

Institut der deutschen Wirtschaft, DekaBank, Börsen-Zeitung | Frankfurt, 3. November 2016

18. Finanzmarkt Round-Table:

Welche Zukunft bleibt Europa? Können die Finanzmärkte überhaupt noch Erwartungen bilden?

Grenzen der Makrosteuerung

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■ Structural Reforms

- » Become even more important as economies are aging ...
- » ... but remain unpopular

■ Monetary policy

- » Did (more than) enough
- » Runs out of (positive) impact, risk of negative side-effects

■ Fiscal policy

- » Hampered after heavy GFC interventions, sustainability issues
- » Back on stage? „Keynes put“? Implications for European governance?

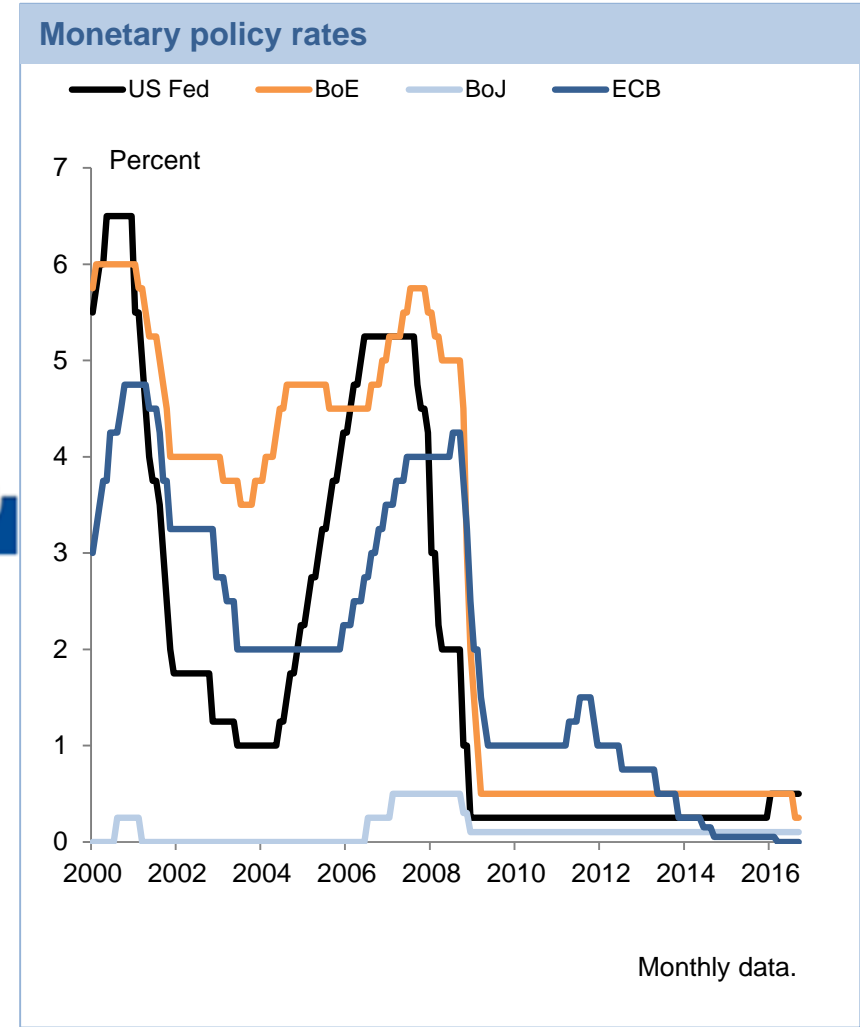
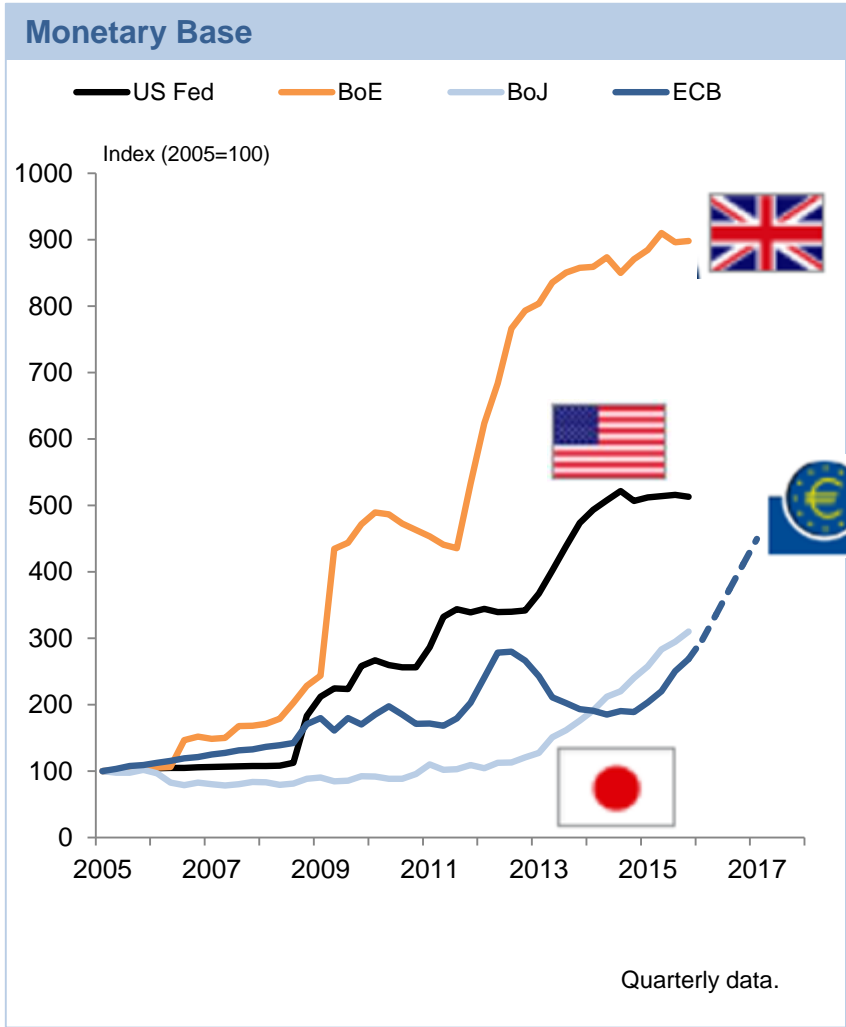
■ Neo-protectionism/economic disintegration (Brexit)

- » Popular (but destructive) temptation: Beggar-thy-neighbor ...
- » ... gains momentum

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Mankind's largest monetary experiment
of all (peace) times

QE/ZIRP around the Western globe



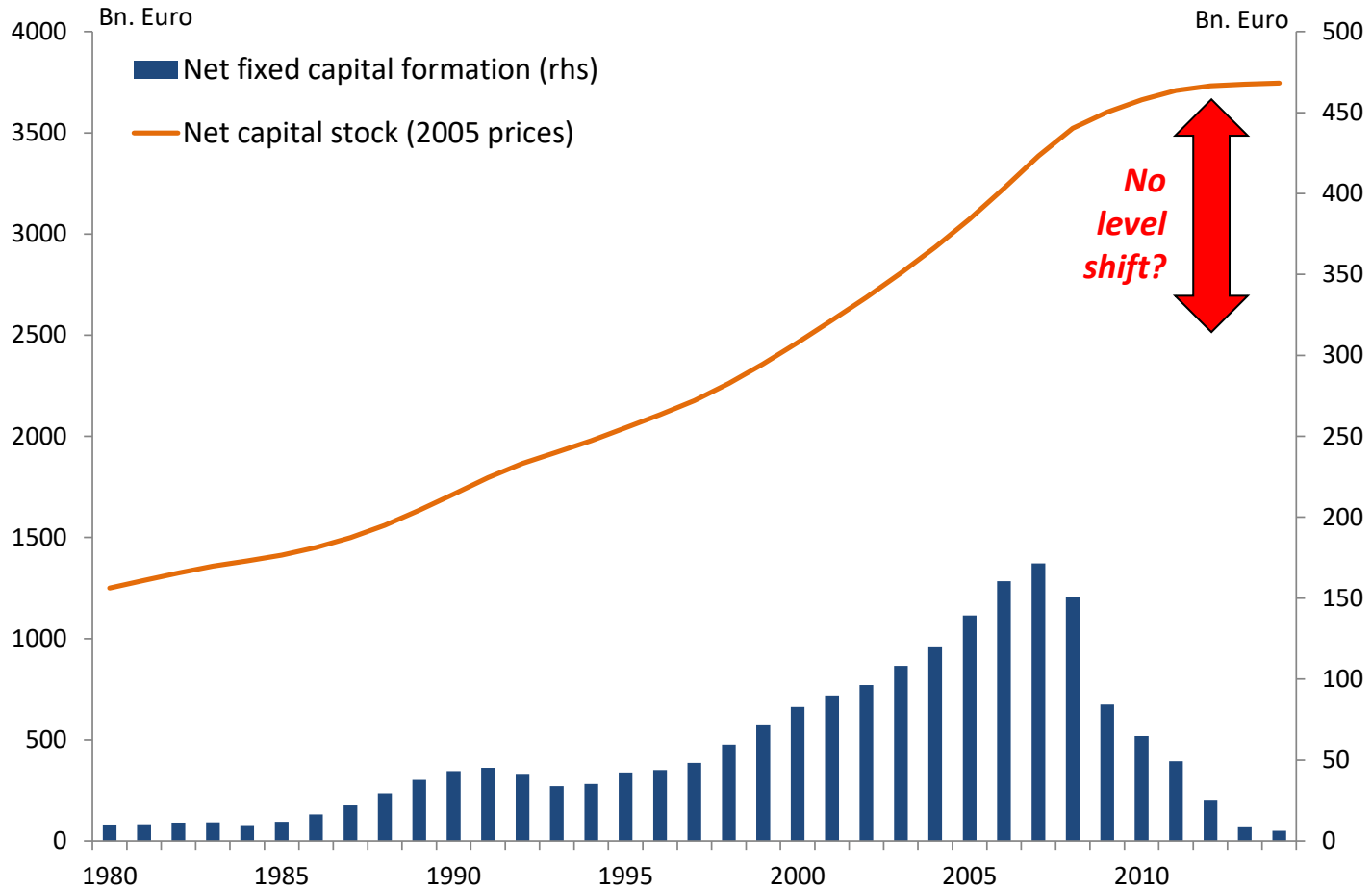
Interest rates ...

