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Χειμερινό εξάμηνο

The Draghieconomics The Ordoliberalism

The Draghieconomics

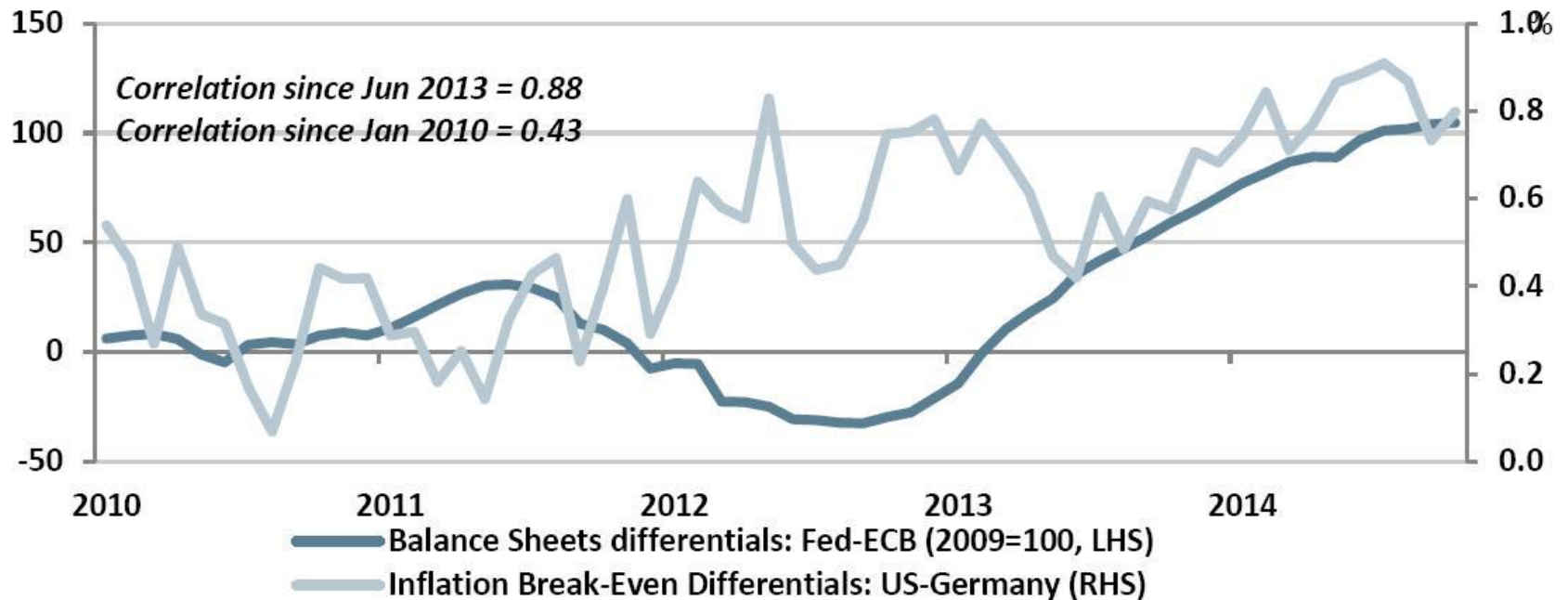
ECB's Draghi: Size *Does Matter!*

(Roubini N, Brunello R (2014) ECB's Draghi: Size Does Matter! RGE Global Economics)

- **The size of the balance sheet matters and will increase** because it tends to have positive spillovers in other areas (a reference to exchange rates), noting that a correlation has been found between the size of the balance sheet and breakeven inflation rates.
 - *The size of the ECB's balance sheet will increase in any state of the world—either because present measures are working or because new ones will be adopted to augment them.*
 - *Asynchronous business (and monetary policy) cycles will ensure that the ECB's balance sheet increases relative to those of other central banks (the Fed and Bank of England) that are entering a new monetary policy phase.*
- **How to increase the balance sheet to €3 trillion:** (the March 2012 figure, up from €2 trillion at present), the €1 trillion of assets eligible for covered bond and ABS purchases cited in the past should not be considered a benchmark: (a) on the downside, large portions of ABS issuance are retained by the issuer and are not available for sale; and (b) on the upside, the size of both the covered bond and ABS markets will increase, given the actions taken by the ECB.

