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International Symposium "Globalization in Danger"

Is Monetary Policy Still the Only Game in Town?

Outlook for Fiscal Policy and Structural Reform

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■ Structural Reforms

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

**Structural
reforms**

■ Monetary policy

- » Did (more than) enough
- » Increasing negative side-effects

**Monetary
policy**

■ Fiscal policy

- » Back on stage? „Keynes put“?
- » Sustainability issues

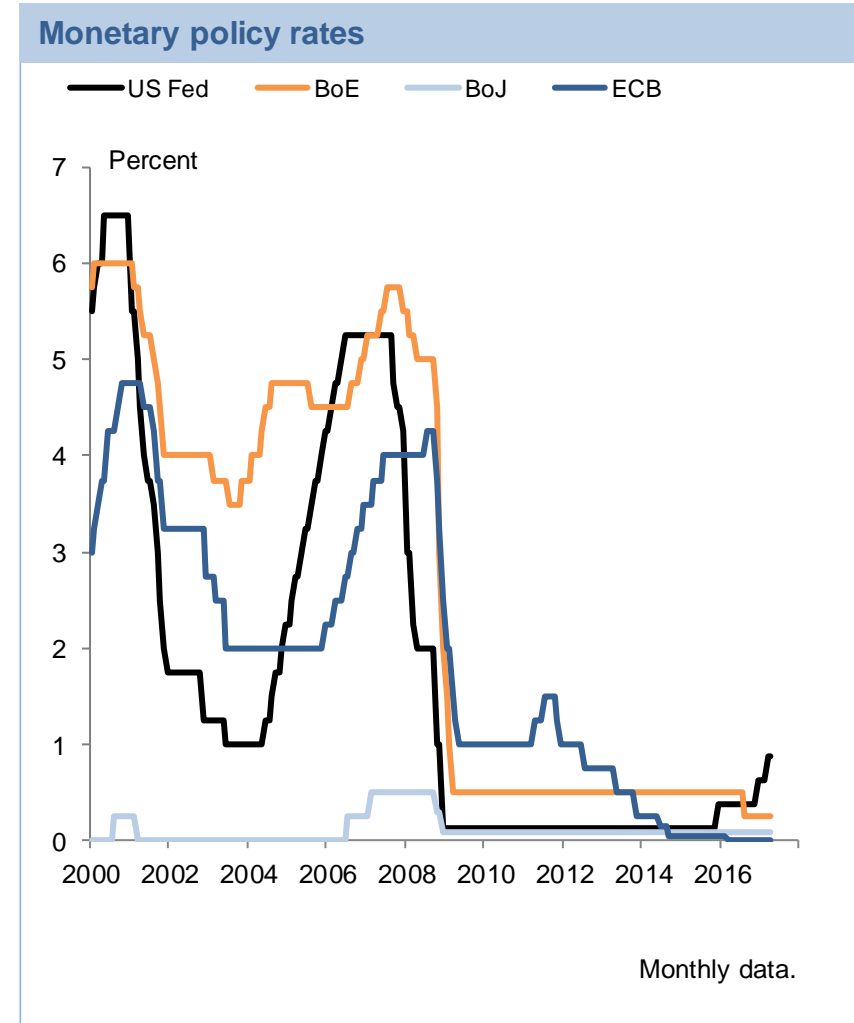
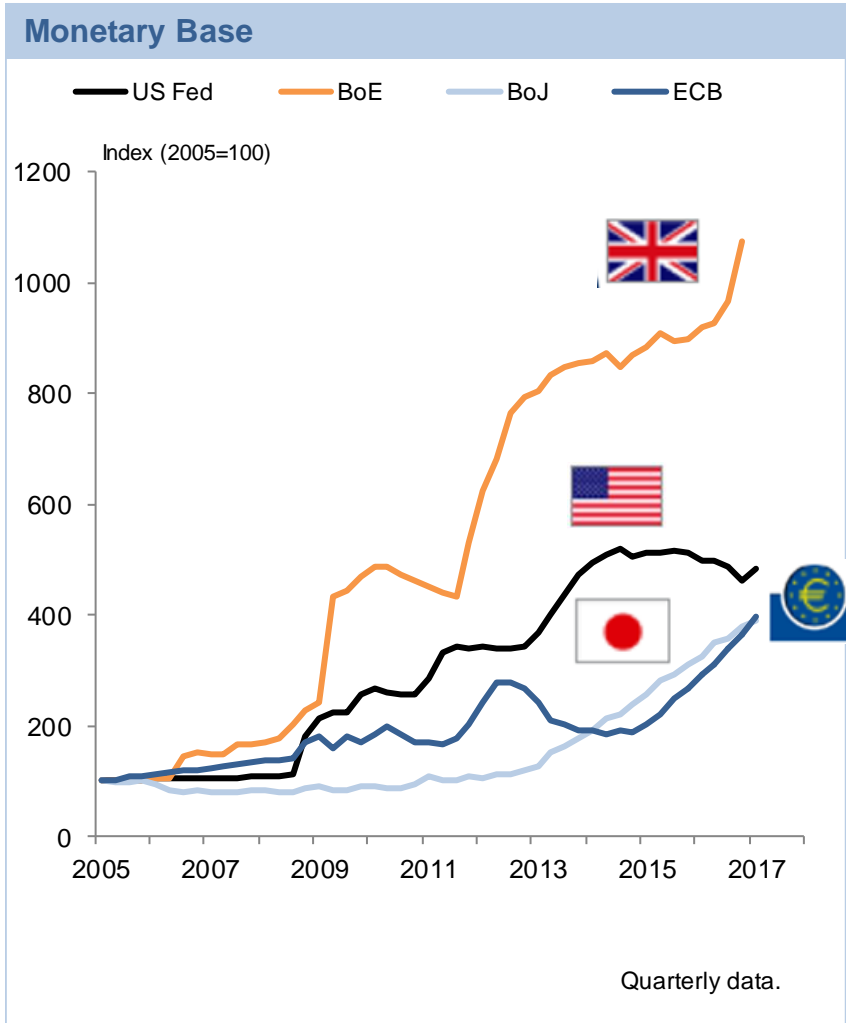
**Fiscal
policy**