- ... just another instrument for macro-management?
- ... or the key price relation within the market system?
 - » Time preference
 - » Coordinating savings and investment
 - » Impact on capital/production structure
 - » Component of all other prices for goods and services (price structure)

⇒ „Capital gives money time to cause trouble.“ (Garrison)

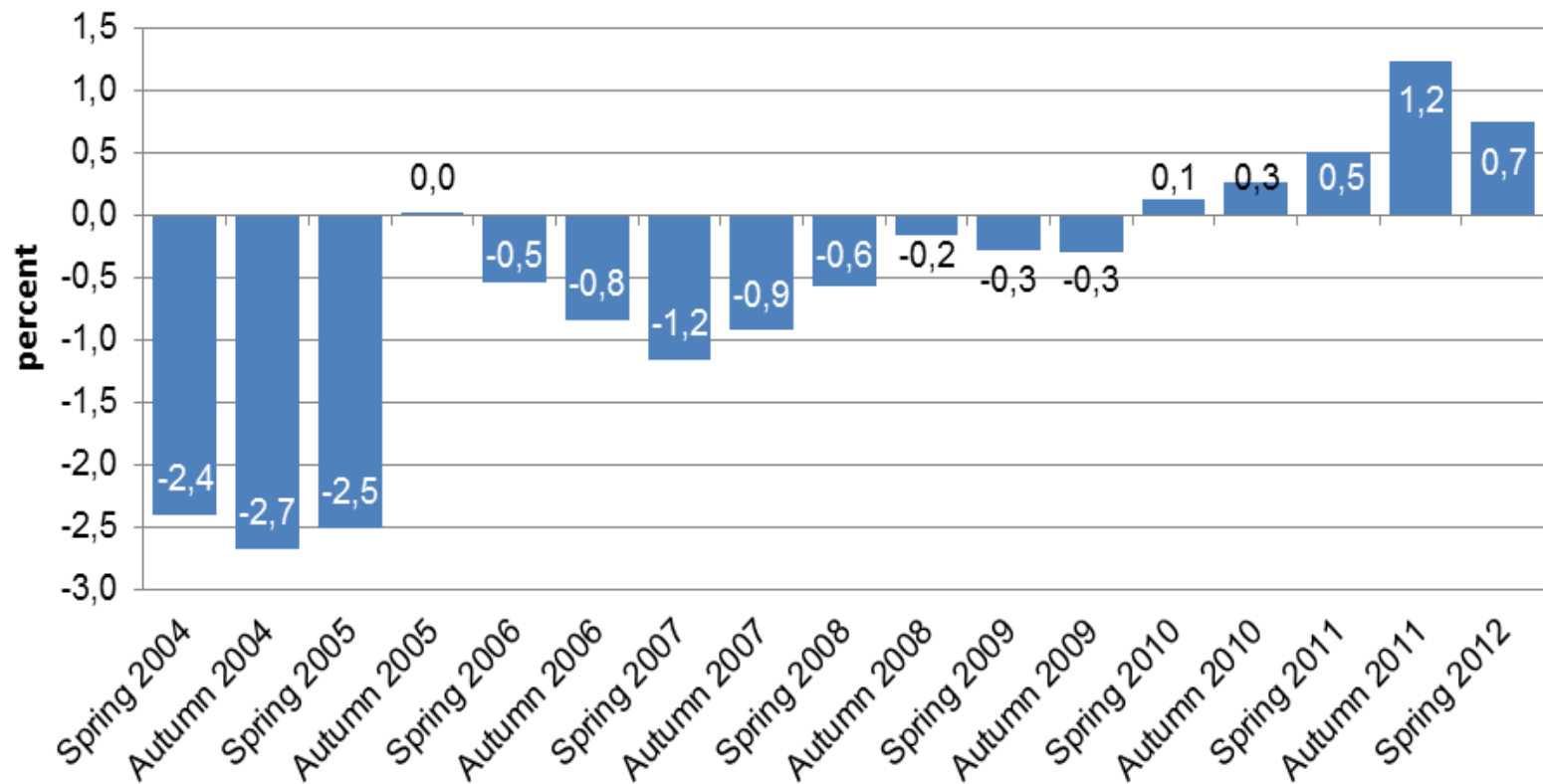
Case study

Value of the Spanish capital stock?



Source: AMECO Database.

Spanish output gap in 2005 (revisions)



Source: European Commission, various years.

- **Idiosyncratic: Entrepreneurial ventures**
 - » Wrong expectations of one market participant
 - » Happens every day, no systemic risk
 - » Liquidation, reallocation of resources

- **Pervasive: Expansionary monetary policy**
 - » Systematically wrong expectations of all market participants
 - » Financial crisis (debt crisis = flip-side of heavy capital stock distortion)
 - Fragile financial system
 - Excess debt positions destabilizes monetary system

