EXITING THE ECB'S HIGHLY ACCOMMODATING MONETARY POLICY: STAKES AND CHALLENGES

THIBAULT DUBREUIL*
OLIVIER KLEIN**

'Prudence'. This virtue, ranked first among the 'divine goods' by Plato (The Laws), above temperance, justice and courage, was the watchword of Mario Draghi's speech in Sintra during June 2017. In a global economic context of continuing uncertainty, the president of the European Central Bank (ECB) was therefore saying that the institution would need a very prudent, gradual approach to adjusting monetary policy parameters and thereby supporting the recovery. However, markets hardly seemed to heed this advice: they overinterpreted at that point Mario Draghi's words on reflationary pressures as an admission that ECB monetary policy would be tightened more rapidly and more strongly than expected. This market anxiety then forced the institution's president in late July 2017 to reaffirm that monetary support would continue unchanged, adding another virtue of 'patience'.

This series of statements in summer 2017, to pave the way for the first announcements of the autumn, reflects great uncertainty and expectations around the exit from the ECB's highly accommodating monetary policy. In the context of recovery, with nominal and underlying inflation still relatively weak, marked by overt criticism from Germany of the long-term continuation of unconventional measures, normalisation of European monetary policy is proving to be an economic and institutional challenge. Built and invented in a voluntarist way by the ECB to respond to the challenges of the global financial crisis, as well as the idiosyncratic crisis in the euro zone, which doubly affected the latter, and having objectively helped safeguard its economy and integrity, this policy must now complete the delicate stage of being gradually dismantled, during a period of more marked recovery.

* Major in finance, HEC Paris. Contact: thdubreuilsoutlook.com.
** Chief Executive Officer, BRED; professor of economics and finance, HEC Paris.
Contact: olivier.kleinsbred.fr.

We are therefore analysing the stakes at play around exiting the ECB's highly accommodating monetary policy. We will first evaluate this policy and present the elements that justify its normalisation. Then we will look at the conditions for completing this successfully, before finally considering the possible exit routes available to the ECB.

TIME TO DISMANTLE A SUCCESSFUL POLICY

The positive results of the ECB's highly accommodating monetary policy have justified its maintenance to date

The financial crisis led to a systemic bank liquidity crisis that was transmitted to the real sphere via two channels: credit and asset depreciation (of both immovable and movable assets). Affecting highly indebted private economic players as much as sovereigns, it therefore entailed a significant systemic risk of strong deflationary pressures for the whole euro zone economy and the US. Faced with this situation, central banks intervened, with their own delays and reactions, initially with conventional monetary policy tools. The Fed (Federal Reserve) and ECB therefore lowered their rates very significantly, seeking to revitalise bank lending and from there investment and consumption through the interest rate and credit channels.

However, the effect of these measures was limited by blocked monetary policy transmission channels, with the constraints of deleveraging, the crisis of trust in banks, the liquidity trap phenomenon (zero interest-rate boundary) and deflationary pressures. From then on, central banks had to include and create unconventional monetary policy tools to have a more direct influence on long-term rates, and in the euro zone to support governments undergoing a sovereign debt crisis from 2010.

This unconventional monetary policy translated into both new uses of conventional tools and putting in place new tools (Pfister and Valla, 2015). Central banks played a role of lender of last resort in this, by extending the maturities and amounts of their financing as well as the list of institutions that could benefit from it. More originally, the ECB implemented a negative rate on its deposit facility from 2014. They also based their policy on forward guidance and used unsterilised quantitative easing (QE), in 2008 for the Fed and from March 2015 for the ECB. The monetary policy of the Fed and the ECB therefore became highly accommodating, based on unusual methods.

The positive results overall of the ECB's monetary policy justified its maintenance hitherto.

The ECB's monetary policy helped steer the euro zone away from deflation

The main objective that pushed the ECB into setting up a real QE programme was the fear of deflation in the euro zone. It was therefore the fall in 2014 in the main inflation measure monitored by the ECB, the five-year inflation swap in five years that alarmed the institution and provided arguments to support QE. With monetary easing in place, this indicator recovered strongly in the first half of 2015, and again during 2016, before falling relatively in 2017, which reflected market uncertainty about the sustainable inflation rate.