Why Size Matters

Inflation Expectations Are Higher in the U.S., Where the Fed Balance Sheet Is Larger

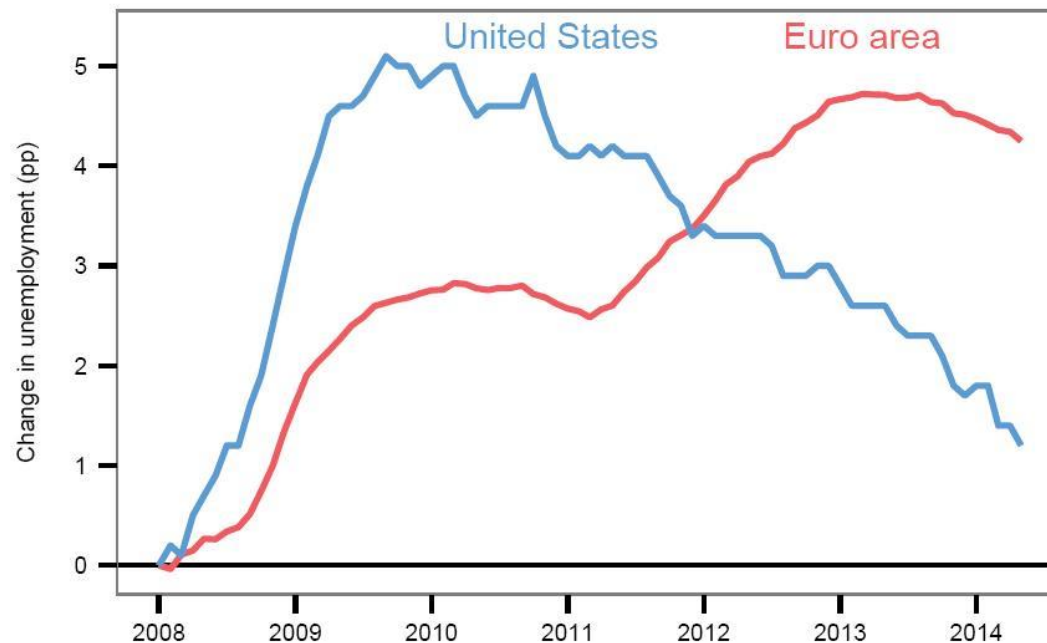


Source: Bloomberg

Demand policies and national structural policies

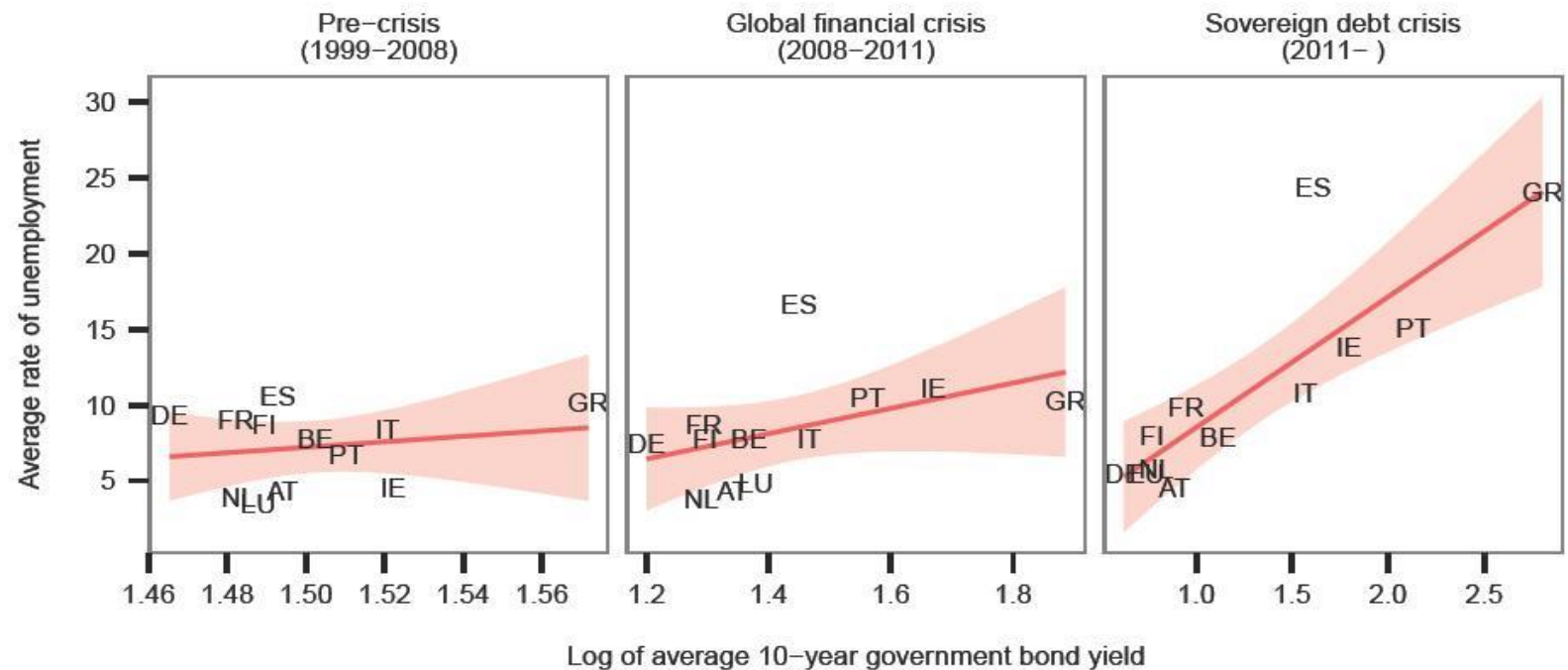
(Draghi M (2014) Unemployment in the euro area, Speech by Mario Draghi, President of the ECB, Annual central bank symposium in Jackson Hole, 22 August 2014)

