

EMU: Challenges for monetary policy and its framework

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Outline

- Economic situation of the euro area
- Monetary policy in the euro area
- Framework of the monetary union
- Bundesbank view on strengths and challenges

Economic situation

Some stylised facts about the euro area (2017 figures)

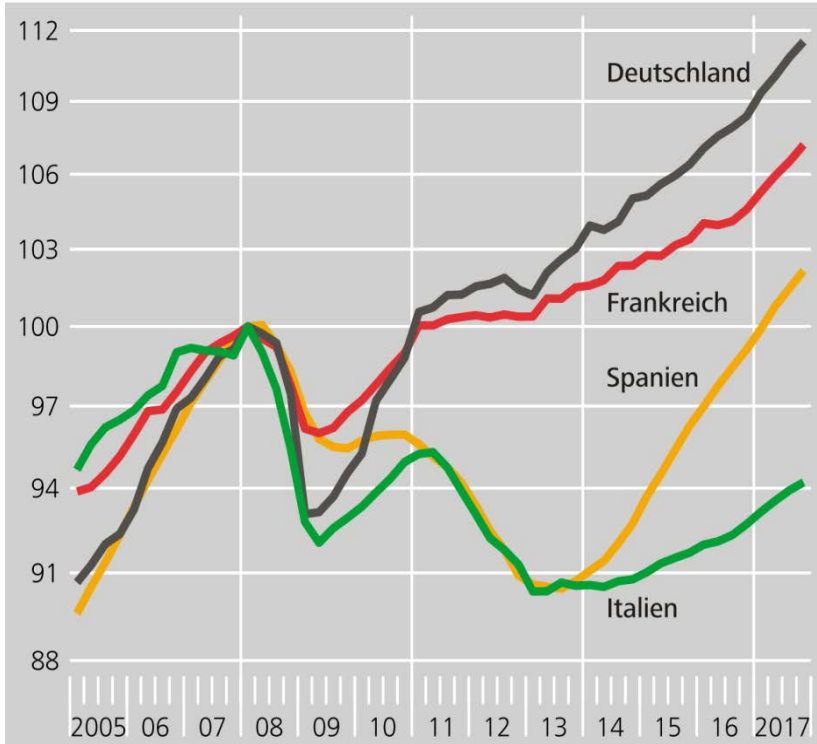
- Comprised of 19 member states
- Population of 340 million people
- GDP: 11,2 trillion €, grew at 2,5 %
- Sovereign debt: 89 % of GDP, deficit 1,1 % of GDP
- Unemployment rate: 9 %
- Outlook (according to most recent ECB forecast): continuing, broad recovery, still subdued increase in inflation should gradually pick up
- Sizeable heterogeneity in terms of economic development, economic structures, business cycle etc.