In a more pronounced way, nominal inflation has risen strongly since 2014, bringing the euro zone out of the deflationary zone to draw nearer to the ECB's inflation target in early 2017. It therefore reached 1.9% in April (Organisation for Economic Co-operation and Development, OECD), before falling back to 1.3% in July, particularly under the pressure of lower energy prices. 'Underlying' inflation, which enables more precise analysis of the effect of the ECB's quantitative easing, has also trended upwards since 2015, despite its relative weakness, to approach in a more encouraging way its average historical rate of 1.3% in the summer.

The ECB's monetary policy has enabled a significant fall in sovereign debt yields in the euro zone, which has been efficiently transmitted to private-sector rates

The fall in sovereign debt yields across the euro zone is the particularly clear and rapid result of the ECB's policy. Insee's business survey of December 2015 shows how purchases of public debt as part of the QE programme, announced in March 2015, were anticipated by the markets from summer 2014. This has led to a significant fall in interest rates on sovereign debt in the euro zone since that date. For example, long-term yields (on ten-year sovereign debt) were particularly high for peripheral euro zone countries, at 8.7% in Greece, 6.0% in Portugal, 4.1% in Spain and Italy, and 3.5% in Ireland. At that point, they were 1.8% in Germany, 2.3% in France and 3.3% on average across the euro zone. In July 2017, these rates all fell markedly to very low levels, with the exceptions of Greece and Portugal. They therefore stood at 5.8% for Greece, 3.0% for Portugal, 2.2% for Italy, 1.6% for Spain and 0.9% for Ireland. Moreover, they were 0.5% in Germany (having been negative in July 2016), 0.7% in France (after a minimum of 0.2% in July 2016) and 1.2% for the euro zone average. These low rates therefore enabled low-cost financing for most euro zone member states and ensured the solvency of their public financing trajectory, which had become explosive from 2010.

This marked fall in sovereign yields was efficiently transmitted to financing conditions for corporate players in the euro zone. Private-sector interest rates and corporate debt rates evolved in a similar way to sovereign yields. In fact, investors who wanted to maintain their yields swapped sovereign debt, where yields had fallen, for corporate bonds in their portfolios. As demand for this type of bonds rose, the interest required fell. The decrease in banks' financing costs and the competition effect with bonds led to a significant reduction in bank interest rates (Heam et al., 2015).

The rates for bank loans to the private sector (non-financial companies and households) therefore dropped sharply under the effect of the ECB's monetary policy, particularly thanks to strong take-up of the various long-term refinancing operations (LTROs). Therefore, according to data from the ECB's Economic Bulletin of April 2017, between May 2014 and February 2017, composite bank lending rates to non-financial companies in the euro zone fell by 117 basis points and those to households by 106 basis points. Similarly, the financing cost for corporate debt, through yields on these companies' debt, has dropped sharply in the euro zone since 2008 – a testament to the effectiveness of the ECB's policies. The ECB's Economic Bulletin of August 2016 estimated that the financing cost for market debt between end-2008 and end-July 2016 dropped by 650 basis points.

This fall in private-sector interest rates enabled a real increase in outstanding non-financial corporate and household debt in the euro zone

This fall in private-sector interest rates, resulting from both QE and credit easing measures put in place by the ECB, supported a rise in demand for debt from private-sector players. The decrease in corporate interest rates (bank loans and bonds) stimulated rising demand for credit from companies for investment purposes, as the fall in the cost of capital made new investment opportunities viable. For households, as well as supporting property investment, lower rates could directly stimulate consumption, via the interest-rate effect on the cost of their credit, and via the wealth effect.

Total outstanding debt for non-financial companies in the euro zone therefore increased significantly. Between January 2016 and January 2017, the amount rose by 2.3% (ECB). Corporate borrowing was however more dynamic in Germany and France, with a rise of 4.5% over the period for the two countries, than in Italy or Spain, which saw a decline of 0.7% over the period (Insee). Similarly, growth in household borrowing in the euro zone increased by 2.2% between January 2016 and January 2017, recording its fastest pace since 2011 (ECB).