Fig 1: Change in the unemployment rate since 2008 —
The euro area and the US



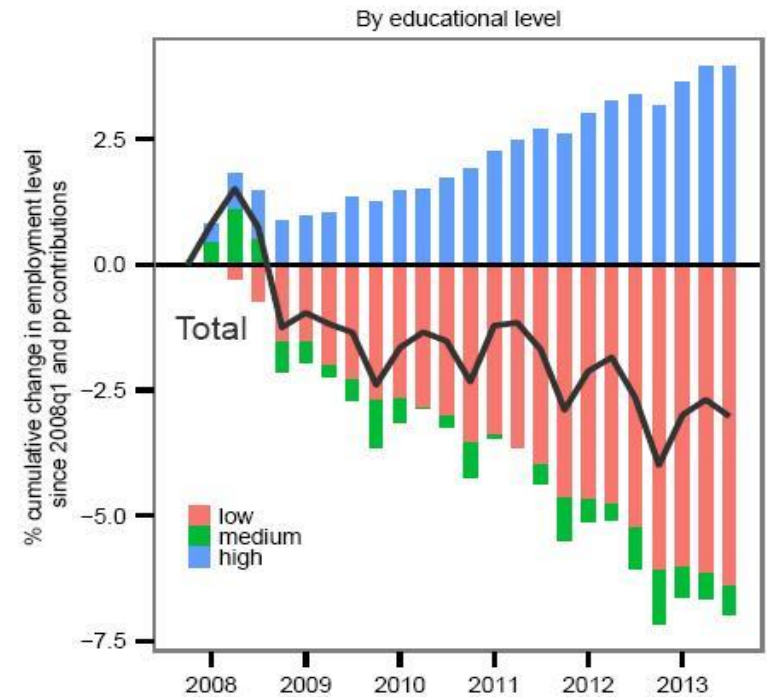
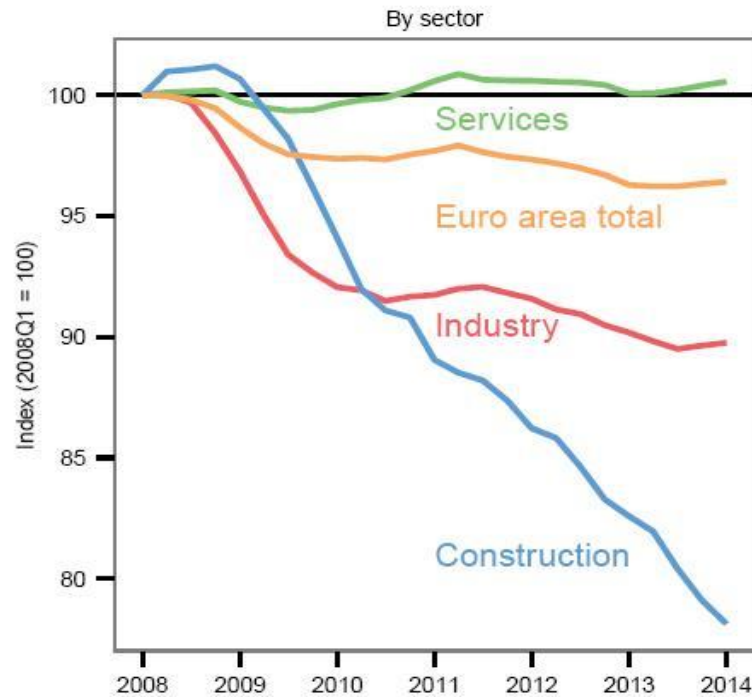
Source: Eurostat

Fig 2: Relationship between financial stress and unemployment



Source: Eurostat and Bloomberg

Fig 4: Evolution of euro area employment by sector and educational level



Source: Eurostat and ESCB calculations

Demand policies and national structural policies

(Draghi M (2014) Unemployment in the euro area, Speech by Mario Draghi, President of the ECB, Annual central bank symposium in Jackson Hole, 22 August 2014)

