Monetary policy normalization and the Euro area - Comments

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The argument

❖ Difficult for the ECB to accurately forecast core inflation: it remains stable at 1%

❖ Projected acceleration of core inflation in coming years, but bad track record

❖ Increasing divergence in inflation rates within the Euro area due to divergent economic conditions

❖ How to sequence monetary policy normalisation is challenging

❖ Some lessons from Sweden, the US and the UK

The case studies

❖ Interesting choice:

  ❖ US and UK: systemically important countries and issuers of reserve currencies, at the core of the GFC, early QE, almost in sync (starting in early 2009)

  ❖ Sweden: non-systemically important, QE in 2015 (like the ECB), 'dysfunctional' housing market, macro-prudential measures, recent improvement in inflation target by focusing on the CPI with mixed mortgage interest rates

❖ 2013: 'forward guidance' didn't work as expected for both the US ('tapering tantrum') and the UK (overshooting of the unemployment rate)

Normalising monetary policy

❖ So far the impact has been muted because of ending purchases without substantial reduction in the balance sheet

❖ Insufficient forward guidance from the ECB: 1. difficult to forecast because of the heterogeneity; 2. forward guidance has lost its shine in 2013

❖ Tensions in Italy may slowdown the process of normalization

The paper's main take-aways

* Macroprudential: if there are two objectives - growth and financial stability - then we need two tools: monetary policy and macro pru

* Not sure forward guidance is still so relevant: let's call it 'consistent messages to markets'

* Stopping asset purchases would not increase long-term rates: it may be different for the ECB

* It is critical not to jump given that the inflation outlook is still uncertain; however, more than the inflation outlook, the stability of the banking sectors in key countries is taken into account

Thank-you

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