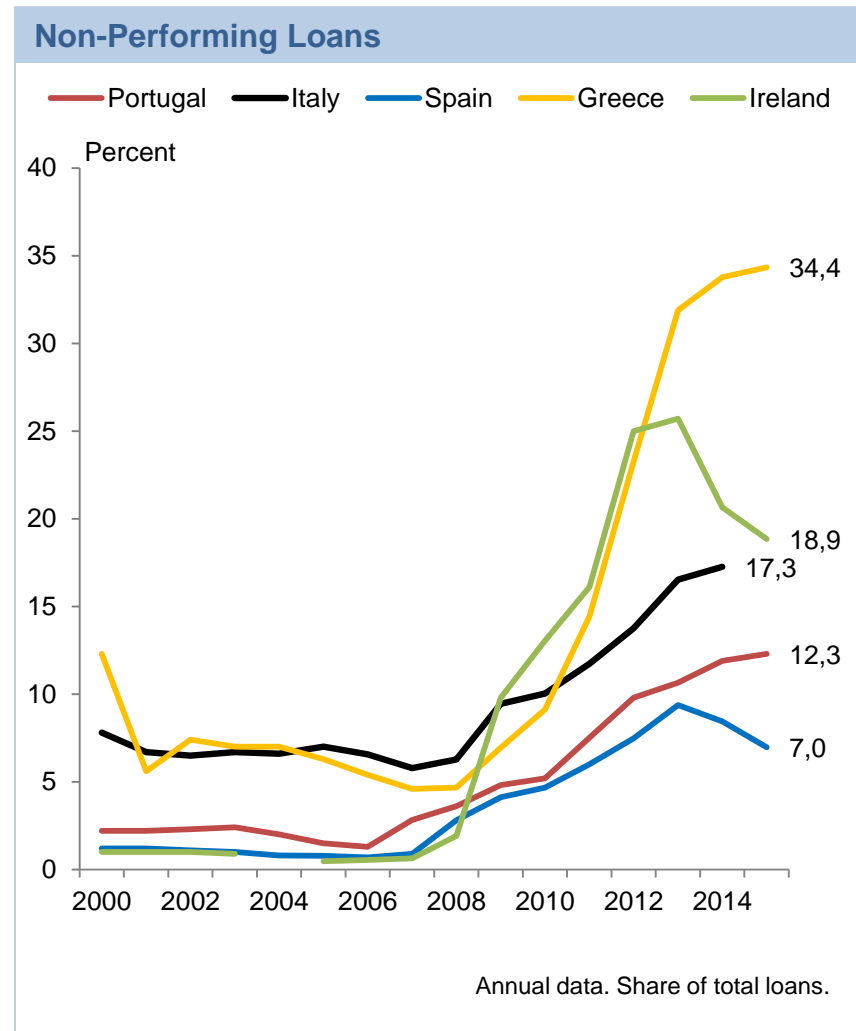
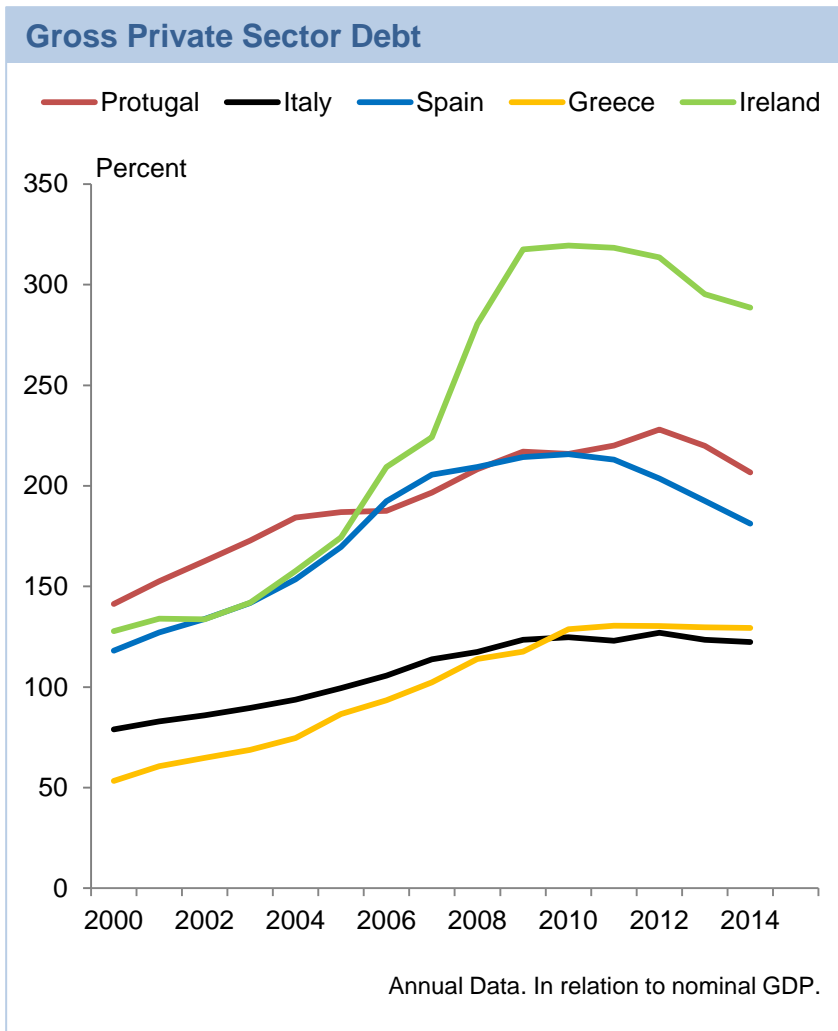
Three options of coping with debt-crises

- **Public bail-outs**
 - » Shifts private debt to public sector
 - » Private debt crisis \Rightarrow sovereign debt crisis
 - » No solution for fiscally distressed countries
- **Inflating the debt away**
 - » Takes a long time, promotes zombification
 - » Puts the currency at risk
 - » Not targeted towards non-performing loans
- **Liquidation**
 - » Tough (cold turkey) in the short-run ...
 - » ... but targeted (and root cause oriented)
 - » Puts capital at second (now first) best use

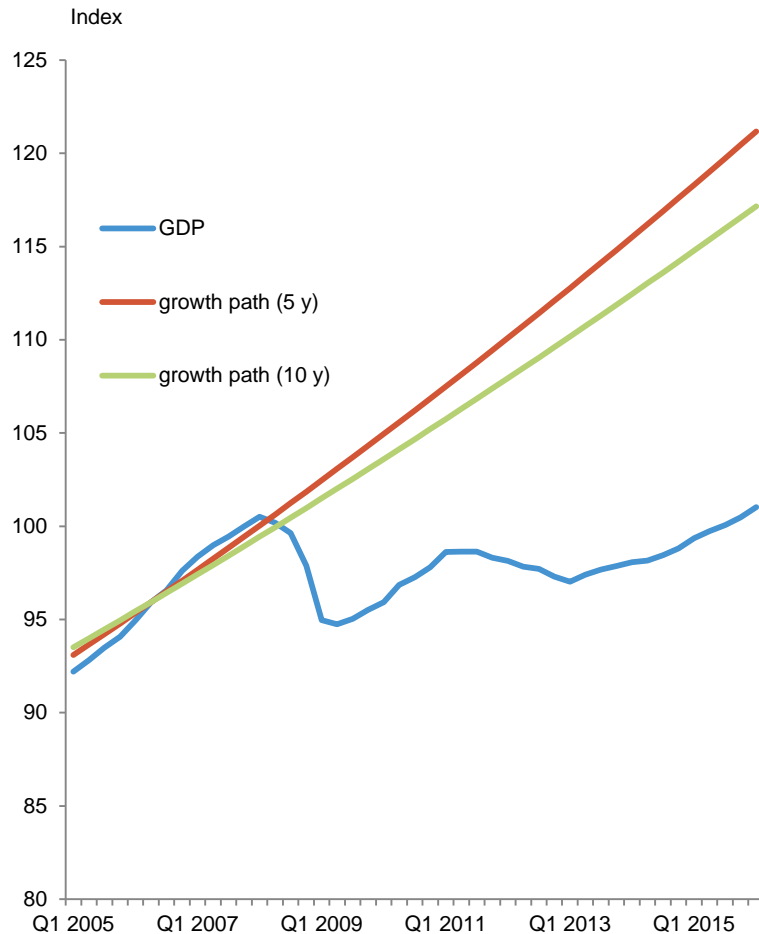
Anti-capitalist approach
(harms principle of accountability, creates moral hazard risks)

Capitalist approach
(in line with free market principles)

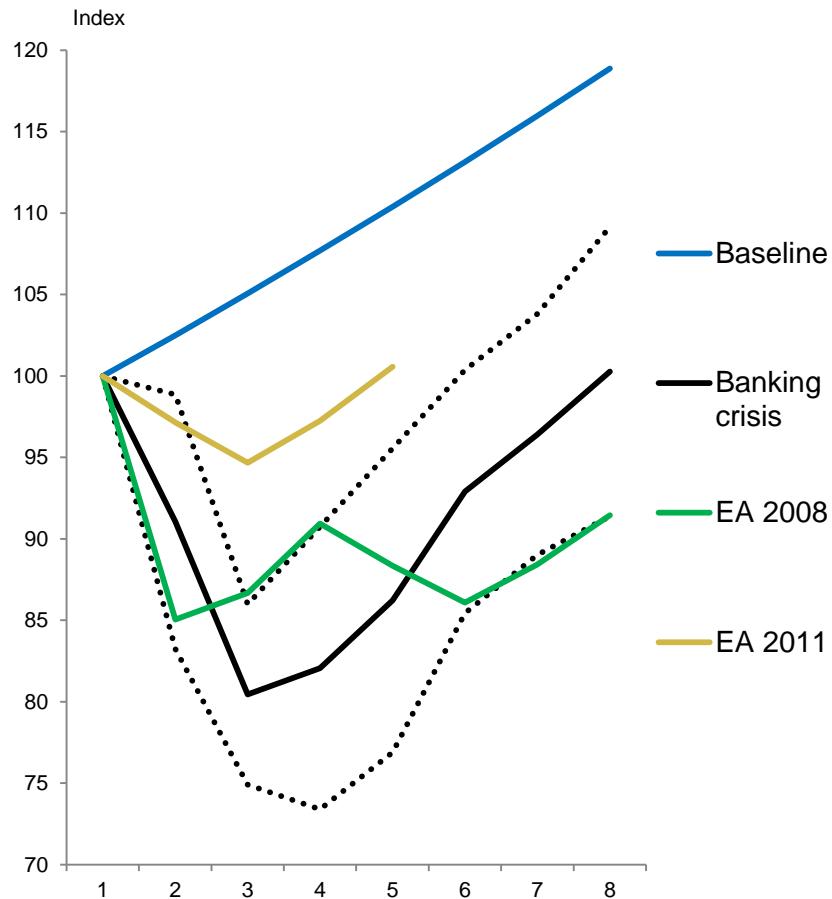
Flip-side of not liquidating (= “buying time”): Excess debt position hamper credit channel



Data source: Bank for International Settlements, World Bank.

