



Financial market institutions

7. Monetary Policy



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- .. MONETARY EXPANSION. SOME POLITICAL ISSUES
 - A. MONETARY EXPANSION VS. RESTRICTIVE POLICIES
 - B. DIFFERENT VIEWS AND INTERESTS BETWEEN MEMBER STATES
 - C. MONETARY RISK VS. FISCAL RISK
 - D. PUBLIC RISK VS. PRIVATE RISK
- .. MONETARY POLICY AND INVESTMENT POLICY
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- .. PRICE STABILITY POLICY
- .. POLICY QUALIFICATION
- .. MONETARY POLICY AND GROWTH POLICY
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SOME POLITICAL ISSUES



Monetary Expansion. Some political issues.

- .. There are some issues related to different political perceptions of monetary expansion.

- .. Our project shouldn't and needs not to get involved in these issues:
 - A. OVERALL RISK OF THE EU INSTITUTIONS
 - B. MONETARY EXPANSION VS. RESTRICTIVE POLICIES
 - C. DIFFERENT VIEWS AND INTERESTS BETWEEN MEMBER STATES
 - D. MONETARY RISK VS. FISCAL RISK
 - E. PUBLIC RISK VS. PRIVATE RISK



Overall risk and efficiency of the EU Institutions

- .. Our project should not get involved in the political debate about to which point the overall risk of the EU Institutions should increase or decrease.
- .. The collaboration we propose between ECB / Eurosystem and EIB (+national promotional banks or agencies) pretends to make monetary policy more efficient ensuring a more direct link to real economy.



Overall risk and efficiency of the EU Institutions

- .. Higher efficiency in monetary expansion may suppose:
 - a) a lower risk with similar results on real economy
or
 - b) better results on real economy with similar risk.

- .. So, there is not any reason to think that the results of this collaboration could –by themselves- increase the overall risk of the EU Institutions unless a political decision in this sense is agreed. Just the opposite should happen.



Overall risk and efficiency of the EU Institutions

- .. This approach will be taken account of, concerning:
 - Monetary Risk distribution between national banks and ECB
 - The relationship between monetary risk and fiscal risk
 - The different risk policies in ECB and EIB operations



Monetary Expansion vs. Restrictive Policies

- .. There are different political views about to which point monetary policy should be more expansionary or more restrictive. Different views in different countries also.
- .. That's not our point. The aim of this EESC Project is related to how monetary expansion is managed, not to the amount of this expansion.



Monetary Risk vs. Fiscal Risk

.. Risk-sharing scheme in the 2015-16 Programme

- .. Monetary expansion is usually related to higher monetary risk. But, in an 80% of the new Programme, risks are taken not by the ECB but by the national central banks. In this case, it's more a matter of fiscal risk than of monetary one.
- .. Fiscal risk falls on the member states more than on the whole Eurozone.
- .. The 20% of shared risk includes possible losses on purchases of bonds of supranational institutions by the National Central Banks (12%), and possible losses on additional asset purchases of the ECB (8%).



Monetary Risk vs. Fiscal Risk

- .. This EESC project must not become involved in this dialectic. The same criteria defined for each monetary expansion programme could be applied to the collaboration between EIB and ECB.
- .. For this purpose, public promotional banks or agencies in member states can get involved. If necessary in the same proportion on risks (80%) as national central banks are now involved.



Involving national promotional banks or agencies

- .. Involving national promotional banks or agencies could include criteria for allocating resources between those institutions, as well as implementation and monitoring of the management of the operations.
- .. The EIB could be in charge of the definition and monitoring of the implementation by promotional banks or agencies of these criteria and requirements



Public Risk vs. Private Risk

- .. ECB: The aim of acquisitions of public debt is not financing governments but injecting resources into the economy through the financial system.
- .. So, it's not clear if resources managed by the EIB should be subject to requirements regarding whether they ultimately reach public or private entities.
- .. If necessary, an specific proportion between private and public sector financing could be agreed.