■ Neo-protectionism

- » Beggar-thy-neighbor gains momentum
- » Popular, but destructive

**Neo-
protectionism**

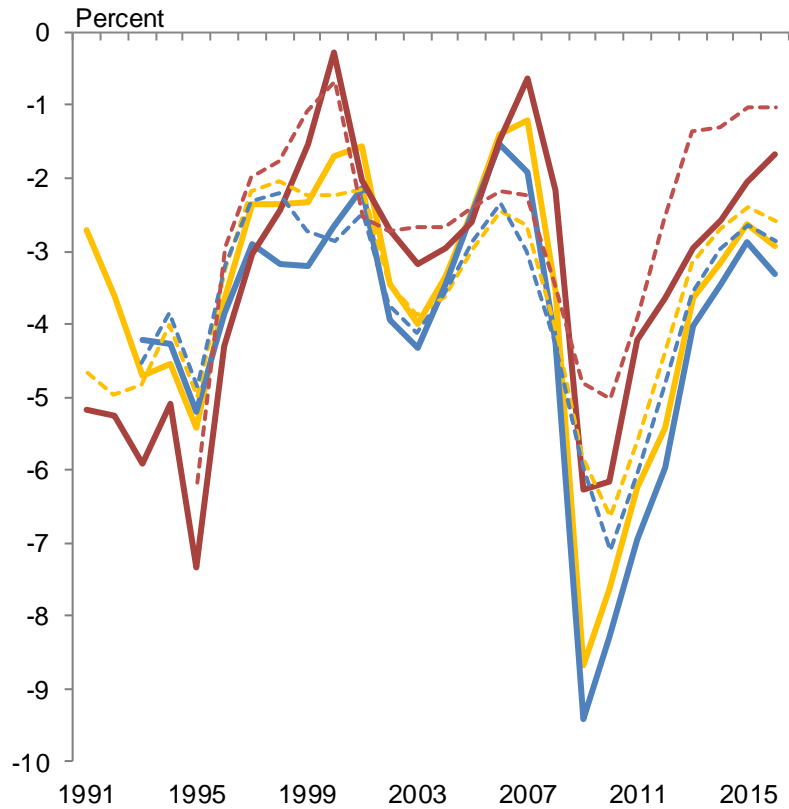
Monetary policy hits limits ...



... as does fiscal policy

Net Public Lending

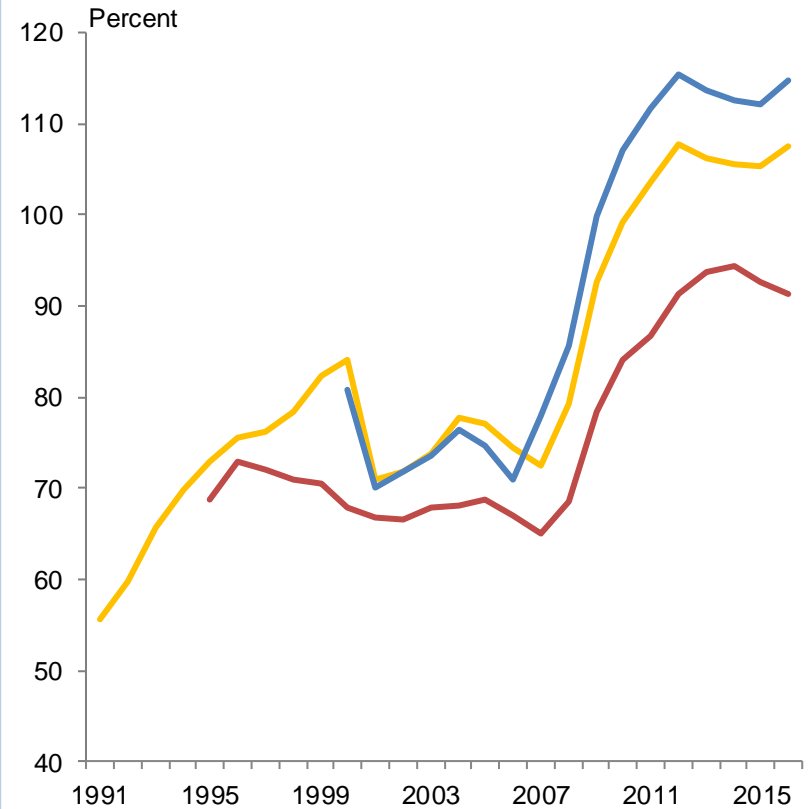
Advanced Economies G20 EMU



Annual Data. In relation to nominal GDP; Dotted lines: Cyclically adjusted.
Source: IMF, Fiscal Monitor.

Gross Government Debt

Advanced Economies G20 EMU

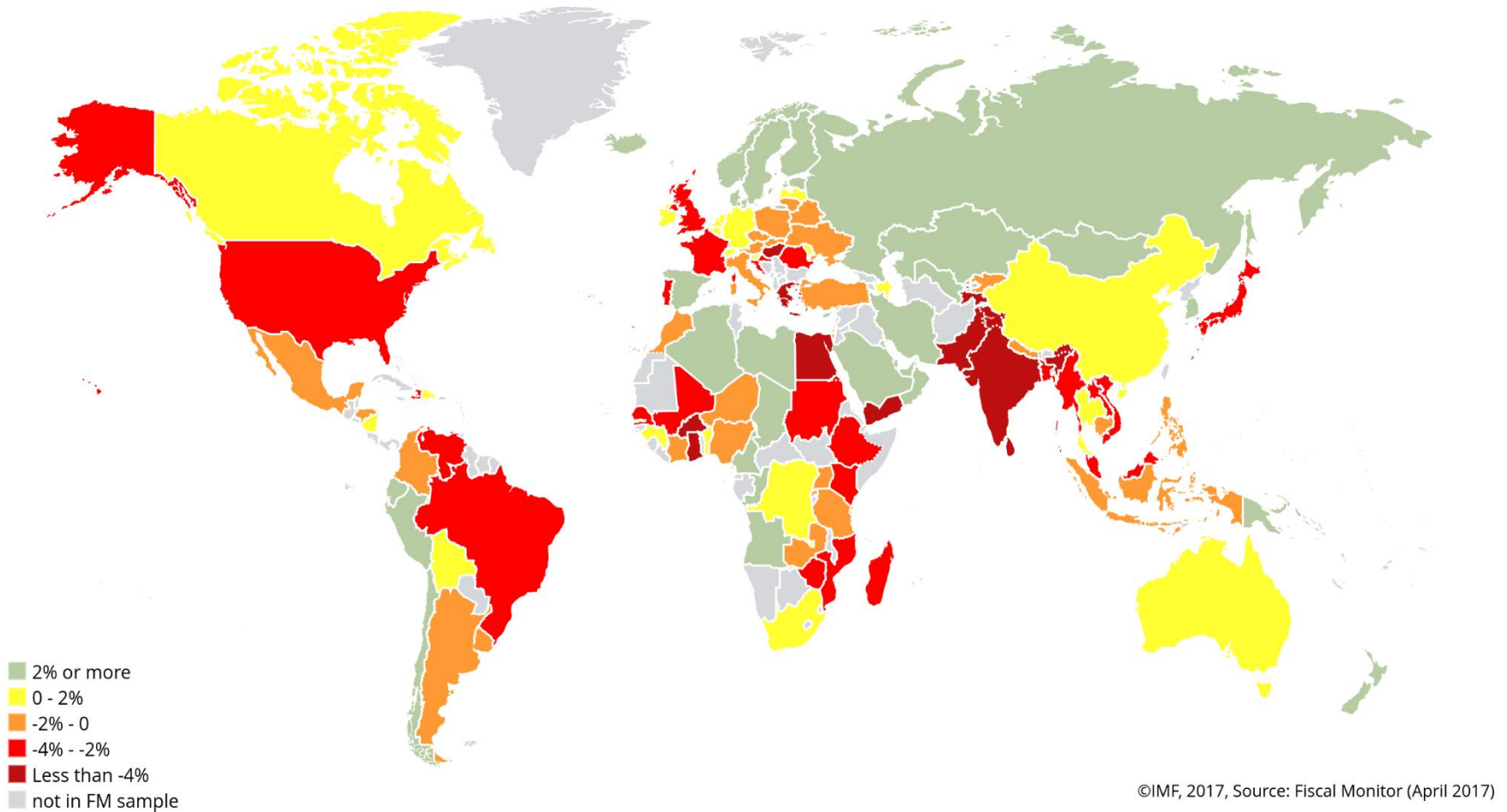


Annual Data. In relation to nominal GDP.
Source: IMF, Fiscal Monitor.