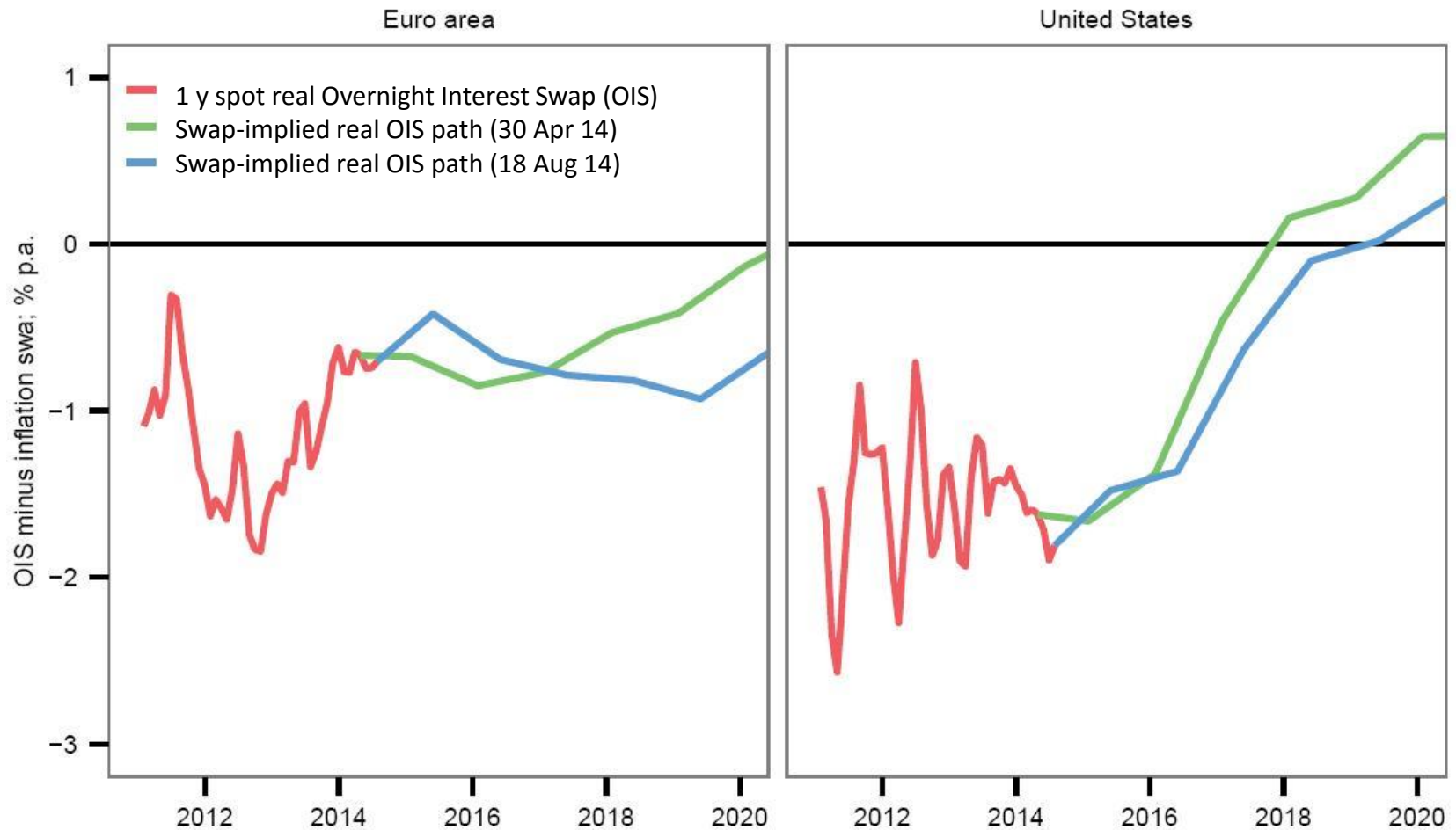
“... we need action on both sides of the economy: aggregate demand policies have to be accompanied by national structural policies”. (Draghi 2014).

- Aggregate demand policies will ultimately not be effective without action in parallel on the supply side.
- Like all advanced economies, we are operating in a set of initial conditions determined by the last financial cycle, which include low inflation, low interest rates and a large debt overhang in the private and public sectors.
- In such circumstances, due to the zero lower bound constraint, there is a real risk that monetary policy loses some effectiveness in generating aggregate demand. The debt overhang also inevitably reduces fiscal space.

Demand policies and national structural policies

- On the demand side, monetary policy can and should play a central role, which currently means an accommodative monetary policy for an extended period of time.
- We have already seen exchange rate movements that should support both aggregate demand and inflation, which we expect to be sustained by the diverging expected paths of policy in the US and the euro area.
- Turning to fiscal policy, since 2010 the euro area has suffered from fiscal policy being less available and effective, especially compared with other large advanced economies.

Expected real interest rate path in the euro area and the US



Fiscal Policy

It would be helpful for the overall stance of policy if fiscal policy could play a greater role alongside monetary policy.

Let emphasize four elements (Draghi 2014):

- *First*, the existing flexibility within the rules could be used to better address the weak recovery and to make room for the cost of needed structural reforms.
- *Second*, there is leeway to achieve a more growth-friendly composition of fiscal policies.
- *Third*, in parallel it may be useful to have a discussion on the overall fiscal stance of the euro area. Stronger coordination among the different national fiscal stances should in principle allow us to achieve a more growth-friendly overall fiscal stance for the euro area.
- *Fourth*, complementary action at the EU level would also seem to be necessary to ensure both an appropriate aggregate position and a large public investment programme.