This recovery in debt supply and demand to companies and households, albeit encouraging and a testament to the growing effectiveness of ECB policy, nonetheless seems limited in light of the strong expansion of the corporate monetary base by the ECB.

Monetary easing provided significant liquidity stocks to banks, who were encouraged to lend, particularly because of the negative rate applied to deposits with the ECB. Nonetheless, this situation of a moderate increase in outstanding debt for the euro zone, given the greater liquidity provided in central bank currency, shows that business and household loans have been the subject of both an offer and a demand that were limited as a whole. To deal with this situation, the implementation of LTRO I (2014-2016) and LTRO II (2016-2017), targeted long-term refinancing operations for which the conditions depended on banks' performance in granting loans, had a positive effect on improving non-financial private-sector borrowing conditions in the euro zone.

These measures led to euro depreciation up to mid-2017, which supported growth across the euro zone

The ECB's accommodating monetary policy led to depreciation of the euro. With the lower interest rates resulting from the central bank's conventional and unconventional monetary policy measures, yields on euro zone sovereign debt fell. Investors therefore decided to reallocate their asset portfolios towards higher-yielding sovereign debt of the same quality, such as US federal bonds. So investors sold their euro assets for foreign-currency assets, leading to depreciation of the euro against other currencies. The depreciation of the euro against the dollar was also reinforced by the expectation and then implementation of faster monetary policy tightening in the US.

QE in early 2015 thus triggered a significant depreciation of the euro (particularly against the dollar and sterling), which was seen as early as spring

2014 because the measure had been anticipated (Heam et al., 2015). The depreciation of the euro against the dollar, its main monetary partner, was 16.4% between 2013 and 2015, and 14.5% against sterling over the period. The euro: dollar exchange rate remained relatively stable between mid-2015 and mid-2017, then saw the euro appreciate from May 2017, particularly because of the prospect of the ECB normalising its monetary policy and uncertainty about Donald Trump's economic policy.

The exchange-rate channel appears an effective one for the ECB's monetary policy, having had a positive impact on the real economy across the euro zone. It is even sometimes viewed as the main channel through which the ECB's QE programme had a positive effect on inflation and growth in the euro zone (Blot et al., 2015).

Moreover, this policy had not yet been accompanied by asset price bubbles

Wealth effects are weak in the euro zone and the efficiency of the asset price channel is therefore low (France Stratégies, 2015). The appreciation effects on European stock markets following the launch of QE were temporary, while property prices were not very sensitive to the ECB programme (Artus, 2016). These modest transmission effects were positively counterbalanced until recently by the absence of bubbles forming for assets, shares or property in the euro zone.

Moreover, although the long-term yield on euro zone sovereign debt has been below the growth rate since 2014, this characteristic does not represent a definite risk (Artus, 2017). This situation, which can manifest as debt prices that are clearly above their equilibrium price, does not however constitute a debt bubble as such, as long-term interest rates have been brought under control by central banks' QE policy. Additionally, this debt market situation has not been transmitted to equities or property in the euro zone because the ECB's debt buying is mainly counterbalanced by sales of debt by non-residents (such as central banks whose foreign-exchange reserves have fallen). Non-residents have not reinvested the liquidity received in other euro-denominated assets such as equities or property, which would not have been the case with domestic investors (Artus, 2017). This characteristic therefore enabled the euro zone to avoid until recently an equity or property bubble, the bursting of which would be far more complex for the ECB to control than the effects of progressive interest-rate rises on the price of debt.

The ECB's unconventional monetary policy therefore represents a positive result in terms of the fight against inflation and support for the real economy. This policy has been essential to support the most vulnerable euro zone member states and the economic recovery. Nonetheless, the limits and risks that pursuing such policies represents over the long term justify their gradual withdrawal, as has been under way in the US since the end of 2015.

The ECB's highly accommodating monetary policy must be normalised because of the risks involved in maintaining it over the long term and the economic recovery

Maintaining unconventional measures over the long term, particularly during a period of economic recovery, does raise questions and has drawn much criticism, notably from Germany.

