

EMU reform and the “new normal” for monetary policy

Background

The financial crisis has deeply impacted theory and practice of central banking. Standard monetary policy based on managing policy rates has been supplanted by the use of non-standard tools, including a huge expansion of balance sheets and greater responsibilities in the realm of financial stability. Ten years after the start of the crisis, it is time to assess whether our institutions are prepared for the next one. If the European Central Bank Asset Purchase Programme is set to fade away in the coming months, a return to the old normal might not be desirable or even possible. The rethinking of monetary policy in Europe must also take into account the specific nature of the monetary union: the ECB is confronted with nineteen different fiscal policies and Treasuries and has to respect Treaties that makes it very different from the Fed or the Bank of Japan, for instance. This makes the challenge to design an effective institutional framework for monetary policy in the Eurozone all the more crucial. In such situation, can the ECB stick with its current monetary policy strategy or will it need to adjust it? Will the instruments it has as its disposal (and that it has developed during the crisis) be sufficient in the future and in the next crisis? Or will the ECB need to resort to new tools or to a whole new strategy (price level targeting, deep negative rates, helicopter money, etc.) given the challenges it faces (low neutral rates, but also the absence of a unique/active fiscal policy in the euro area)?

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The publications were prepared by the Policy Department A of the European Parliament and are available in the relevant section ([Monetary Dialogue](#)) of the ECON committee website.

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For the November 2018 session of the Monetary Dialogue, the Committee on Economic and Monetary Affairs (ECON) of the European Parliament has asked monetary experts to analyse the EMU reform and monetary policy. References to the relevant in-depth analyses are provided below.



In-depth analyses of the November 2018 Monetary Dialogue

[A monetary policy framework for the ECB in the age of uncertainty](#) by Grégory Claeys, Maria Demertzis and Jan Mazza (Bruegel)

The authors argue that monetary policy faces different challenges to those faced during the period of the great moderation. Greater uncertainties over the ability of monetary policy to control inflation, the instruments that were used and their effects on financial stability imply that we need to rethink whether the current framework is appropriate. The authors recommend a few adaptations to the current framework that would provide greater flexibility to the ECB without departing very far from current practices, to avoid risking the credibility that the ECB has acquired since its inception.

[EMU reform and the 'new normal' for monetary policy](#) by Christopher A. HARTWELL (Center for Social and Economic Research)

The ECB may already be facing the next crisis in the euro area while it is still deploying the tools of unconventional monetary policy from the last crisis. This paper shows how more unconventional approaches would not help the euro area. Given the complexity of money and the effects of expectations, expanding the ECB's unconventional arsenal is likely to have deleterious consequences across Europe.

[Does a single monetary policy need a single fiscal counterpart?](#) by Daniel Gros (Centre for European Policy Studies)

The absence of a single fiscal policy in the euro area does not necessarily constitute a problem for the ECB. In a deep financial crisis poorly coordinated national fiscal policies are likely to be insufficient to combat the crisis. But outside crisis periods, spill-over effects of fiscal policy are likely to be small and of uncertain nature. Moreover, fiscal policy is always subject to policy errors and other shocks. With many different national policies, individual errors and shocks would tend to cancel out each other, at least partially, thus delivering a more stable policy in the aggregate, which should facilitate the task of the ECB to maintain price stability. EMU reform efforts should thus not aim at creating a unified fiscal policy.

[EMU Reform and the new normal for monetary policy: Challenges and Perspectives](#) by Andrew HUGHES HALLETT (Copenhagen Business School)

This paper assesses the scope for monetary policy in the euro area as it returns to normal financial conditions without support from easy money but with a financial stability objective. The author finds that both financial stability and traditional monetary objectives can be achieved without one limiting the achievement of the other because, in the new normal, the ECB can use new policy tools derived from the regulatory metrics required under the post-crisis macro-prudential framework. Risks to monetary policy in the new normal are mainly external and depend on the transmission of monetary policies not aligned with ECB policies.

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