AT A GLANCE

Monetary Dialogue November 2018

Monetary policy implications of transitory versus permanently subdued growth prospects

Background

Since the start of the global financial crisis and despite unprecedented policy support, per-capita income growth has stagnated in many jurisdictions, including the euro area. Some economists have interpreted the lack of growth as a temporary phenomenon caused by the legacy of the crisis, with growth rates expected to resume to their pre-crisis trend once the current debt overhang is absorbed. According to an alternative view, lower long-term growth is a consequence of an unfavourable evolution of labour, capital and productivity. Assessing long-term growth trend has implications for the monetary stance. Should the current low growth momentum be mainly a transitory phenomenon, central banks could go back to standard monetary policy tools. By contrast, should most advanced economies face secular stagnation, non-standard monetary policy could become the new "normal" for central banks.

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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.

Contact us: **poldep-economy-science@ep.europa.eu**

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

Policy Department for Economic, Scientific and Quality of Life Policies
Directorate-General for Internal Policies
Authors: Dario Paternoster, Denitza Dessimirova
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In-depth analyses of the November 2018 Monetary Dialogue

Growth prospects, the natural interest rate and monetary policy by Salomon FIEDLER (Kiel Institute for the World Economy), Klaus-Jürgen GERN (Kiel Institute for the World Economy), Nils JANNSEN (Kiel Institute for the World Economy) and Maik WOLTERS (Friedrich Schiller University Jena)

The recovery from the global financial crisis was characterised by sluggish output growth and by inflation remaining persistently below the inflation targets of central banks in many advanced economies despite an unprecedented monetary expansion. Ten years after the crisis GDP remains below its pre-crisis trend in many economies and interest rates continue to be very low worldwide. This raises the question of whether low GDP growth and low interest rates are a temporary phenomenon or are due to a decline in long-run growth prospects (potential output growth) and equilibrium real interest rates (natural interest rate). This paper addresses this very important question for central banks and discuss implications for monetary policy.

Monetary policy implications of transitory vs. permanently subdued growth prospects ("secular stagnation") by Eddie GERBA (London School of Economics)

Since the start of the global financial crisis, per-capita income growth has stagnated in many advanced economies. Some scholars have interpreted the lack of growth as a temporary phenomenon caused by the legacy of the crisis. Others view the lower long-term growth as a consequence of an unfavourable evolution of the productive inputs (labour and capital) as well as of productivity. Against this background, the current paper examines the long-run evolution of the euro area economy, and suggests some causes for this low-growth phenomenon.

Monetary policy with transitory vs. permanently low growth by Christophe BLOT, Jérôme CREEL and Paul HUBERT (OFCE)

The recent economic slowdown in the euro area depends on supply-side and demand-side factors with different consequences on potential output. On the one hand, it may grow at a low pace for a long time; on the other hand, it may soon grow a bit faster. The ECB strategy has to adapt to these different possible outcomes. The authors argue that the ECB has room for manoeuvre whatever the trend in output.

Monetary policy in an era of low average growth rates by Karl WHELAN (University College Dublin)

Economic growth in the euro area has been sluggish since the onset of the global financial crisis. While some of this sluggishness reflected cyclical patterns, ongoing weak productivity growth and demographic factors point to slow average growth rates for the euro area in the coming decades. This will most likely translate into a lower equilibrium real interest rate. The author suggests that the ECB should follow the Federal Reserve in providing to the public estimates of the average nominal interest rate it expects to set over the long term and that this is likely to be lower than average rates during the pre-crisis era. The ECB should continue advocating for growth-boosting structural reforms but should also consider advocating for higher immigration levels to improve Europe's demographic profile and growth potential.

Administrator responsible: Dario Paternoster Editorial assistant: Janetta Cujkova
Contact: Poldep-Economy-Science@ep.europa.eu

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