

# FUTURE OF THE EMU

## The challenges of a low interest rate era

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# THE GERMAN PENSIONERS' LAMENT

ECB POLICIES HAVE LED TO....

- Interest rates at zero or below
- QE inflating other asset prices
- Banks struggling to make profits

... WITH THE RESULT THAT

- Virtuous savers are penalised

Rates changed		Deposit rate	Refinancing rate
2019	18 Sep.	-0.50	0
2016	16 Mar.	-0.40	0
2015	9 Dec.	-0.30	0.05
2014	10 Sep.	-0.20	0.05
	11 Jun.	-0.10	0.15
2013	13 Nov.	0	0.25
	8 May.	0	0.50
2012	11 Jul.	0	0.75
2011	14 Dec.	0.25	1.00
	9 Nov.	0.5	1.25
	13 Jul.	0.75	1.5
	13 Apr.	0.50	1.25
2009	13-May	0.25	1.00

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## Graf Draghila

Wie Mario Draghi die Sparer aussaugt

# ARE LOW INTEREST RATES/QE BAD?

## THE CASE FOR...

- Risk of longer term undermining of price stability goal
- Distorts lending: 'zombification' and weakened banks
- Becomes de facto financing of governments

## ...AND AGAINST

- Recovery from years of crisis still fragile
- Deflation risk cannot be ruled out

The ECB's monetary policy is therefore based on a wrong diagnosis. The frequently used argument that the ECB would be violating its mandate with low inflation rates is simply inaccurate – **6 former leading central bankers**: October memo

# THE PROBLEM TODAY

- Monetary policy lacks scope to act
  - How, then, to respond if current downturn worsens
- Structural policies are, no doubt, worthwhile
  - But most are slow to deliver benefits
  - And some inflict short-term disruption before gains arise
- Fiscal policy is constrained
  - Formally a member state competence
    - Member states subject to fiscal rules
  - Reluctance to accept new EU-level mechanisms
    - Fears of moral hazard

# WHAT THEY HAD TO SAY

‘An internationally coordinated fiscal response, tied to country circumstances, may be required’  
***Gita Gopinath, IMF***

[We need] ‘Fiscal action in countries with the requisite room for manoeuvre’ and ‘wage growth in the full-employment countries’  
***Jean-Claude Trichet***

‘Put bluntly, public debt may have no fiscal cost’  
***Olivier Blanchard***

‘Most actors who work with these rules agree that they are severely compromised. Governments in turn do not appear to be willing to reform them. They do not realise the costs of maintaining the status quo’  
***Thomas Wieser, Eurogroup***

