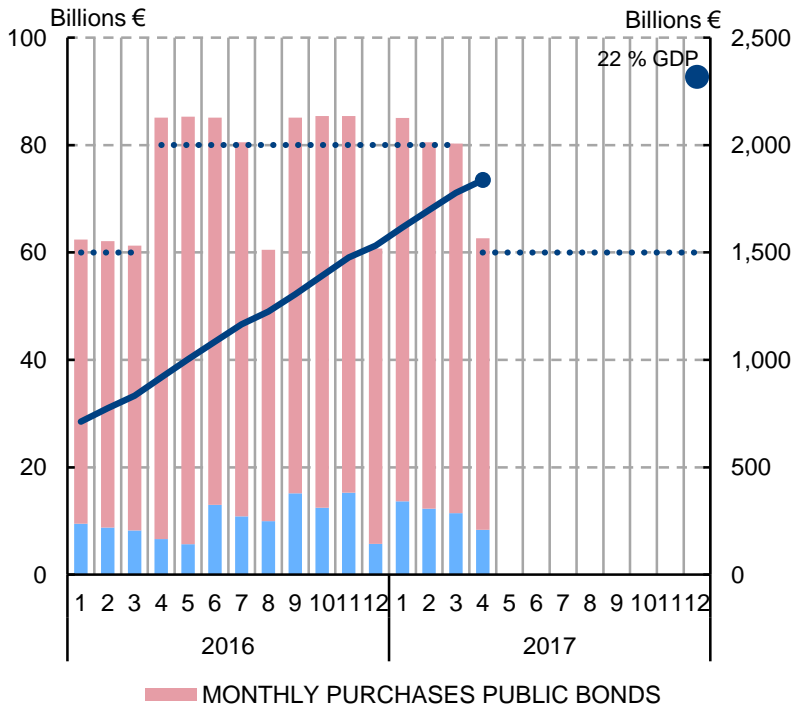
- Reduction of official rates
 - Marginal lending facility 0.25%
 - Main refinancing operations 0%
 - Deposit facility -0.40%
- Ample provision of liquidity
 - Fixed rate full allotment
 - LTROs-TLTRO and TLTRO II
- Forward guidance
- Asset Purchase Programmes (CBPP, ABSPP, PSPP y CSPP)



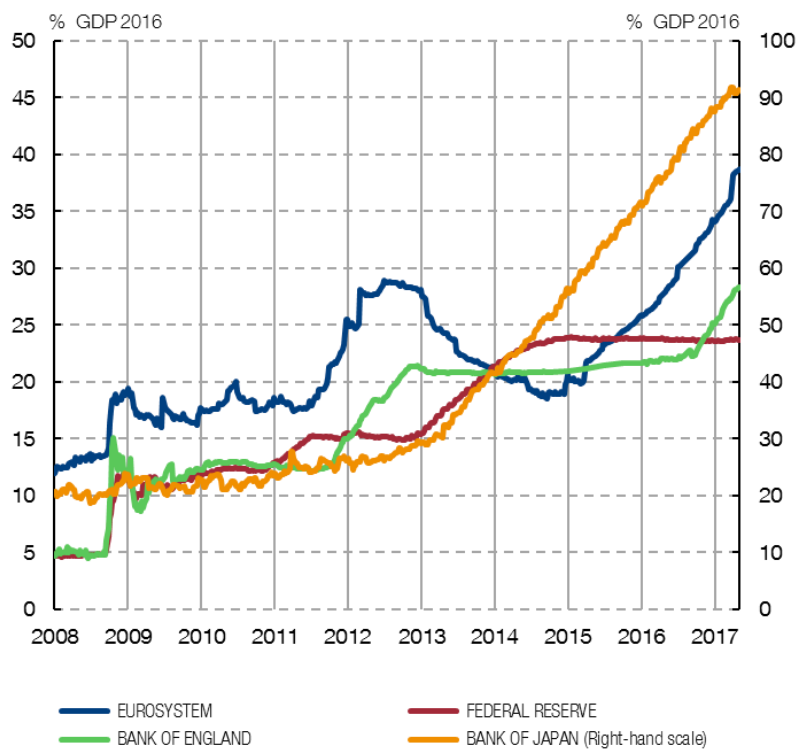
STRONGLY EXPANSIONARY MONETARY POLICY OF THE ECB TO SAFEGUARD THE PRIMARY OBJECTIVE OF PRICE STABILITY (II)

- Monthly asset purchases of € 60 billion are intended to run until the end of December 2017, or beyond, if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with its inflation aim.

