

European Fiscal Board

FISCAL AND MONETARY POLICY INTERACTIONS

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A LONG-TERM PERSPECTIVE ON EU FISCAL-MONETARY INTERACTIONS REVEALS MAJOR SWINGS OVER THE LAST HALF-CENTURY

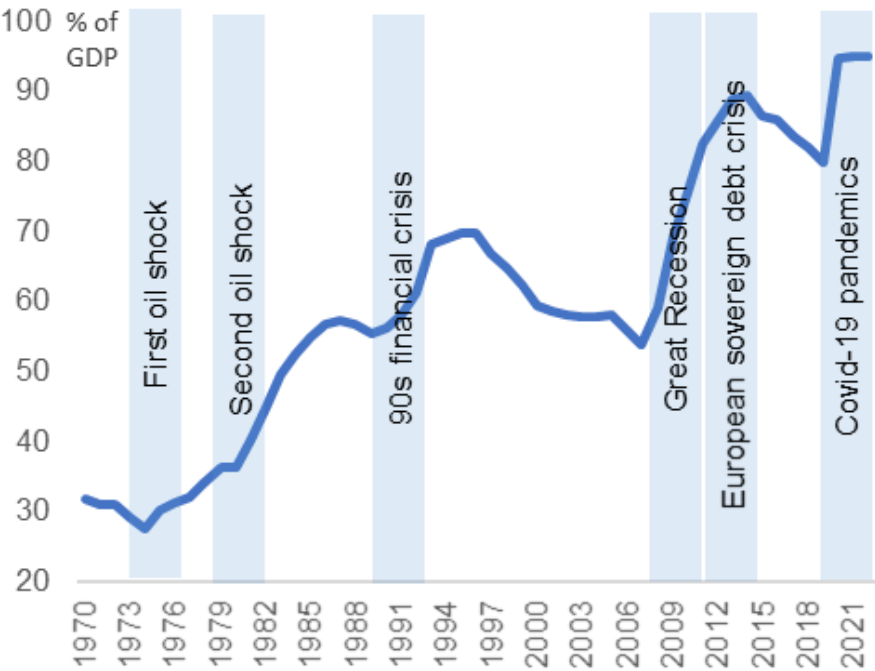
- from **strong confidence** in coordinated national fiscal policies for both macroeconomic stabilization and faster growth (1970)
- **via disillusion** in the years of stagflation and divergence (1971-84), with often procyclical fiscal policies
- to the '**Maastricht bargain**': fiscal constraints as a counterpart to the lower and more stable inflation and interest rates only EMU could bring

THAT BARGAIN IS NOW SEEN BY MANY AS OUTDATED

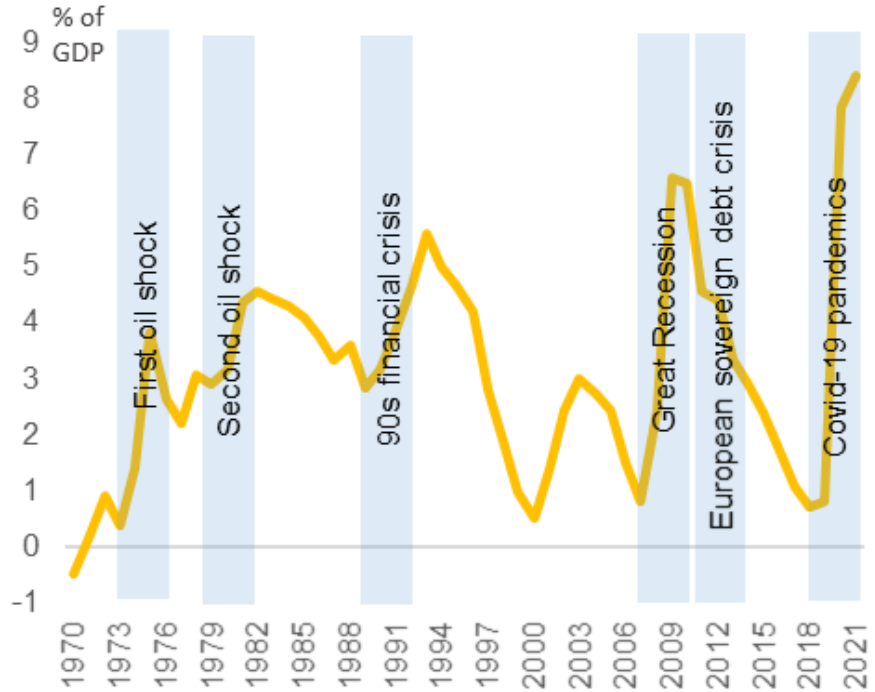
- **fiscal constraints** - rules that focus on sustainability - no longer seem a prerequisite for low inflation, now made a consequence of trend-wise falling equilibrium rates
- the pandemic has nailed that view, already emerging in 2014-19 with (even) the ECB asking for **more fiscal expansion** to make monetary and fiscal policies '**strategically complementary**', no longer substitutes
- as **national governments**, supplemented by new joint action (NGEU) **responded massively** (and appropriately) to the severe downturn, interest rates remained low throughout, due to ECB asset purchases
- still, when looking at long-run trends in public finances, the **Maastricht bargain needs an update** more than relegation to limbo