Fiscal stance 2007 (pre-crisis)

IMF DataMapper

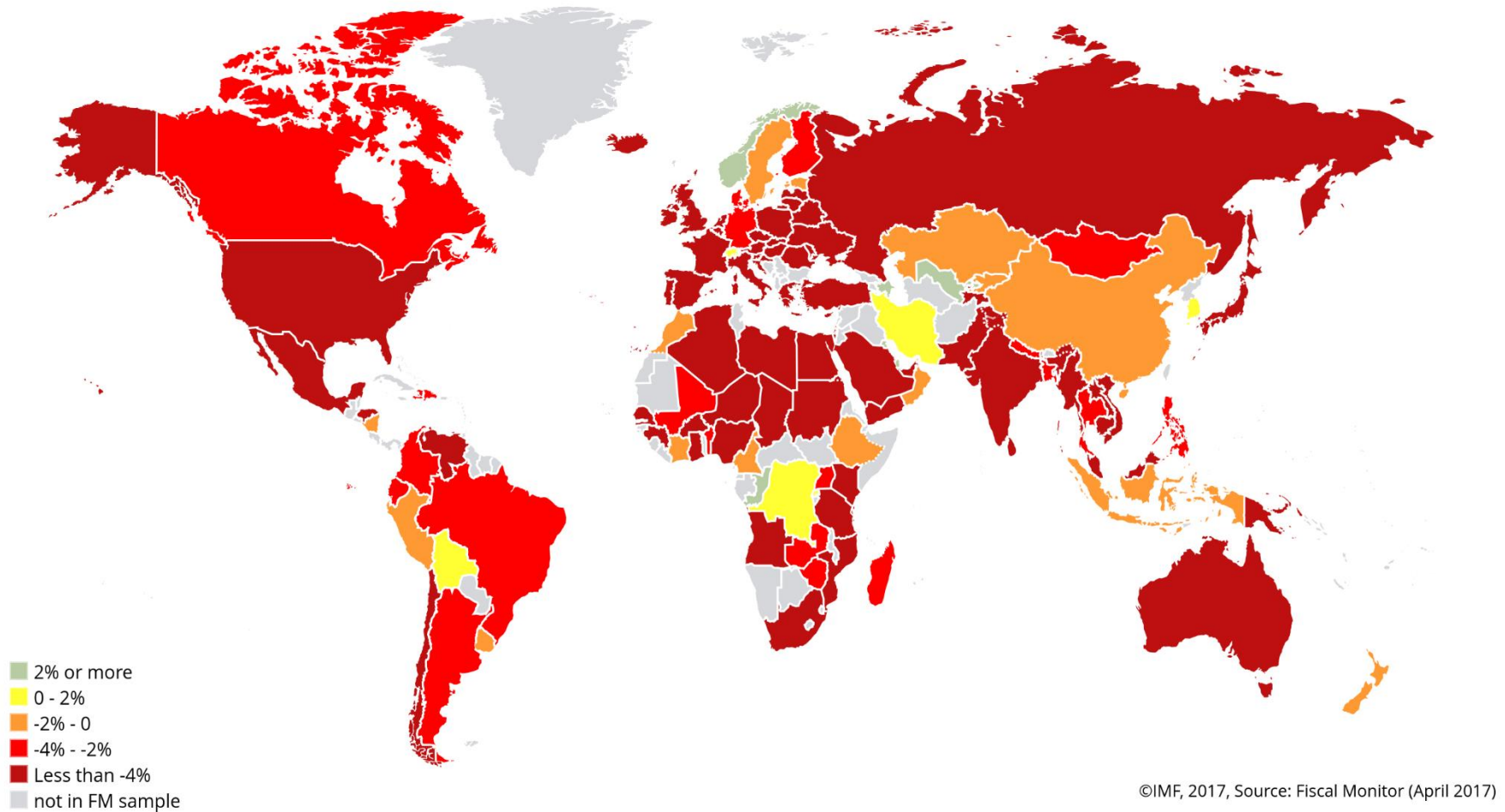
Net lending/borrowing (also referred as overall balance) (% of GDP, 2007)



Fiscal stance 2009 (in crisis)

IMF DataMapper

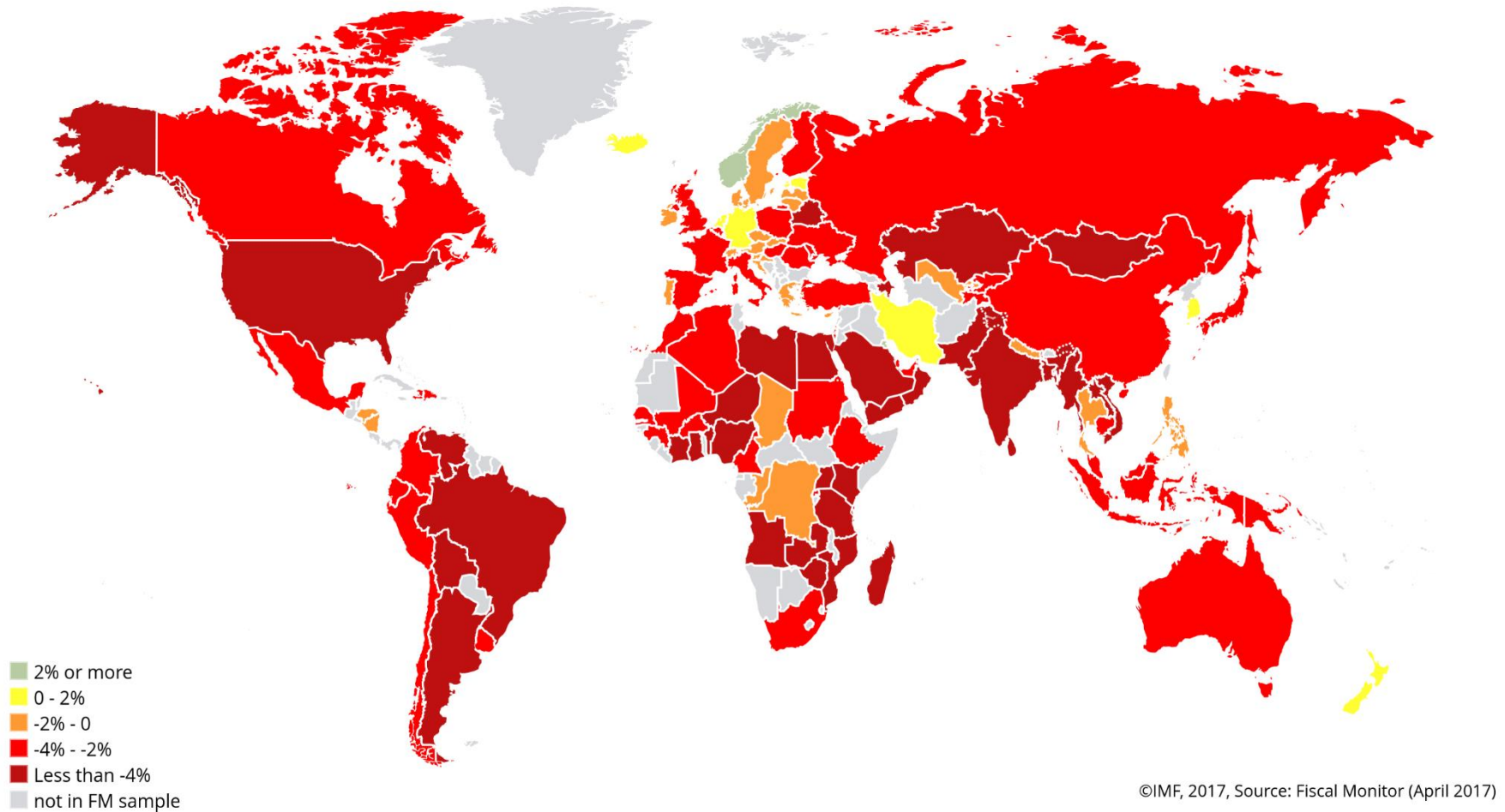
Net lending/borrowing (also referred as overall balance) (% of GDP, 2009)