ASSET PURCHASE PROGRAMME (APP)
Monthly net purchases and cumulative purchases



CENTRAL BANKS' BALANCE SHEET



MONETARY POLICY TRANSMISSION TO FINANCIAL MARKETS AND THE REAL ECONOMY (I)

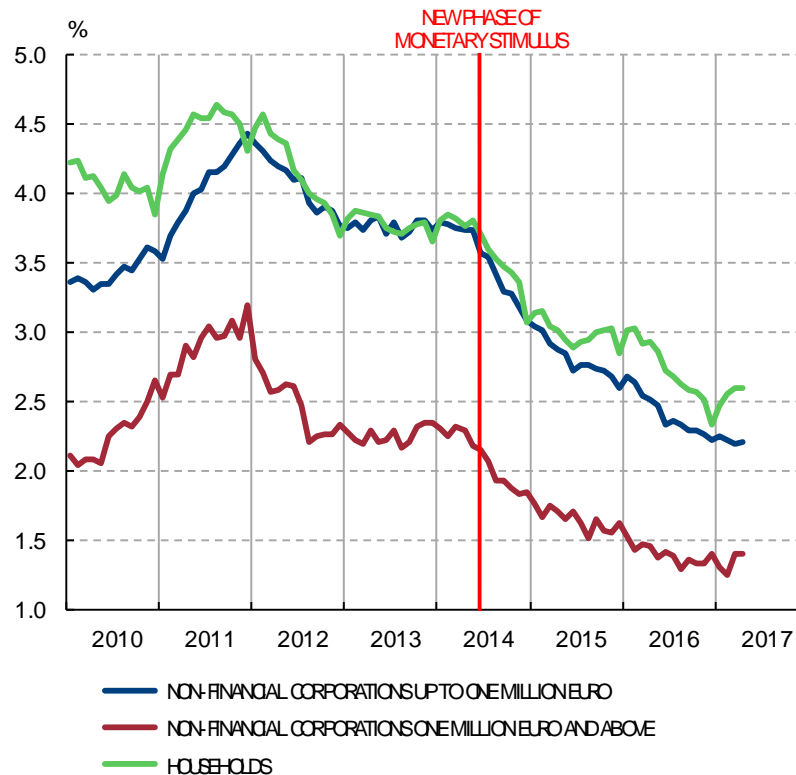


EURO AREA FINANCIAL CONDITIONS

TEN-YEAR INTEREST RATES



INTEREST RATES ON BANK LOANS



MONETARY POLICY TRANSMISSION TO FINANCIAL MARKETS AND THE REAL ECONOMY (II)

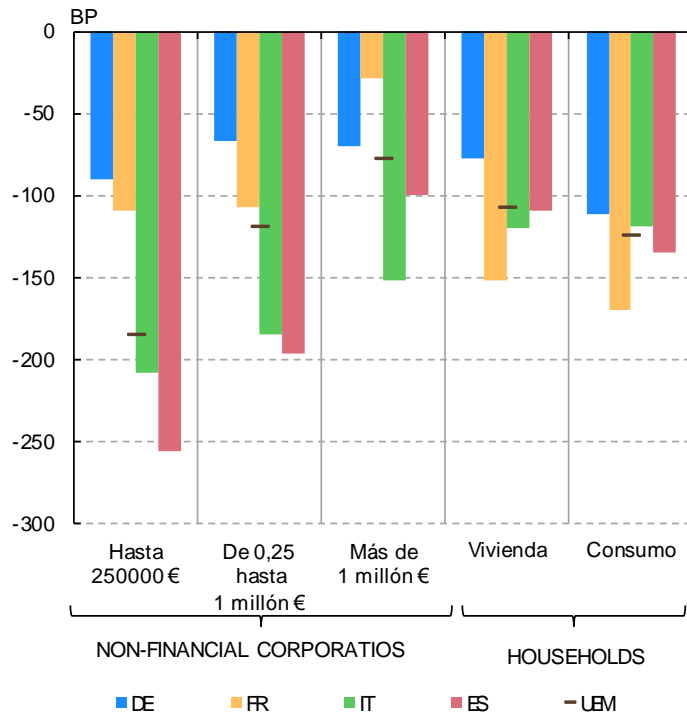


➤ A significant part of the easing in financial conditions can be attributed to ECB measures