MONETARY POLICY AND INVESTMENT POLICY



Monetary expansion and investment policy

- .. The main activity of monetary expansion (ECB) and EU investment (EIB) may be similar: “INJECTING MONEY IN THE ECONOMY”

- .. However, the main policies to which these activities respond look different:
 - Monetary policy (ECB)
 - Investment policy (EIB)

- .. But, as we´ll see:
 - both policies cannot be separated.
 - Monetary Policy is neither an objective of the main receptor of Monetary Expansion (the Banking System)



An Opportunity for Investment Policy

- .. Involving EIB in monetary expansion would be quite an opportunity for EU investment policy.
- .. Just remember that the Asset Purchase Programme of the Eurosystem (1,14 trillion €) is 50 times bigger than the Juncker Plan (21.000 million €)
- .. If needed by the dimension of the resources or for other reasons, the EIB would collaborate with public promotional banks or agencies of member states



Investment Policy and Demand of Credit

- .. From the point of view of the demand of credit, there should be no much concern.
- .. Because of the differential between key interest rates of the ECB and retail interest rates, there is a huge capacity for providing credit to industry – and, very specially, to SMEs, cooperatives, ...- at lower interest rates. That would ensure demand.



LIMITS OF MONETARY POLICY

The EU Treaty

Objectives of Monetary Policy

The EU Treaty



- .. The tasks of the European System of Central Banks (ESCB) include the *"definition and implementation of monetary policy"* (Art. 127.2 EU Treaty) within the primary objective of maintaining *"price stability"* (Art. 127.1 EU Treaty).

Art. 127.1:

"1. The primary objective of the European System of Central Banks (hereinafter referred to as "the ESCB") shall be to maintain price stability. Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union. The ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 119".



Objectives of the Eurosystem

So, main criteria:

1. PRIMARY OBJECTIVE: PRICE STABILITY
2. General economic policies of the Union (art. 3)
3. Principle of an open market economy with free competition
4. Efficient allocation of resources
5. Principles Art. 119 (Coordination of Member States' economic policies, internal market, sound public finances, sustainable balance of payments).



Limits of Monetary Policy

The EU Treaty

**EU Court of Justice
Advocate General
OPINION Jan 14 2015**

130. “... if a measure belongs to the category of instruments which the law provides for carrying out monetary policy, there is an initial presumption that such a measure is the result of ... monetary policy ... a presumption that could be rebutted if ... the measure were to pursue objectives other than those specifically listed in Articles 127(1) TFEU and 282(2) TFEU”.
132. “... in order for a measure of the ECB actually to form part of monetary policy, it must specifically serve the primary objective of maintaining price stability and it must also take the form of one of the monetary policy instruments expressly provided for in the Treaties and not be contrary to the requirement for fiscal discipline and the principle that there is no shared financial liability”.

(OPINION of Advocate General EU Court of Justice Jan 14 2015)



Limits of Monetary Policy

The EU Treaty

So, for our purpose, these requisites must be fulfilled:

1. Price stability as objective (Art. 3 objectives only in a secondary plane).
2. Take the form of one of the monetary policy instruments (buying and selling financial instruments, credit operations)



Limits of Monetary Policy.

Price Stability

- .. The point is not if Price Stability is an objective for the EIB. It is not. But it is neither so for the main receptor of ECB funds: the Banking System.
- .. The main point is if channeling funds through the EIB can be a tool for Price Stability in a similar way as doing so through the Banking System, as usual.



PRICE STABILITY POLICY



What's Price Stability Policy?