Fiscal stance 2017 (post-crisis?)

IMF DataMapper

Net lending/borrowing (also referred as overall balance) (% of GDP, 2017)



■ Structural Reforms

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

**Structural
reforms**

**Overstretched macro-management
(core problems are non-cyclical)**

**Monetary
policy**

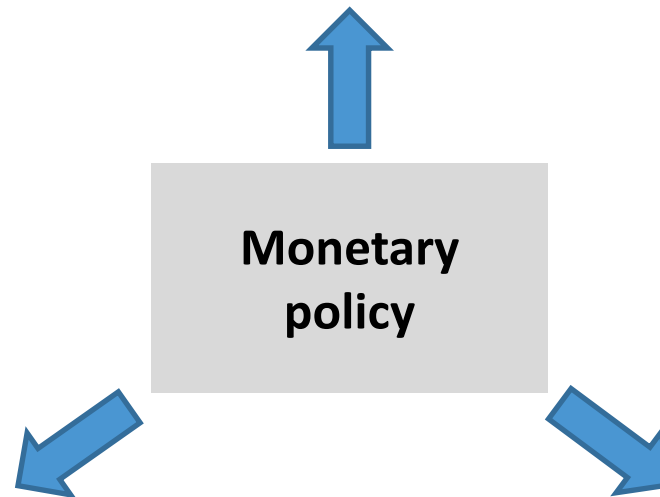
**Fiscal
policy**

■ Neo-protectionism

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

**Neo-
protectionism**

Money-policy-nexus



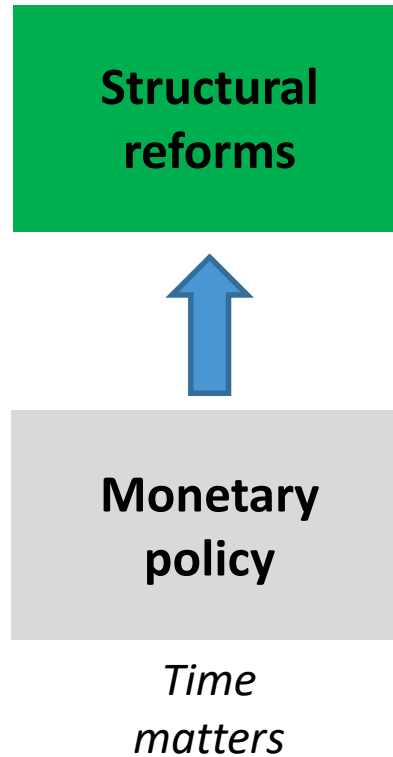
**Structural
reforms**

**Monetary
policy**

**Fiscal
policy**

**Neo-
protectionism**

The Non-neutrality of money



Interest rates ...

- ... just another instrument for macro-management?
 - ... or the key price relation within the market system?
 - » Time preference
 - » Coordinating savings and investment
 - » Component of all prices for goods and services (relative prices)
 - » Impact on capital/production structure
- ⇒ **„Capital gives money time to cause trouble.“ (Garrison)**

Two types of mal-investments

- **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 destabilize monetary system