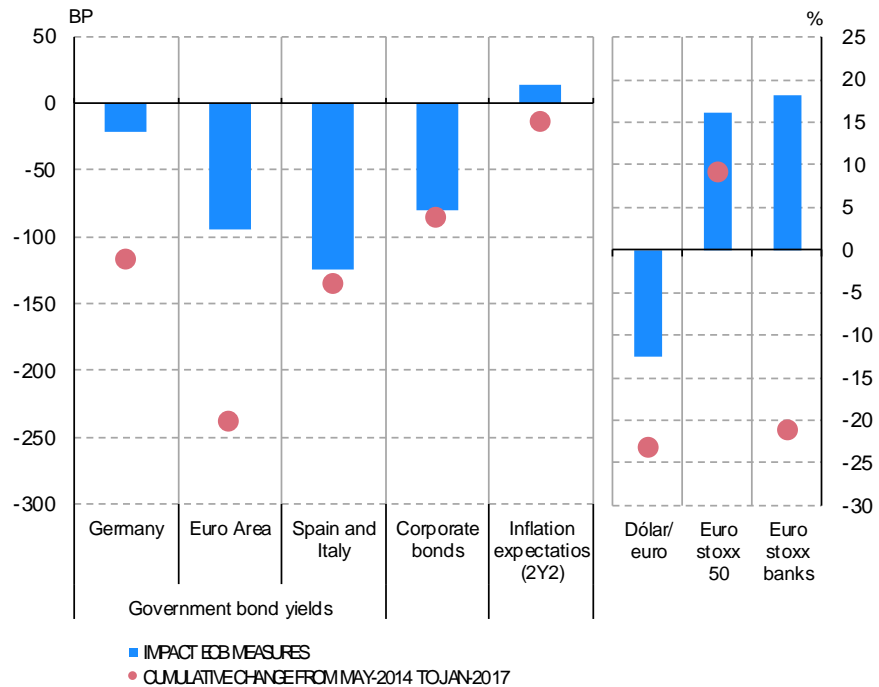
Event study (Bank of Spain, Annual Report 2015, chapter 3.

- Assumption: asset prices react fast to the announcement of measures. Two day window around ECB decisions since May 2014. Total 36 events including ECB Governing Councils, publication of accounts and public interventions to capture anticipatory behavior of markets

INTEREST RATES ON BANK LOANS
CHANGE MAY-2014/APRIL-2017



CHANGE IN SELECTED FINANCIAL VARIABLES SINCE MAY 2014
AND CONTRIBUTION OF MONETARY POLICY DECISIONS



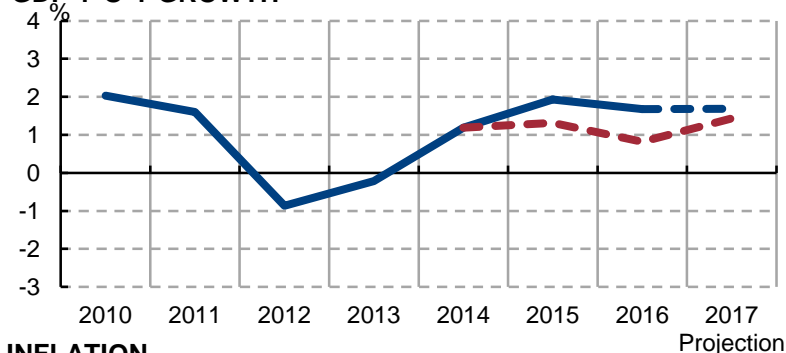
MONETARY POLICY TRANSMISSION TO FINANCIAL MARKETS AND THE REAL ECONOMY (III)



