AT A GLANCE

Requested by the ECON Committee

Monetary Dialogue September 2019

Below-target inflation and subdued growth in the euro area and elsewhere: implications for monetary policy

Background

A prolonged subdued inflationary pressure has today become widespread in the industrialized world, with inflation rates remaining persistently below central banks targets. The broadness across the industrialized world of the phenomenon after the financial crisis in 2008-09, despite widely diverging national fiscal and monetary policies, suggests that global and/or structural factors play an important role. In several advanced economies, including the euro area, this low inflation phenomenon is associated to weak growth patterns. What accounts for this subdued price and output dynamics across different jurisdictions? Is an increasingly competitive global environment putting a strong downward pressure on wages and thus on domestic inflation?

MONETARY DIALOGUE September 2019

The publications are prepared by Policy Department A of the European Parliament and are available online, in section **Monetary Dialogue** of ECON website

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

In the aftermath of the global financial crises, most central banks have made use of several non-standard instruments to fight low inflation and support the recovery. The ECB was no exception and it is generally recognised that the set of non-standard measures put in place have been instrumental to save the euro and protect the transmission mechanism of monetary policy. Last 12 September the ECB announced an additional package of measures to fight low inflation and stimulate growth. It includes an open-ended Quantitative Easing program of asset purchases, a further cut in the deposit rate, a strengthened forward guidance on interest rates and also easier terms for Targeted-Longer-Term-Refinancing-Operations. The fact that low inflation persists is worrying.

What are the factors causing such a "Japanification" of the euro area economy? What are the implications of a low inflation structural trend for the monetary policy of the next decade? Can the ECB liquidity injections ensure, in the absence of any effective stimulus from the real economy, the achievement of the inflation target for the euro area? How important is the cooperation between central banks for the achievement of the inflation targets in the medium term? Does a globalised world call for a better coordination of the policy instruments, including monetary policy? Four papers prepared for the September 2019 session of the Monetary Dialogue try to find answers on the above questions.

Policy Department for Economic, Scientific and Quality of Life Policies
Directorate-General for Internal Policies
Authors: Dario Paternoster, Drazen Rakic and Denitza Dessimirova
PE 638.433 - September 2019

EN

The Committee on Economic and Monetary Affairs (ECON) of the European Parliament has requested the contributions of leading experts on the topics.

In-depth analyses of the September 2019 Monetary Dialogue

Global trends in inflation: are central banks barking up the wrong tree? by D. GROS (Centre for European Policy Studies)

The author points that the ECB will not be able to achieve its inflation target over the foreseeable future. Further expansionary measures will have at most a modest impact on financial market conditions and even less on overall demand. Moreover, the impact of any demand stimulus on inflation is highly uncertain. The reasons for low inflation persistence despite tight labour markets almost everywhere are not fully understood. It is a global phenomenon, but not necessarily due to globalisation. One global factor seems beyond dispute, namely a fall in global equilibrium real interests. However, different views of how the economy operates lead to very different views how central banks should react to this phenomenon. There is little evidence that cooperation between central banks would have a significant impact on their (limited) ability to achieve their inflation targets.

Fighting the previous war: does the world economy face a deflationary threat? by M. DABROWSKI (Center for Social and Economic Research)

Inflation in advanced economies is low by historical standards but there is no threat of deflation. Slower economic growth is caused by supply-side constraints rather than low inflation. Below-the-target inflation does not damage the reputation of central banks. Thus, central banks should not try to bring inflation back to the targeted level of 2%. Rather, they should revise the inflation target downwards and publicly explain the rationale for such a move. Risks to the independence of central banks come from their additional mandates (beyond price stability) and populist politics.

Yes, We Are Probably All Japanese Now by J. F. KIRKEGAARD (Peterson Institute for International Economics)

This paper argues that the euro area has in recent years shared the same unfortunate concurrent systemic economic/financial crisis and demographic turnaround to an outright declining working age population that Japan suffered in the early 1990s. This combination will continue to depress euro area inflation dynamics for the foreseeable future, making it imperative that new fiscal policy initiatives, including public climate related investments, complement the ECB's ongoing monetary policy stimulus.

Subdued inflation, targets and monetary policy cooperation by A. HUGHES HALLETT (Department of Economics, Copenhagen Business School)

This paper examines the case that there has been a structural change in the determination of inflation in the EU (and elsewhere) that has led to a low real-wages, low inflation, slow productivity growth regime. In fact, there appears to have been no structural change. Instead, there has been a marked convergence between the performance of those variables in national economies. The implication is that there is little scope for greater monetary coordination in the conventional sense, or adjusting the monetary rules (e.g., targets), since this uniformity is the origin of the low inflation problem. Outcomes can be improved with better coordination of monetary policy with non-monetary variables. There are two lines of attack. One is a short term approach using conventional instruments (monetary-fiscal, structural or labour market reforms, improving policymakers' credibility). The other is a long term approach based on improved income distribution, a better distribution of the gains from productivity growth, and stabilisation by means of an external anchor (exchange rate).

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

This document is available on the internet at: www.europarl.europa.eu/supporting-analyses
IP/A/ECON/2019-29
Print ISBN 978-92-846-5542-7 | doi:10.2861/76651 | QA-02-19-753-EN-C
PDF ISBN 978-92-846-5541-0 | doi:10.2861/919325 | QA-02-19-753-EN-N