- .. EU Justice Court: “Fight against inflation”
- .. ECB: “Fight against inflation” or “fight against deflation”, with the aim of keeping inflation “below but close to 2%”.
- .. Usually, it is done by Central Banks through impulses aimed at ▲/▼ money supply



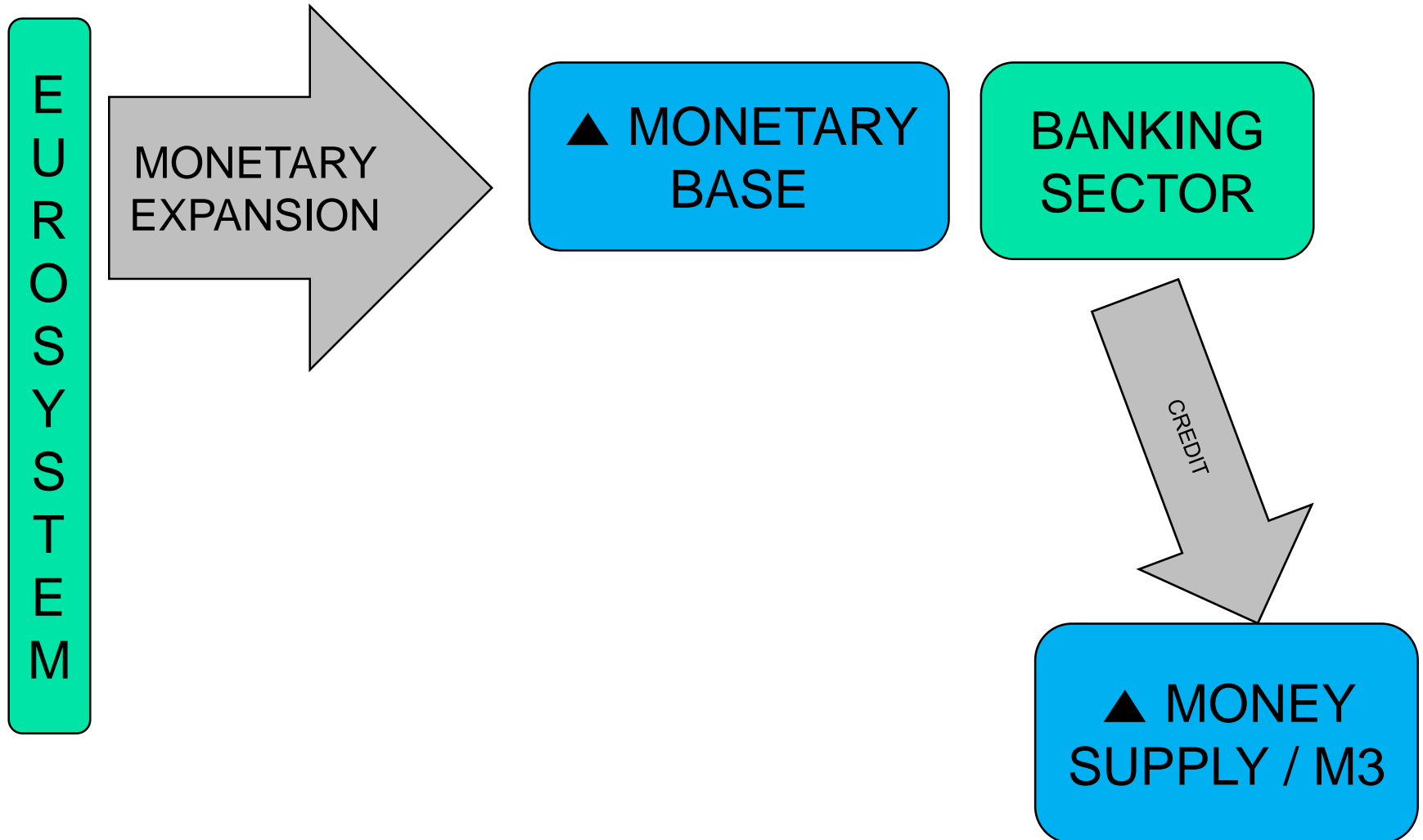
What's Price Stability Policy?

- .. Monetary policy impulses work through the increase of the monetary base, hoping that banks make use of this monetary base to increase the “broad money” (M3) through credit.