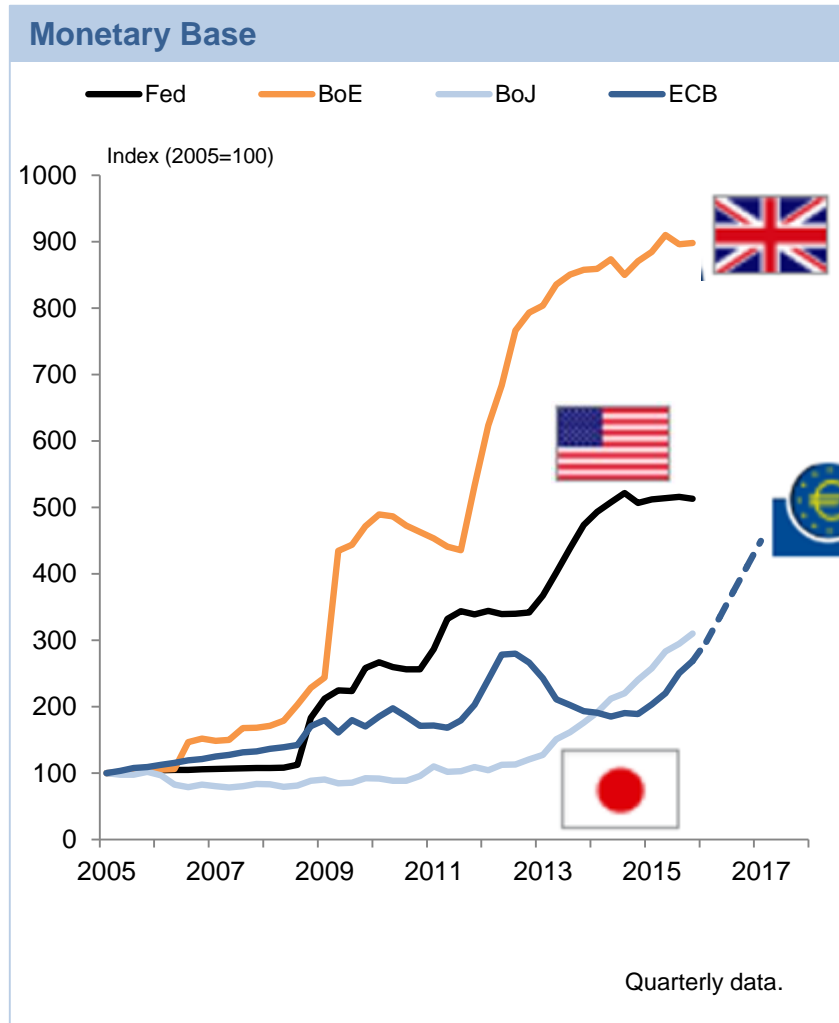


- Weak expansion ...
 - » ... compared to pre-crisis trends
- Two crises in a row
 - » Global financial crisis (2007/2008)
 - » European debt crisis (2011 ff)



- Typical post-crisis pattern
- Investment stimulus?
 - » Capacity creation ...
 - » ... or cacapity utilization?

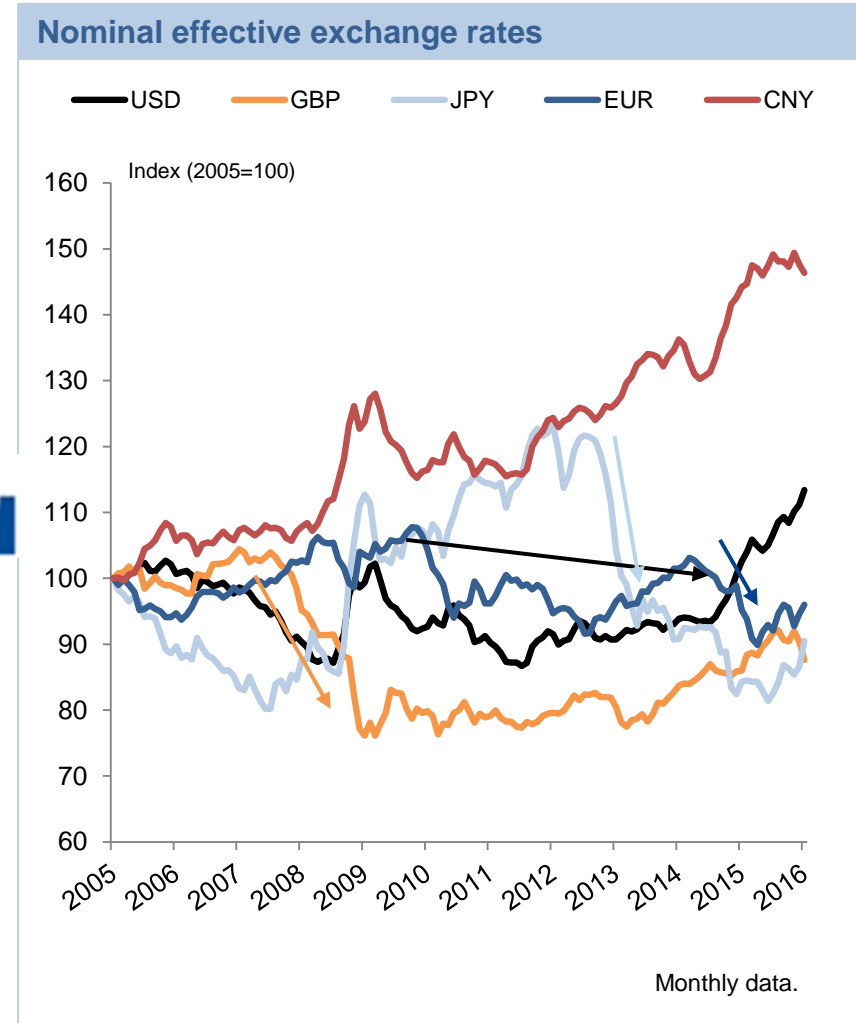
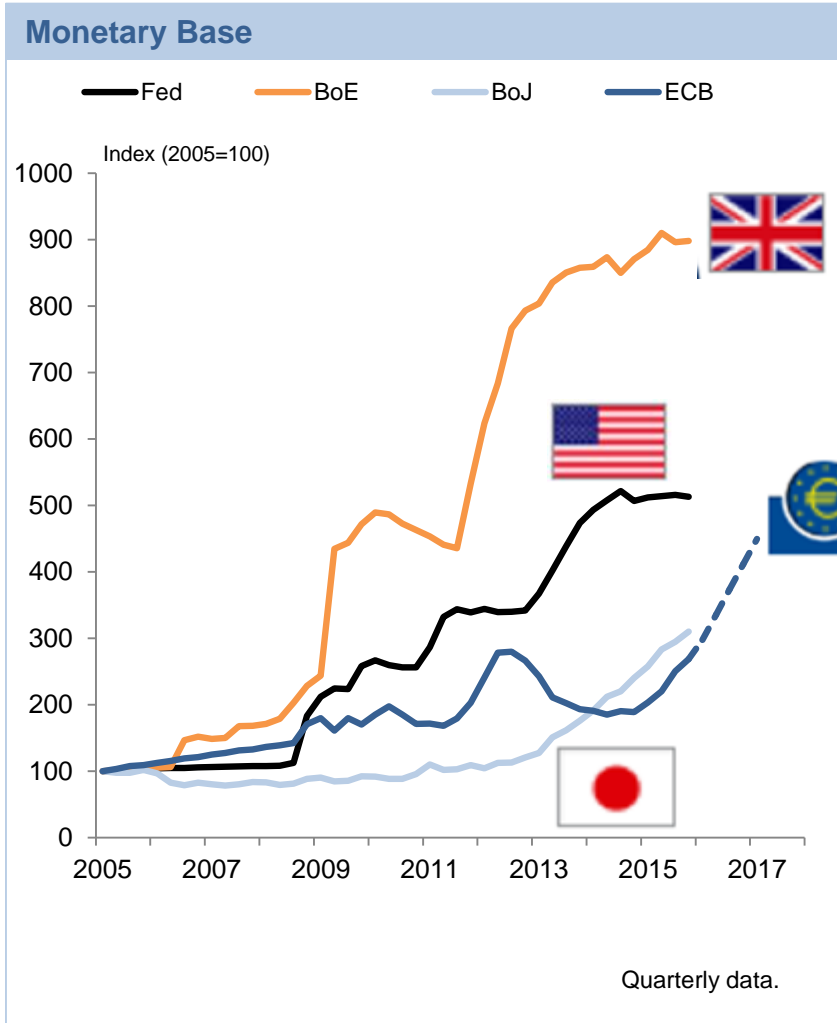
Quantitative „Easing“



- Type 1: Liquidity provision in times of financial stress (effective)
 - Type 2: Stimulus at the zero lower bound (ineffective)
- ⇒ Exit strategy?
- ⇒ ECB: Need for softer criteria for next purchase programs