Macroeconomic Policy Mix in the Transatlantic Economy

(Vitor Constâncio (2014) Macroeconomic Policy Mix in the Transatlantic Economy, ECB, 25 August 2014, New York)

International policy coordination

- Theoretically, coordination leads to globally optimal policy outcomes (since spill-overs will be internalised) and is better than domestic oriented policies and a Nash equilibrium.
- However, quantitative studies and analysis like Obstfeld/Rogoff (2002) show that gains from coordination, relative to policies in pursuit of domestic policy objectives, may be small. Monetary and exchange rates have many possibilities of absorbing external shocks and attain domestic goals.
- Also, there are other important factors: *i) Political economy*: central banks operate under different mandates, time horizons, and accountability arrangements; *ii) Uncertainty*: correct identification of spill-overs and shocks in real time and across countries typically elusive and there is no general agreed model to analyse them.

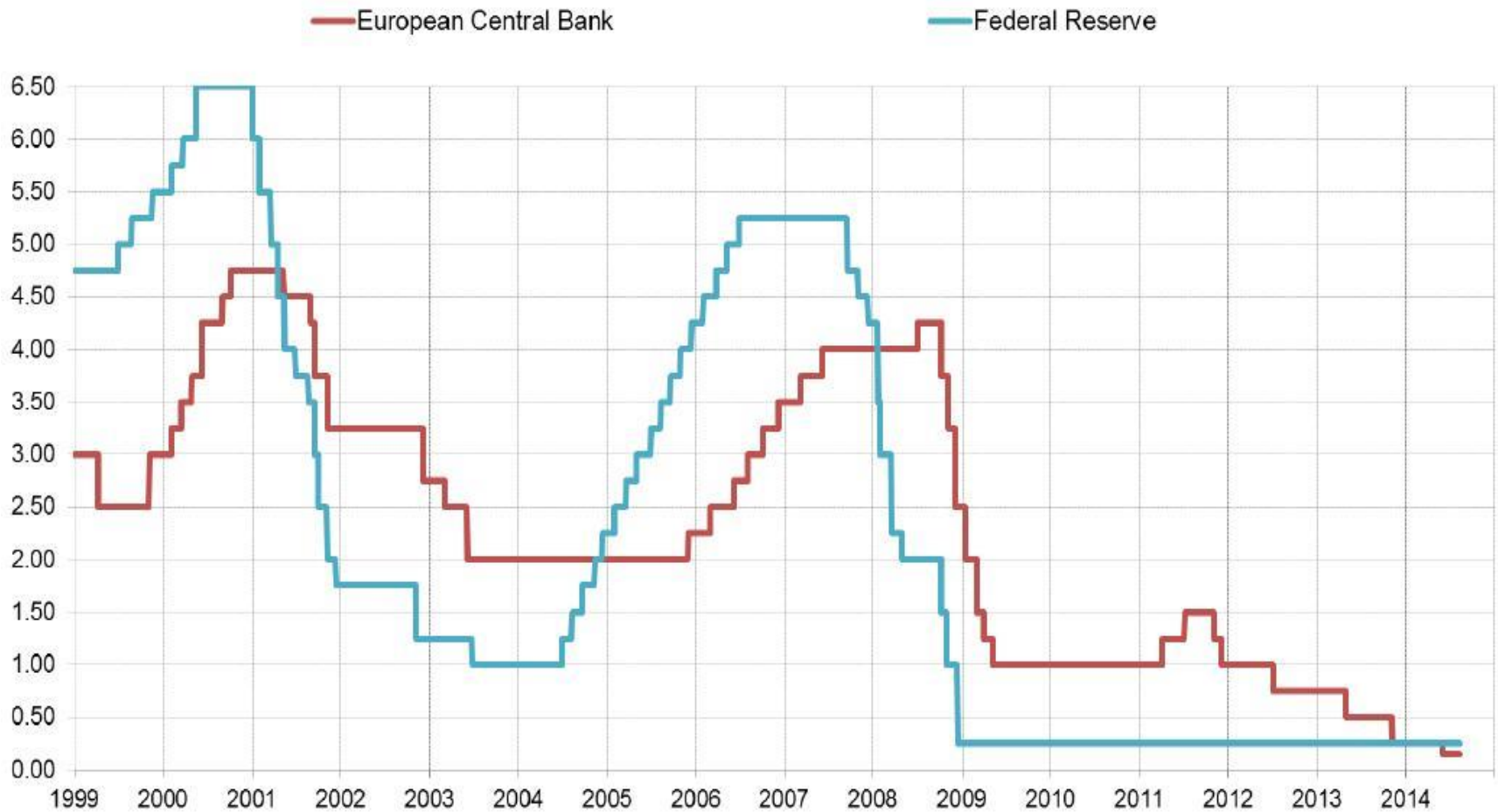
Policies in the Crisis

- **Monetary Policy:**
- 2008-2010: Initial monetary policy response to the financial crisis in EA and US: similar direction, but different instruments
 - Strong interest rate cuts in parallel
 - Different (non-standard) instruments :

ECB: Fixed rate full allotment, LTROs	Fed: QE and CE
ECB: expansion of traditional lending of last resort role, providing liquidity to banks at longer maturities and full allotment mode. Small outright purchases (SMP, CBP).	Fed: outright purchases affecting directly asset prices(including the exchange rate), generating portfolio and wealth effects

- Since 2010: euro area sovereign debt crisis led to fragmentation. Policy accommodation finds it difficult to reach real economy. Only OMT significantly reduced fragmentation
- **Fiscal Policy:** More expansionary in the US, in spite of the “sequester”

Comparison of policy rates



Source: ECB calculations.