Economic situation

Heterogeneity: GDP paths after the crisis

Wirtschaftsaktivität in den vier großen Ländern des Euroraums

Reales BIP, 1. Vj. 2008 = 100, saisonbereinigt, log. Maßstab



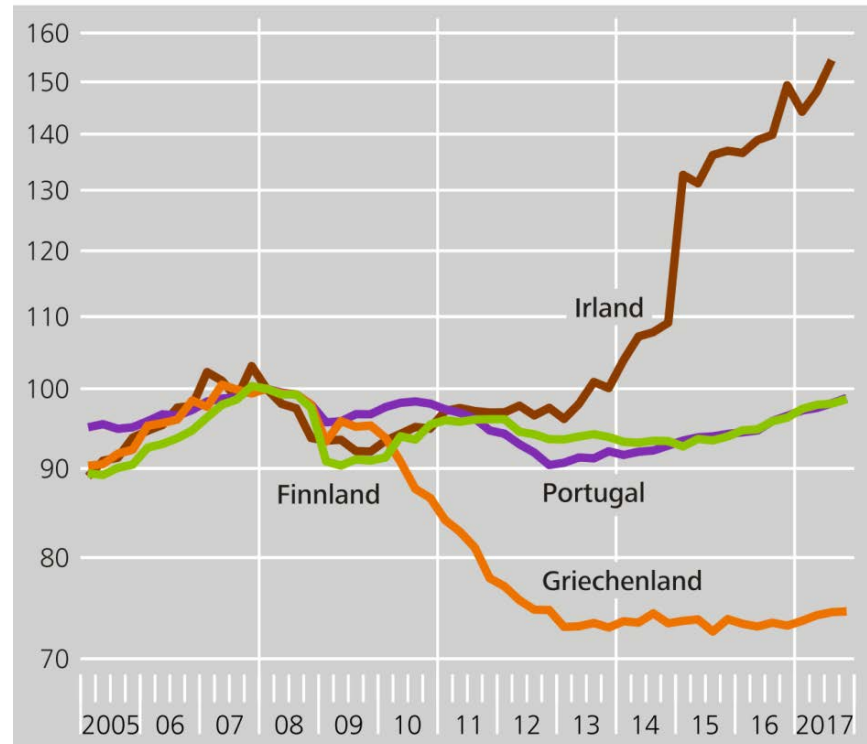
Quelle: EZB und eigene Berechnungen.

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Wirtschaftsaktivität in peripheren Ländern des Euroraums

Reales BIP, 1. Vj. 2008 = 100, saisonbereinigt, log. Maßstab



Quelle: EZB und eigene Berechnungen.

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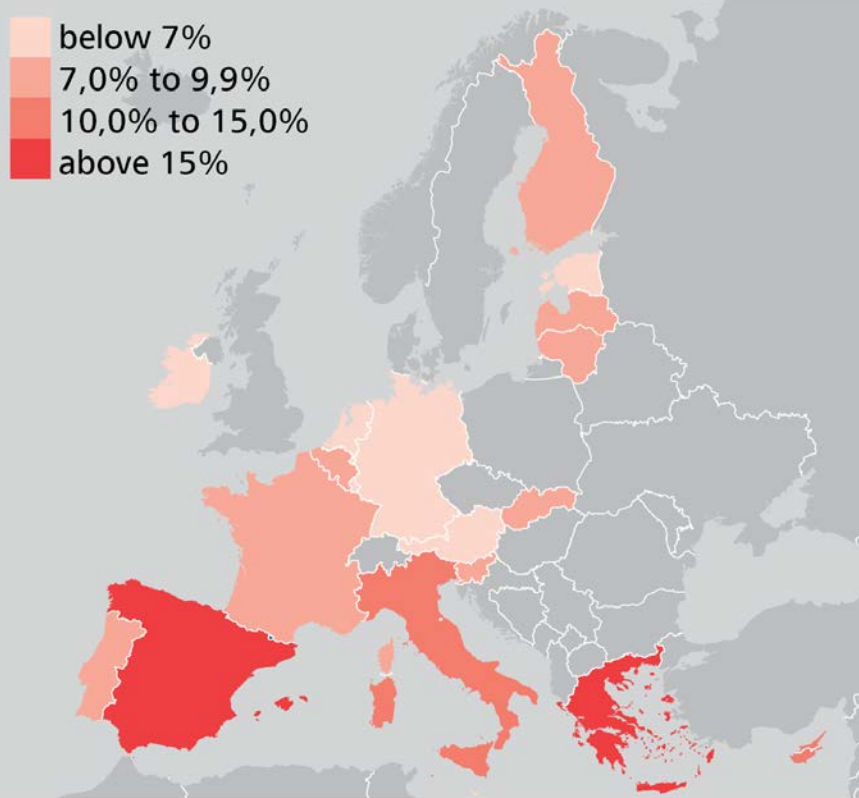
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Economic situation

