IS EUROPEAN CENTRAL BANK MONETARY POLICY FRAMEWORK OPTIMAL FOR ECONOMIC GROWTH?

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Presentation`s outline

- **Monetary policy framework of the European Central Bank (ECB)**
- **Elements of theoretical analysis of the influence of the anti-inflation oriented monetary policy on economy**
- **The ECB monetary policy framework and processes of economic growth in EMU**
- **Summary**

Main thesis

European Central Bank framework of monetary policy aiming to maintain inflation rates at a low level does not necessarily create optimum conditions for the long-term economic growth.

Monetary policy framework of the European Central Bank (ECB)

Maastricht Treaty, New Neoclassical Synthesis consensus on the role of economic policy, decisive role of monetary policy, controlling inflation as main target; other objectives of economic policy (economic growth, employment) as well as methods of this policy (fiscal policy, income-related policy, etc.) were subordinated to the anti-inflation policy implemented by central banks.

What does it meen „price stability”?

In the European Central Bank’s practice until May 2003 it had been believed that it was inflation within the range of 0 to 2% annually. Then, the limit permissible for stability was established at ca. 2%.

In the United States the permissible price stability margins in the 2000s were within 1-2 %

On the other hand, some theoreticians were inclined to widen them even up to 5%

The ECB's arguments supporting the concept of price stability:

1) creation of an adequate buffer against deflation,

2) a possibility of overvaluation of inflation measured by the harmonized index of consumer prices,

3) willingness to take into account the differences in the inflation rates among the Euro zone member countries and, in particular, to avoid a situation in which individual countries of this zone could function in the circumstances of too low inflation or even deflation.

Thus, the most important arguments in favor of maintaining inflation at a level close to the 2%-limit of price stability are not the results of studying the history of inflation in individual member countries, defining its optimum levels, for example from the point of view of long-term economic growth, but rather of an intuitively understood intention of not permitting deflation processes to develop in the Euro zone. It is a considerable drawback of this concept which, as a result, affects general effectiveness of the monetary policy implemented by the ECB.

Elements of EBC monetary policy doctrine

- The first group comprises: 1) treating the requirement of price stability by the central bank as the main objective of its monetary policy, 2) central bank's independence from any political influence; its conditions were formulated in the Maastricht Treaty, 3) conducting efficient information policy bearing in mind strong anchoring of long-term inflation expectations.
- The second group includes medium-term orientation of the ECB policy, resulting from the conviction about existence of fairly differentiated time-lags between monetary authority decisions and their effects in the so called real sphere, which actually excludes its use as an instrument of short-term price stabilization and demand (*fine tuning*).

Cont.

This framework proved to be particularly effective in the case of German economy which in 1983 (that is, the moment of getting out of the so called second oil crisis) started a long period of boom which was accompanied by a positive current account balance, declining rate of unemployment and very low inflation (sometimes even deflation) .

It is difficult now to say how far the positive experiences of the Deutsche Bundesbank monetary policy of the 1980s affected the shape of the ECB’s monetary policy in the last decade.

There is no doubt, **however, that the framework of this policy was more oriented to damping inflation than it would appear from the assumptions of the direct inflation targeting doctrine**, which is referred to by some central banks (including the National Bank of Poland) adopting provisions of the new consensus as a theoretical basis of their monetary policy

B.C.Bernanke`s view on monetary policy strategy

“The Federal Reserve has a statutory mandate to foster maximum employment and price stability. It is evident that neither of our dual objectives can be taken in isolation: On the one hand, a central bank that aimed to achieve the highest possible level of employment in the short run, without regard to other considerations, might well generate unacceptable levels of inflation without any permanent benefits in terms of employment. **On the other hand, a single-minded focus by the central bank on price stability with no attention at all to other factors, could lead to more frequent and deeper slumps in economic activity and employment with little benefit in terms of long-run inflation performance” [Bernanke, 2010, p.4].**

Questions to answer:

Can ECB be regarded as a central bank which is single-mindedly focused on price stability?. Can this policy threaten the Euro zone and EU economy with “more frequent and deeper slumps in economic activity”?

Elements of theoretical analysis of the influence of the anti-inflation oriented monetary policy on economy.