Latest observation: 13 August 2014.

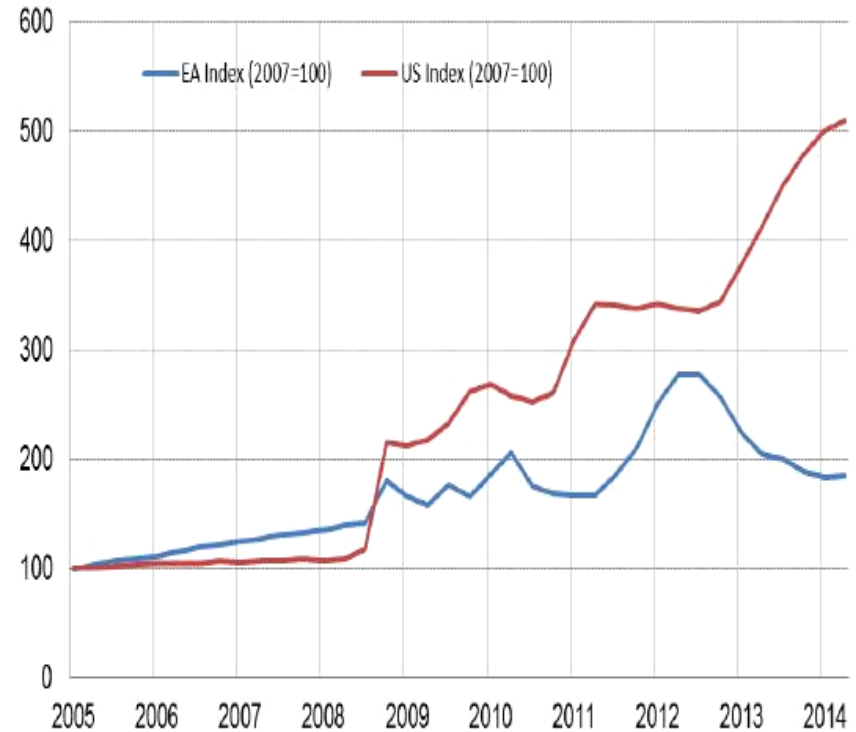
Comparison of central bank balance sheets

Central banks balance sheet, total assets (index 2007=100)



Source: ECB and FED.
Latest observation: 15 August 2014.

