



# CHALLENGES FOR EMU

**Javier J. Pérez**

**Director, International Economics and Euro Area**

**Banco de España**

UCIIM, Madrid

19 November 2019

## The EU / EMU project

*The EU project has certainly improved the life of millions of people in Europe since its creation, not only in economic terms, but also regarding rights and living standards across the whole Union.*

*The success of the EU project cannot be assessed solely on the basis of its economic performance; we must also look at its other original objectives, namely, to increase the level of political and economic integration in the region.*

*Throughout its history, the EU integration process has not been linear, and not even gradual. Actually, over nearly seven decades, the European project has experienced long, quiet periods –where little or nothing remarkable happened– punctuated by, so to speak, ‘transformative periods’, that have contributed decisively to its development and to shaping its current form.*

# The division of labour in EMU

## Monetary Policy

- Single monetary policy and an independent central bank
- The primary objective is maintaining price stability
- Without prejudice to this, support the policies in the Community

## Fiscal Policies

- Exclusive competence of Member States
- Budgetary autonomy is, in formal terms, absolute
- But: Fiscal policies are subject to rules of budgetary discipline

## Other

- **Banking Union?**
- **Capital markets Union?**
- **Structural, institutions, ...**

# MONETARY POLICY IN EMU



# THE EUROPEAN SYSTEM OF CENTRAL BANKS (ESCB)



ORGANISATION

€ European Central Bank

1 Nationale Bank van België/  
Banque Nationale de Belgique

2 Българска народна банка  
(Bulgarian National Bank)

3 Česká národní banka

4 Danmarks Nationalbank

5 Deutsche Bundesbank

6 Eesti Pank

7 Central Bank of Ireland

8 Bank of Greece

9 Banco de España

10 Banque de France

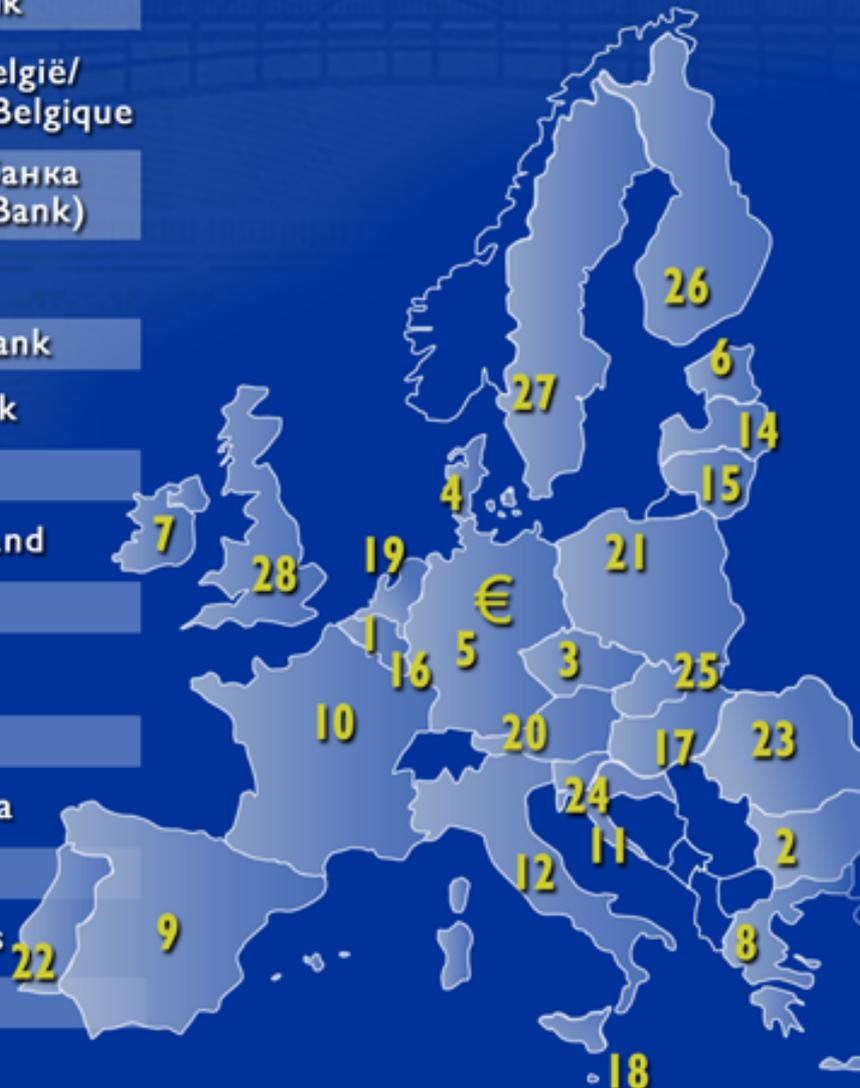
11 Hrvatska narodna banka

12 Banca d'Italia

13 Central Bank of Cyprus

14 Latvijas Banka

15 Lietuvos bankas



16 Banque centrale du  
Luxembourg

17 Magyar Nemzeti Bank

18 Bank Ċentrali ta' Malta/  
Central Bank of Malta

19 De Nederlandsche Bank

20 Oesterreichische  
Nationalbank

21 Narodowy Bank Polski

22 Banco de Portugal

23 Banca Națională a României

24 Banka Slovenije

25 Národná banka Slovenska

26 Suomen Pankki –  
Finlands Bank

27 Sveriges Riksbank

28 Bank of England

# THE NCBs AS AN INTEGRAL PART OF THE EUROSISTEM



ORGANISATION

## Article 282

"The European Central Bank, together with the national central banks of the Member States whose currency is the euro, which constitute the Eurosystem, shall conduct the monetary policy of the Union."





**Article 130** of the Treaty on the Functioning of the European Union:

“When exercising the powers and carrying out the tasks and duties conferred upon them by the Treaties and the Statute of the ESCB and of the ECB,...



...neither the **ECB,**

nor a **national central bank,**



nor any **member of their decision-making bodies**



**shall seek or take instructions** from Union institutions, bodies, offices or agencies, from any government of a Member State or from any other body.”

# DECISION-MAKING BODIES OF THE ECB



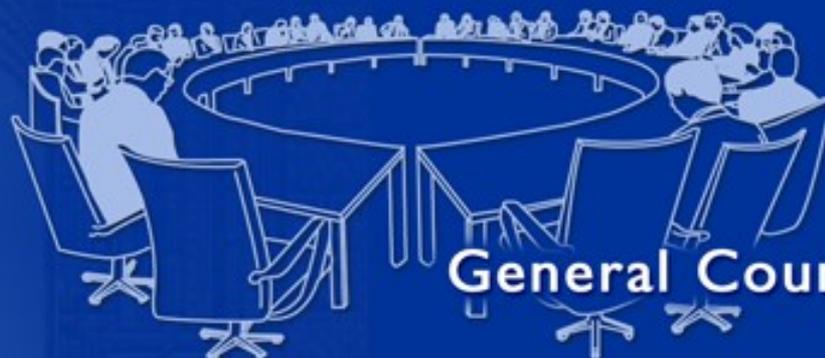
ORGANISATION



**Governing Council**



**Executive Board**



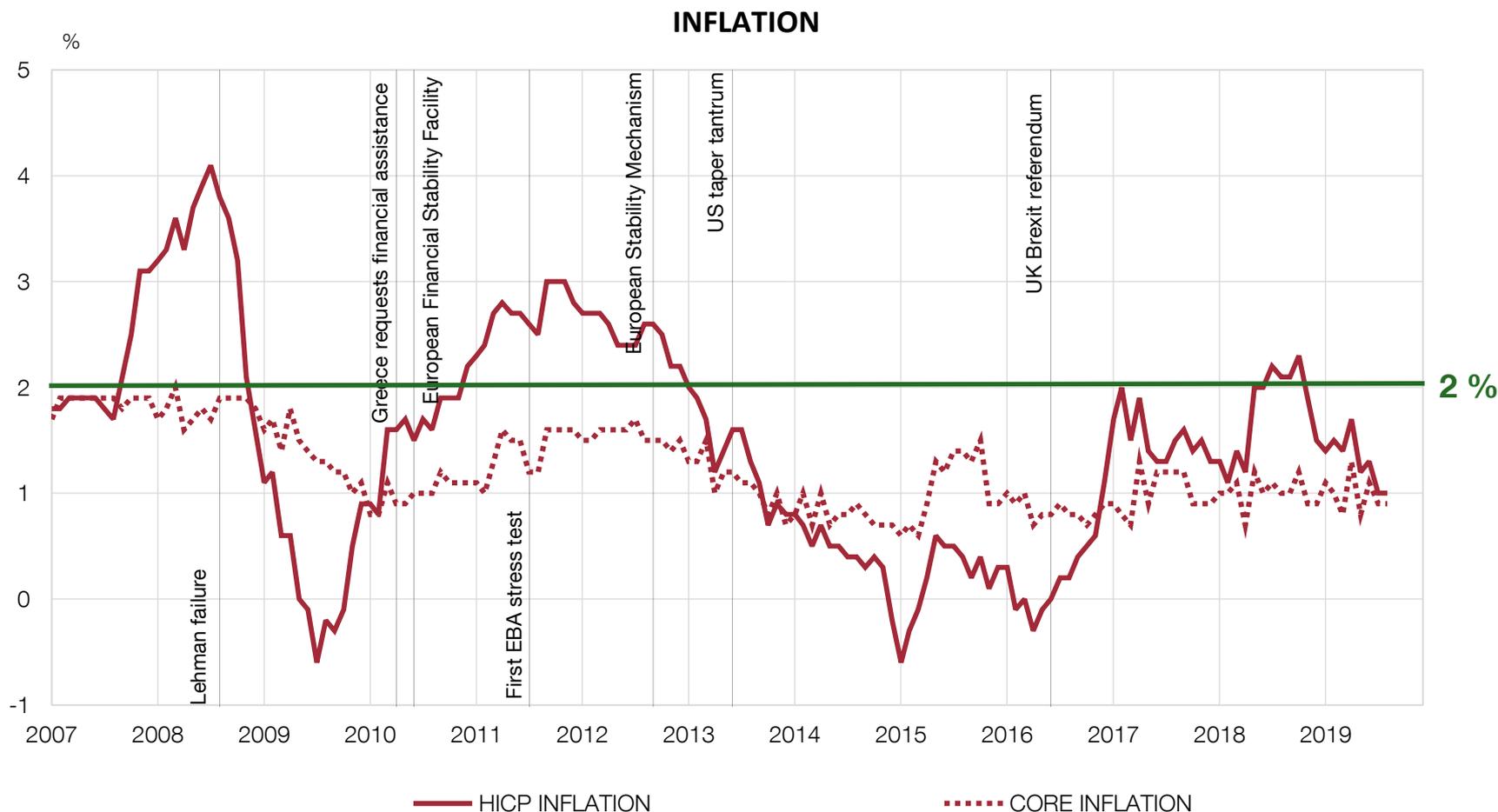
**General Council**



- Accounting and Monetary Income Committee (AMICO)
- Banknote Committee (BANCO)
- Committee on Controlling (COMCO)
- Eurosystem/ESCB Communications Committee (ECCO)
- Eurosystem IT Steering Committee (EISC)
- Financial Stability Committee (FSC)
- Information Technology Committee (ITC)
- Internal Auditors Committee (IAC)
- International Relations Committee (IRC)
- Legal Committee (LEGCO)
- Market Operations Committee (MOC)
- Monetary Policy Committee (MPC)
- Organisational Development Committee (ODC)
- Payment and Settlement Systems Committee (PSSC)
- Risk Management Committee (RMC)
- Statistics Committee (STC)
- Budget Committee (BUCOM)
- Human Resources Conference (HRC)