In fact, the encouraging figures for unemployment in the euro zone (9.1% in July), its lowest level since February 2009, despite underlying inflation that still seems a bit low, could provide guarantees for a progressive recalibration of this policy. Indeed, given the abatement of deflationary fears and euro zone recovery, maintaining highly accommodating monetary policy over the long term involves significant risks, which start to seem greater than the risks linked to its withdrawal. This monetary policy represents a de facto risk, because of the potential change in behaviour and situation that it triggers among economic players. Indeed, with a policy of very low or even negative rates, below the nominal growth rate, the ECB, by supporting borrowers, negatively affects the remuneration of savers and lenders.

This policy therefore affects the life insurance sector, which sees the revenue from its investments fall (Ragot et al., 2016), as well as all savers, whose income from savings decreases (Thimann, 2016). This constraint is particularly punitive in countries with a funded pension system, as well as for savers who want to supplement the public system. It fuelled lively criticism on this point in Germany, a country with declining demographics, which argued therefore for a rapid exit from this monetary policy of very low interest rates. In this context, institutional investors, such as insurers and pension managers, who may or may not be obliged to deliver a minimal return by contract, may tend to take more risks in their search for yield. In particular, they may be led to extend the maturities of their placements and accept greater counterparty risk in exchange for better remuneration. This policy, if maintained longer than is necessary, could therefore be a source of financial instability in future.

This search for yield coupled with the rise in asset prices caused by monetary policy could then encourage speculative behaviour, creating bubbles (Leppin and Nagel, 2016). Such behaviour involves borrowing at low rates to acquire risky assets, be they equities or property, to gain the yield differential. Now, while such bubbles have not yet been clearly visible until recently, there seems to have been a sharp escalation in some asset prices on US equity markets, for example, and in property markets for some large European and US cities (including in Germany). Beyond this risk of bubbles, the heightened risk-taking, together with strengthened prudential regulation for commercial banks, has led to the development of a parallel banking system that does not receive deposits and is therefore unregulated – shadow banking (Beck and Kotz, 2016).

Moreover, even though the ECB pursued this policy to buy time for the euro zone, so that member states could undertake the necessary structural reforms (easier to do in a context that supports growth) and complete the institutional framework of the monetary zone to respond to the various challenges of the crisis, such monetary policy can influence the behaviour of public borrowers. The risk is then that low interest rates do not encourage euro zone countries to deleverage or consolidate their public finances because they have the opportunity to take out new debt on very favourable terms (Leppin and Nagel, 2016). We cannot help but note today that the result in terms of structural reforms in the member states concerned – reforms which are nonetheless essential for some countries to exit emergency monetary policies – currently seems mitigated and would need to be pursued further.

Finally, this situation puts pressure on commercial banks to lower their net interest-rate margins. Commercial banks undertake short-term borrowing at referenced rates and long-term lending mainly at fixed rates. But central banks, seeking through their QE policies to position long-term interest rates very low, although savers' remuneration for their bank savings cannot concretely be below zero, provoked flattening of the interest-rate curve (shrinking the differential between long-term and short-term rates). But the differential between lending rates and the collection rate for banking resources constitutes an essential revenue base for commercial banks. Their net interest margins have been significantly squeezed as a result. Since 2016, this unfavourable effect is also no longer compensated, in France in particular, by growth in credit volumes combined with the fall in credit risk costs, also caused by the same very low rates (Klein, 2017a). As a result, the drop in banking revenue risks hampering, sooner or later, their capacity to keep up with the credit growth that accompanies economic recovery, while the solvency ratio required by prudential regulation has increased. Normalising the ECB's monetary policy therefore becomes a necessity. It would also enable the institution to rebuild essential room for manoeuvre to guard against a future reversal of the cycle – all the more important because fiscal policy in several member states currently seems hard to mobilise given their level of public debt. With this in mind, the Fed started tightening its monetary policy in December 2015, as inflation and unemployment were approaching its targets. Normalising the ECB's monetary policy should nevertheless entail conditions, particularly to ensure its compatibility with stability in the zone.