EVOLUTION OF DEFICITS AND DEBT OVER THE LONG RUN

EU-15: Government debt (1970-2020)



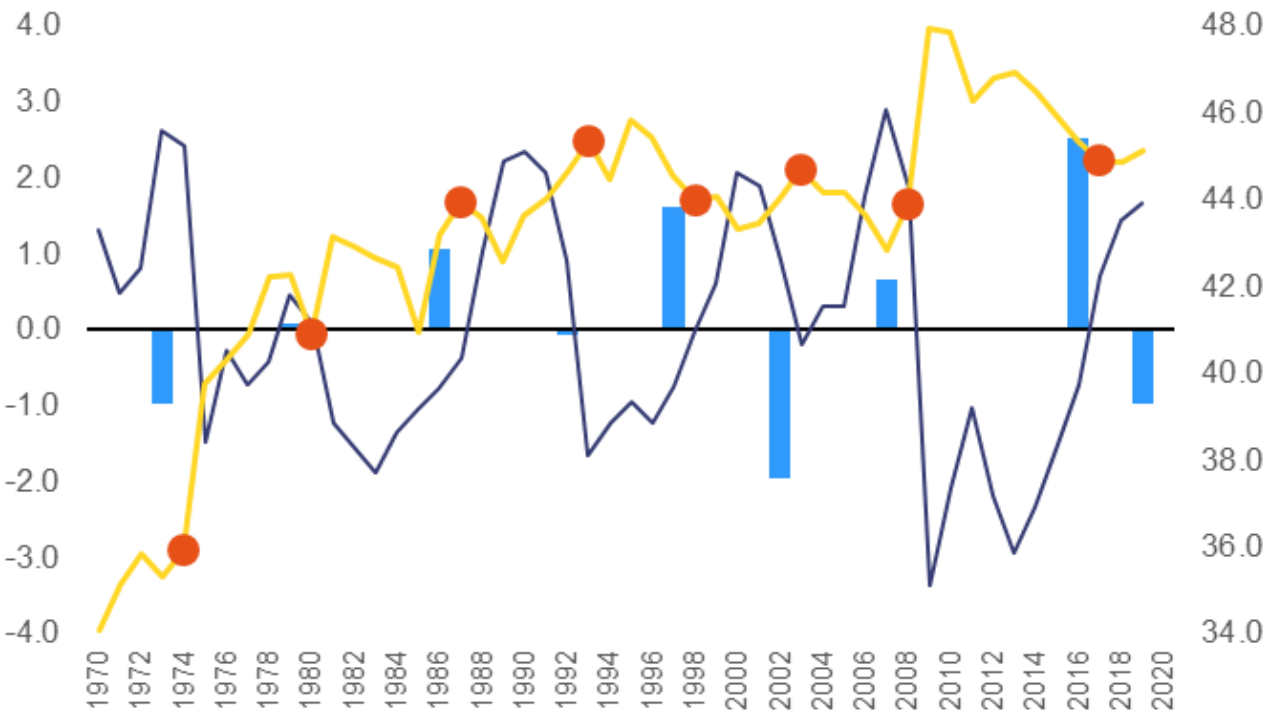
EU-15: Government deficit (1970-2020)



EU-15: AT, BE, DK, FI, FR, DE, EL, EI, IT, LU, NL, PT, ES, SE, UK

EVOLUTION OF GOVERNMENT EXPENDITURE

Primary expenditure to GDP ratio of EU



Notes: (1) The graph shows the primary expenditure-to-GDP ratio (yellow line) and the output gap (blue line) for the aggregate of available EU Member States. The sample includes a growing number of countries in line with the subsequent waves of EU enlargement.
 (2) The red dots represent the primary expenditure-to-GDP ratio in years when the output gap was zero.
 (3) The light blue bars show the cumulative change in the cyclically adjusted budget balance since the beginning of the previous phase of the cycle, i.e. when GDP was close to its potential.

Sources: European Commission

- █ Cumulative change in CAPB since the end of previous cycle phase
- Output gap
- Primary expenditure to GDP
- Output gap equals zero

A LONGER-TERM INTERACTION SCENARIO FOR THE FUTURE

- when the recovery is well under way - 2022 ? - a balance will have to be found between supporting a **return to growth** and protection of the **sustainability of public finances** also in more normal times
- overconfidence in the potential of fiscal policy has for half a century led to **public expenditure growth outstripping revenues** despite ever lower burdens of debt-servicing costs
- that tendency will have been accentuated by the boost from **success in mitigating the pandemic** and diminished attention the underlying trend growth in the normal drivers of public expenditures
- it is not necessary to invoke **fear of inflation** to be concerned...

Thank you for your time!

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