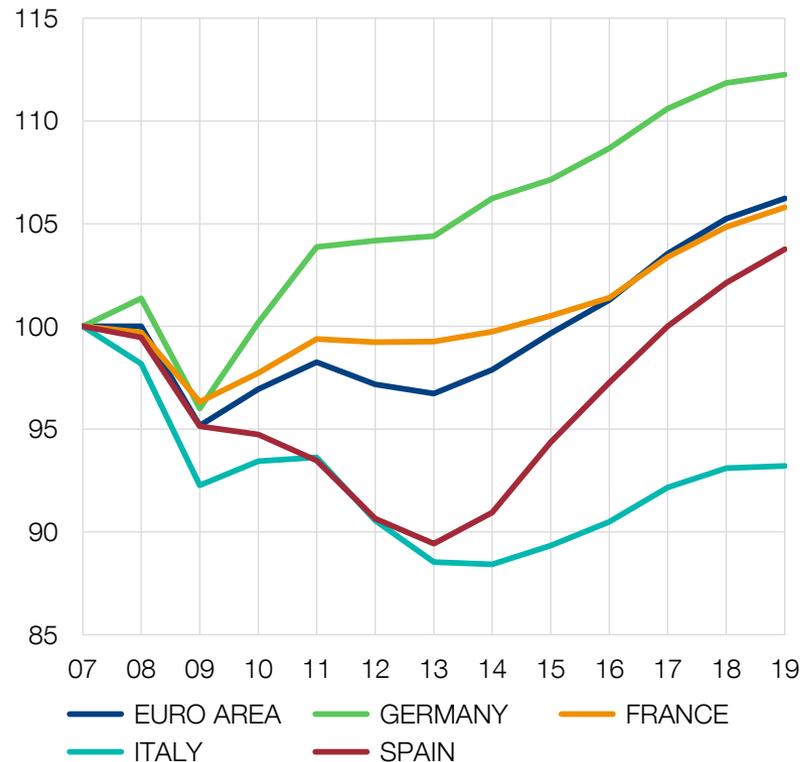
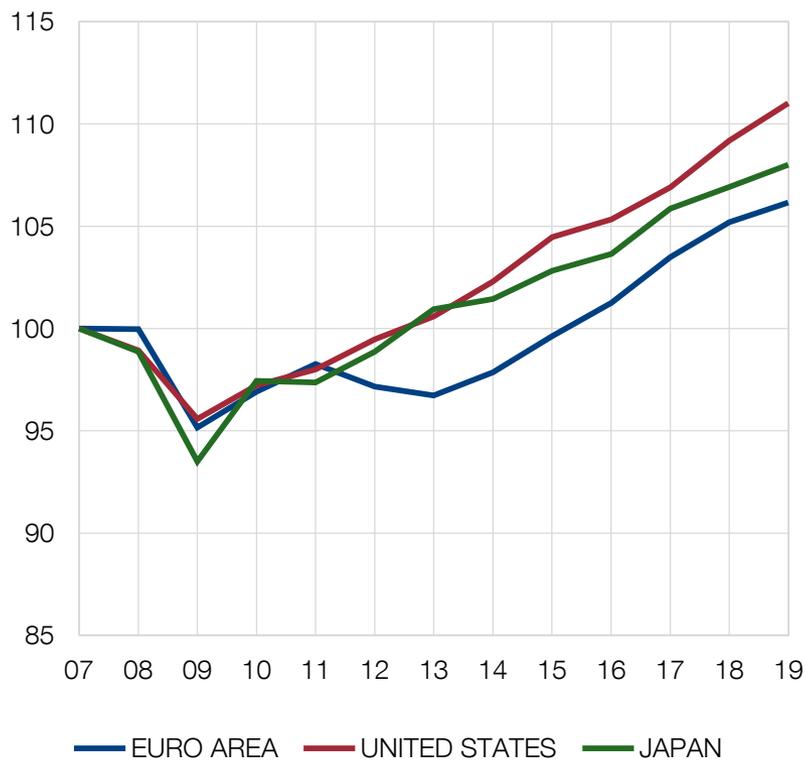
# AFTER THE FINANCIAL AND SOVEREIGN DEBT CRISES, THE EURO AREA HAS WITNESSED DISINFLATIONARY PRESSURES SINCE 2013



Source: Eurostat. Last observation: 2019 August.

# PER CAPITA GROWTH IN THE EURO AREA HAS BE DISAPPOINTING SINCE 2012

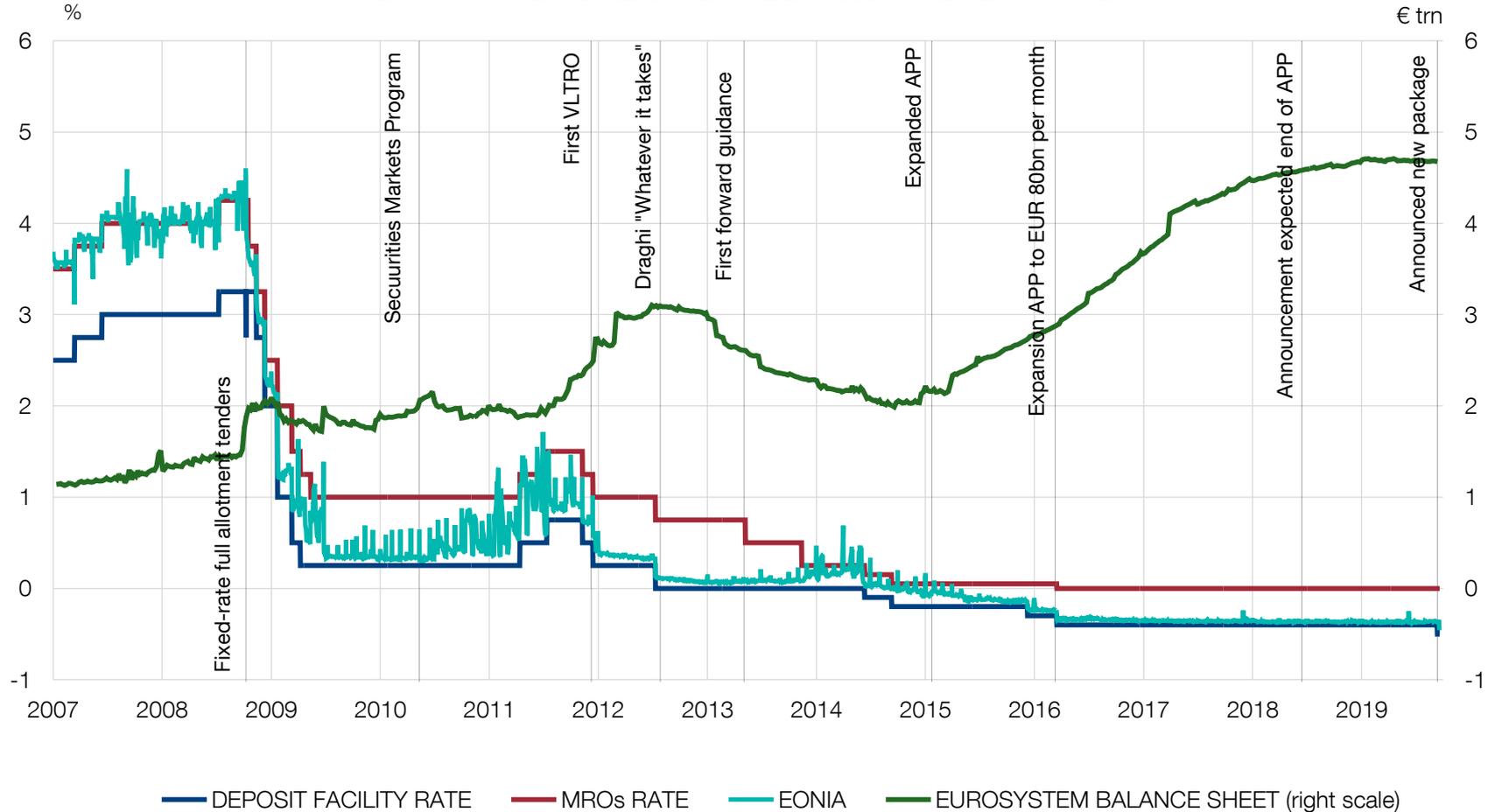
**GROWTH OF THE REAL GDP PER HEAD OF POPULATION  
(2010 prices; 2007=100)**



Sources: Datastream and European Commission

# OVER THE DIFFERENT PHASES OF THE CRISIS, THE ECB HAS DEPLOYED A PACKAGE OF MUTUALLY REINFORCING MEASURES

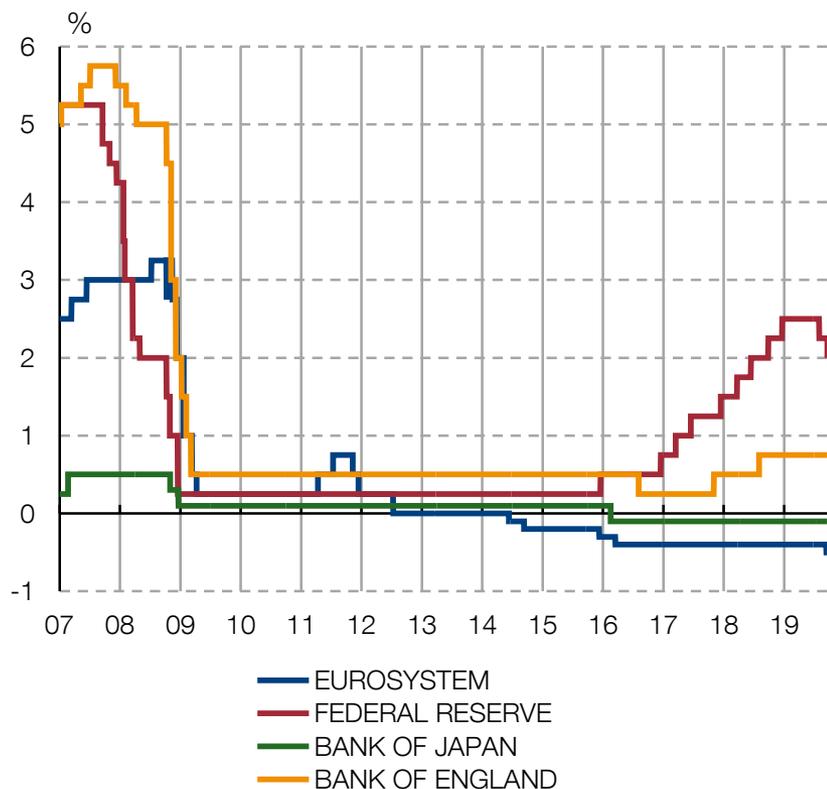
## EUROSYSTEM BALANCE SHEET AND INTEREST RATES