Heterogeneity: Unemployment and per capita income

Unemployment rates in the euro area

As of Q2 2017¹

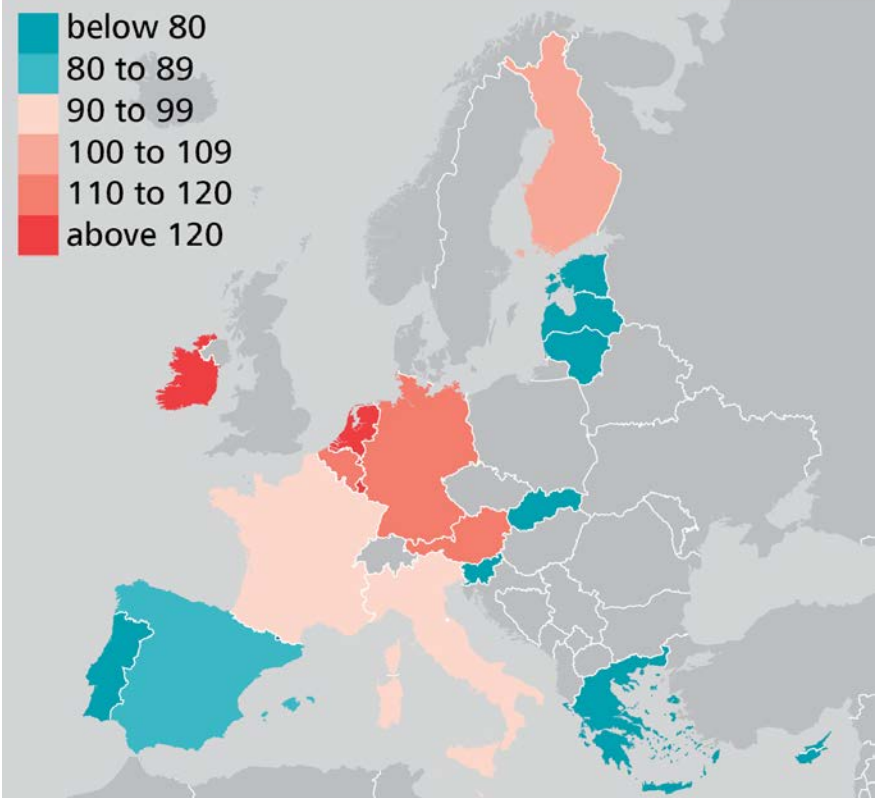


Source: EU-LFS. ¹ Q1 2017: Belgium, Greece, Italy and Austria.
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GDP per capita in the euro area in 2016

in purchasing power standards, Euro area = 100



Sources: Eurostat and Bundesbank calculations.
Deutsche Bundesbank

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Economic situation

Heterogeneity: Inflation

Gebiet	Gewicht 2018	2017				2018			
		Jahr	2.Vj.	3.Vj.	4.Vj.	1.Vj.	Feb	Mrz	Apr
Euroraum	100,0	1,5	1,5	1,4	1,4	1,3	1,1	1,3	1,2
Deutschland	28,1	1,7	1,6	1,7	1,6	1,3	1,2	1,5	1,4
Frankreich	20,2	1,2	1,0	0,9	1,2	1,5	1,3	1,7	1,8
Italien	17,4	1,3	1,6	1,3	1,1	0,9	0,5	0,9	0,6
Spanien	11,5	2,0	2,1	1,8	1,6	1,1	1,2	1,3	1,1
Niederlande	5,1	1,3	1,0	1,5	1,4	1,3	1,3	1,0	0,7
Belgien	3,8	2,2	2,0	1,9	2,0	1,6	1,5	1,5	1,6
Österreich	3,4	2,2	2,2	2,2	2,4	2,0	1,9	2,1	1,9
Griechenland	2,2	1,1	1,3	0,8	0,8	0,3	0,4	0,2	0,5
Portugal	2,2	1,6	1,7	1,3	1,8	0,9	0,7	0,8	0,3
Finnland	1,9	0,8	0,9	0,7	0,6	0,8	0,6	0,9	0,8
Irland	1,5	0,3	0,0	0,1	0,5	0,5	0,7	0,5	-0,1
Slowakei	0,8	1,4	1,0	1,6	2,0	2,4	2,2	2,5	3,0
Litauen	0,5	3,7	3,4	4,5	4,1	3,1	3,2	2,5	2,2
Slowenien	0,4	1,6	1,4	1,3	1,5	1,5	1,4	1,5	1,9
Luxemburg	0,3	2,1	2,0	2,0	1,8	1,2	1,1	1,1	1,3
Lettland	0,3	2,9	3,0	2,9	2,5	2,0	1,8	2,3	2,1
Zypern	0,2	0,7	1,3	0,2	0,1	-0,8	-0,4	-0,4	-0,3
Estland	0,2	3,7	3,4	4,0	4,1	3,2	3,2	2,9	2,9
Malta	0,1	1,3	1,1	1,2	1,4	1,3	1,3	1,3	1,8