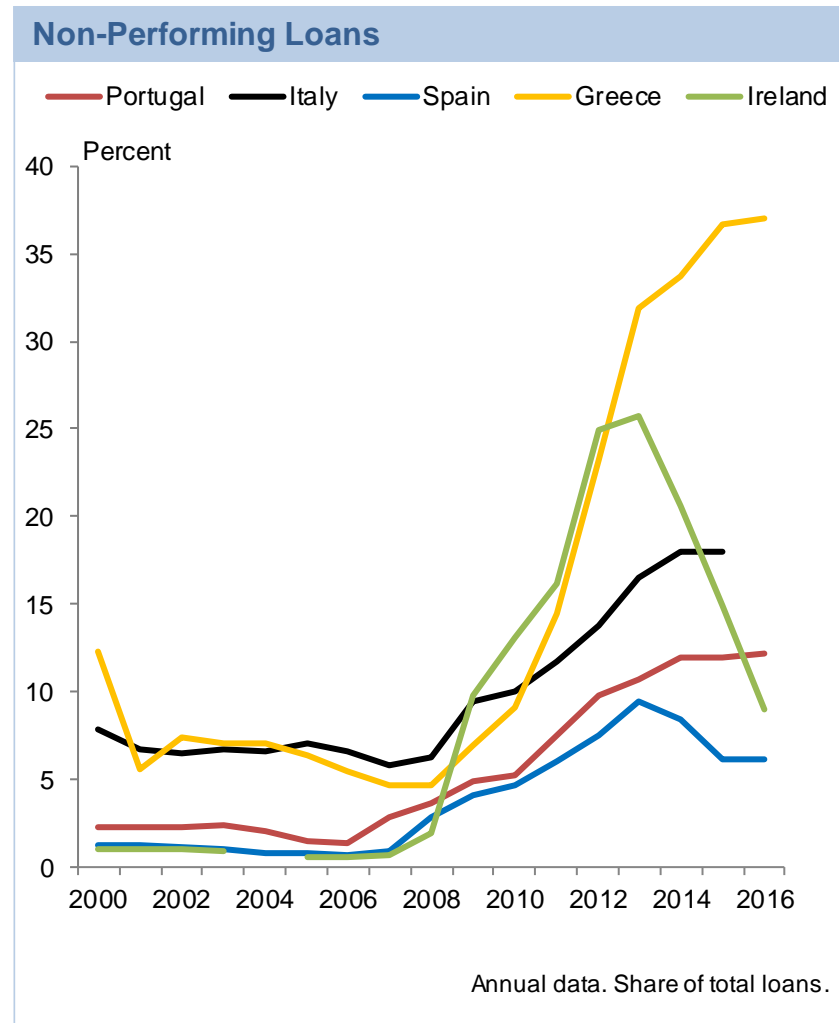
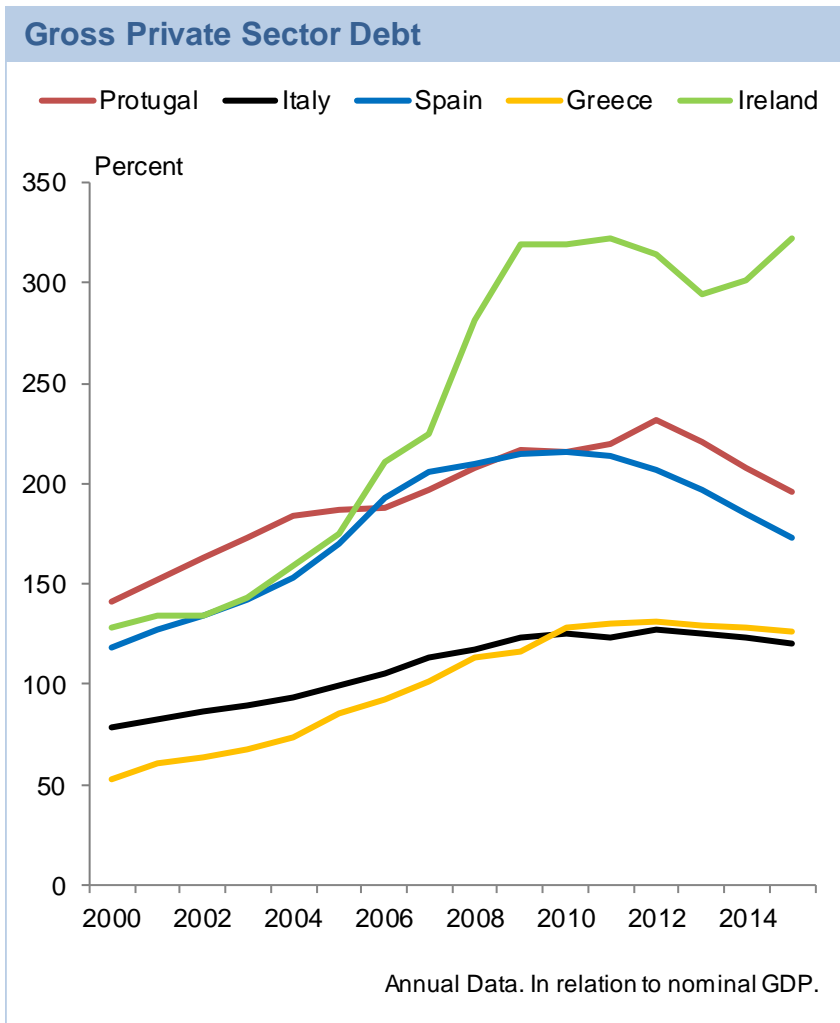
Three options of coping with debt-crises

- **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)

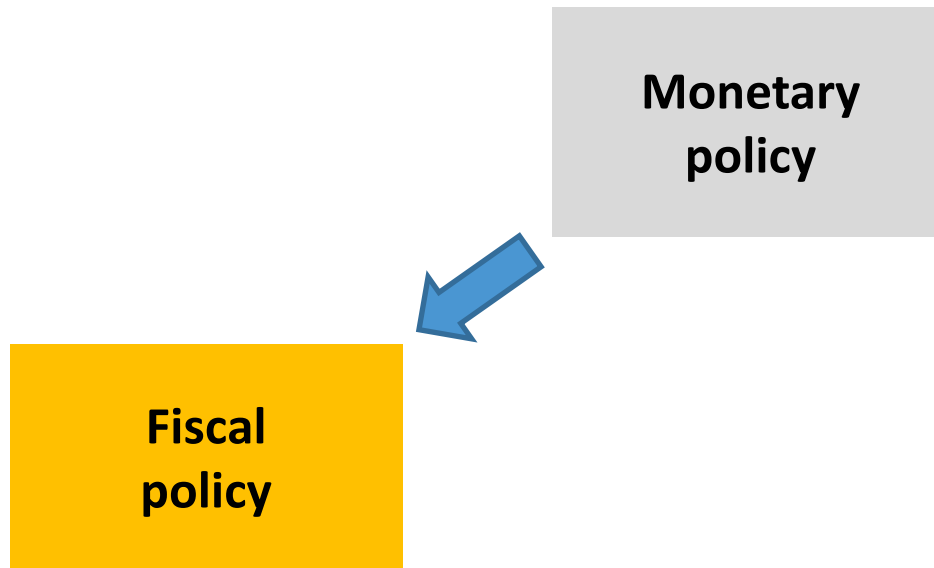
Capitalist approach
(in line with free market principles)

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



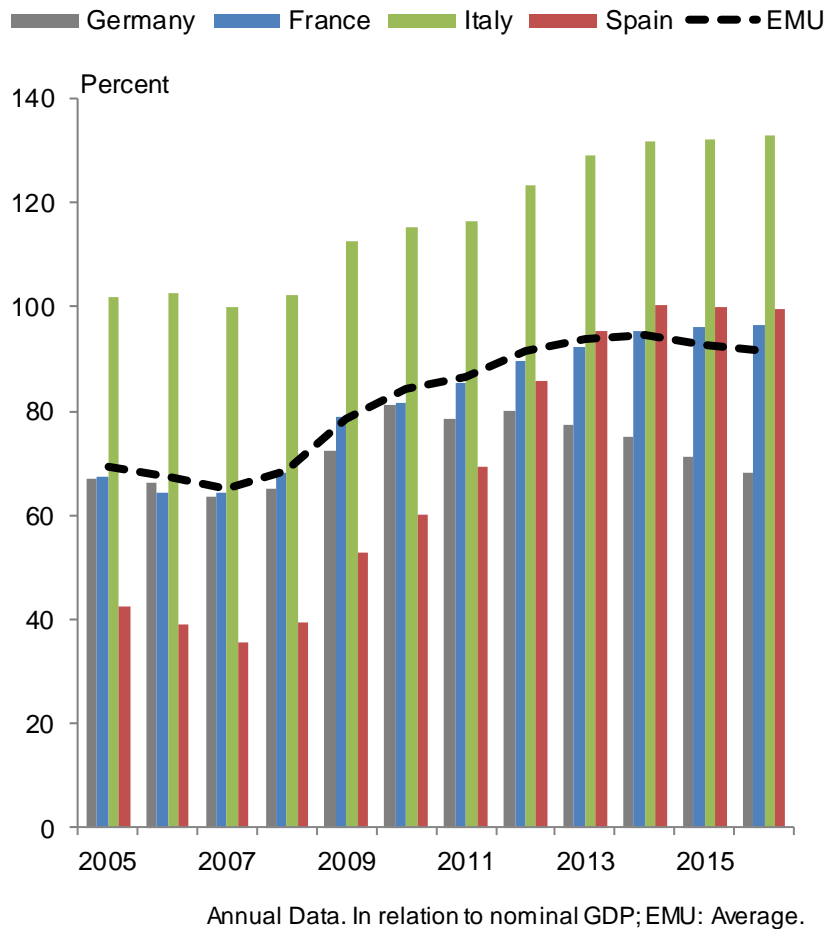
Data source: Bank for International Settlements, World Bank.