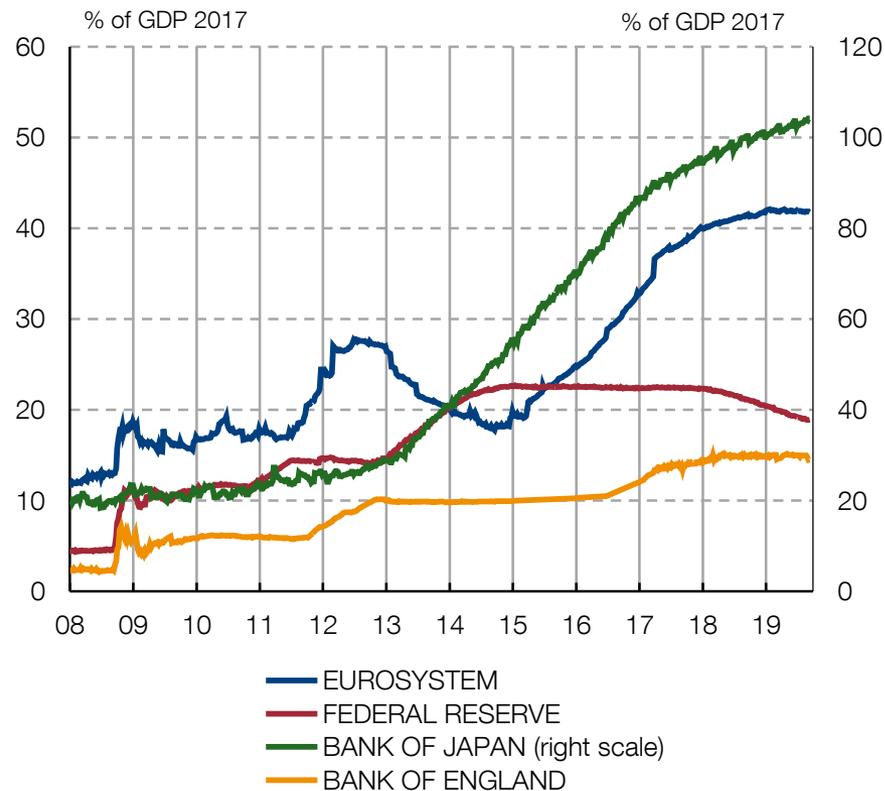
Source: European Central Bank. Last observation: Rates, 19 September 2019; Balance sheet: 12 September 2019.

# THE MONETARY POLICY RESPONSE HAS BEEN COMPARABLE TO THAT IN OTHER LARGE ADVANCED ECONOMIES

## POLICY INTEREST RATES



## CENTRAL BANKS BALANCE SHEET

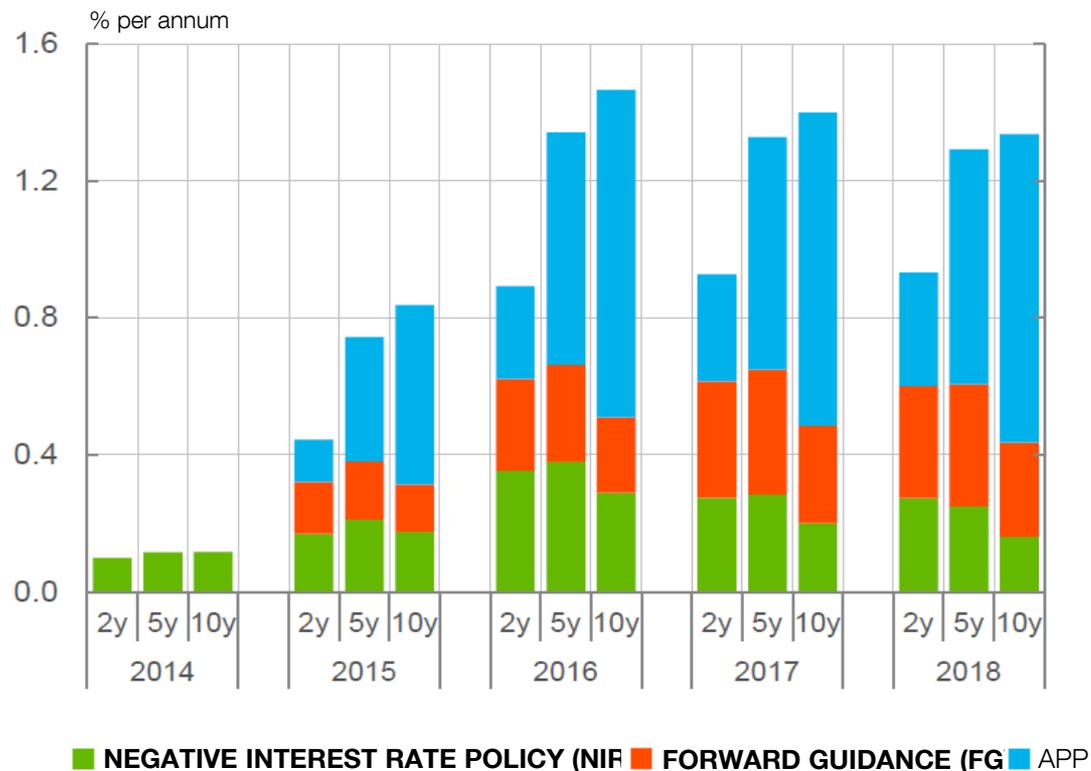


Sources: Datastream, European Central Bank and Banco de España.

Last observations: Rates, 19 Sep 2019; Balance sheet: Eurosystem, 12 Sep 2019; FED, 11 Sep 2019; BoJ, 09 Sep 2019; BoE,

# THESE MEASURES HAVE BEEN EFFECTIVE AT EASING FINANCIAL CONDITIONS, SUCH AS YIELD CURVES...

**UPWARD PRESSURES ON EURO AREA SOVEREIGN BOND YIELDS  
IN ABSENCE OF ECB'S NON-STANDARD MEASURES 2014-2018**

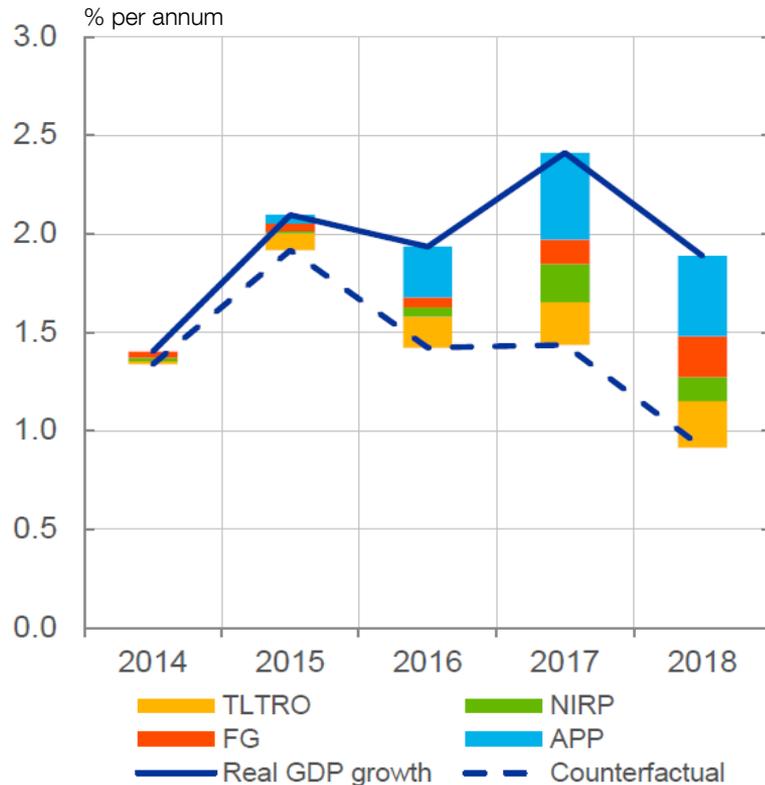


Source: Rostagno, Altavilla, Carboni, Lemke, Motto, Saint-Guilhem, Yiangou (2019), forthcoming.

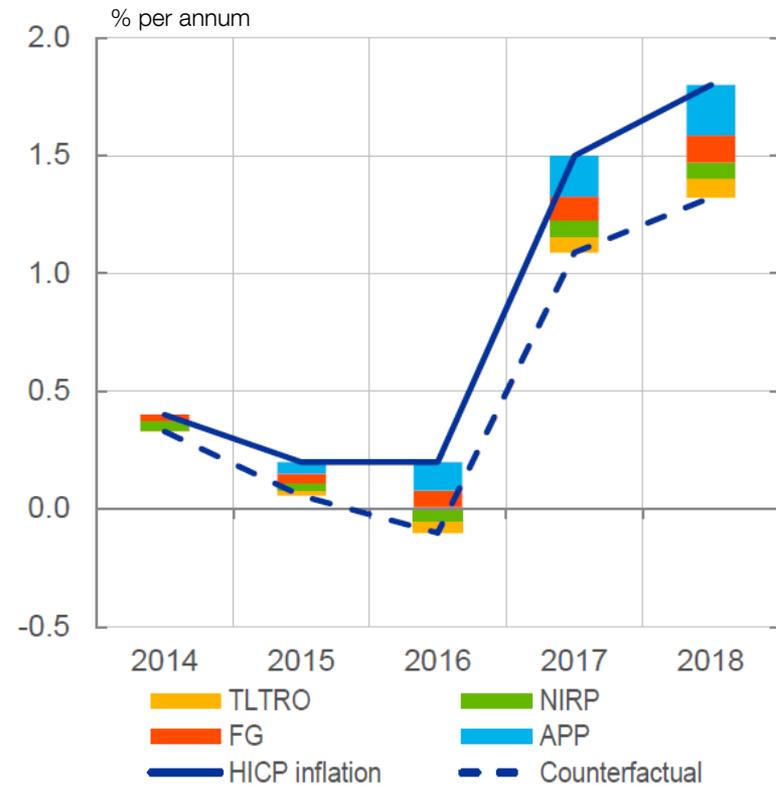
Notes: The chart shows the impact of ECB non-standard measures on the GDP-weighted aggregate of euro area sovereign bond yields.