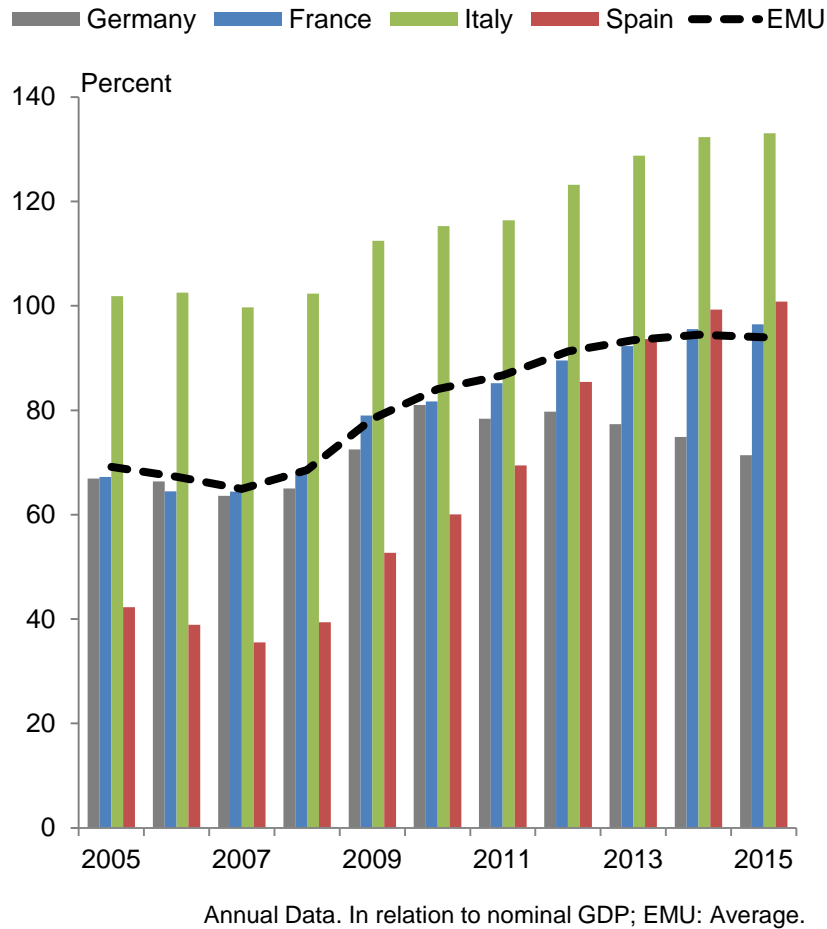
Global QE: Risk of currency wars

Source: Thomson Reuters Datastream, IfW-calculations

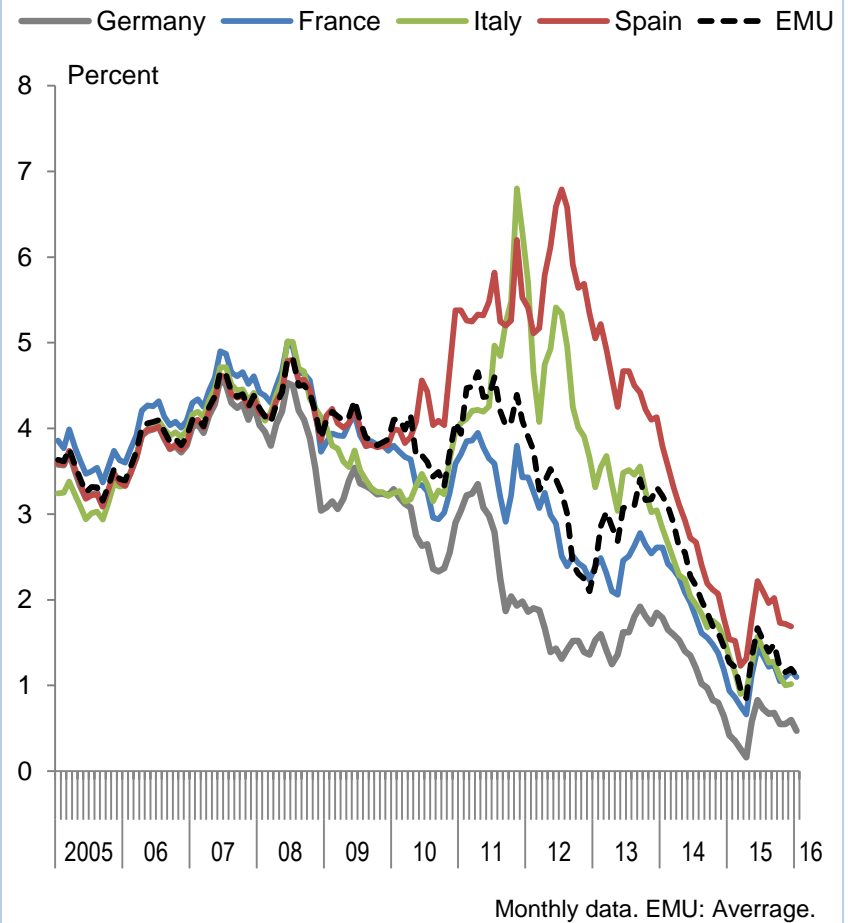


Euro Area: Monetary financing of governments

Gross Government Debt



Government Bond Yields (10-year)

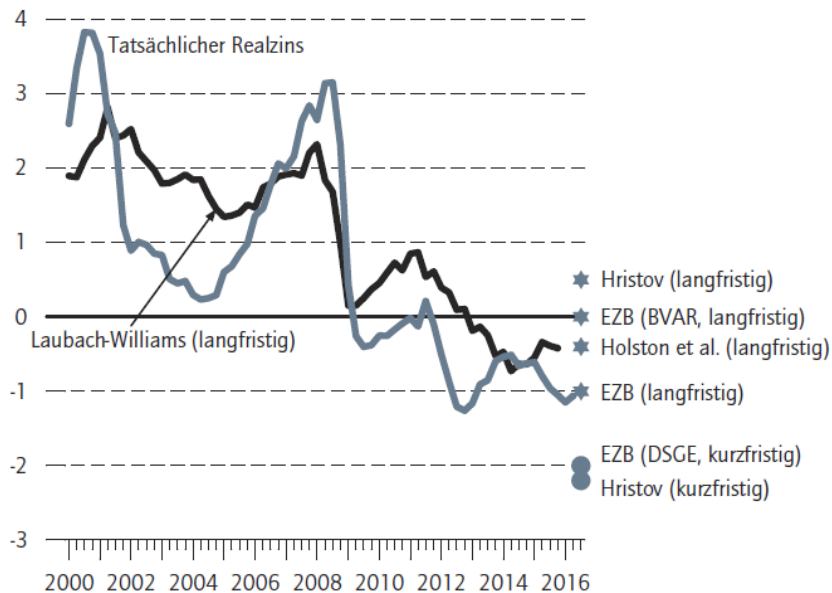


Data source: Eurostat, European Commission.

„Neutral“ real interest rates and monetary expansion

Tatsächlicher und neutraler Realzins

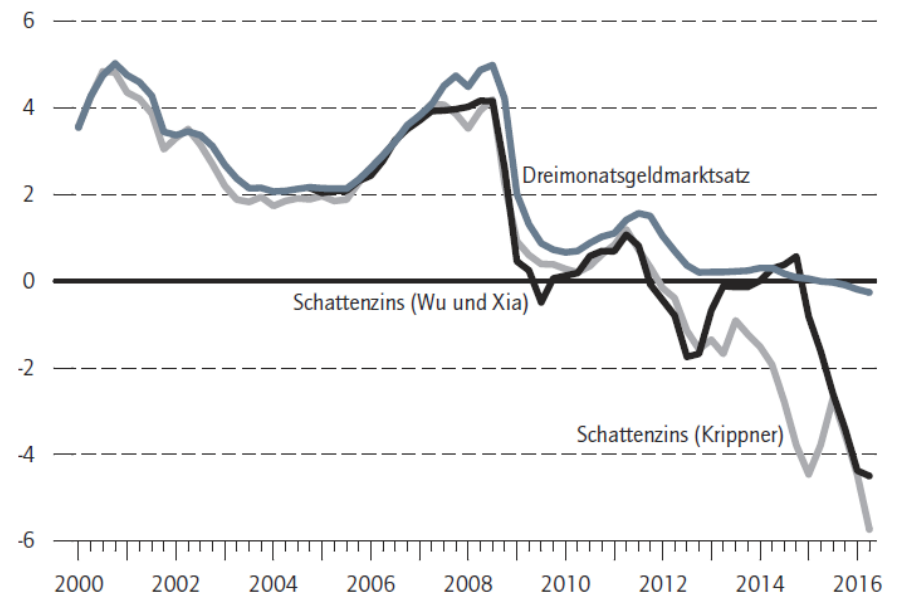
In Prozent



Quellen: Eurostat; EZB; OECD; Holston et al. (2016); Hristov (2016); Berechnungen der Institute.