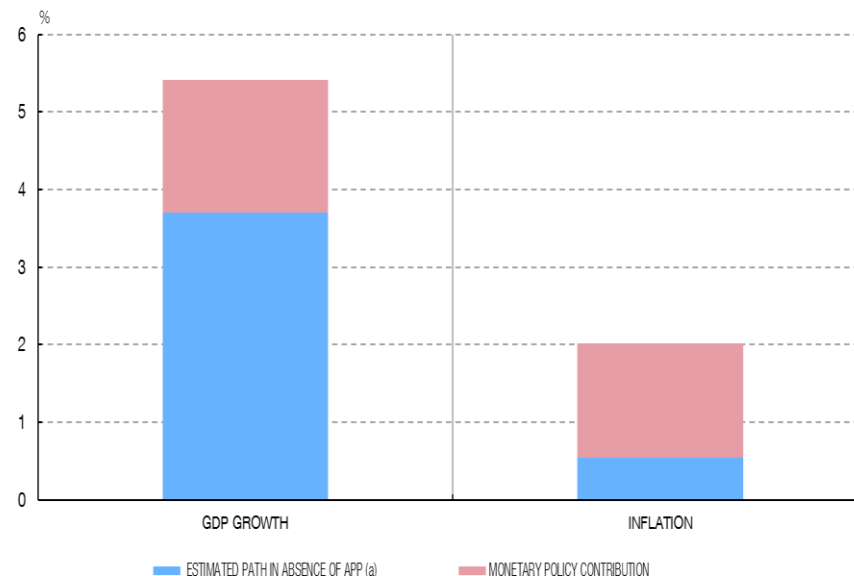
- Counterfactual analysis by Banco de España suggests that the ECB balance sheet expansion has had a positive impact on euro area GDP and inflation (Accumulated effect in 2015-17: 1.7 pp for GDP growth, 1.5 pp for inflation)

IMPACT OF THE ASSET PURCHASE PROGRAMME (APP) ON EURO AREA GDP AND INFLATION (a)

GDP Y-O-Y GROWTH

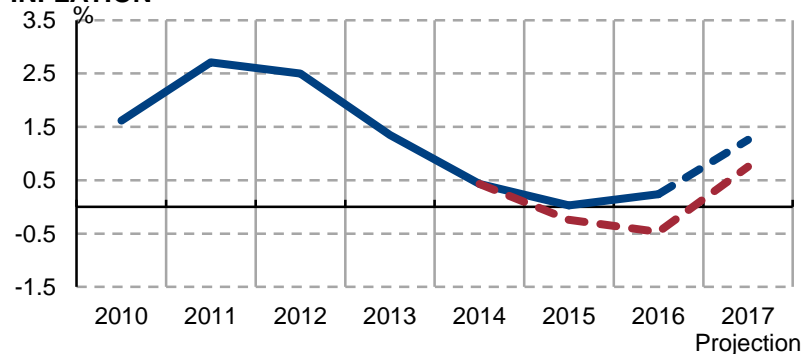


CONTRIBUTION MONETARY POLICY TO GROWTH AND INFLATION 2015-2017 (ECB March projection)



a. Estimation based on Burriel and Galesi (2016), Working paper 1631, Banco de España.

INFLATION



ACTUAL AND DECEMBER 2016 ECB PROJECTION

--- ESTIMATED PATH IN ABSENCE OF APP

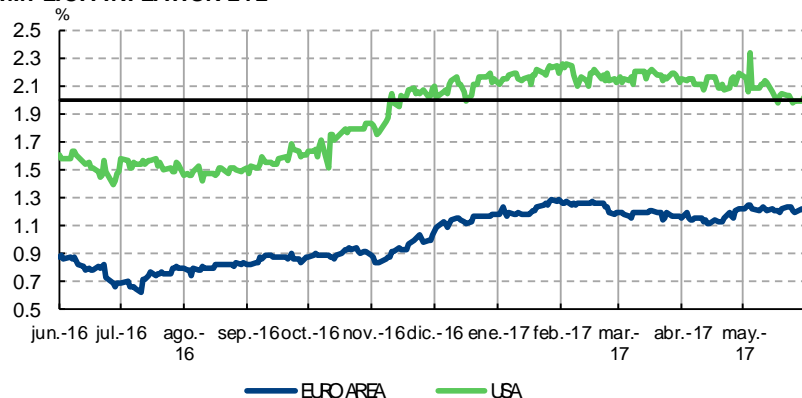
a. Estimation based on Burriel and Galesi's (2016) Global VAR model

