

Monetary Policy—Unintended Consequences On the Way Out

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A challenge?

- ▶ Asynchronized policy cycles among major central banks can be challenging:
 - ▶ Capital flows—with or without a global savings glut.
 - ▶ Macroprudential concerns.
- ▶ Following the successful implementation of prompt and decisive QE, Fed has embarked on policy tightening.
- ▶ Should other major central banks follow? Even CBs that, unlike the Fed, did not engage in prompt and decisive QE?
- ▶ Is it wise to ignore domestic “lowflation” and continued weakness in real economy to follow the Fed?
- ▶ Could an unintended consequence of following the Fed “on the way out” be a classic policy tightening mistake

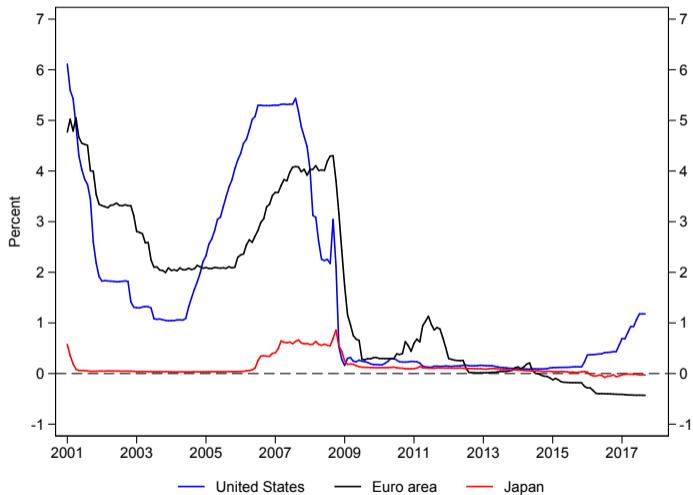


Classic tightening mistakes at the ZLB in global CB history

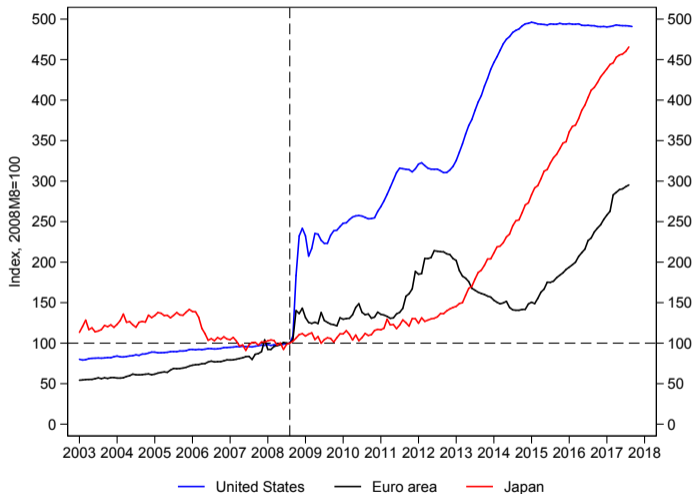
- ▶ Fed:
 - ▶ 1936: doubling of reserve requirements, implied rate hike.
- ▶ BoJ:
 - ▶ 2000: end of ZIRP rate hike.
 - ▶ 2006: rate hike and quantitative tightening.
- ▶ ECB:
 - ▶ 2010-11: rate hikes.
 - ▶ 2012-14: quantitative tightening (shrinking balance sheet by a third).



Three major CBs at the ZLB: Overnight interest rates



Three major CBs at the ZLB: Size of Balance Sheet



Index, August 2008 = 100.



Follow the leader on the way out? The ECB challenge

- ▶ Did the ECB follow the Fed in its prompt and decisive QE?
- ▶ Has the ECB done enough to fulfill its mandate? Has inflation been restored to 1.9% in a sustained manner?
- ▶ Has the ECB done enough to restore the health of the real economy in the euro area?
- ▶ Do the answers to any of these questions matter for assessing whether it is sensible for the ECB to follow the Fed on the way out?



Fed vs ECB: Outlook for headline inflation

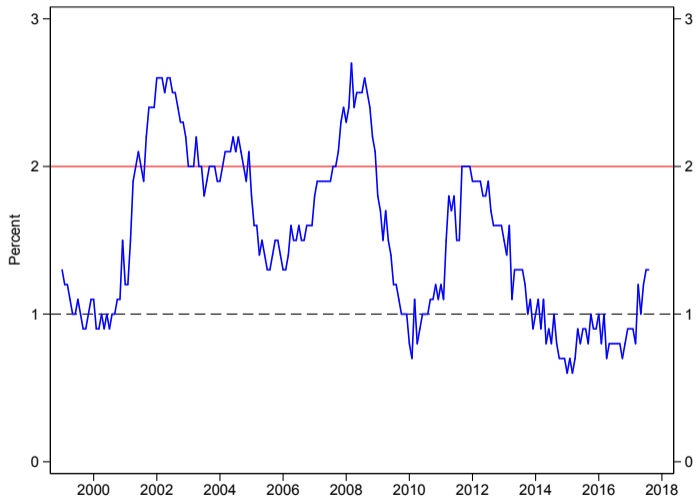
	September 2017 projections				
	2016	2017	2018	2019	2020
Fed	1.4	1.6	1.9	2.0	2.0
ECB	0.2	1.5	1.2	1.5	

Implications of **not** following the Fed's prompt and decisive QE.

- ▶ “Lowflation” projected to continue well into the future in the euro area.
- ▶ Unnecessary harm to real economy in most member states of the euro area.
- ▶ Deterioration of debt dynamics—raising odds of failure of euro.
- ▶ . . . the price to pay? **More and for longer QE** is now essential in the euro area to compensate for earlier policy mistakes. (Similar to BoJ experience a decade earlier and decisive QE in 2013.)