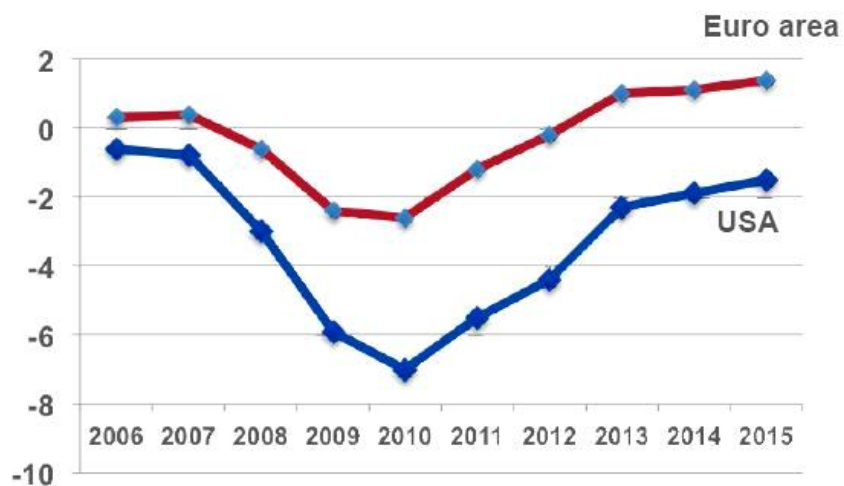
Eurozone vs US Monetary Base



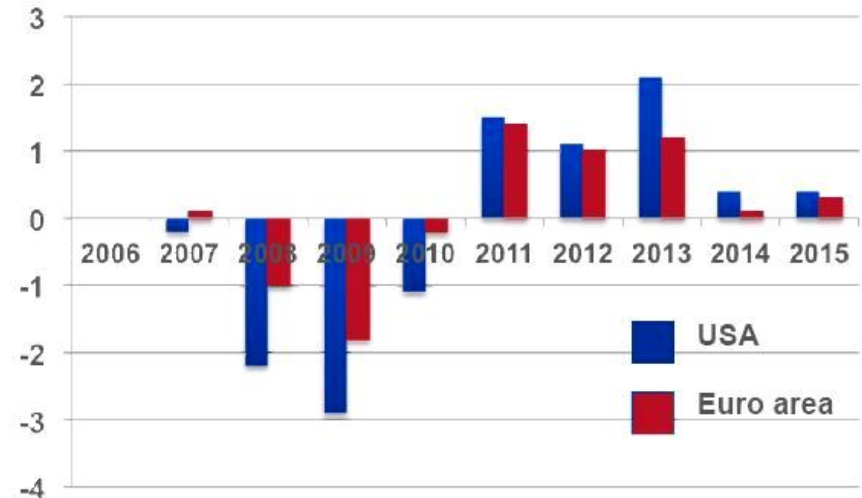
Source: ECB.
Latest observation: July 2014.

Cyclically adjusted primary balance

CAPB levels



CAPB annual changes



Source: IMF April 2014 WEO.

Going forward

Decoupling of EA and US developments

EA faces moderate and uneven recovery, very low rates of inflation, subdued monetary and credit dynamics,

Different speeds of normalization:

- *understood by markets*
- *not an issue of cooperation, self-oriented policies will do it*

Common challenge: reliability of measures of slack?

The Ordoliberals

Ordoliberalism as the basis of German economic thinking

- It is often claimed that the German approach to the euro crisis, and in particular its emphasis on price stability, is based either on its narrowly defined interest as a capital surplus country or on the historical experience of the hyperinflation in the Weimar Republic.
- *Ordoliberalism* is closely linked to the first phase of the social market economy from 1948 to 1966.
- Although it was broader and also included social goals, the concept of the social market economy incorporated the basic ideas of ordoliberalism, which were reflected in the legislation of the time—for example, the law on collective bargaining, the law against restraints on competition and the Bundesbank law.
- Having helped to create rapid reconstruction and a swift increase in its standard of living during this period, the social market remains one of the most positively charged terms in the German policy debate.

German Approach to the Euro Crisis

- Understanding the main tenets of *ordoliberalism* appears important to investigate the reasons behind the European aversion towards countercyclical policy.
- An important but rarely discussed reason for Germany's emphasis on price stability is the influence on German economic thinking of "*ordoliberalism*"
- *Ordoliberalism* developed by economists such as Walter Eucken, Franz Böhm, Leonhard Miksch and Hans Großmann-Doerth as a reaction both to the consequences of unregulated liberalism in the early years of the twentieth century and subsequent Nazi fiscal and monetary interventionism.

Policy Positions of Ordoliberalism

(Dullien and Guérot (2012) “The Long Shadow of Ordoliberalism: Germany's Approach to the Euro Crisis”, European Council on Foreign Relations (ECFR))

1. Economic policy co-ordination

While many in France believe in co-ordinating economic policy (fiscal policies, wage increases, social security contributions and taxation) across the eurozone, Germans have been more sceptical.

2. External imbalances

The German mainstream sees current account imbalances in the eurozone as a consequence of a loss of competitiveness and excessive consumption in the deficit countries and weak investment in Germany.