Easing fiscal consolidation?

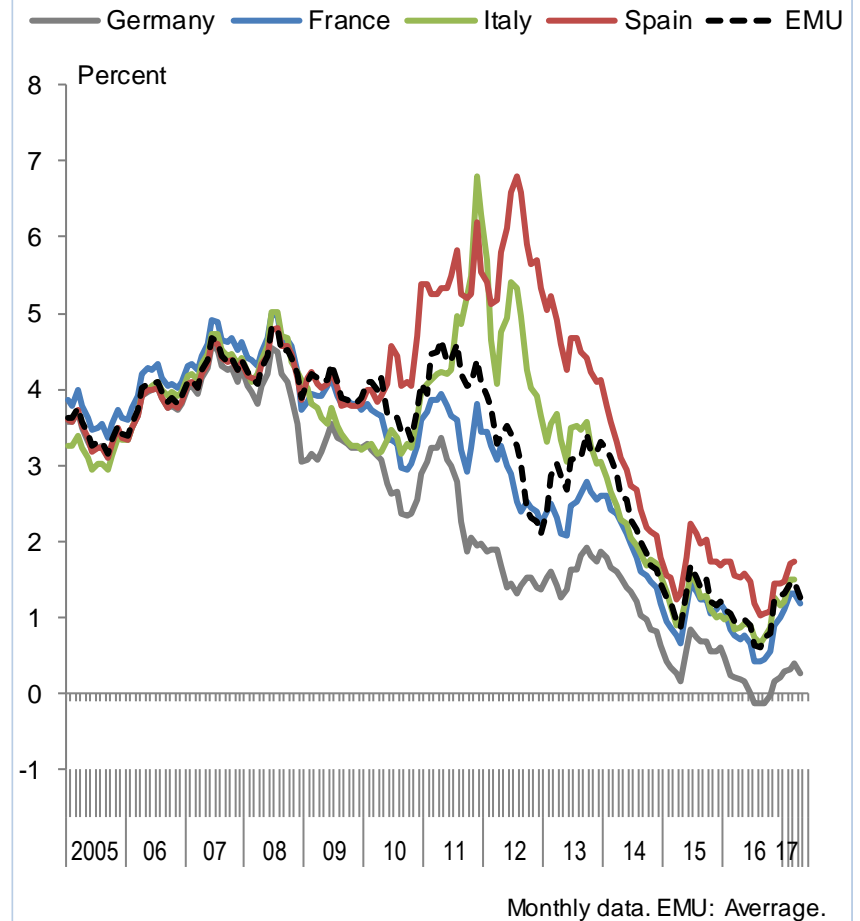


Euro Area: Monetary financing of governments

Gross Government Debt

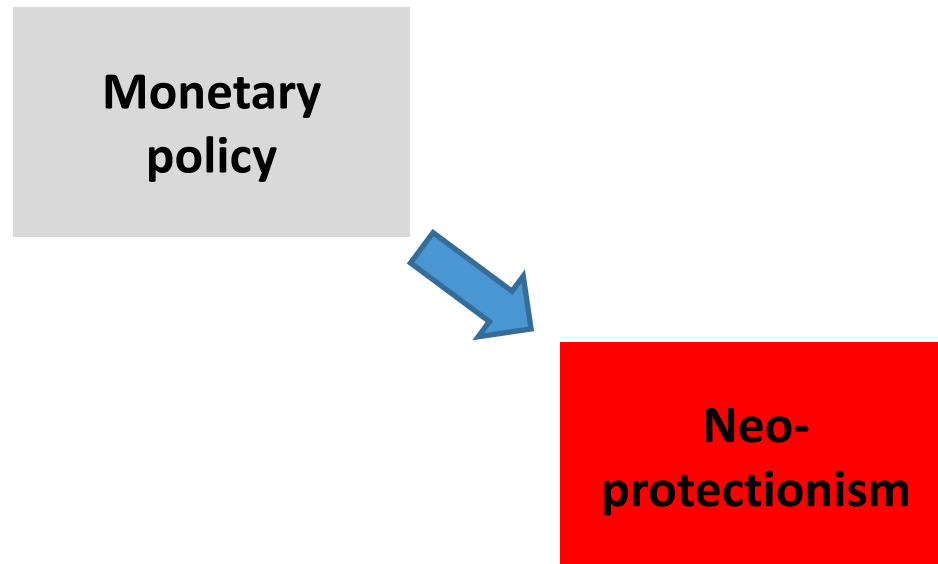


Government Bond Yields (10-year)

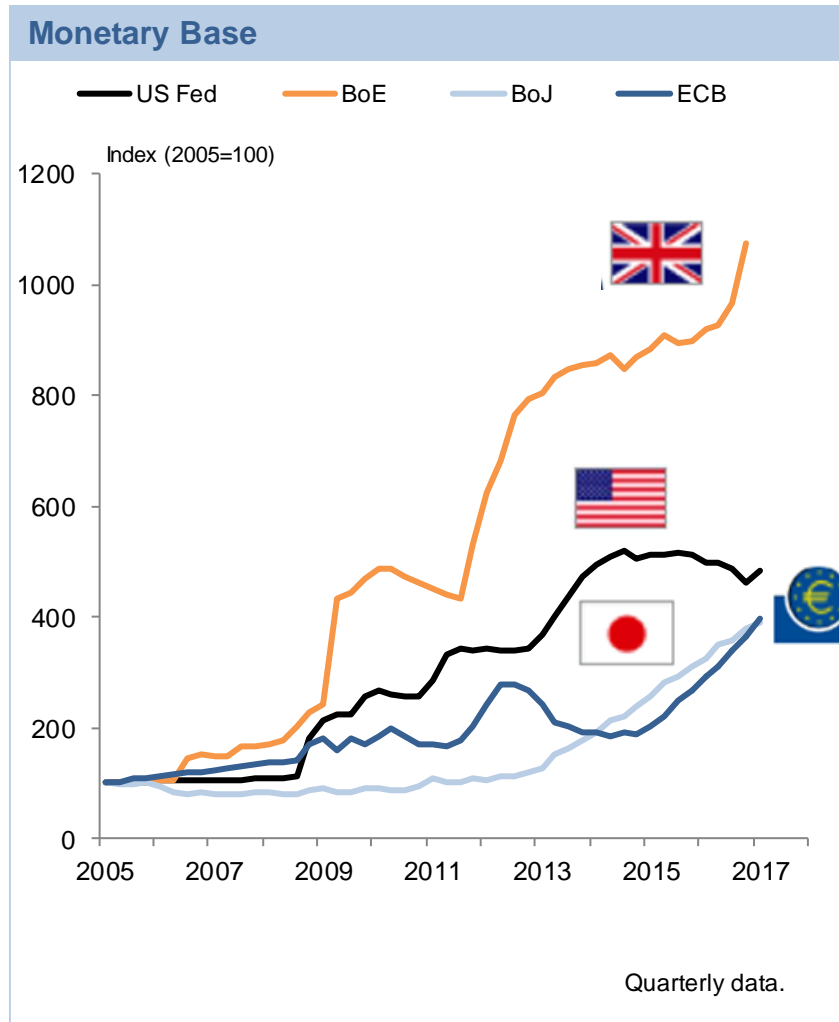


Data source: Eurostat, European Commission.