# ...WHICH IN TURN HAVE STIMULATED GROWTH AND INFLATION OVER THE PERIOD 2014-2018

**CONTRIBUTION OF ECB NON-STANDARD MEASURES TO REAL GDP GROWTH 2014-2018**



**CONTRIBUTION OF ECB NON-STANDARD MEASURES TO HICP INFLATION 2014-2018**

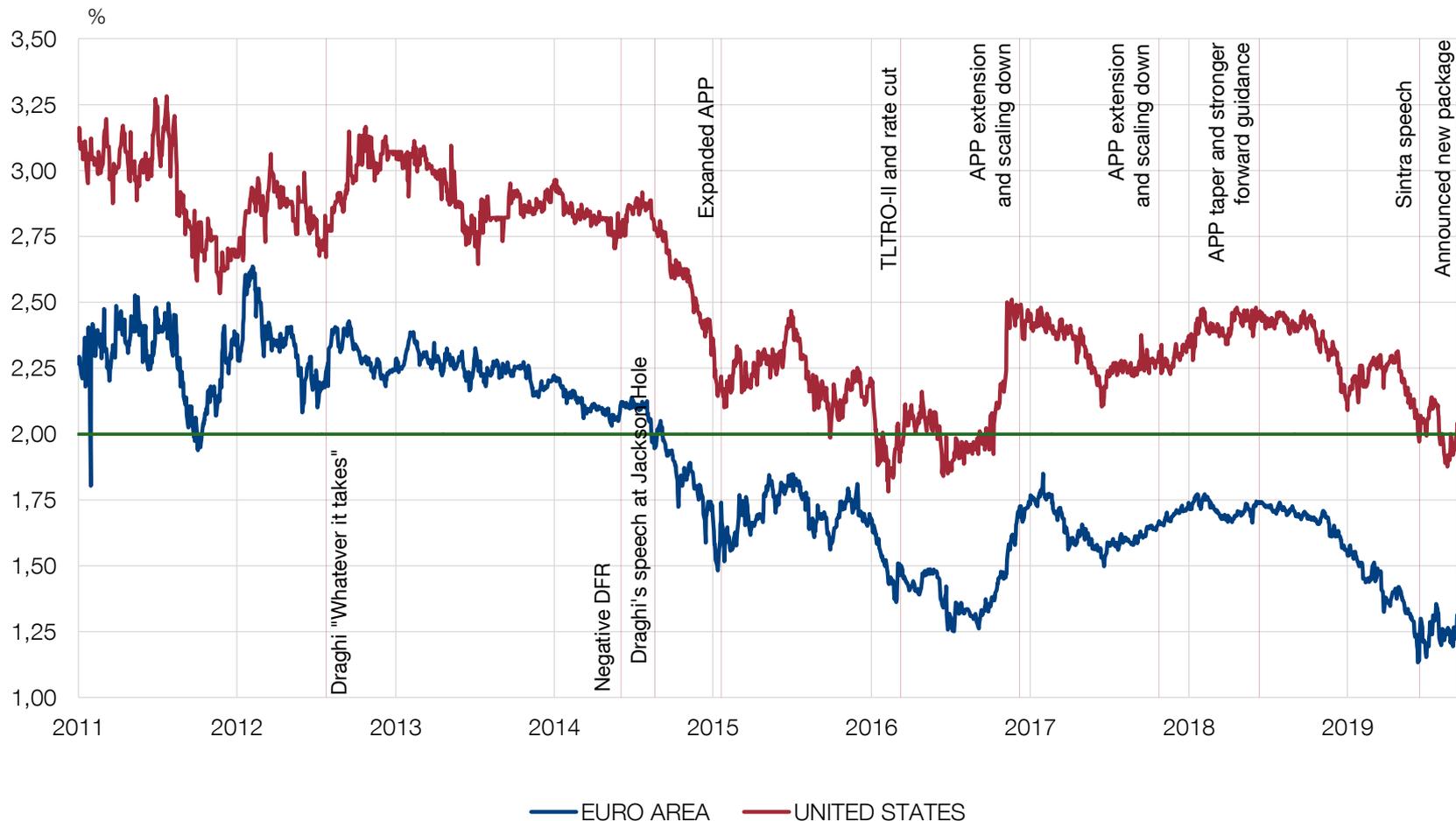


Source: Rostagno, Altavilla, Carboni, Lemke, Motto, Saint-Guilhem, Yiangou (2019), forthcoming.

Notes: The chart shows the impact of ECB non-standard measures on macro variables based on a macroeconomic model with financial variables conditioning on the yield curve impact shown in the previous slide.

# IN 2019 WE WITNESS AGAIN THE THREAT OF A DISANCHORING OF INFLATION EXPECTATIONS...

## FIVE-YEAR FORWARD BREAK-EVEN INFLATION RATE FIVE YEARS AHEAD

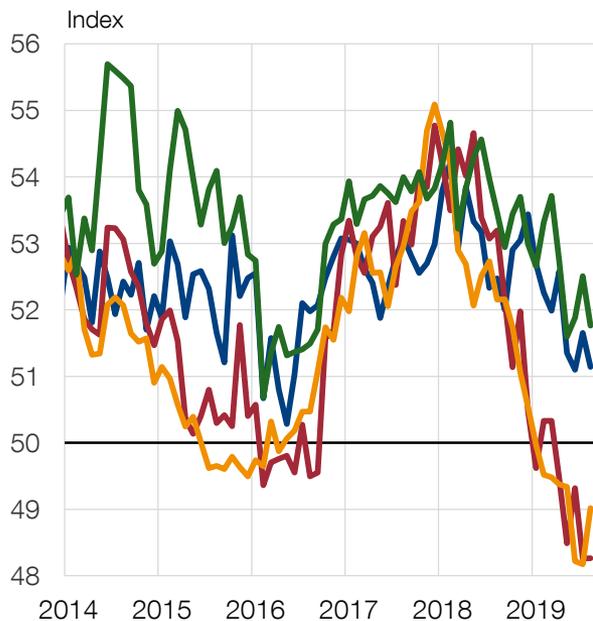


Sources: Thomson Reuters and Banco de España. Last observation: 19 September 2019.

# ... IN A CONTEXT OF DECELERATING GLOBAL GROWTH

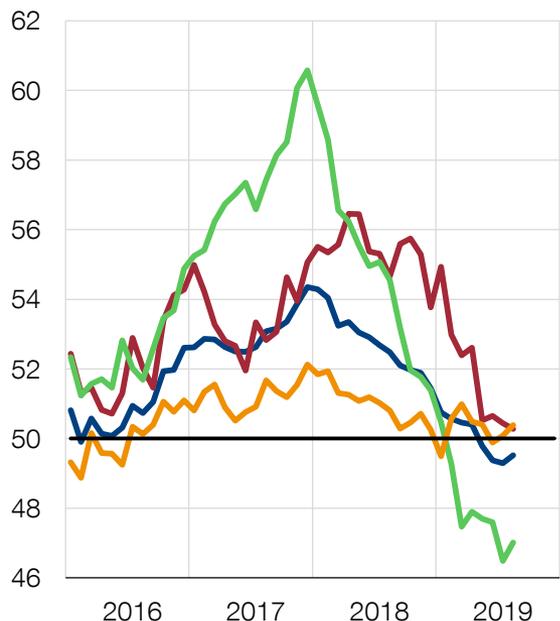
- The world economy slowed down in the second quarter and high-frequency indicators point to a continuation of this trend in the next months.
- World trade slowed down against a background of growing uncertainty over the trade policy of USA and China.

### GLOBAL PMI



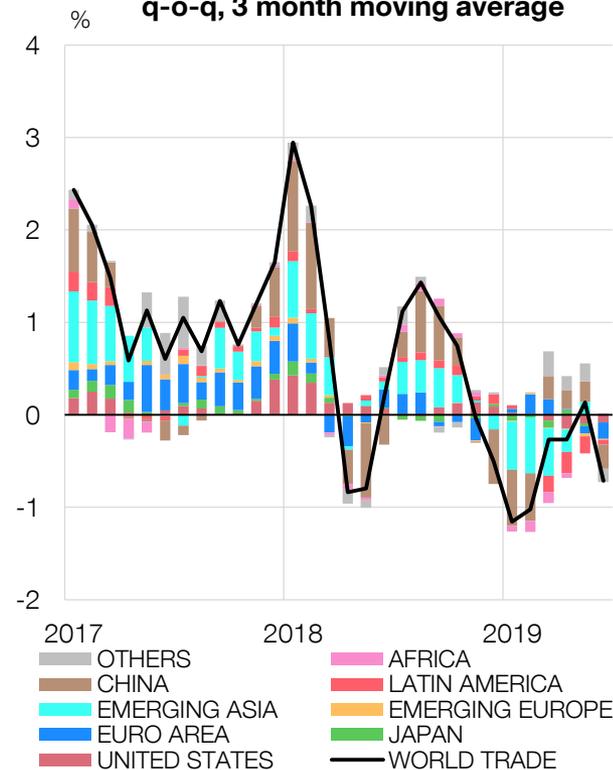
— MANUFACTURING. CONSUMER GOODS  
 — MANUFACTURING. INVESTMENTS GOODS  
 — MANUFACTURING. INTERMEDIATE GOODS  
 — SERVICES

### MANUFACTURING PMI



— GLOBAL  
 — EURO AREA  
 — UNITED STATES  
 — EMERGING

### WORLD TRADE GROWTH q-o-q, 3 month moving average



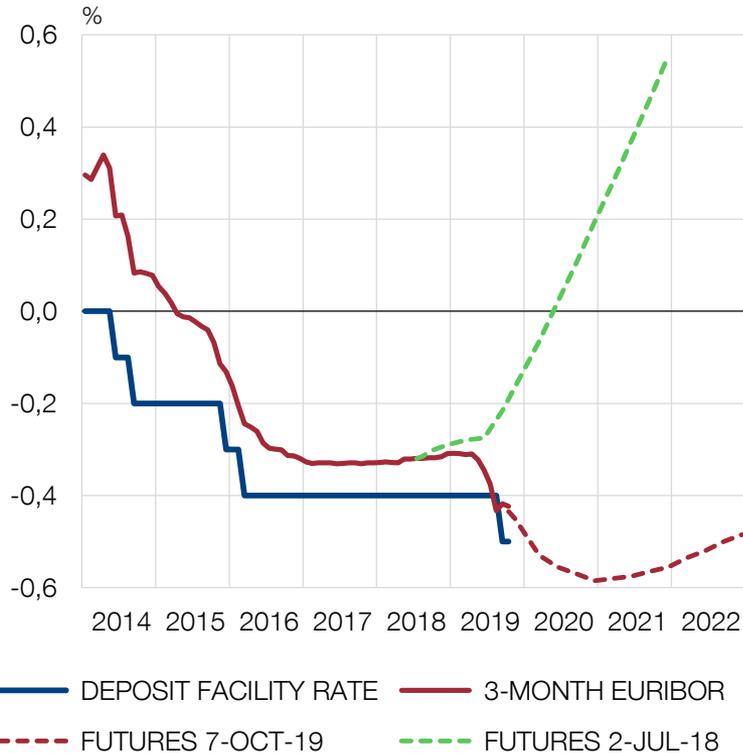
— OTHERS  
 — CHINA  
 — EMERGING ASIA  
 — EURO AREA  
 — UNITED STATES  
 — AFRICA  
 — LATIN AMERICA  
 — EMERGING EUROPE  
 — JAPAN  
 — WORLD TRADE

Sources: IHS Markit and CPB. Last observation: PMI, August 2019; Trade, June 2019.