MONETARY POLICY TRANSMISSION TO FINANCIAL MARKETS AND THE REAL ECONOMY (IV)

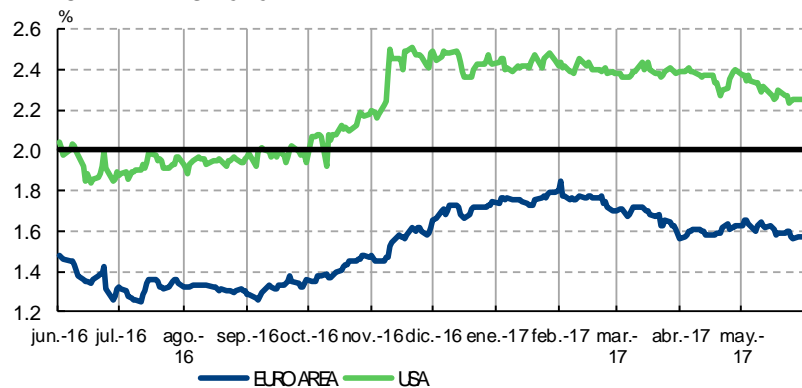


- Despite the recent energy-driven pick up in inflation, indicators of inflation expectations remain relatively subdued, predicting slow convergence to the 2% reference.

IMPLICIT INFLATION 2Y2



IMPLICIT INFLATION 5Y5



IMPLICIT INFLATION EXPECTATIONS. INFLATION SWAPS



MONETARY POLICY FACES LIMITS

IS THERE ANY ROLE FOR FISCAL POLICY?



- After a prolonged period of exceptional monetary policy accommodation, economic recovery in the euro area is firming and broadening across countries
- Yet, the case for **maintaining** the current monetary stimulus is compelling:
 - *The macroeconomic outlook is largely **dependent** on the current monetary stimulus*
 - *Underlying inflation remains subdued, and convergence of headline inflation towards the 2% reference is projected to be slow...*

Is there any role for fiscal policy?

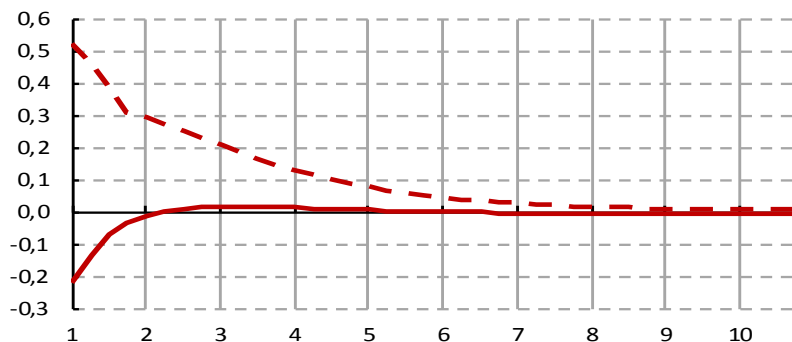
SYNERGIES BETWEEN MONETARY AND FISCAL POLICIES



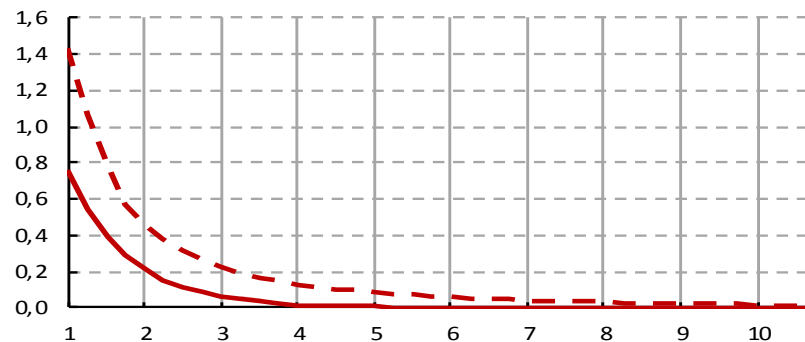
In the current circumstances, there may be positive synergies between monetary policy and fiscal policies: an expansionary fiscal policy carried out by countries with fiscal space may have a greater impact on the EMU as a whole, in a context of low growth and inflation if the central bank preserves the degree of monetary accommodation. Positive spillover effects between countries are reinforced