Schattenzinsen

In Prozent



Quellen: Wu, J. C., Fan, D. X. (2016): Measuring the Macroeconomic Impact of Monetary Policy at the Zero Lower Bound. *Journal of Money, Credit and Banking*, 48 (2-3); Krippner, L. (2016): Documentation for measures of monetary policy. 13. Juli 2016. Berechnungen der Institute.

Source: Gemeinschaftsdiagnose Herbst 2016.

Monetary policy: The all-purpose tool?

- Generic target: Provision of a means of exchange
 - Other targets
 - » Government financing
 - » Debt-monetization
 - » Boosting employment
 - » Business-cycle stabilization
 - » Systemic financial stability
 - Monetary policy
 - ⇒ **Potential conflicts**
 - ⇒ **Room for excessive rent-seeking**
 - ⇒ **High risk of sacrificing the (most abstract, general) generic target for (more simplistic, partisan) non-generic targets**
- What about Tinbergen?

Geldpolitik: Überladen!



Quelle: FAZ, 26. Oktober 2011, p. 11

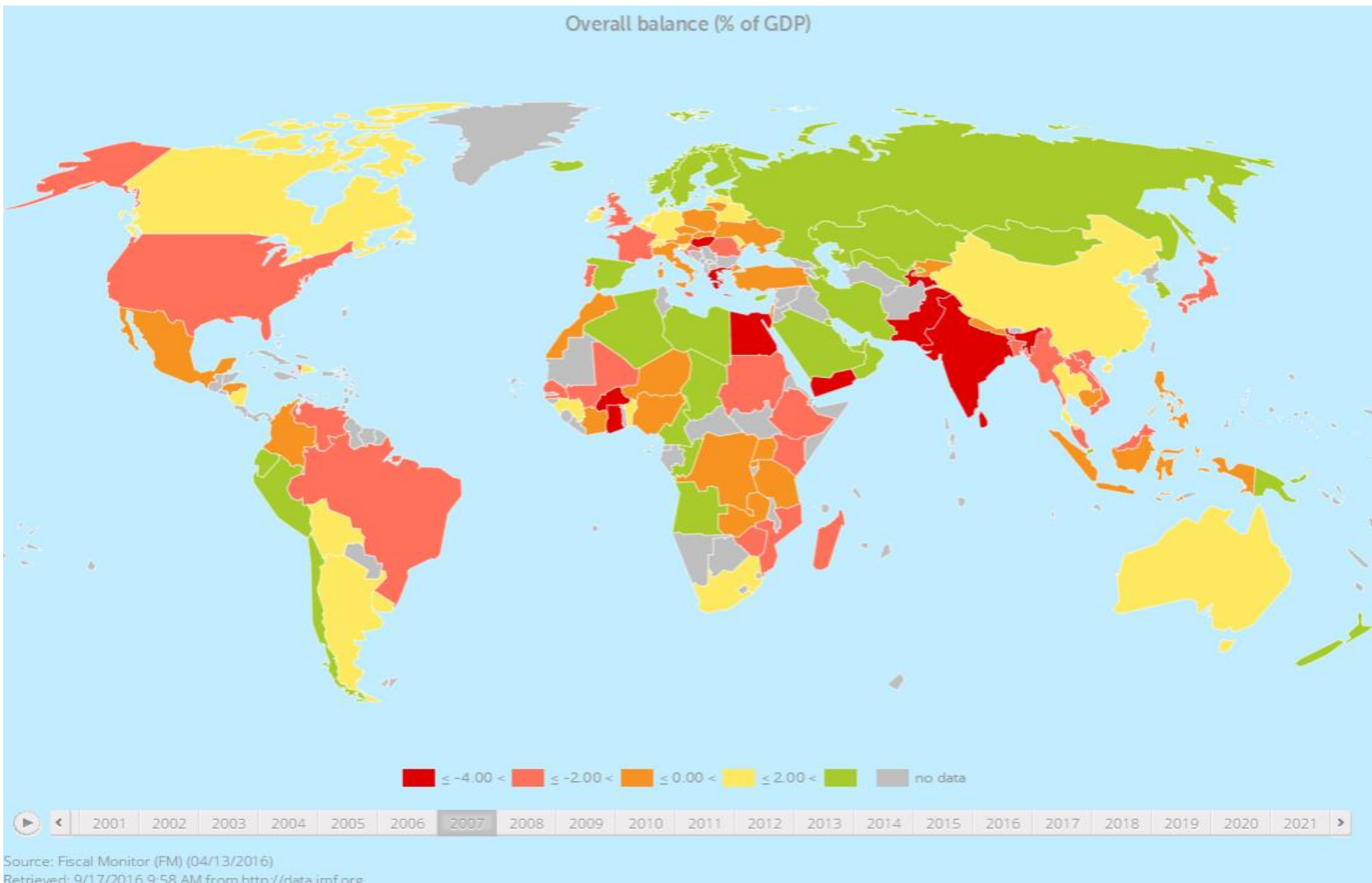
- Verzerrung der Kapitalstock- und Produktionsstruktur
 - Zombifizierung
 - Verzögerung der Konsolidierungs- und Reformpolitik
 - Verwässerung des strukturellen Budgetsaldos
 - Überschuldungskrise nicht gelöst, sondern vertagt
 - Monetäres Niemandsland schürt Unsicherheit
 - Anstieg der Inflationsrate offenbarte Dilemma für die EZB
 - Gefahr globaler Abwertungswettläufe
 - Interventionsspirale: Too-big-to-fail vs. Too-small-to-perform?
- ⇒ **Monetäres Umfeld für D auf Jahre hinaus zu expansiv**
- ⇒ (Monetäre Strategie des „Inflation Targeting“ überdenken)

(Radical) Policy instruments to enhance the effectiveness of QE

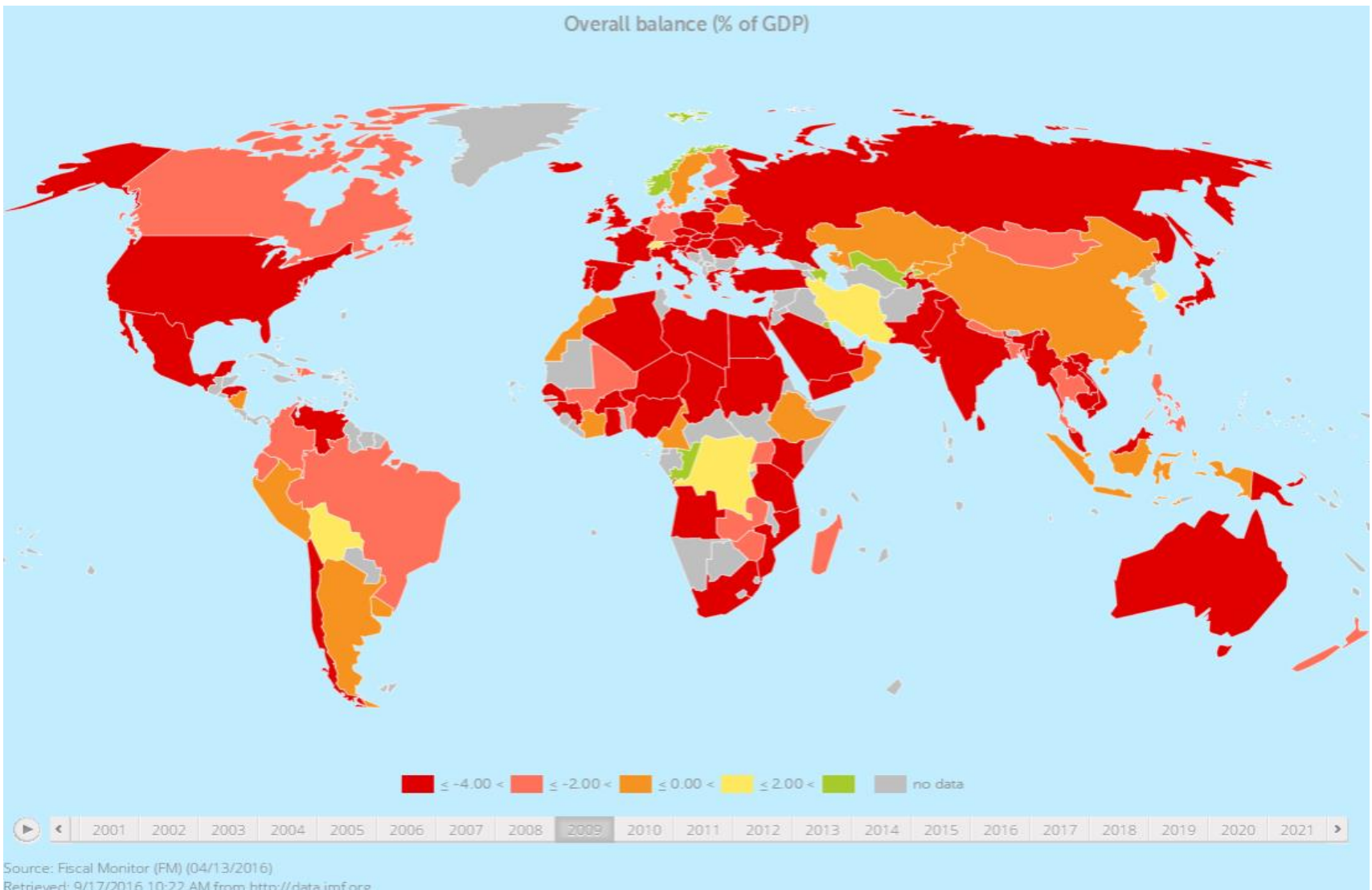
- Buying risks upfront instead of lowering risk free yields
 - » More private sector securities
 - » Distortion of risk premia and related cost of capital
 - Targeting non-performing assets
 - » Monetary bail-out
 - » Turning the Eurosystem into a bad bank
 - Helicopter money
 - » Bypassing the credit channel to inflate the debt-overhang away
 - » Transforms the Eurosystem into a pure fiat money system
- ⇒ **Hardly in line with ECB's mandate, radical consequences**
- ⇒ **Chicago plan 2.0 requires credible post-resolution design**