3. Budget consolidation and bailouts

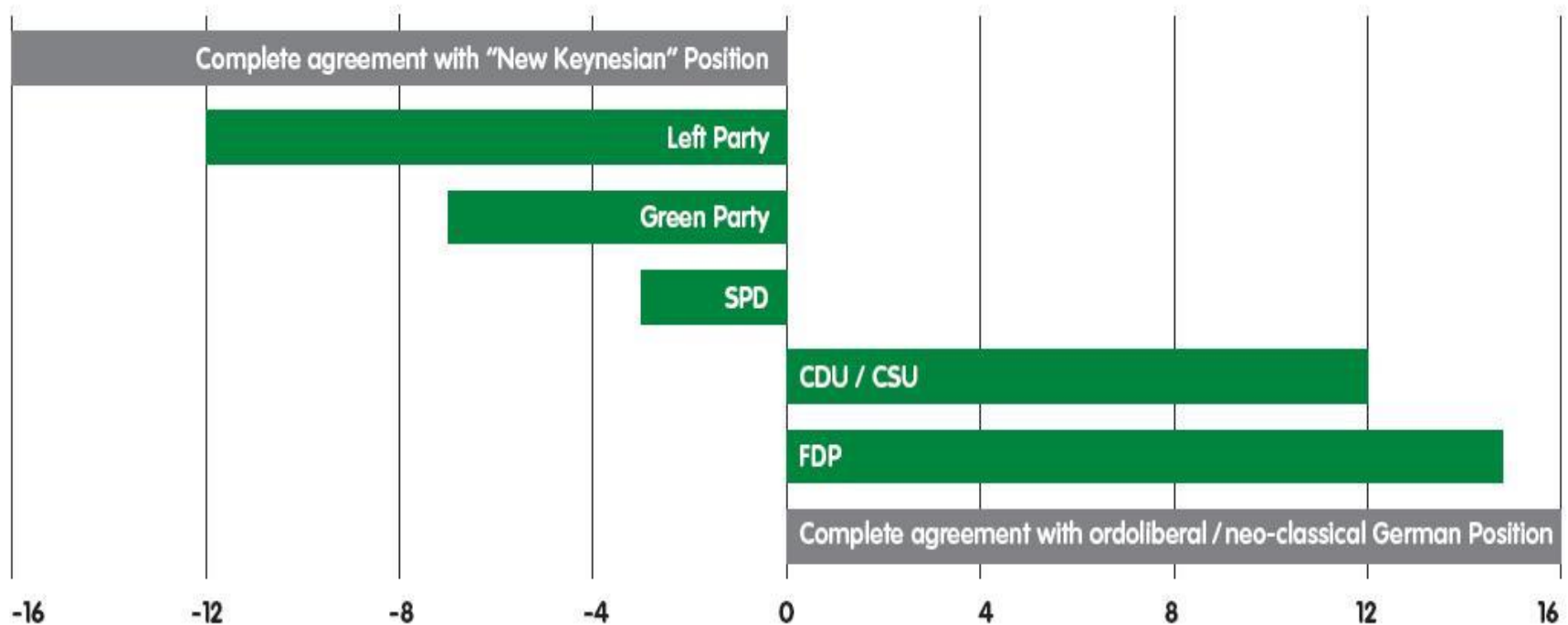
The German mainstream believes in quick and decisive budget consolidation to be achieved through reducing government expenditure and, to a lesser extent, increasing taxes. Difficulties in reaching fiscal targets are seen as a failure on the part of the political class to make or pass the necessary cuts or tax increases.

4. ECB bond purchases

The German mainstream worries that the ECB will find it hard to limit bond purchases going forward. Ultimately, bond purchases might lead to permanent financing of budget deficits through the central bank, with no instruments left to punish misbehaving governments. Such deficit financing could lead to inflation and an erosion of the monetary system.

German parties' adherence to the traditional German position in the euro crisis debate

(Index: 16 Points = perfect adherence)



Source: Dullien and Guérot (2012) "The Long Shadow of Ordoliberalism: Germany's Approach to the Euro Crisis", European Council on Foreign Relations (ECFR).

How to jumpstart the Eurozone economy

(Giavazzi F, Tabellini G (2014) How to jumpstart the Eurozone economy, voxeu.org, 21 August 2014)

The main challenge currently faced by the Eurozone is a lack of aggregate demand. This is much more important than internal imbalances or lack of competitiveness in the periphery.

At the end of 2013:

- Private consumption in the Eurozone was 2% below its 2007 level;
- Private investment was 20% below the 2007 level;
- Producers' prices have been decreasing for over a year.
- The only bright spot is the rise of exports by almost 10% since late 2013.
- In the US, by contrast, GDP and private consumption are 6-7% above where they were six years ago, and investment too is above its pre-crisis level.

Macroeconomic policy in the Eurozone is no longer a national prerogative

What can be done to increase aggregate demand in the Eurozone?

- All countries should enact a large tax cut, say corresponding to 5% of GDP.
- They should be given several years (say three or four), to reduce the budget deficit created by this tax cut, through a combination of higher growth and lower expenditures.
- To finance the additional deficits, members states should issue long-term public debt with a maturity of say 30 years.

This extra debt should all be bought by the ECB, without any corresponding sterilisation, and the interest on the debt should be returned to the ECB shareholders as seigniorage.

Juncker's investment plan is too timid

The new Commission President, Jean-Claude Juncker, hinted that he plans to address the lack of aggregate demand by launching a public investment program worth €300 billion over the next three years. But the plan is much too timid.

- The monetary expansion part is missing, which makes financing problematic and reduces the effectiveness of the stimulus.
- Higher public investment has several disadvantages compared to tax cuts, as the experience of Japan has shown.
- Critically, it would take much longer to be implemented, and action is needed now, not in two years.

Moreover, in some countries it is likely to lead to corruption and misallocation of resources. Some investment in European infrastructure is welcome and should be financed by the European Investment Bank, but not on the scale that is needed to overcome the aggregate demand failure that is sinking the Eurozone.

Political Obstacles and Germany

- The main objection to the combined monetary and fiscal stimulus described above is not economic, but political. It would be opposed by **Germany**, and perhaps a few other member states, because it runs counter to the principle of monetary and fiscal policy separation that is enshrined in the Treaty, and because the idea that taxes are too high in Europe does not go down well with the principles of a social market economy.
- If political concerns were to prevent a coordinated action to revive aggregate demand, six months down the road the ECB would be forced to engage in quantitative easing anyway, to try and fight deflation. But this will not work. And the Eurozone will remain depressed, fuelling anti-European sentiment among its citizens.