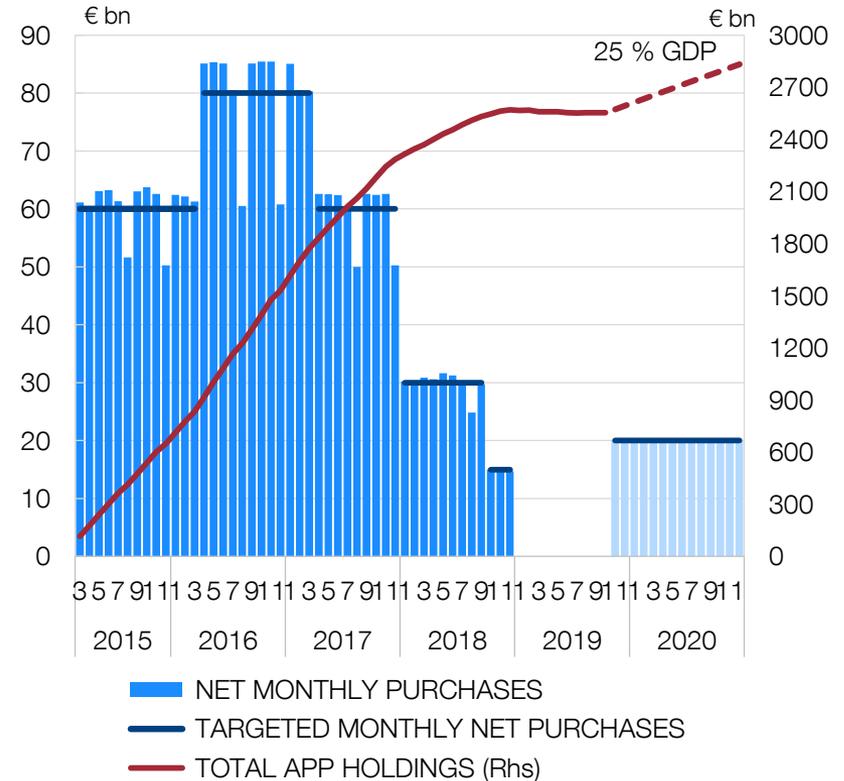
# THE ECB INTENSIFIED MONETARY STIMULUS WITH A COMPREHENSIVE PACKAGE OF MEASURES

- Lower **interest rates** (Deposit Facility to -0.50%) and a new two-tier system for reserve remuneration to support the bank-based transmission of monetary policy
- Reinforcing **forward guidance** (dependent on inflation outlook)
- Resumption of **net asset purchases** (APP) and modifications in TLTRO-III

ECB OFFICIAL INTEREST RATES AND 3-MONTH EURIBOR FUTURES



ASSET PURCHASE PROGRAMME (APP)  
Net monthly purchases and holdings



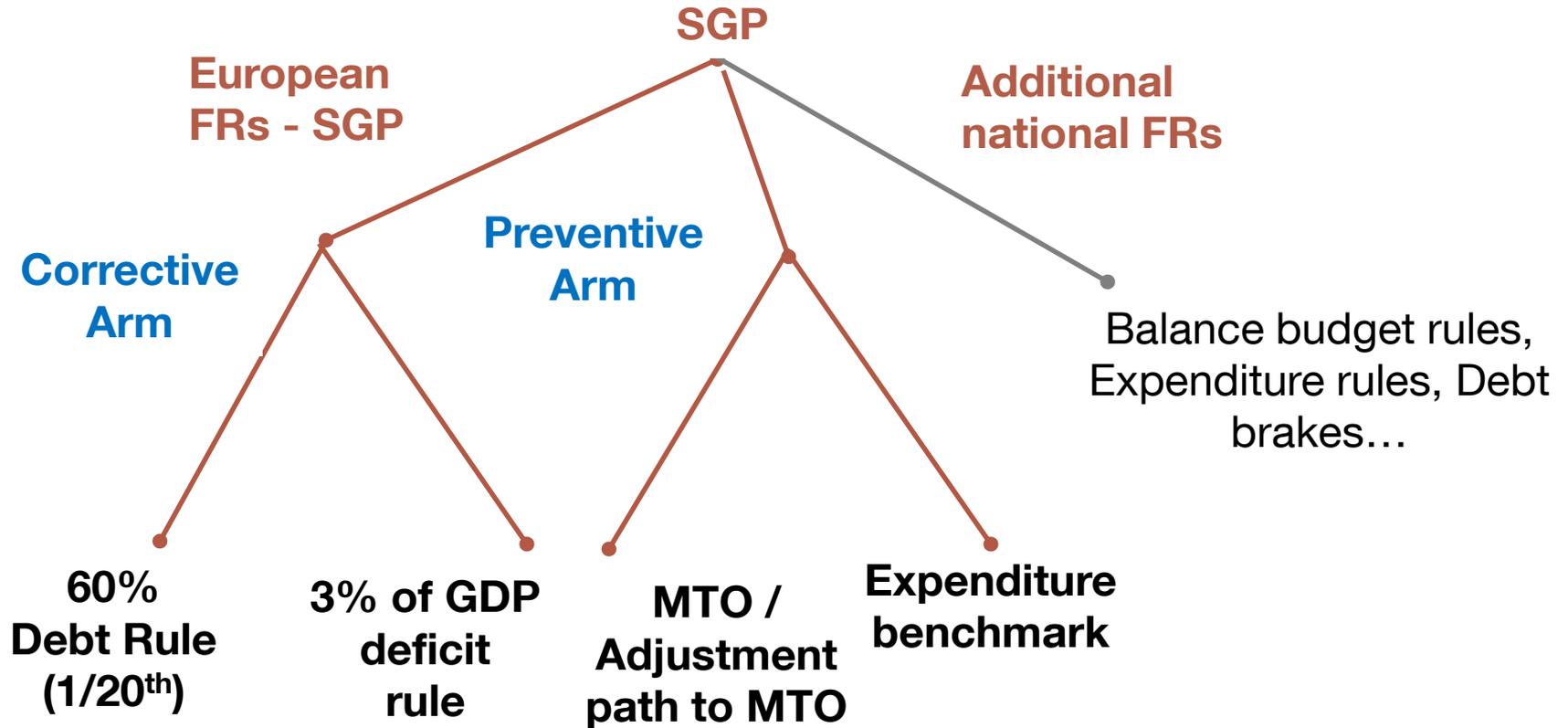
Sources: ECB and Thomson Reuters

# CURRENT DEBATE: THE PARTICIPATION OF NON-MONETARY ECONOMIC POLICIES IS ESSENTIAL

- **Fiscal stimulus**
  - Countries with fiscal space
  - The composition of spending is important
  - Positive synergies to other countries in a context of low interest rates
- **Developing a common fiscal capacity**
  - Cyclical stability for the monetary union as a whole
  - Provides public risk sharing in case of country-specific shocks
  - *Instrument for convergence and competitiveness*: right direction but insufficient
- **Structural reforms**
  - Need to raise potential growth
  - Also positive synergies in parallel with demand-side expansionary policies
- **Further progress on the euro area institutional architecture**
  - Completing banking union will help to create pan-European banking groups and it will make the monetary union more robust and resilient
  - Further progress on the Capital Market Union project will help to increase market financing and it will promote risk sharing through private channels

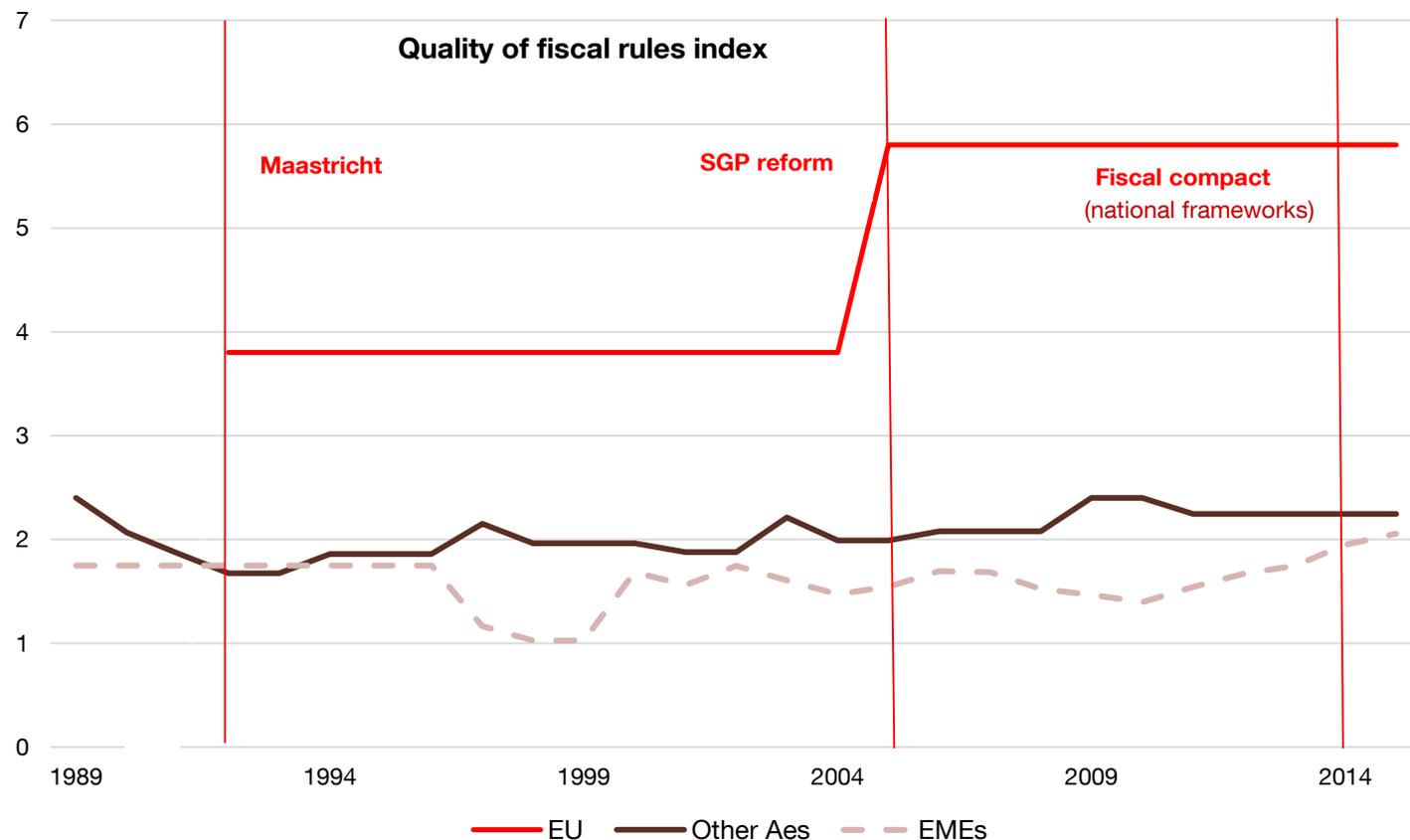
# FISCAL POLICY IN EMU

# DESIGN – THE EU FISCAL FRAMEWORK IN A NUTSHELL



- + Independent Institutions: EC / National IFIs / European Fiscal Board
- + Monitoring of national budgetary process