Monetary policy and currency manipulation



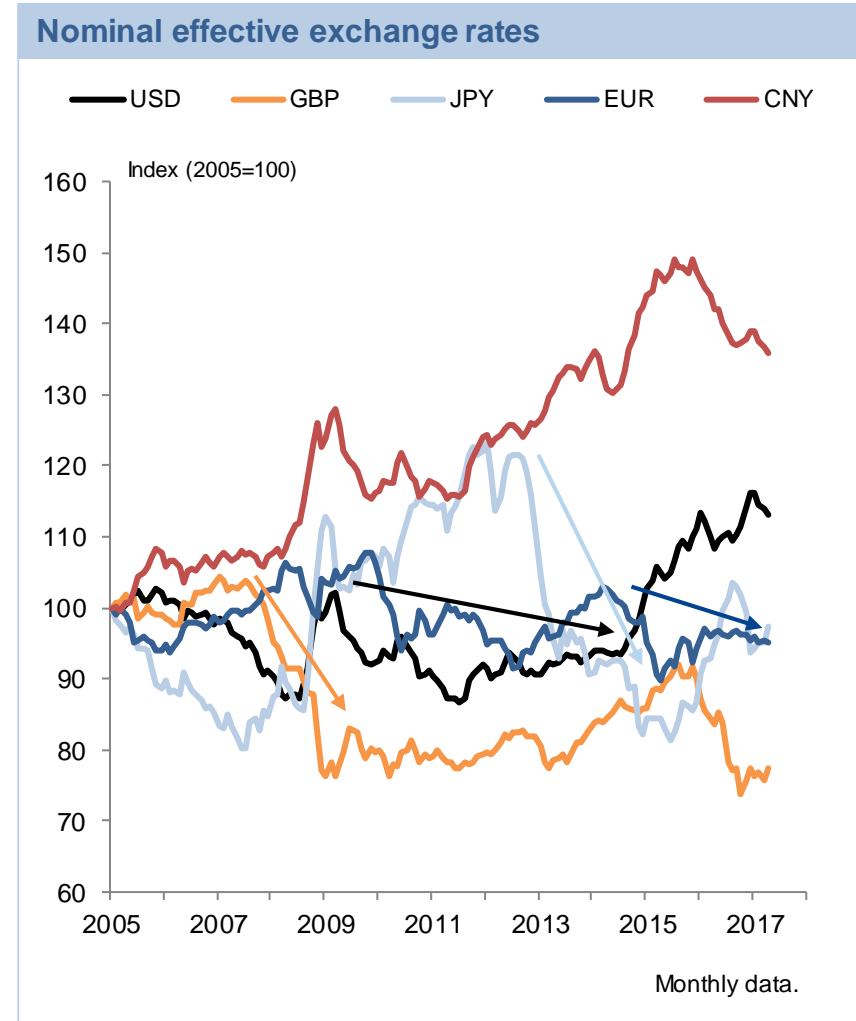
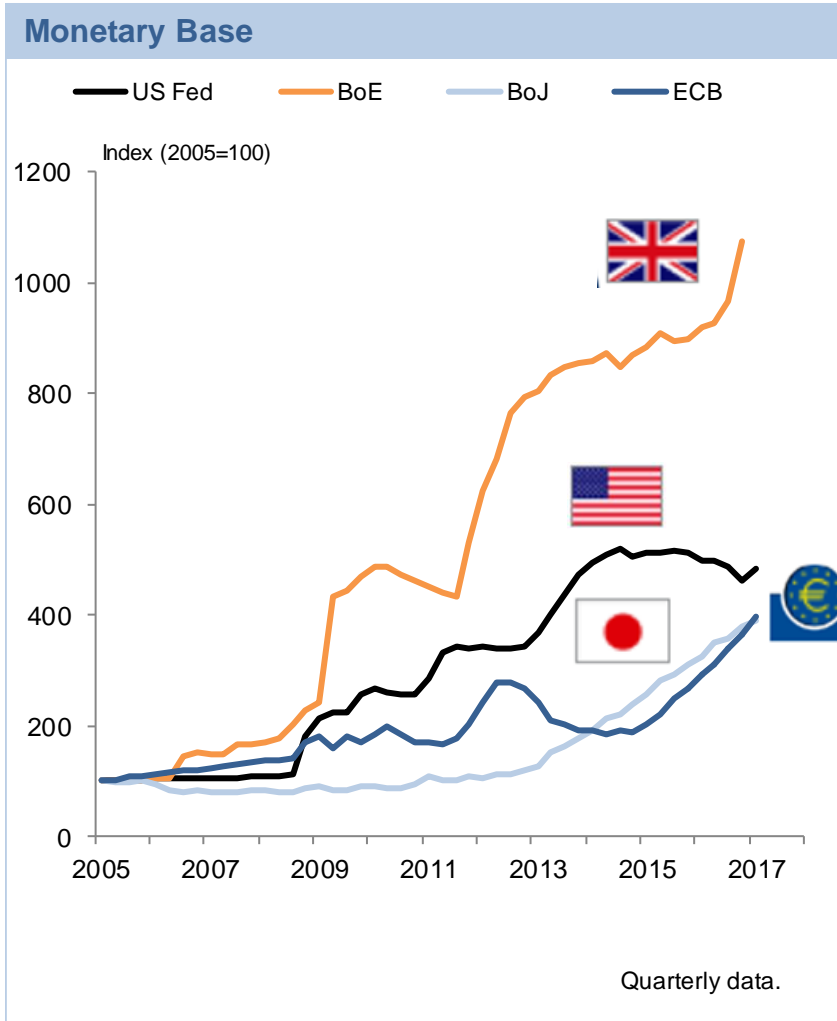
Quantitative „Easing“