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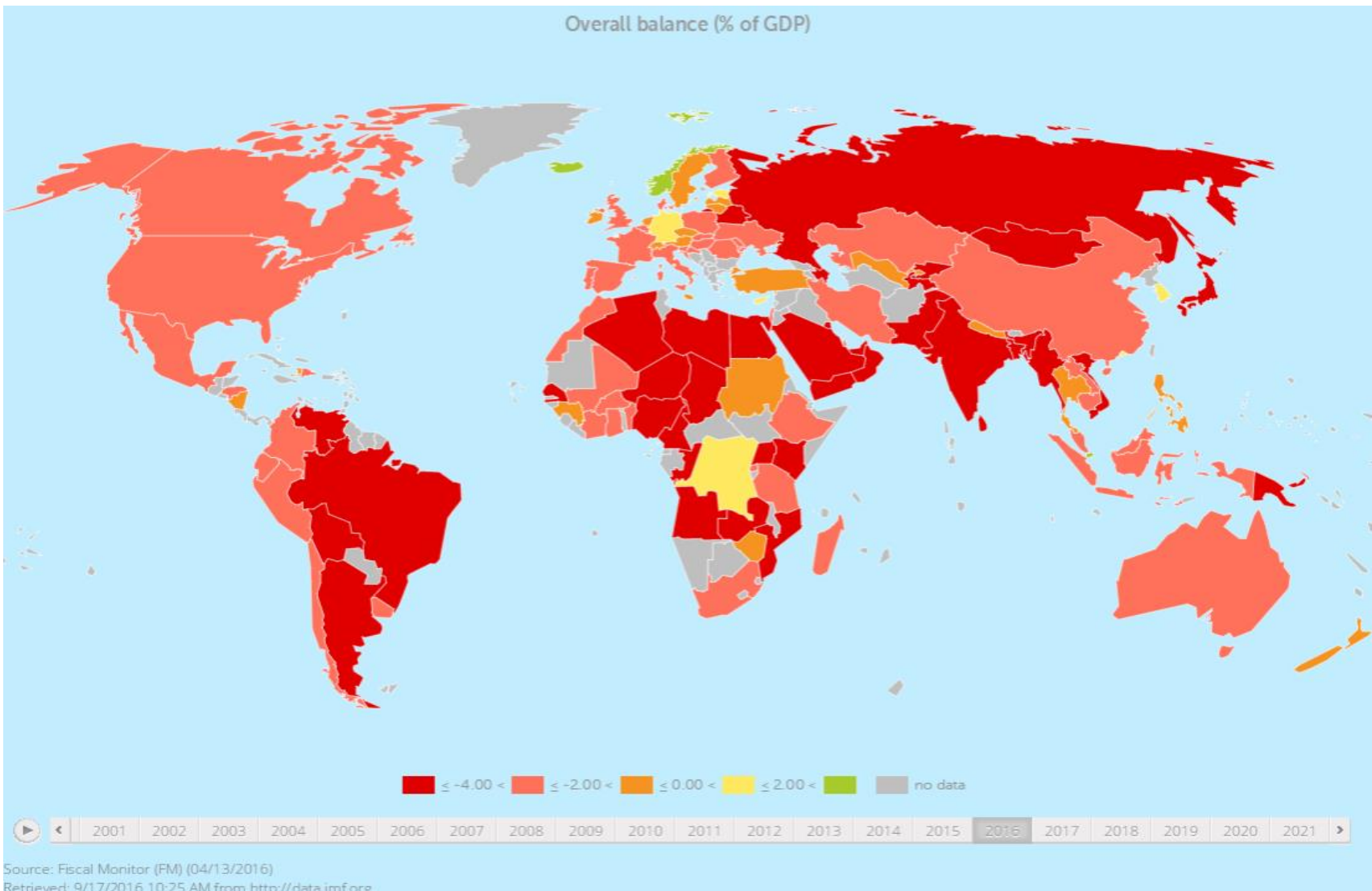
Fiscal stance 2007 (pre-crisis)



Fiscal stance 2009 (in crisis)

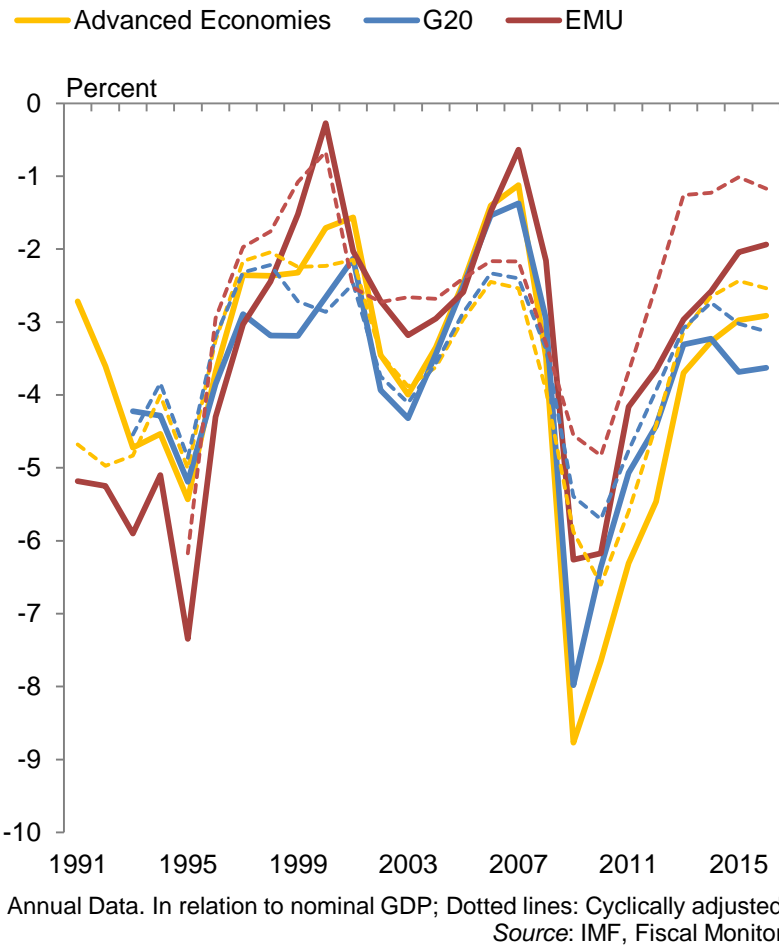


Fiscal stance 2016 (post-crisis?)