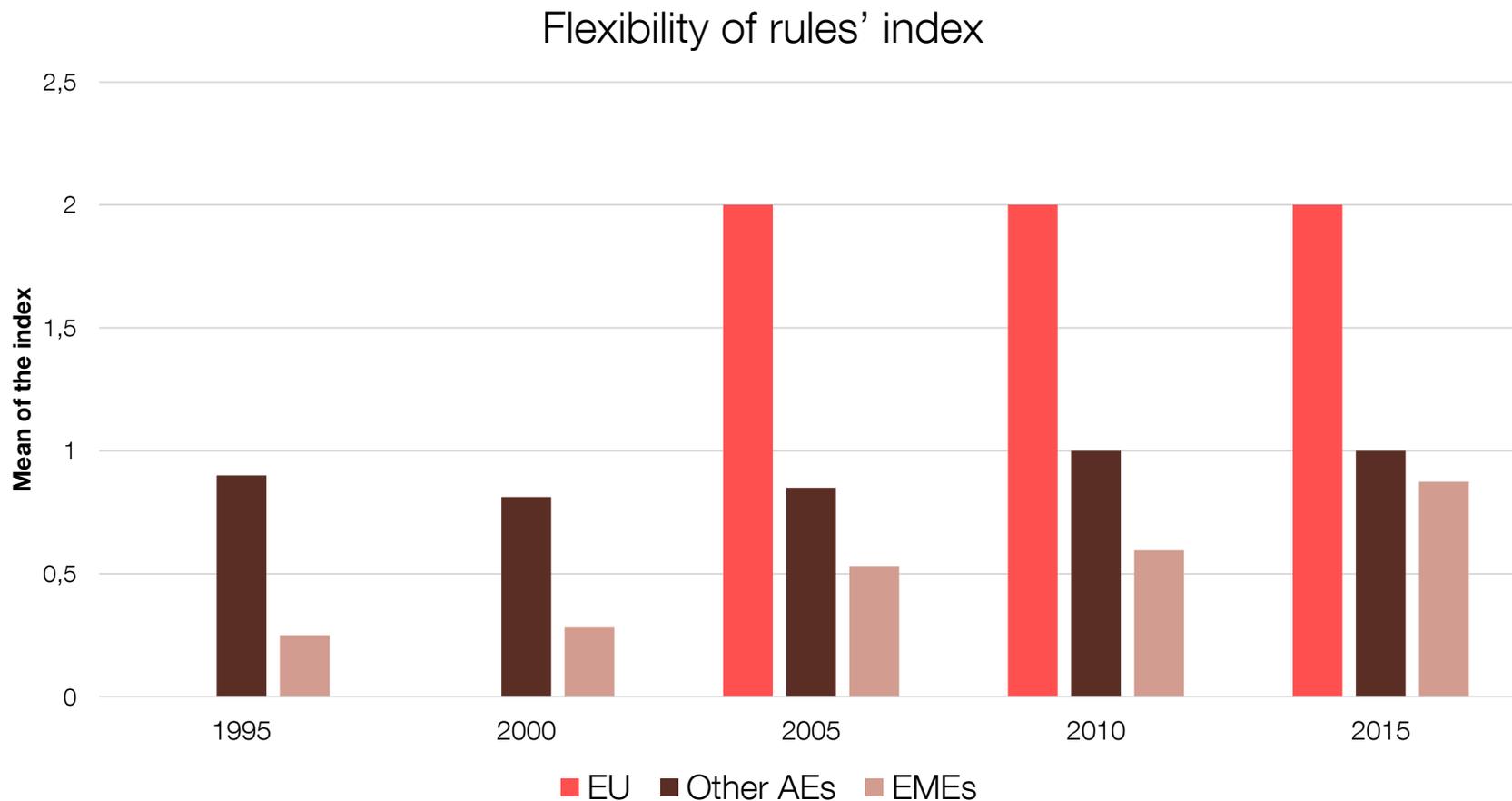
## The EU has been at the policy frontier in designing fiscal rules



Source: own elaboration based on IMF Fiscal Rules Dataset, 2016 (independent bodies; formal application; legal basis; coverage; escape clause; stabilization; investment)

Note: index for budget balance rules

## The flexibility of EU fiscal rules is high by international standards

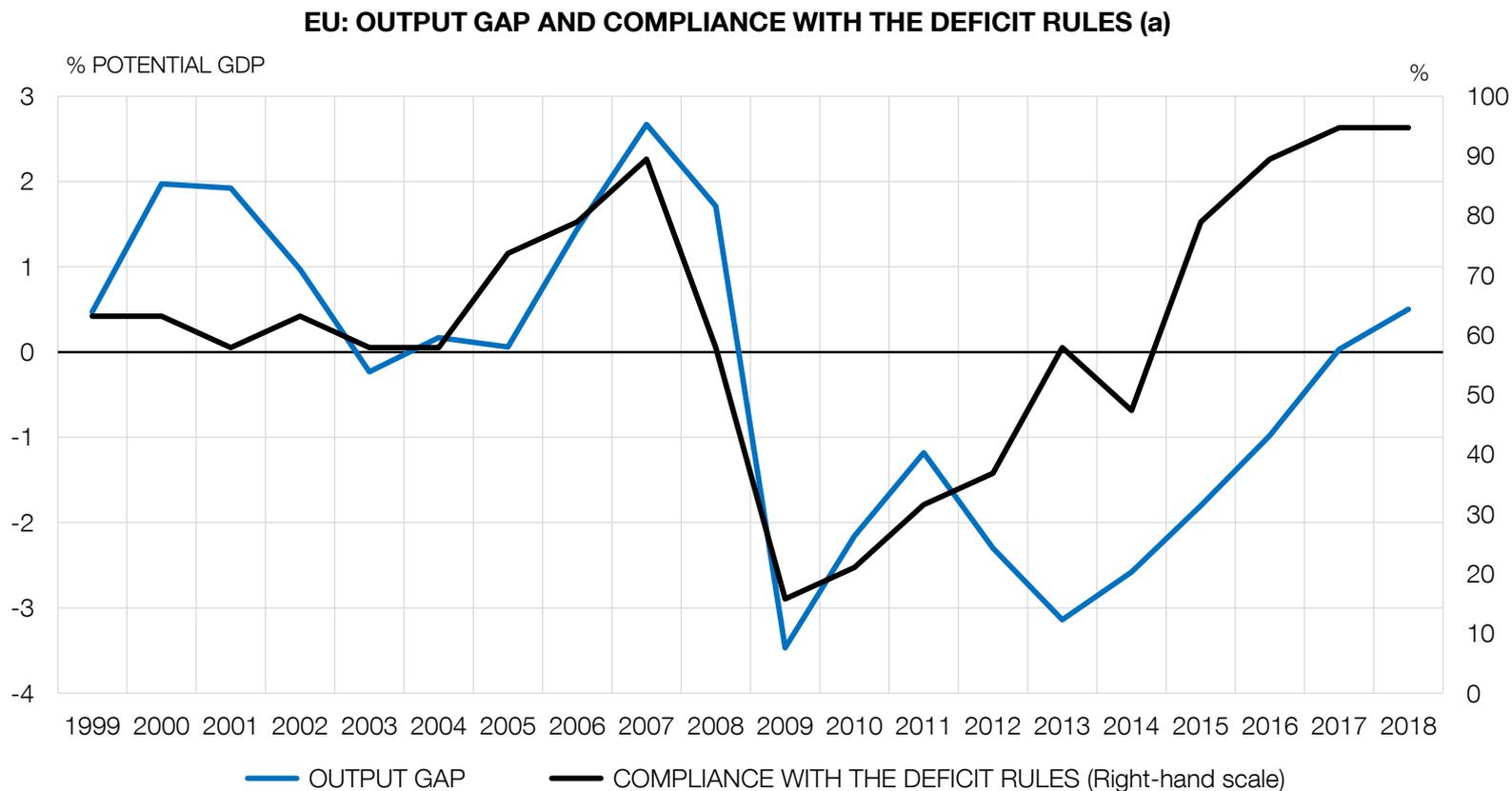


Source: own elaboration based on IMF Fiscal Rules Dataset, 2016

Note: index for budget balance rules. In 2015, the EU included a new investment clause in the fiscal framework

## The rules in practice

- Compliance not brilliant



Source: European Commission  
(a) % of countries with public deficit higher than 3% of GDP

# OTHER POLICIES AND WAY FORWARD

# DIAGNOSTICS

**BEFORE**

**SGP**

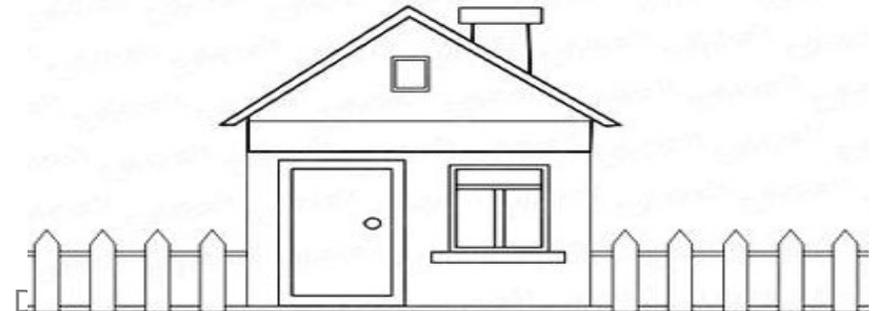
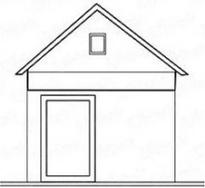
**TODAY**

**SGP**

- + Reinforced rules
- + ESM (rescue fund)
- + Banking Union (joint, SRF)
- + Tried-and-tested ECB

## REFORMS

- **Banking Union to be completed**
  - SRF backstop / EIDS
- **Shock absorption mechanisms**
  - Private: capital markets
  - Public: funds/debt, central?
- **Elements that complement current framework**
- **Elements that substitute parts of current framework**