A DELICATE EXIT REQUIRING STRONG CONDITIONS

Avoiding a crash

The main risk of an uncontrolled exit from the ECB's unconventional monetary policies is of triggering a bond-market crash. Indeed, hardening monetary policy too quickly with a brutal hike in long-term rates, following a rise in interest rates or a rapid reduction in its asset-buying, could lead to a bond-market crash like that in the US in 1994. By maintaining very weak long-term interest rates, banks and institutional investors build up significant bond portfolios with very low coupons. If the central bank tries to exit its accommodating monetary policy by brutally hiking its rates, the rise in long-term interest rates, by triggering a fall in bond prices, could lead to major capital losses for these players. The risk is then that economic players cannot bear such a rise and highly accommodating monetary policy therefore becomes irreversible.

If this situation therefore greatly affects lenders, it also affects borrowers (both private and state) who did not deleverage despite the low interest rate policy and who would then see a significant rise over the medium term in the interest rate burden on their debt. Because of this, highly accommodating monetary policy that is continued over the long term can become particularly difficult to tighten, with significant negative effects on all economic players and sovereigns, and therefore on the economic and financial stability of the zone.

The two conclusions that result from these various risks are that the ECB's highly accommodating monetary policy must not be maintained for too long, so that these positions do not build up, and that a very gradual, well programmed and announced exit is important. In general, economic players need time to prepare for a new monetary policy after a long period of abundant liquidity.

Exiting the zone of weak inflation

The weakness of nominal and underlying inflation implies that monetary support should be maintained during a period of recovery. This situation therefore also argues for a gradual exit, with rates being raised over several years, as the Fed is implementing.

Thus, although using highly accommodating monetary policies together with unconventional tools could theoretically raise the risk of triggering high inflation in a mechanical way (monetarist approach), we have to note that this theory has not been verified. On the contrary, relatively weak inflation expectations minimise the risk of uncontrolled inflation in the euro zone. Moreover, structural reasons also limit inflation, such as the ever-present effects of globalisation (economic emergence of new developing countries) and the technological revolution (in terms of productivity), the resultant weakening overall of employees' bargaining power (less indexation of wages to prices) and relatively low commodity prices.

However, such structural factors that constrain a strong rise in inflation may seem to come into play less at the moment, with an increase in global growth and relatively low global unemployment (5.7% in 2016). This situation could imply moderate reinforcement of inflation with time, for these non-monetary reasons, which requires supervision by central banks. For this reason, the rise in inflation above its target in February 2017, buoyed by energy prices, gave the Fed another argument to increase its rates by one-quarter of a point the following month. Nonetheless, the conditions which could trigger the return of an inflationary regime including wage and price indexation do not seem present, particularly because of current wage formation methods.

This why both the ECB and the Fed will only proceed to raise rates very gradually. Underlying inflation, a statistical expression of the strength or weakness of indexation systems, is indeed still very modest, as Mario Draghi often emphasises, for example. Similarly, seen from the euro zone, the appreciation of the euro vis-à-vis a weak dollar further frustrates the rise in the inflation rate and can present risks to growth. This prerequisite for exiting the weak inflation zone, which corresponds to the ECB's price stability mandate and should work in tandem with that of supporting growth in the zone, therefore has a strong influence on the ECB's choices regarding its method and timetable for exiting its highly accommodating monetary policy.

THE ECB'S OPTIONS FOR IMPLEMENTING THIS EXIT

The potential strategy regarding methods of withdrawing its conventional and unconventional measures

The question arises of the exit sequence for the various measures that comprise the ECB's highly expansionary policy. The ECB could therefore go through the same sequence for exiting as the Fed, with first a gradual reduction (tapering) then end of its securities-buying programme, keeping its balance sheet at the same size, then second a gradual increase in its deposit and refinancing rates. This currently seems the scenario preferred by the ECB and expected by markets. Although the public and private asset repurchase programme is expected to end in December 2017, the ECB nonetheless reaffirmed in May 2017 that the volume of repurchases could be increased and the length of the programme extended if the outlook for inflation and financing conditions worsened. The extension of this programme, with the pace of purchases potentially slowing in early 2018, is therefore an option for the ECB. Moreover, at the meeting of its Governing Council in June 2017, the ECB took action to start its normalisation strategy by announcing that it did not envisage any further reduction in its rates. Its press release therefore stated that "the Governing Council expects the key ECB interest rates to remain at their present levels for an extended period of time, and well past the horizon of the net asset purchases". It was therefore expected to present its tapering at its meeting in late October 2017.