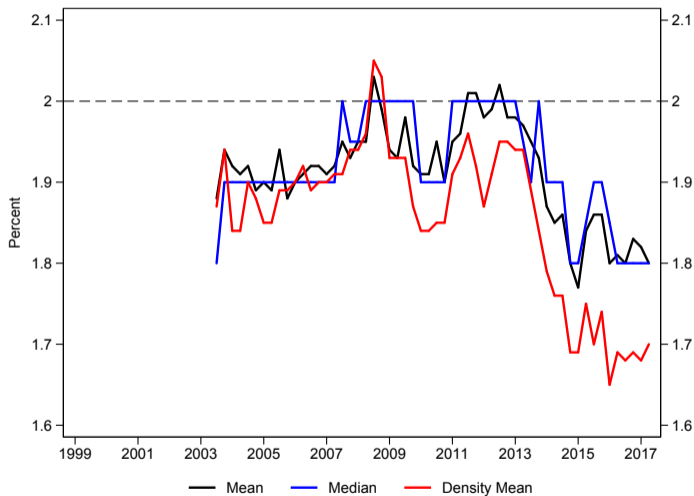
Core inflation in euro area



Notably below and **not** close to 2% for several years.



Long-term inflation expectations in euro area



ECP SPF. Surveys after May 2003 clarification of ECB inflation objective.

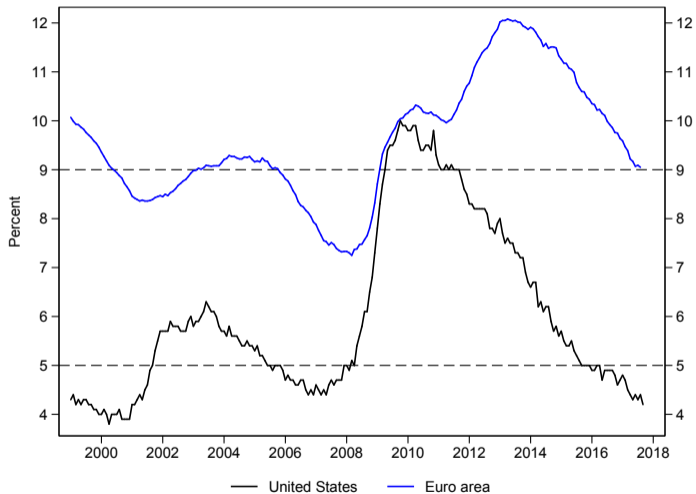
An unhelpful disanchoring of inflation expectations.



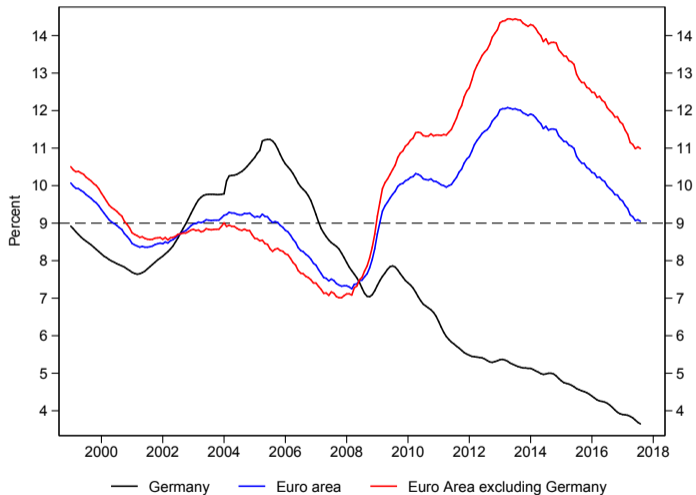
Inflation projections since start of ECB QE

Forecast Date	ECB Forecast			
	2016	2017	2018	2019
Mar. 2015	1.5	1.8		
June 2015	1.5	1.8		
Sept. 2015	1.1	1.7		
Dec. 2015	1.0	1.6		
Mar. 2016	0.1	1.3	1.6	
June 2016	0.2	1.3	1.6	
Sept. 2016	0.2	1.2	1.6	
Dec. 2016	0.2	1.3	1.5	1.7
Mar. 2017	0.2	1.7	1.6	1.7
June 2017	0.2	1.5	1.3	1.6
Sept. 2017	0.2	1.5	1.2	1.5

Health of the economy: Unemployment rate

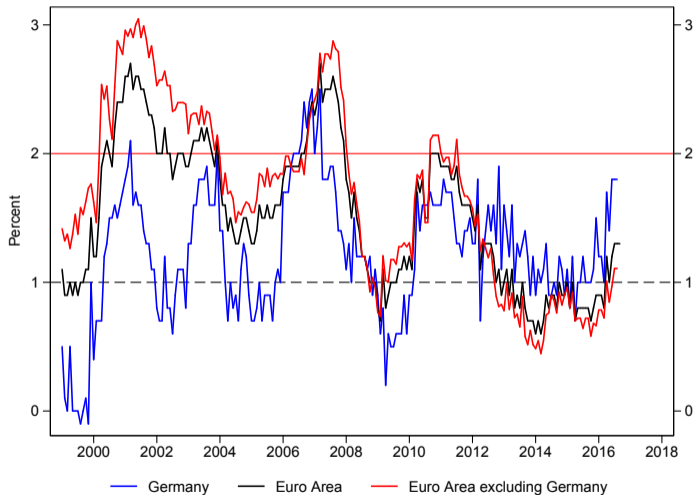


Health of the euro area economy: Unemployment rate



Which euro area?

Core inflation in the euro area



Which euro area?