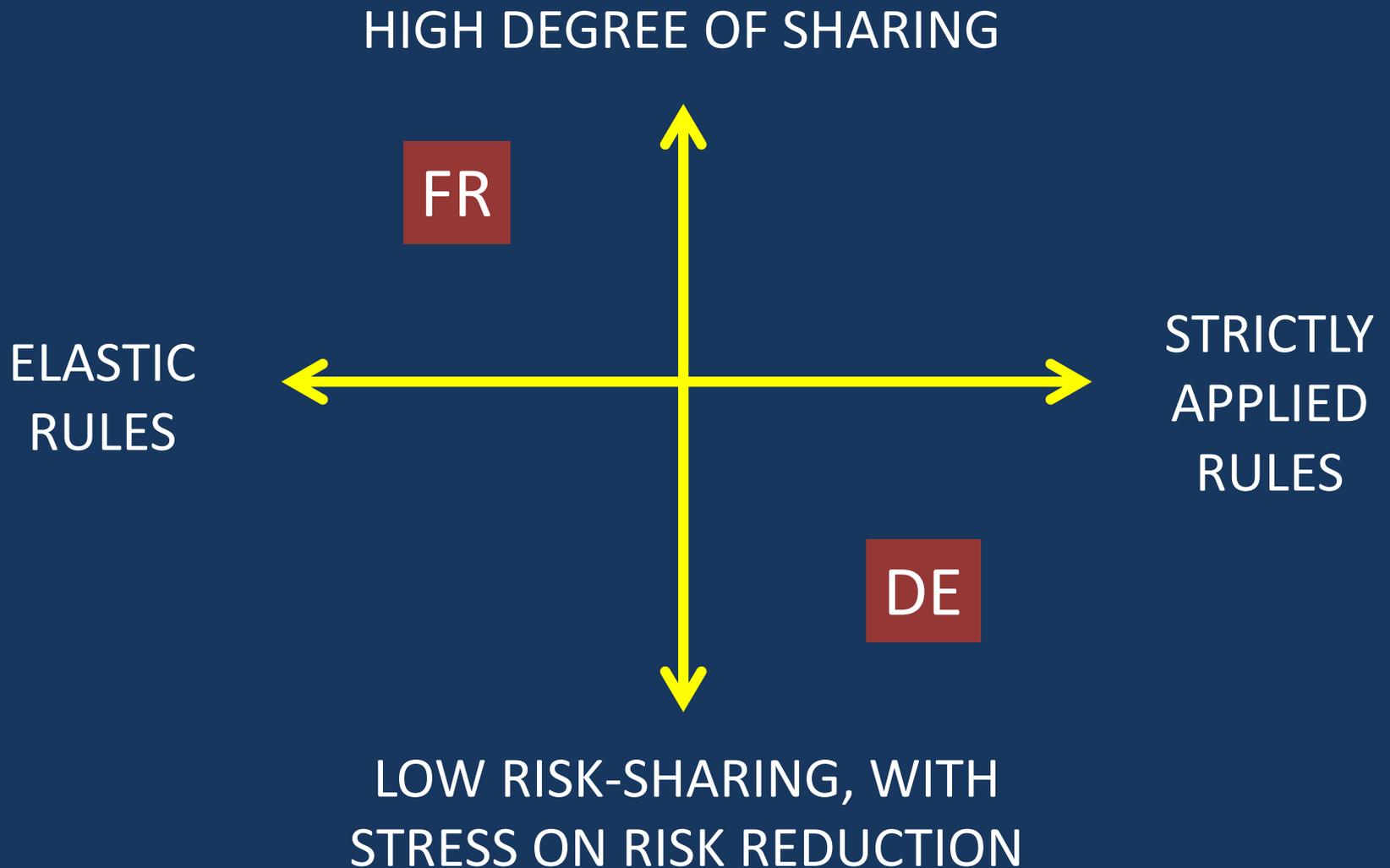
# INEXORABLE LOGIC

- Fiscal policy has to do more: question is how?
- National fiscal policy:
  - Strongly advocated by Trichet, Draghi and Lagarde
  - Yet subject to economic and political complications
- Or additional supranational resources
  - Draghi's valedictory recommendations
  - Proposed stabilisation budgets in hundreds of millions when need is tens of billions or more
    - Only really credible for smaller states
    - Certainly not for whole Eurozone

“When you look at the list of euro area countries and those that are virtually at zero deficit, or within 0.5% of deficit, it's a majority of countries in the euro area. So certainly there is not a lot of room, but there is room that can be used, in terms of fiscal policies.”

Christine Lagarde, new ECB President

# RISK & RULES: THE NUB OF THE PROBLEM



‘we know now what it takes to provide stabilisation across countries, and we know what we risk if we act too late to stabilise the union as a whole’

Mario Draghi, October 2019

# POLITICAL ECONOMY ISSUES

- Nationally: those who could relax fiscal policy won't or face labour shortages...
- ... those who need it lack room for manoeuvre
- EU level: capabilities-expectations gap quandary
- Concerns, above all, about Italy
- How to break the deadlock when:
  - Germany & other creditors stress moral hazard risks
  - While debtors want to emphasise solidarity
  - All at a time when populations are rebelling

# CONCLUDING COMMENTS

- Monetary policy cannot be the only answer
  - Evident tensions among central bankers – current & ‘ex’
- Logical conclusion: fiscal policy must do more
  - Too much weight has been given to fiscal rules
  - But not enough to common fiscal policy
    - Divisions within Eurozone are a concern
    - Incentives misaligned
- Credible Eurozone fiscal capacity now required
  - >> Redefine ‘whatever it takes’, it needs to ‘be enough’

“Strengthening fiscal union is not about creating a transfer union. It is about creating a euro area in which there is *less* need for public risk-sharing in future, because we have the instruments in place to stabilise crises more quickly”

Mario Draghi, Athens, October 2019