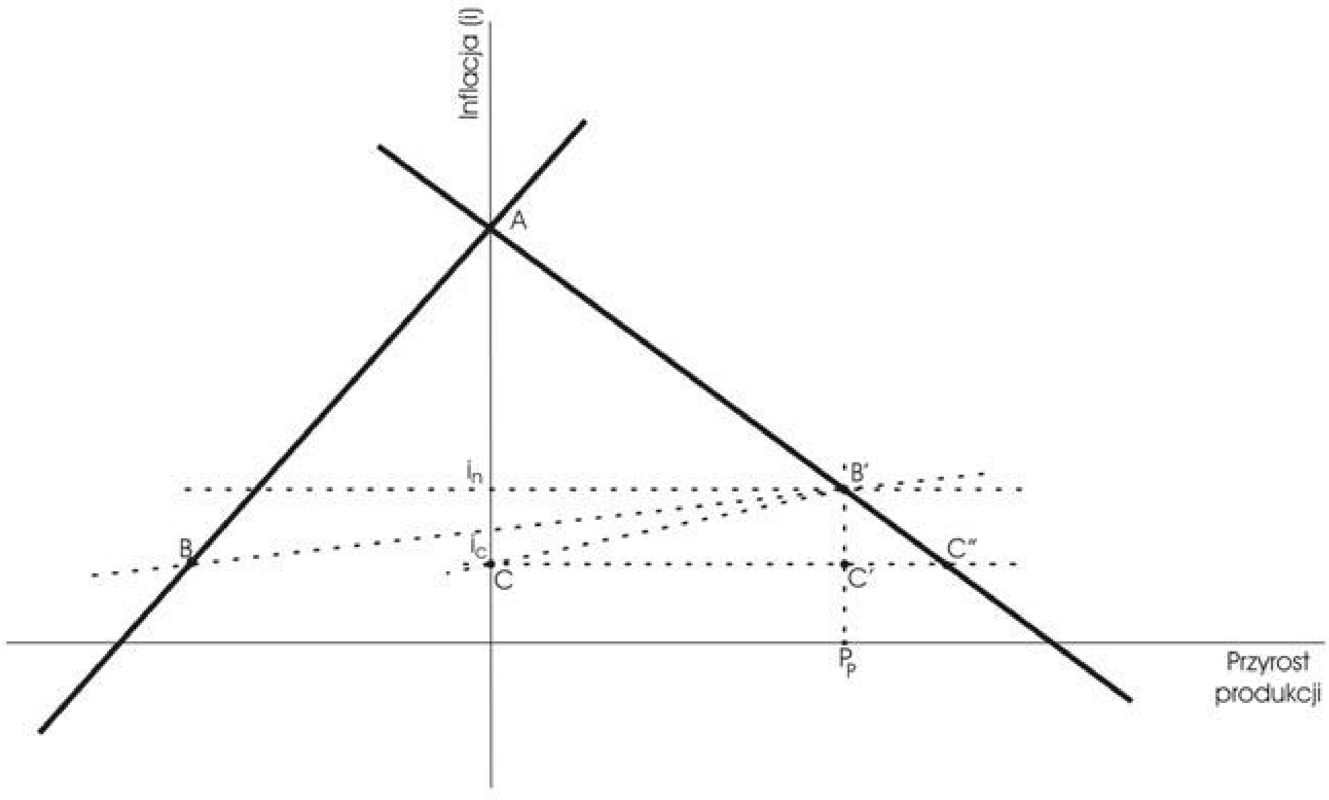

Fig. 1. Central bank's inflation target and economic situation

Source: Bednarczyk, 2010, p. 23.

Conclusion

The above analysis of the impact of the anti-inflation policy on the economic situation indicates that an effect of the economic policy oriented to ruthless fight against inflation may be consolidation of stagnative tendencies in economy and increased unemployment.

In the context of integration processes within the European Union framework, these phenomena can become a hotbed of conflicts among member countries over the benefits obtained from the participation in these processes.

The ECB monetary policy framework and processes of economic growth in

Table 1. Comparison of macroeconomic indicators from the Euro zone, United States and Japan in the years 1999- 2010

Specification	Years				
	1999-2005	2006-2010	2008	2009	2010
1. Real GDP growth rate					
Euro zone	2.0	0.9	0.3	-4.1	1.7
United States	2.8	1.3	0.0	-2.6	2.7
Japan	1.2	0.6	-1.2	-5.2	3.7
2. Private consumption growth rate					
Euro zone	2.0	0.9	0.3	-1.1	0.6
United States	3.6	1.5	-0.3	-1.2	1.7
Japan	1.1	0.8	-0.7	-1.0	2.4
3. Fixed asset investment growth rate					
Euro zone	2.3	-0.1	1.0	-11.3	-1.0
United States	3.0	-1.8	-4.5	-14.8	3.4
Japan	-0.8	-2.5	-2.6	-14.0	-0.1
4. Current account balance as a percentage of GDP					
Euro zone	0.4	-0.1	-0.8	-0.4	-0.2
United States	-4.3	-4.6	-4.7	-2.7	-3.4
Japan	2.9	3.7	3.3	2.8	3.4

5. Retail price growth index					
Euro zone	2.0	1.9	3.3	0.3	1.5
United States	2.5	2.4	3.8	-0.3	1.6
Japan	-0.5	-0.2	1.4	-1.4	-0.9
6. Unemployment rate					
Euro zone	8.4	8.5	7.4	9.3	9.9
United States	5.1	6.5	5.8	9.3	9.7
Japan	5.0	4.4	4.0	5.1	5.1
7. Budget deficit as a percentage of GDP					
Euro zone	-2.0	-3.2	-2.0	-6.2	-6.3
United States	-1.8	-6.1	-6.3	-11.3	-10.5
Japan	-7.2	-4.6	-2.1	-7.1	-7.7
8. Economic success index [1]					
Euro zone	2.3	-0.4	0.2	-9.0	-2.4
United States	3.3	-0.6	-0.7	-7.2	-0.7
Japan	-0.6	-0.1	-0.8	-10.5	1.4

1.Economic success indices are calculated as a difference between the economic growth rate and GDP gap for individual years.

Source: author's own compilation on the basis of (OECD, 2008),and (OECD, 2010).

Summary

Conclusion 1.

The data included in Table 1 imply that there is a sort of a *trade off* between the Euro zone economy and American economy in terms of the economic growth rate and unemployment rate on the one hand, and inflation rate on the other. In both distinguished sub-periods, lower inflation indicators in the Euro zone (on average by 0.5 percentage point) were accompanied by a lower than in the US economy economic growth rates and higher than the American ones unemployment levels. At the same time one can easily notice that the American economy experienced a much “shallower” economic slump in 2009 and seems to recover more quickly and steadily than the European economy.

Conclusion 2

Low inflation Japanese economy noted in 2009 higher growth rate in comparison to USA and EU, but achieved it after the deepest and the longest recession in the group of industrialised contries. Actually Japanese indices of economic growth have been low all the time, which well characterizes the commonly-known problems of this economy.