Monetary policy in the euro area

Pre-crisis framework, response to the crisis and outlook

- Financial system more bank-based, hence strong reliance on providing liquidity to relatively wide range of banks
- Financial crisis: initially primarily ample provision of liquidity
- Economic and sovereign debt crisis saw increasing role of unconventional measures:
 - Large-scale provision of longer term liquidity, along with reduction of collateral requirements
 - Targeted asset purchase programmes (CBPP1&2, SMP, OMT)
- Successive reduction of key interest rates as inflation came down
- Transition to QE as inflation came ever lower and concerns about deflation rose → APP with by now four pillars which will contribute significantly to increasing the size of the Eurosystem's balance sheet to about 4.5 trillion € by the end of 2017
- Current and coming issues: exit (when and how), future outline of monetary policy (strategy, conduct/instruments)
- Concern: some measures have blurred the line between monetary and fiscal policy

Framework of the monetary union, including crisis-induced updates, and current issues (1/2)

- Common monetary policy with primary objective of price stability, prohibition of monetary financing, decided on by ECB's GovC and implemented in a decentralised manner
 - stronger role of ECB, conceptually but also in operational matters? additional responsibilities? new normal of monetary policy?
- Independent national fiscal and economic policies, no-bail-out clause
 - introduce insurance against macro shocks (e.g. rainy-day funds), investment subsidies or even permanent transfers?
- Limited coordination ("do not harm others") of national policies via fiscal rules (SGP, fiscal compact), MIP
 - more active coordination, e.g. aiming for euro area fiscal stance?
- ESM as financial rescue mechanism
 - upgrade to EMF, supervising national fiscal policies, having more firepower etc.?

Framework of the monetary union, including crisis-induced updates, and current issues (2/2)

- Banking union with SSM, SRM and common standards for deposit insurance
 - proceed to common deposit insurance?
- Macprudential Policy Framework: National competence and European coordination and supervision; top-up power for the ECB in the banking sector of SSM countries
 - How to streamline the highly complex web of institutions and procedures to increase both, effectiveness and efficiency?
- Further initiatives to strengthen cohesion, e.g. via capital market union
- Beyond the horizon: for example impact of digitisation on
 - structure of the financial system (→ transmission of monetary policy)
 - role of cash → CBDC (central bank digital currency) as substitute for cash (“digital euro”)?

BBk's view on strengths and challenges

- EMU more resilient thanks to past reforms at national and E(M)U level, ...
- ... but stable footing requires further reforms; BBk sees two viable paths
 - Strengthening Maastricht framework (self dependence, market discipline), strict limits on mutualisation of risks
 - Stronger integration, requiring transfer of sovereignty to EU level; could then go along with stronger burden sharing
- Middle course of merely increasing burden sharing risky, also politically
- Specific reform proposals for financial stability, fiscal policy, economic policy and monetary policy, e.g.:
 - Do away with preferential treatment of sovereign debt in banking regulation (capital requirements, large exposure limits) to cut sovereign-bank-nexus
 - Automatic maturity extension if ESM assistance granted
 - Create framework for more orderly sovereign insolvency
 - Simpler and cleaner fiscal rules, strictly applied and supervised independently
 - Eurosystem: Stick to narrow(er) interpretation of monetary policy mandate, institutional segregation of monetary policy and banking supervision
 - Monetary policy: begin normalisation soon by ending net APP-purchases

Thank you for your attention!