# A WORD CLOUD VIEW OF THE REPORTS

## Report 1 CEPR FR-DE



## Report 2 ADEMU



... and linked to that, also on (sovereign) debt, risk & markets



# SOME OPEN ISSUES





# ISSUE #2

## On (fiscal) governance – remark 1/2



### Technocracy vs. democracy?

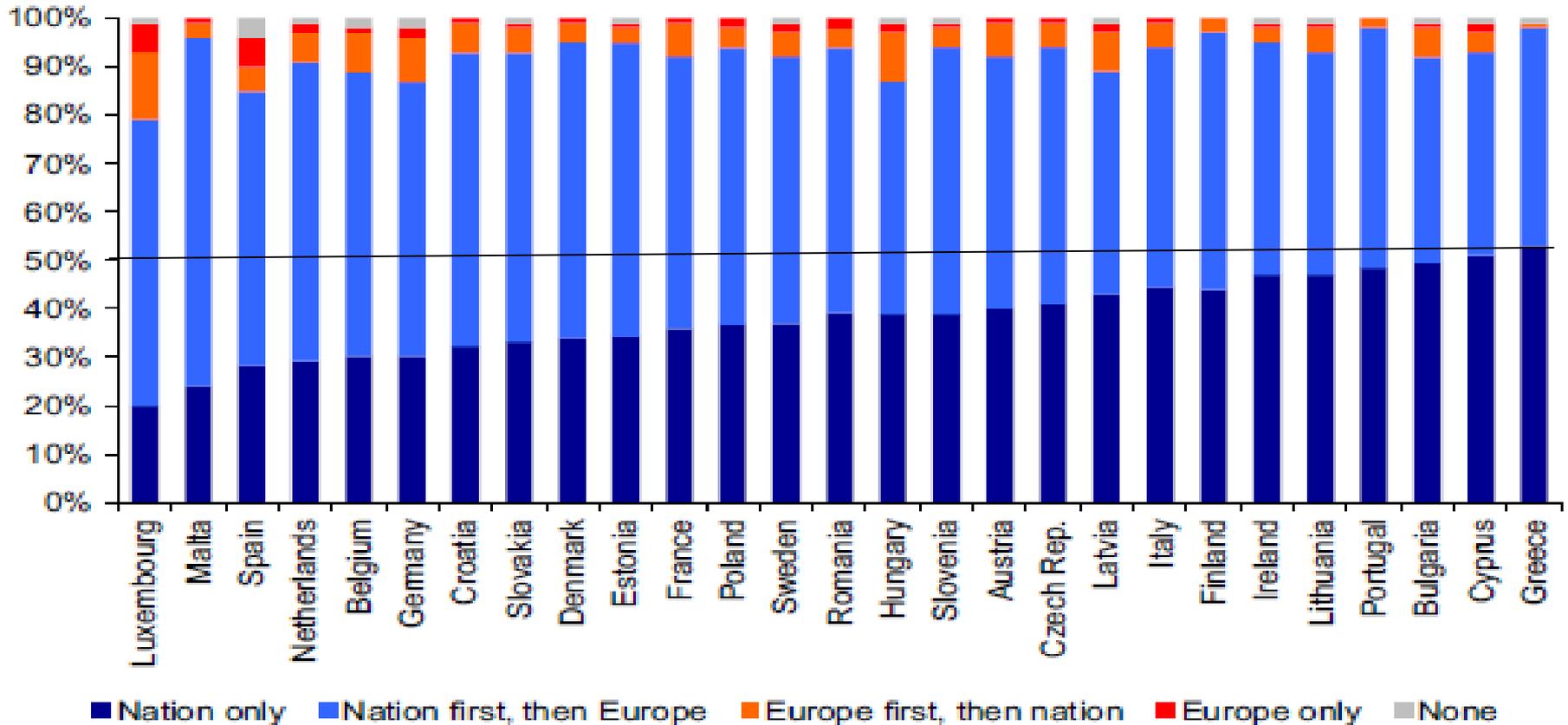


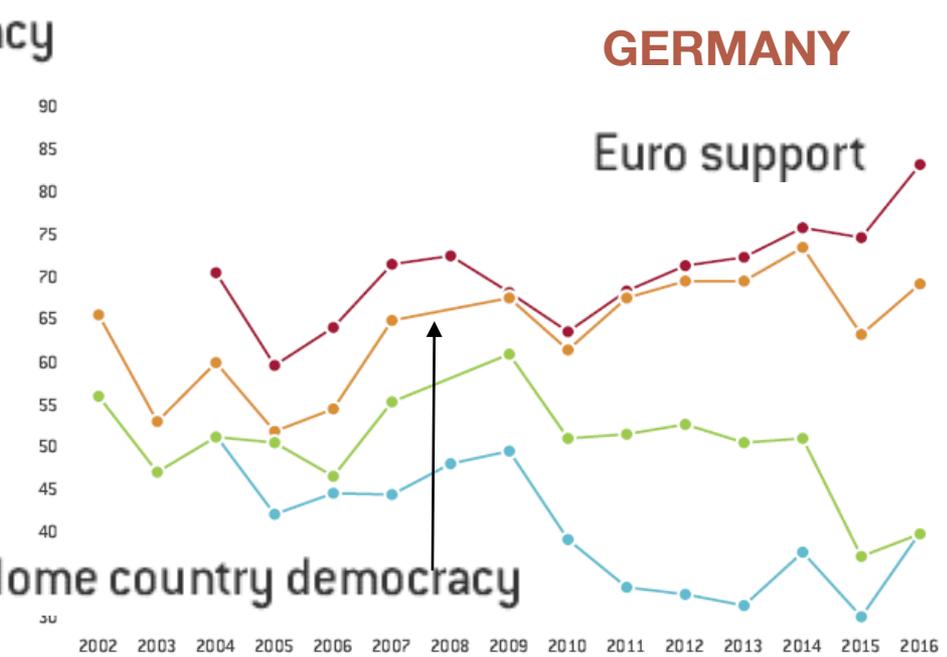
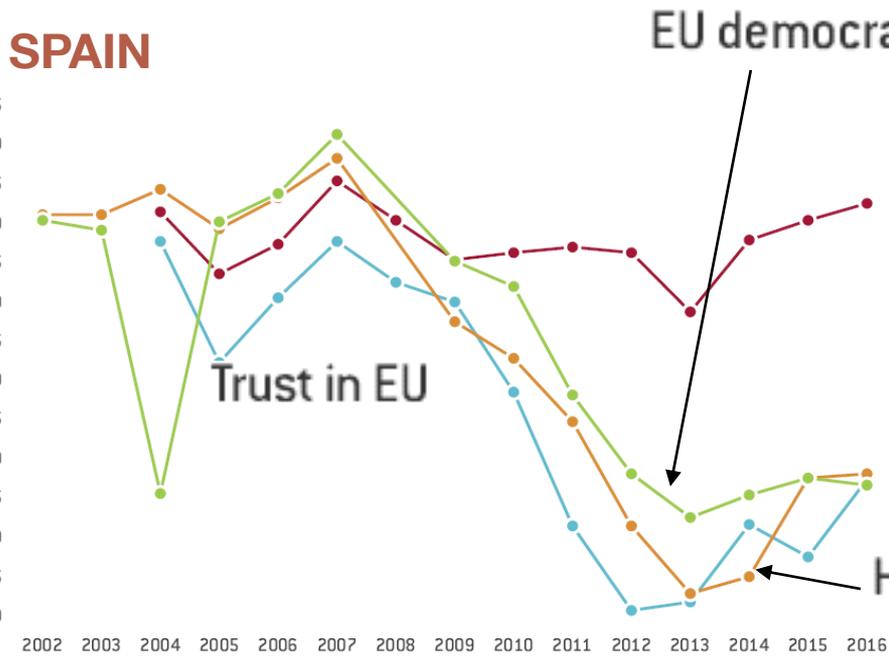
Figure 1: National versus European self-identification in twenty-seven EU member states [Colour figure can be viewed at [wileyonlinelibrary.com](http://wileyonlinelibrary.com)]



# EU FISCAL FRAMEWORK...

... Useful in the axis “EU citizens versus National Governments”?

... Specially in countries with low trust in national governments



Source: Bruegel note 24 March 2017, based on Eurobarometer





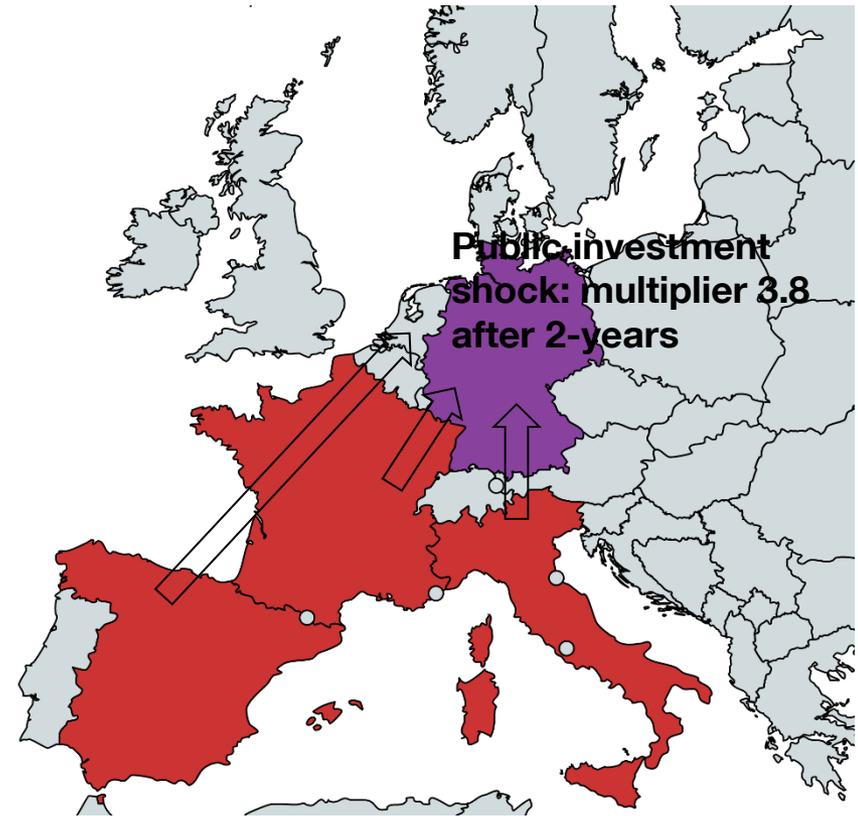
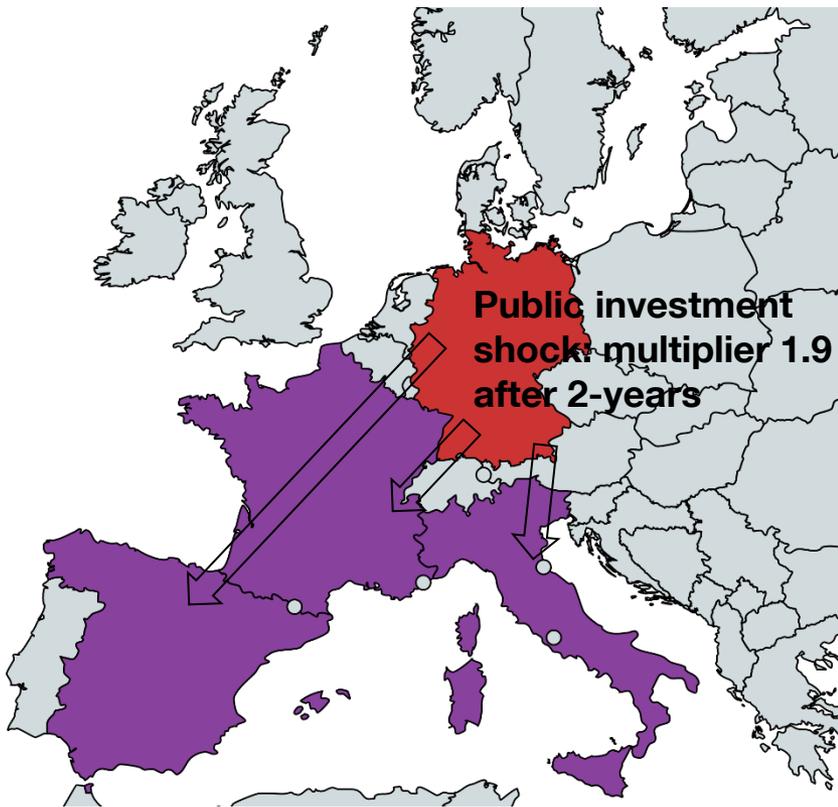