It was during 2014 that the Fed moved to gradually reduce its securities-buying programme, before stabilising its balance sheet in October 2014 and starting to increase its rates in December 2015. It maintained the size of its balance sheet by reinvesting the amounts of securities reaching term. Janet Yellen announced in September 2017 that the end of this reinvestment policy, and therefore the start of the reduction in the Fed's balance sheet, was expected in October 2017, at an initial pace of a US$10bn reduction the first month but with the amount gradually increasing over the following months. The central bank had previously made known in its monetary policy normalisation principles, published in 2011 and updated in 2014, that it would not a priori proceed with selling securities it held. If the economy overheated or bond yields were considered too low, securities sales would involve US Treasury bills and would be announced in advance. The institution has not detailed the total assets it aims to keep on its balance sheet at the end of the normalisation process, but indicated that this amount would be above pre-crisis levels.

Applied to the ECB, such an exit strategy would have the advantage that the unconventional measures designed to restore good money market functioning, such as the long-term refinancing operations or expanding the range of eligible collateral, would be withdrawn before any rise in rates. Raising rates without restoring money market functioning could indeed have a negative effect, whereas continuing to provide market liquidity through unconventional monetary policy while increasing rates could send an ambiguous message to economic players (Bini Smaghi, 2009). Another advantage of this method is that it enables increases in key rates to be planned over several years, thereby limiting the risk of a crash and giving euro zone economies time to implement structural reforms and more broadly to reinforce growth and underlying inflation in the zone.

With a very gradual exit strategy from its bond-buying programme, the ECB could therefore trigger a very prudent rise in long-term rates. It could more or less in parallel raise the rate on its deposit facility towards zero, as negative rates would no longer be justified because of the recovery in credit demand and more distant deflationary risk. This particular feature of negative rates, which differentiates it from the Fed's monetary policy, can actually only be highly exceptional. With a certain delay, the ECB could then gradually raise its refinancing rate. This method would have the advantage of rapidly loosening the strong financial constraint weighing on banks and institutional investors while maintaining support in terms of low key rates for financing member states, economic players – and therefore growth. The ECB could thereby steer a very gradual increase in long-term rates and a return of short-term rates to positive territory, while ensuring that the slope of the yield curve recovers little by little, so that commercial banks again have the margins they need for their health and domestic business.

The idea of a decoupling that is highly unusual in the ECB's management of its refinancing and deposit rates has not officially been proposed by the ECB, although it was supported by the governor of the Austrian central bank, Ewald Nowotny (a member of the ECB Governing Council) in March 2017. He defended the possibility of the ECB increasing the rate on its deposit facility before its refinancing rate, without waiting for the end of its QE programme, and the different ECB rates would not need to be raised at the same time or to the same extent.

From 2019, the ECB will very likely accentuate its readjustment to move towards more neutral monetary policy. It is in fact in 2019 that the output gap should close (IMF, 2017). The many years of negative output gap after the crisis will then have been followed by a period during which the effective growth rate will in contrast have exceeded the potential growth rate, with an accumulation of this differential that will have compensated for the accumulation of the converse gap when the effective growth rate was below the potential growth rate. A stronger adjustment in monetary policy will then be even more justified.

More generally, whichever exit strategy from its unconventional monetary policy the ECB chooses, the institution will communicate in advance its future monetary policy stance. Communicating its exit strategy should indeed be an integral part of the exit strategy (Belke, 2009). The transparency on monetary policy from the central bank gives credibility to its monetary policy objectives and anchors players' expectations. The ECB's communication is all the more important for unconventional monetary policy, because the highly unusual nature of this creates uncertainty for economic players as to its effects and exit timetable. Moreover, to be well prepared and rooted in an environment that supports recovery, this exit must take place against the backdrop of strengthened macroeconomic stability.

The need to strengthen European macroeconomic stability to prepare, support and secure this exit

The end of the average recessive bias in euro zone fiscal policies supports normalisation of the ECB's monetary policy. However, coordinating fiscal policy turns out to be a crucial element in the smooth functioning of European monetary union to counteract the variability of economic cycles, particularly in the absence of a system of sufficient fiscal transfers at the community level and given the limits affecting wage mobility between member states, as the theory of optimal monetary zones postulates. Because of this, the situation in the euro zone leads to very asymmetric adjustments between the various member states that comprise it (Klein, 2017b). Now, although national fiscal policy is currently coordinated in theory by the rules of the Stability and Growth Pact (SGP), in reality this coordination has significant limits.