* MARGINAL IMPACT OF A FISCAL EXPANSION

PERIPHERY COUNTRIES



CORE COUNTRIES



— Normal times
- - - Monetary policy at the Zero Lower Bound

Sources: Banco de España.

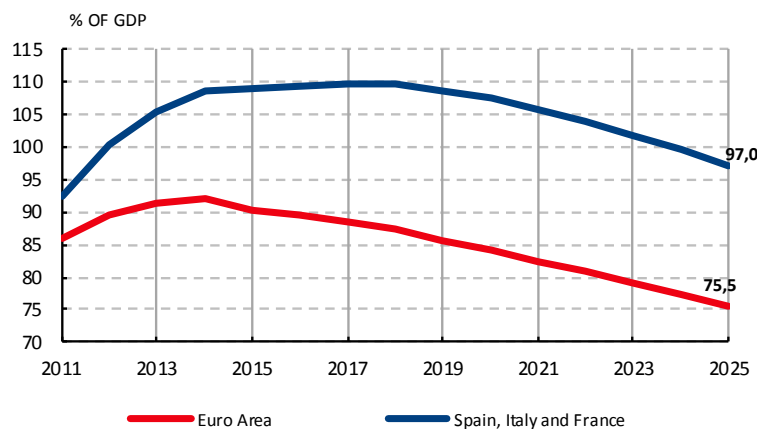
a. Deviations with respect to the baseline. Arce, O., S. Hurtado y C. Thomas (2016), "Sinergias entre política monetaria y políticas nacionales en la Unión Monetaria", Boletín Económico del Banco de España, diciembre.