# ISSUE #3

## (Central) stabilization tools- remark 2/3



Coordination: spillovers empirically relevant (ex. ARRA & ERP of 2009)



# ISSUE #3

## (Central) stabilization tools- remark 3/3



**Centralised tool/fiscal capacity** - an average contribution of some 1% of GNP would suffice to get a “fiscal insurance” similar to the one of the US

*The creation of a stabilisation fund in 1999, when certain cyclical conditions were met, would have enabled a risk-sharing capacity (in terms of insurance or fiscal stabilisation) similar to that in the United States to have been achieved, without having committed major resources or permanent income transfers between countries. However, its design would not have obviated the difficulties in estimating countries' cyclical position in real time.*

SIMULATION OF THE CONTRIBUTIONS AND FUNDS RECEIVED UNDER A HYPOTHETICAL SCHEME. AVERAGE 1999-2015

% of GNP

CYCLICAL INSURANCE SCHEMES (based on the output gap) (a)

	Scheme 1		Scheme 2	
	Contribution	Receipt	Contribution	Receipt
Euro area	1.0	1.0	0.2	0.2
Belgium	1.0	0.3	0.2	0.1
Germany	1.0	0.7	0.1	0.2
Greece	1.0	2.5	0.3	0.5
Spain	1.0	2.1	0.3	0.4
France	1.0	0.5	0.3	0.1
Italy	1.0	1.1	0.2	0.2
Netherlands	1.0	1.2	0.1	0.3
Austria	1.0	0.5	0.1	0.1
Portugal	1.0	1.3	0.2	0.3
Finland	1.0	0.9	0.2	0.2
Memorandum item: Stabilisation capacity	0.37		0.15	

a In Scheme 1, the countries make a set contribution of 1% of GNP and receive a transfer when their output gap is negative. The amount of the benefit is determined on the basis of the country's size, its output gap and the size of the fund. In Scheme 2, the countries make contributions to the fund if they have a positive output gap, while they receive a transfer if the gap is negative. The amount of the transfer and of the contribution of each country is 25% of the size of the output gap. For further details see E. Gordo (2017), “The risk-sharing mechanisms in EMU”, forthcoming. The stabilisation capacity refers to the percentage of the adverse shock which is softened with each schema, where 1 would represent the maximum possible percentage (100%).

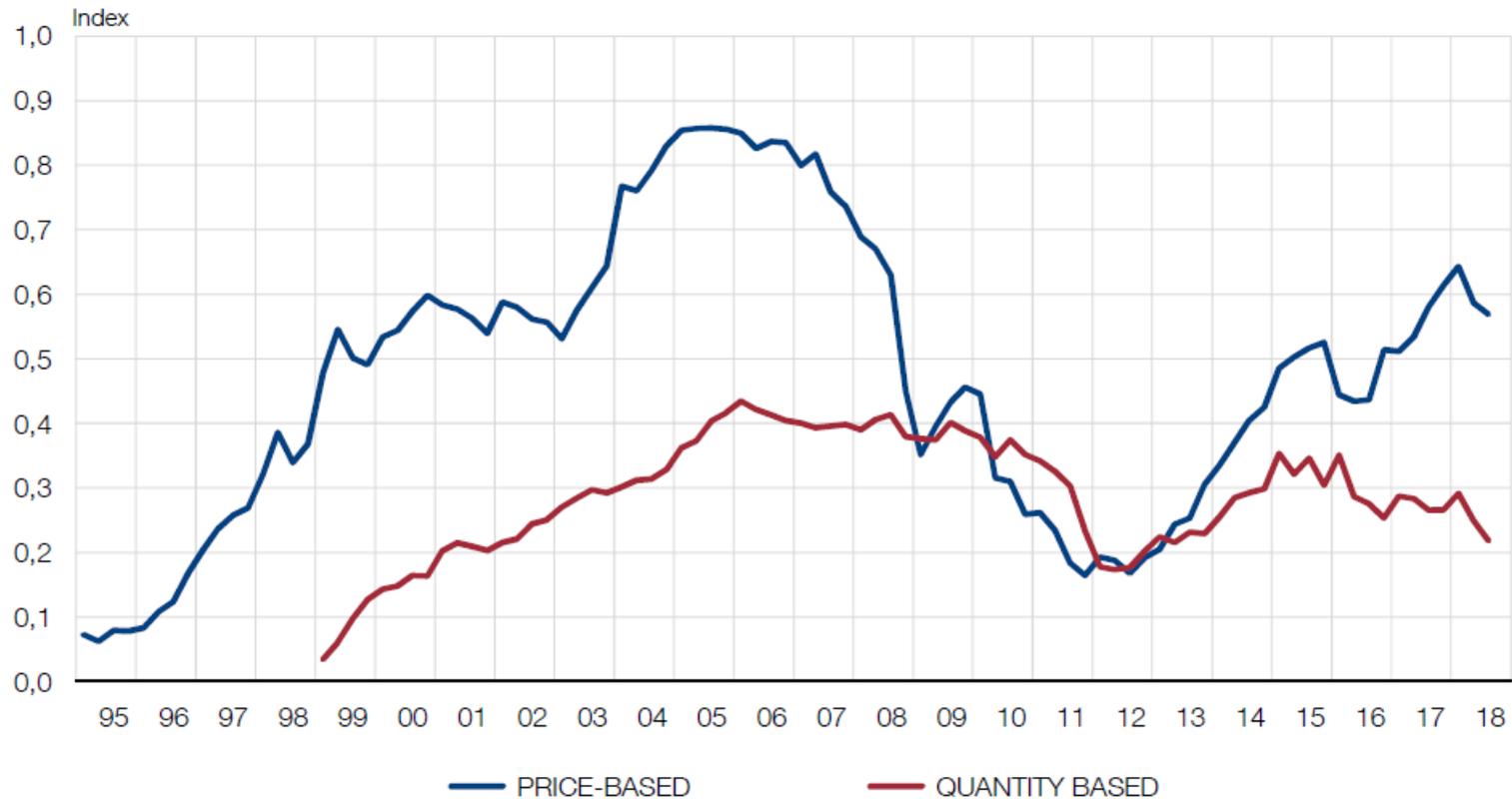
# ISSUE #4

## Financial integration - remark 1/3



**Financial integration** - completing the Banking Union, together with the CMU, will also benefit the financing conditions in the euro area

**INDICATORS OF FINANCIAL INTEGRATION IN THE EURO AREA**



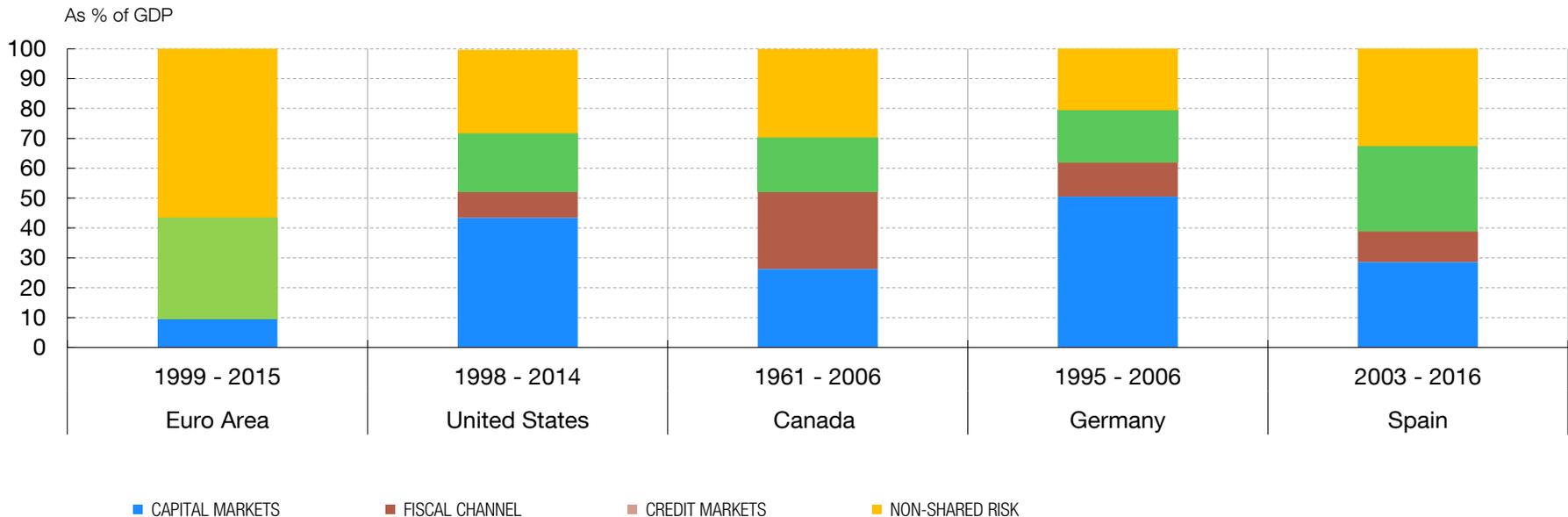
# ISSUE #4

## Financial integration - remark 2/3



### Financial integration - strengthen the region's risk absorbing capacity

#### STRENGTH OF RISK-SHARING CHANNELS (a) INTERNATIONAL COMPARISON



(a) Estimated following the methodology of Asdrubali et al (1996), which approximates the percentage of shocks recorded in an economy's GDP that pass through to that economy's residents' income and consumption decisions. The channels that enable the impact of the shocks to be softened are, firstly, the capital markets channel whose strength depends on the income that residents obtain from other countries not affected by the shock because they hold shares in the companies of those countries and obtain income from labour and from other financial assets. Secondly, the shock may be softened by public intervention through fiscal transfers from the federal budget, as in the case of the United States, or from other regions (fiscal channel). Finally, households and firms in that economy may smooth their consumption by resorting to their savings or to the credit market (credit channel)

Source: Banco de España Annual Report 2016 and Burriel (forthcoming)