The existence of countercyclical fiscal policies to support monetary policy is however especially important when monetary policy transmission channels are weakened (zero interest-rate boundary) and during normalisation of the latter, in order to maintain support for growth. Yet it seems that national fiscal policies have not been coordinated to support euro zone monetary policy over the recent period. Fiscal policy has often actually been conducted in the opposite direction to monetary policy, proving to be procyclical. Thus, over the 2008-2015 period, aggregate discretionary fiscal policy can only be described as countercyclical in 2009 and 2011, emerging as procyclical in 2008, 2012 and 2013, while the other years showed no clear stance (Bénassy-Quéré et al., 2016). These uncoordinated and procyclical national fiscal policies then have a negative effect on growth and amplify deflationary pressure in the zone, thereby limiting the ECB's expansionary monetary policy. This situation therefore leaves monetary policy solely responsible for macroeconomic stabilisation.

From then on, coordinating fiscal policy is a key element of the economic and monetary union, to support monetary policy and take over once it is normalised. This coordination should aim more broadly to counteract variability in economic cycles and strengthen resistance to economic and financial crashes affecting the euro zone.

In this context, the SGP rules prove to be one reason for the procyclical character of national fiscal policies. Thus, the procyclical trend of 2012 and 2013 is attributable more to member states constrained by the SGP than to those undergoing crisis (Bénassy-Quéré et al., 2016). By encouraging member states whose deficit exceeded the general criterion to adopt a fiscal policy designed to reduce this, the SGP rules limit de facto the potential for recovery policies – and all the more so for states subject to an excessive-deficit procedure. The European Commission, aware of this issue, therefore published a communication on fiscal stance for European institutions in November 2016. In this, it criticises the asymmetric nature of the European fiscal framework, which imposes rules for high budget deficits but, for member states that respect the criteria and have fiscal room for manoeuvre, can only recommend and not impose fiscal support.

Moreover, the need to efficiently coordinate fiscal policy, which supports monetary policy and the recovery, is even greater because the room for manoeuvre in monetary policy is limited by the zero interest-rate boundary. This coordination is all the more vital because the real neutral interest rate in the euro zone (rate at which monetary policy has neither a deceleration nor stimulation effect on growth) is particularly low. The weakness of this rate, in the euro zone and in the US, is explained by economic factors weighing on global demand, particularly credit access conditions, economic players deleveraging, restrictive fiscal policies and weak growth.

This rate weakness serves to limit the expansive nature of monetary policy. The central bank then has less room for manoeuvre to relaunch the economy by lowering rates. The result for the Fed and ECB is a situation whereby, because of these very low neutral rates, if there were a recession, short-term rates would be cut more regularly towards the zero boundary, which would entail using more unconventional measures during future economic crises (Coeuré, 2016). The weakness of real neutral interest rates in the euro zone as in the US could therefore lead central banks to maintain and use unconventional monetary policy after the normalisation of highly accommodating monetary policies as key tools in their monetary action. In time, these policies would thereby become almost conventional. In this sense, Janet Yellen confirmed during her speech at Jackson Hole in August 2016 that she believed forward guidance and asset purchases would continue to be an integral part of the Fed's toolbox.

This situation of less monetary room for manoeuvre for the ECB reveals the great importance of coordinated and countercyclical fiscal policies to support monetary policy – particularly during its normalisation. The potential for unconventional measures to become conventional also foreshadows further future episodes of unconventional monetary policy. These episodes therefore form a model that needs to demonstrate its success.

Moreover, normalising ECB monetary policy is all the more necessary to enable members states to implement structural reforms to increase their value added (quality/price competitiveness) and support their growth potential. They could therefore lower their public deficits, including social ones, and structural current deficits, without having recourse to austerity measures. Such progress constitutes a key prerequisite for building a euro zone that is stronger, better coordinated and more cohesive – capable of confronting future economic crises.

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