LIMITED SPACE ACROSS COUNTRIES

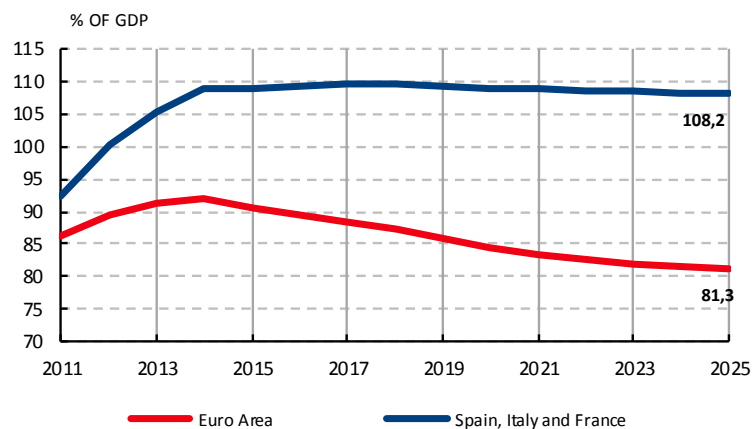


SCENARIOS OF PUBLIC DEBT IN THE EURO AREA

BASELINE



NO CHANGE IN FISCAL POLICY



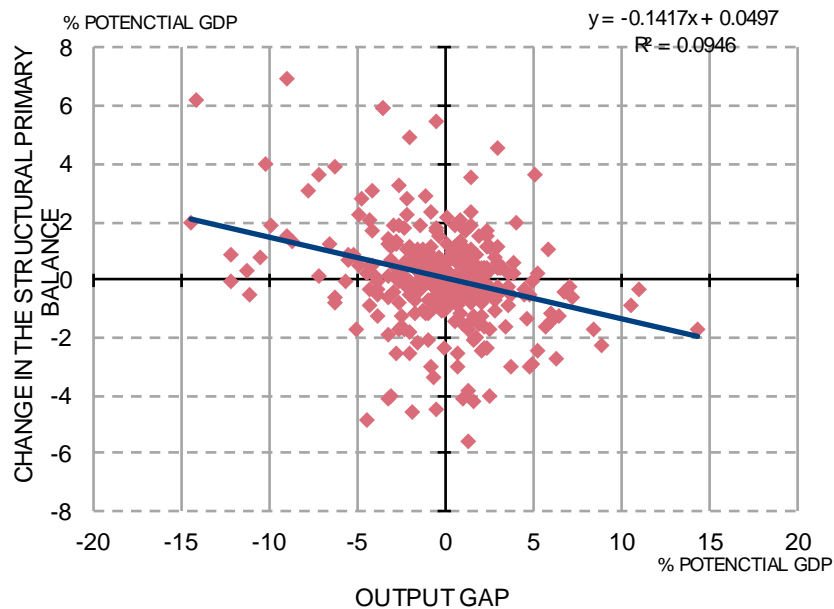
Source: P. Hernández de Cos, D. López y J. J. Pérez (2017), "Los retos del desapalancamiento público", Documento Ocasional del Banco de España, y en O. Bouabdallat C. Checherita (2017) "The DSA Tool", Documento Ocasional del BCE.

IMPROVING FISCAL GOVERNANCE

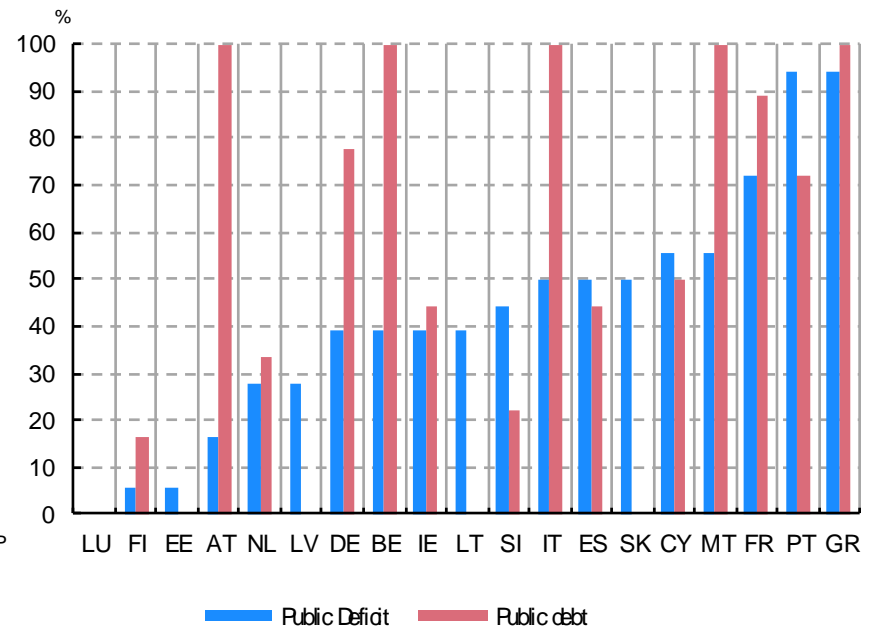


- The SGP was implemented too loosely to ensure the appropriate design of public finances over the cycle.
- It is crucial to improve fiscal governance to contribute to the design of countercyclical fiscal policies (Five Presidents' Report): (1) Improving the transparency and reducing the complexity of the current fiscal rules; (2) Strengthening fiscal institutions

STRUCTURAL BALANCE AND OUTPUT GAP IN THE EURO AREA COUNTRIES



COMPLIANCE WITH THE DEFICIT AND THE DEBT CRITERION (a)



a. % of years between 1999 and 2016 with public deficit higher than 3% of GDP and public debt higher than 60% of GDP.