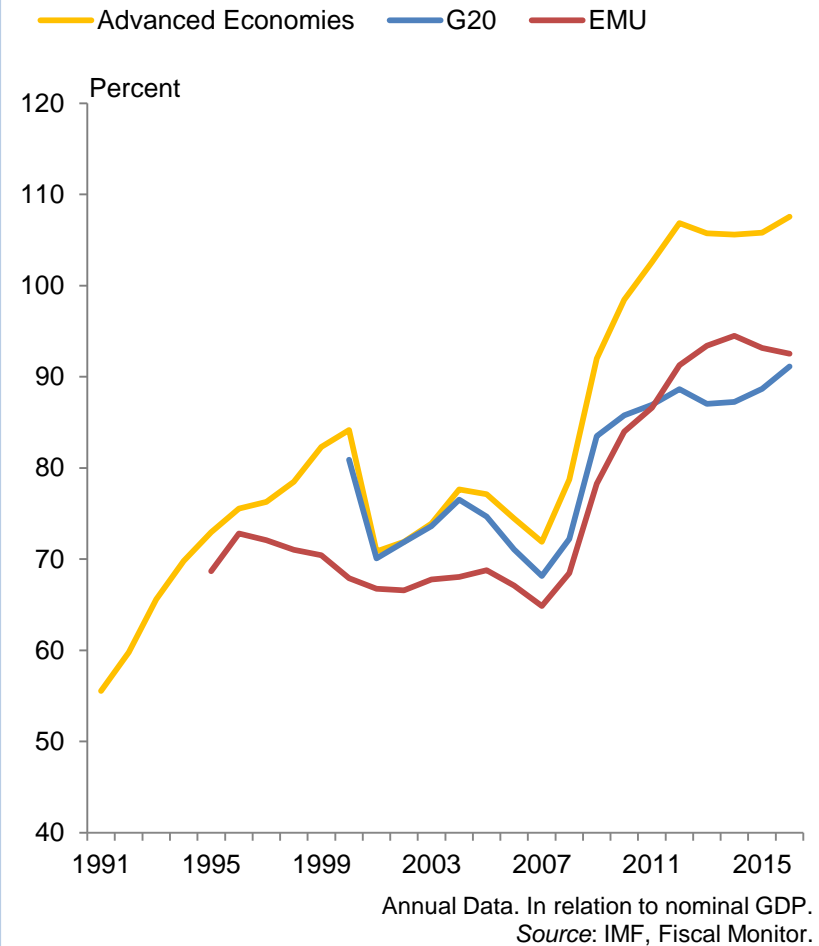


Fiscal stance and public debt

Net Public Lending



Gross Government Debt

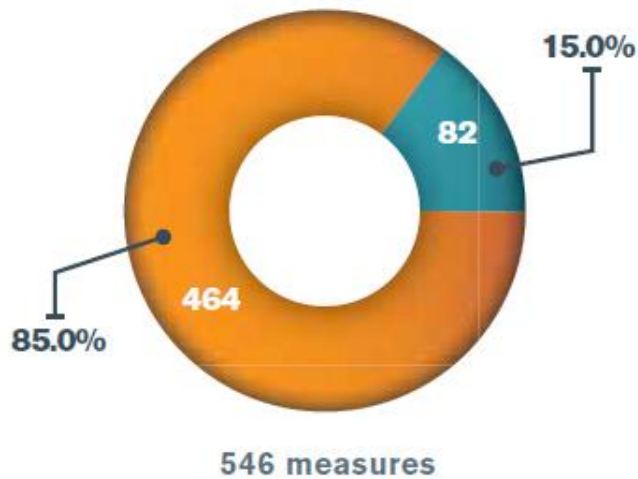


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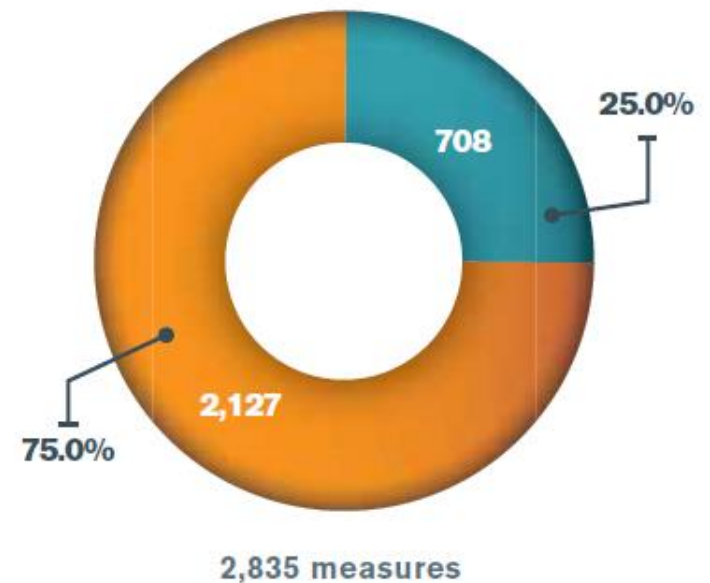
Neo-protectionism via non-tariff barriers to trade

Stockpile of trade-restrictive measures initiated since October 2008

By mid-October 2010



By mid-May 2016

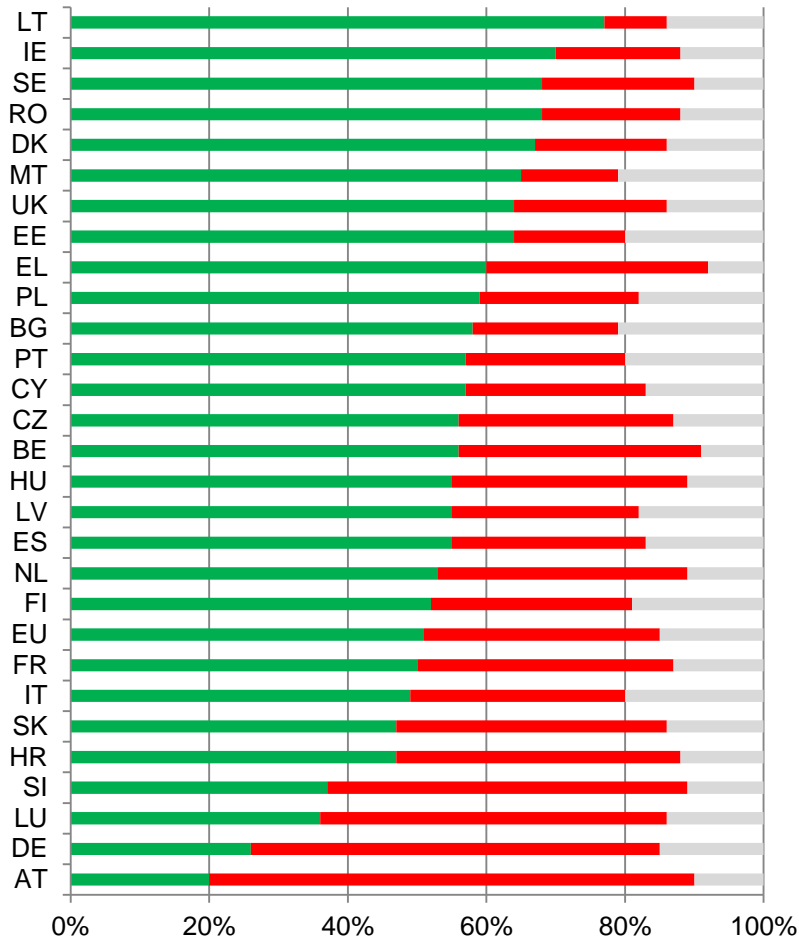


● Effectively eliminated measures ● Stockpile of restrictive measures

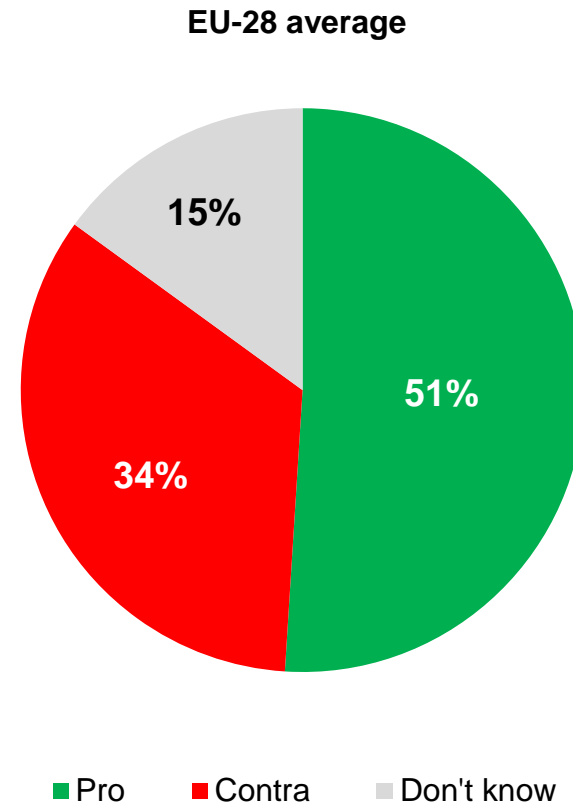
Note: The stockpile of trade-restrictive measures also includes trade remedy actions.

Source: WTO, World Trade Statistical Review 2016.

EU citizens' attitudes towards TTIP



Source: Eurobarometer 85.2 (Spring 2016).



- Harmful uncertainty calls for clarity in fundamentals
- **Spirit of maximum cooperation** vs. exemplary warning
- EU as a club
 - » Stability by valuable club goods (voting rights!)
 - » Sanctions for leaving belittle benefits from membership
 - ⇒ **Focus on union-wide collective goods (principle of subsidiarity)**
- Hidden mercantilism in EU politics
 - » Free trade (cherries?) vs. free movement of labor (bitter pill?)
 - » Free trade as a bargaining chip (belligerent great-power policy)
 - » Trade surplus not relevant for benefits from integration
- Protectionism backfires (social poison)
- Integration must rest on understanding, not on coercion
 - » Constructive agreement on everything enjoying consensus support
 - » No “all-or-nothing” ultimatums, but time for adjustment
 - ⇒ **Multiple speeds to keep overall integration processes alive**

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