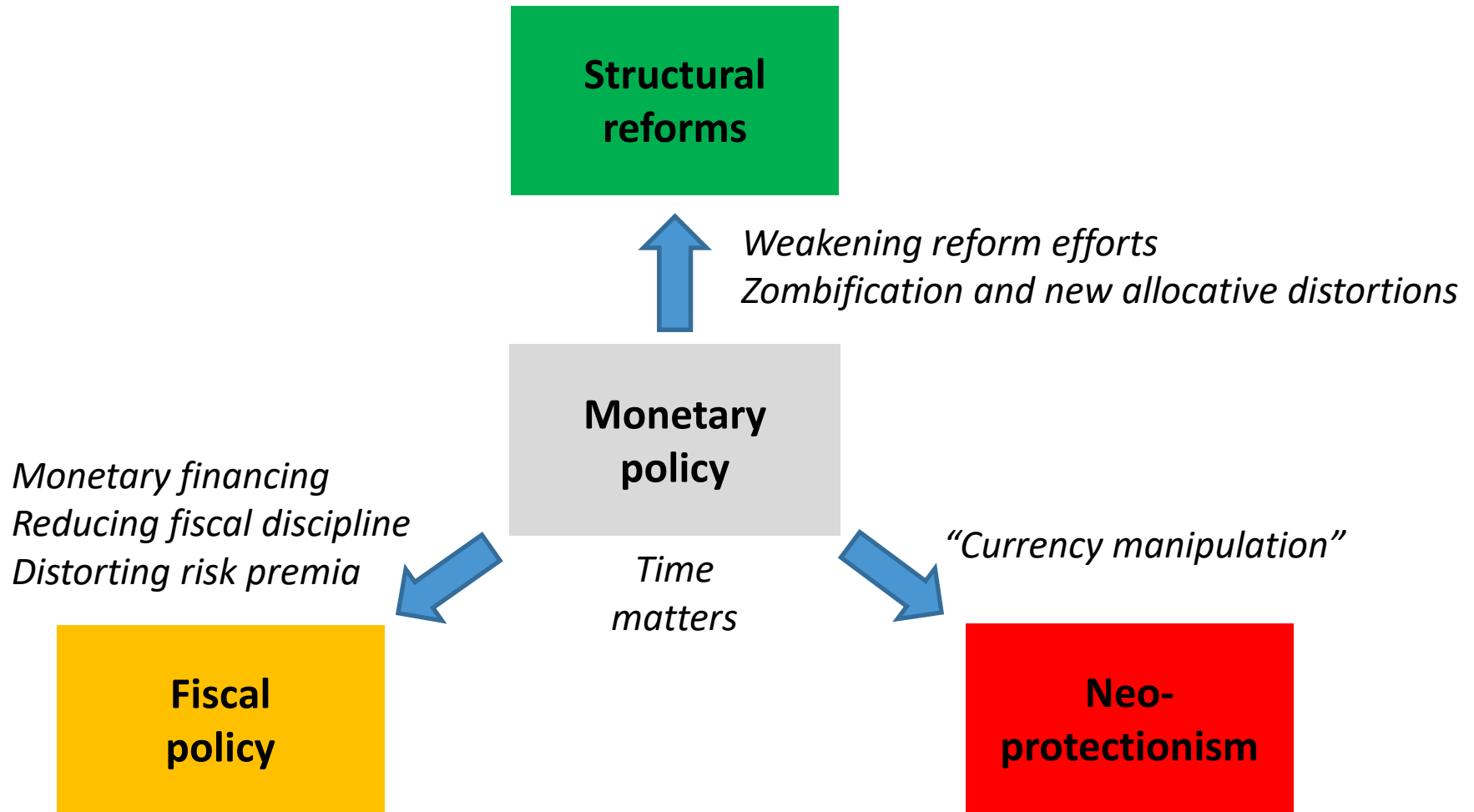
- Type 1: Liquidity provision in times of financial stress (effective)
 - Type 2: Stimulus at the zero lower bound (domestically ineffective)
- ⇒ Exit strategy?
- ⇒ ECB: Need for ever softer criteria for next purchase programs

Global QE: Risk of currency wars

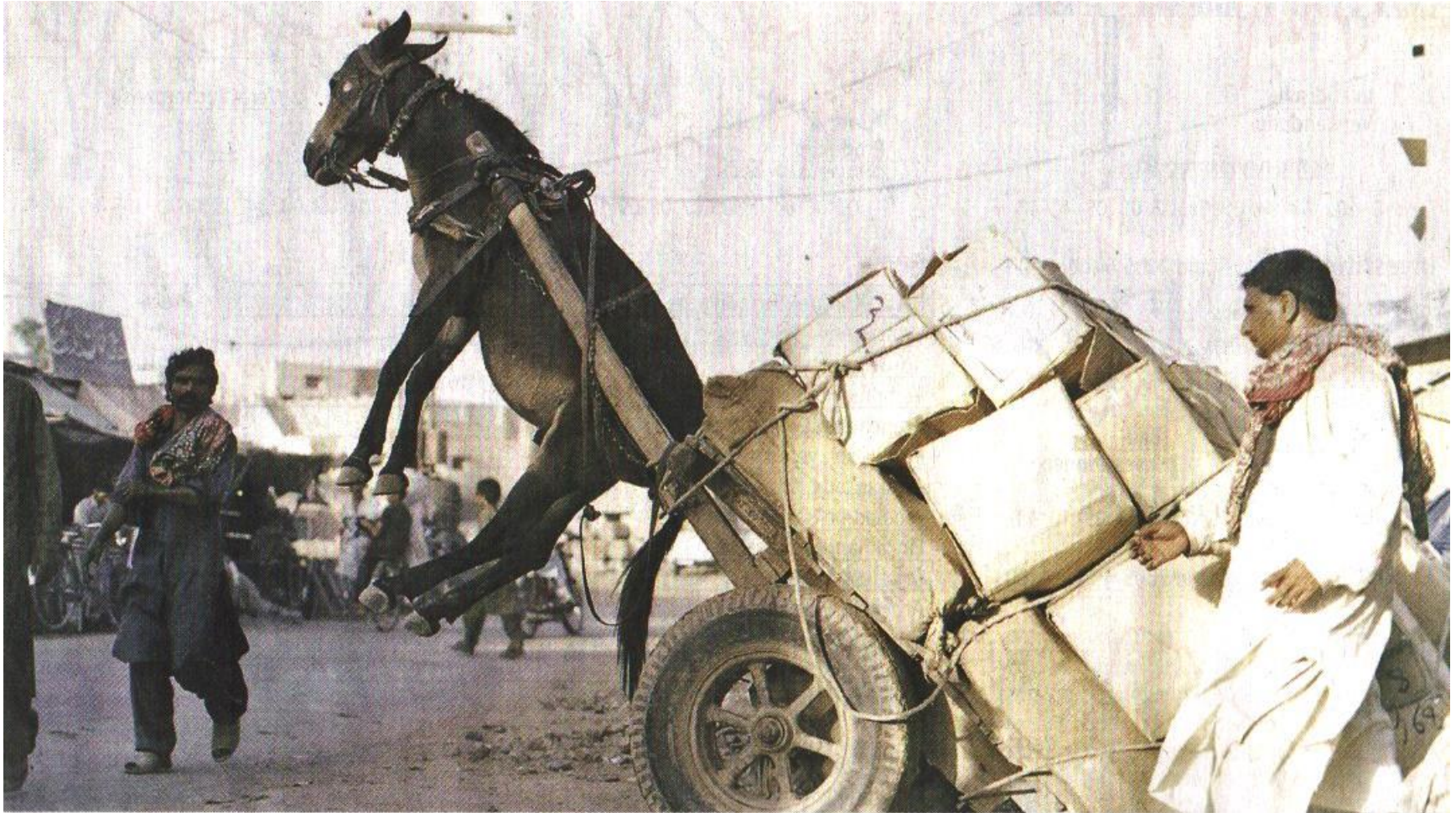
Source: Thomson Reuters Datastream, IfW-calculations



ZIRP/QE: A risky game to play (for longer)



Monetary policy: Overloaded



Quelle: FAZ, 26th October 2011, p. 11

Conclusion

- Macro-management is already overstretched
- “Buying time” strategy failed
(lets fiscal discipline and structural reform efforts wane)

⇒ **Structural reforms as only game in town**

Institut
für Weltwirtschaft



Institute
for the World Economy



(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**