A FISCAL UNION FOR THE EURO AREA? A CYCLICAL INSURANCE SCHEME



- It is possible to design a relatively simple scheme that would act as an automatic stabilizer, with symmetric effects across the cycle, no discretionary policy decision and no permanent transfers.
- A relatively low contribution would be sufficient to achieve a level of overall income stabilization comparable to the one observed in other existing federations
- Difficulties to estimate the cyclical position in real time

A COMMON CYCLICAL INSURANCE FUND (based on the output gap) (a)
CONTRIBUTIONS AND PAYMENTS (average 1999-2015. % of GNP)

	SCHEME 1		SCHEME 2		SCHEME 3	
	Contribution	Payment	Contribution	Payment	Contribution	Payment
Euro Area	1.0	1.0	0.2	0.2	0.2	0.2
Belgium	1.0	0.3	0.2	0.0	0.2	0.0
Germany	1.0	0.7	0.1	0.2	0.1	0.2
Estonia	0.9	1.3	0.8	0.3	0.8	0.3
Ireland	0.9	1.0	0.4	0.3	0.3	0.2
Greece	1.0	2.5	0.3	0.6	0.3	0.5
Spain	1.0	2.1	0.4	0.5	0.3	0.4
France	1.0	0.5	0.4	0.0	0.3	0.1
Italy	1.0	1.1	0.1	0.3	0.2	0.2
Chipre	1.0	0.9	0.3	0.2	0.4	0.1
Latvia	0.9	2.1	0.5	0.5	0.5	0.5
Lithuania	0.9	2.3	0.5	0.5	0.4	0.6
Luxemburg	1.0	1.6	0.3	0.4	0.3	0.3
Malta	0.9	0.5	0.2	0.1	0.1	0.1
Netherlands	1.0	1.2	0.2	0.2	0.1	0.3
Austria	1.0	0.5	0.2	0.1	0.1	0.1
Portugal	1.0	1.3	0.2	0.3	0.2	0.2
Finland	1.0	0.9	0.3	0.2	0.2	0.2
Stabilization capacity	37%		15%		18%	

a. Scheme 1 follows Furceri and Zdzienicka (2013). Scheme 2: contributions and transfers are estimated to reduce 25% of the output gap of each country. Scheme 3: contributions and transfers are estimated to reduce 25% of the relative output gap of each country (with respect to the EA average) .

A COMMON UNEMPLOYMENT INSURANCE SCHEME FOR THE EA



A common unemployment insurance system has been widely debated in the literature. One major challenge of this type of schemes is avoiding potential persistent transfers against a background of significant heterogeneity in labor market institutions. They should include mechanisms to reduce the risk of permanent transfers (experience rating, claw-back clauses)

	UNEMPLOYMENT INSURANCE SCHEMES			
	SCHEME 1		SCHEME 2	
	Contributions	Transfers	Contributions	Transfers
Euro Area	0,2	0,2	0,2	0,2
Belgium	0,1	0,0	0,2	0,0
Germany	0,0	0,2	0,1	0,2
Ireland	0,4	0,3	0,3	0,2
Greece	0,4	0,6	0,3	0,5
Spain	0,4	0,4	0,3	0,4
France	0,3	0,0	0,3	0,1
Italy	0,1	0,2	0,2	0,2
Netherlands	0,1	0,2	0,1	0,3
Austria	0,1	0,0	0,1	0,1
Portugal	0,2	0,3	0,2	0,2
Finland	0,3	0,2	0,2	0,2
Stabilization capacity	0,02		0,03	

a. Transfers are calculated taking into account the short term unemployment level and the average wage of the economy (replacement rate = 0.5). Scheme 1: contributions are the same for each country, but varies across time to ensure the financial equilibrium of the scheme. Scheme 2: contributions vary across countries an across time to ensure non permanent transfers and the financial equilibrium of the system.

CONCLUSIONS

- Although economic recovery is firming and broadening, ensuring the return of inflation to figures close to the 2% reference remains a significant challenge for monetary policy
- As shown in research by the BdE staff (Arce, Hurtado & Thomas), in the current macroeconomic context, positive synergies may exist among monetary and fiscal policies in the euro area
- But fiscal space is, in general, limited.
 - *it would be appropriate to strengthen monitoring and control tools to generate fiscal space in times of expansion, in order to increase the stabilizing role of fiscal policy in EMU.*
 - *The difficult macroeconomic context points to the desirability of designing supranational instruments to deal with adverse shocks.*



THANK YOU FOR YOUR ATTENTION

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