Monetary Policy

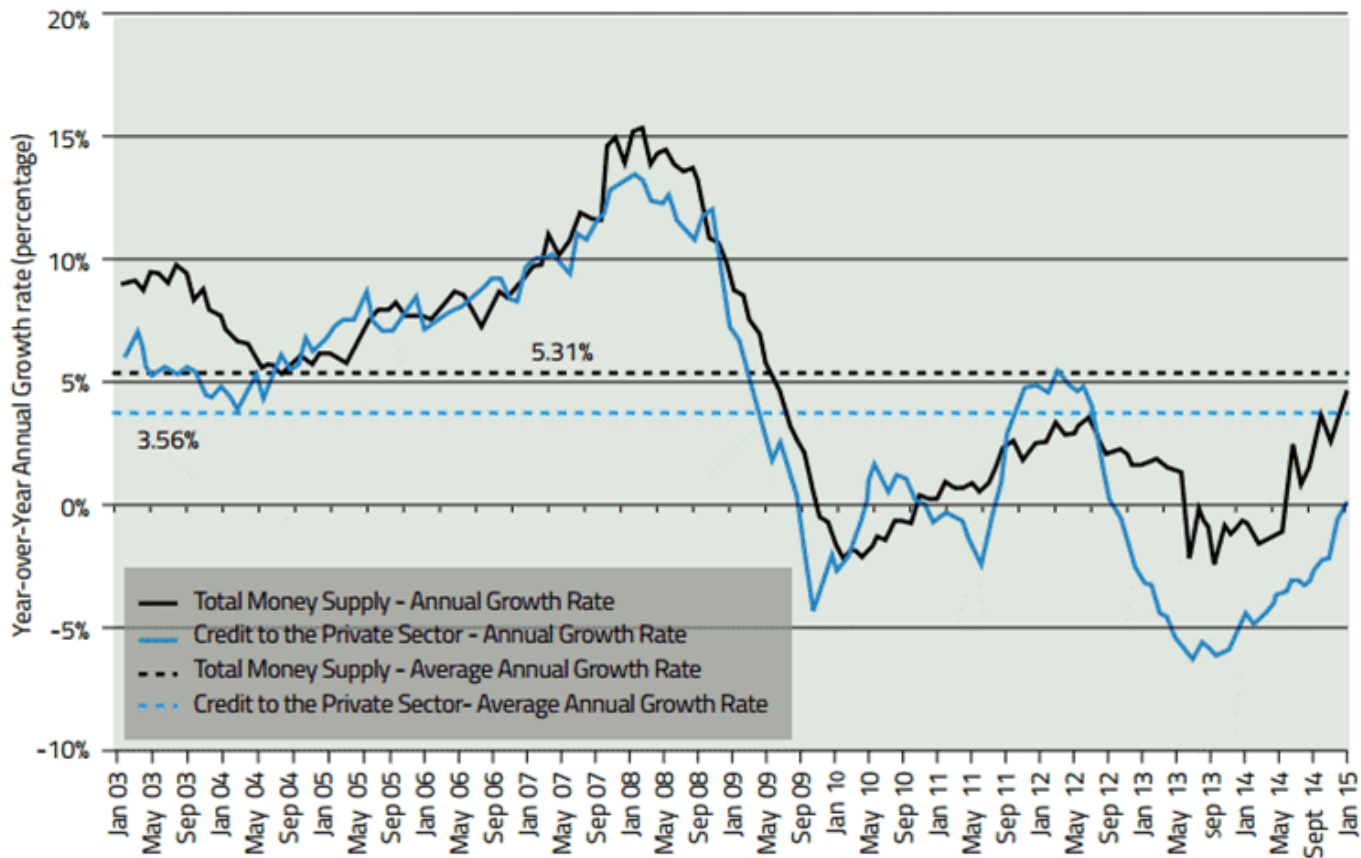
FROM EUROSISTEM TO MONEY SUPPLY





Money Supply and Credit are directly related

Eurozone money supply (M3) and private credit



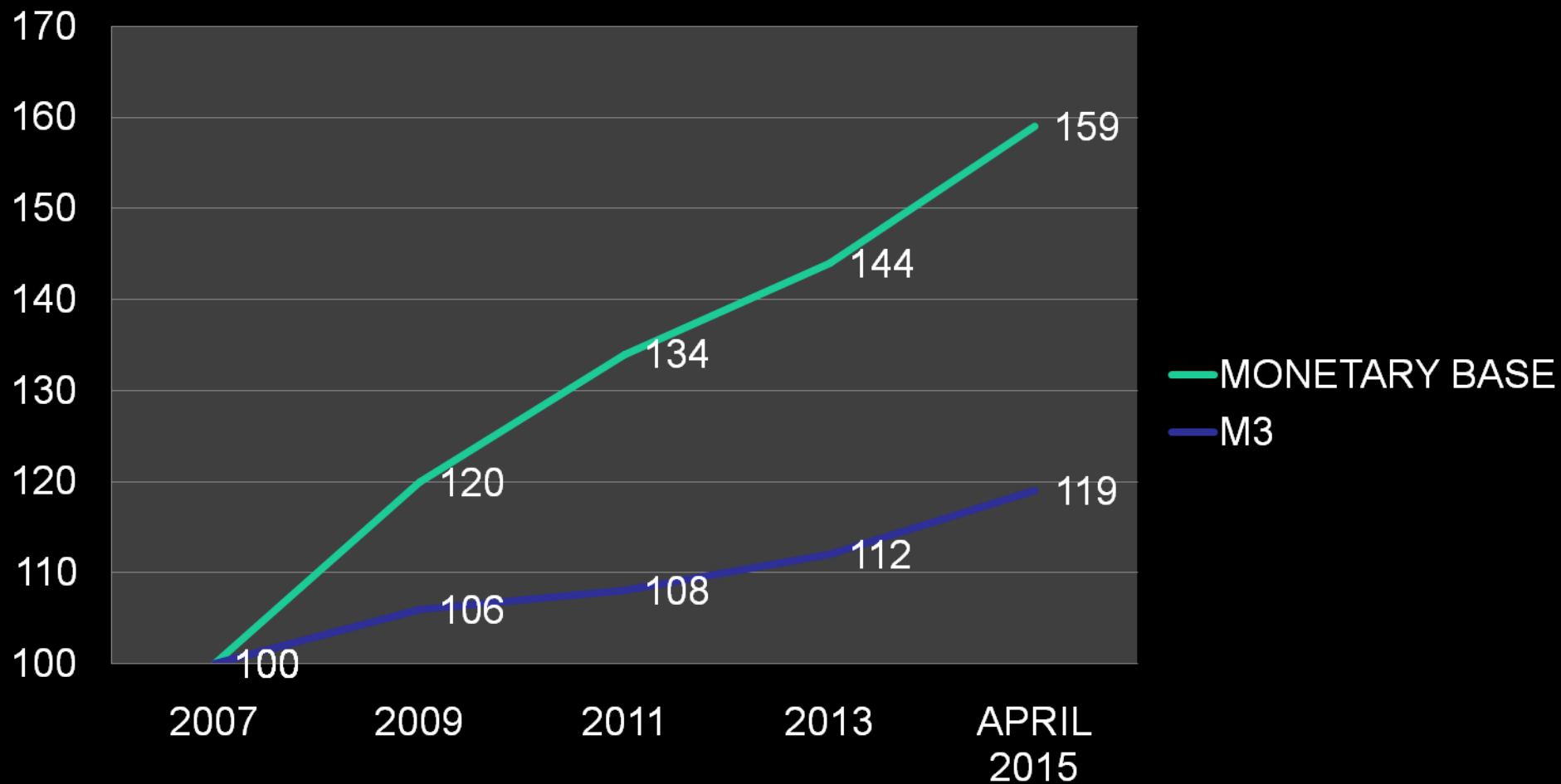
Sources: ECB, ONB and calculations by Prof. Steve H. Hanke, The Johns Hopkins University.

Note: The average annual growth rates for money supply and private credit are calculated over the period from Jan-03 to Jan-15



Monetary Expansion is less and less related to Money Supply

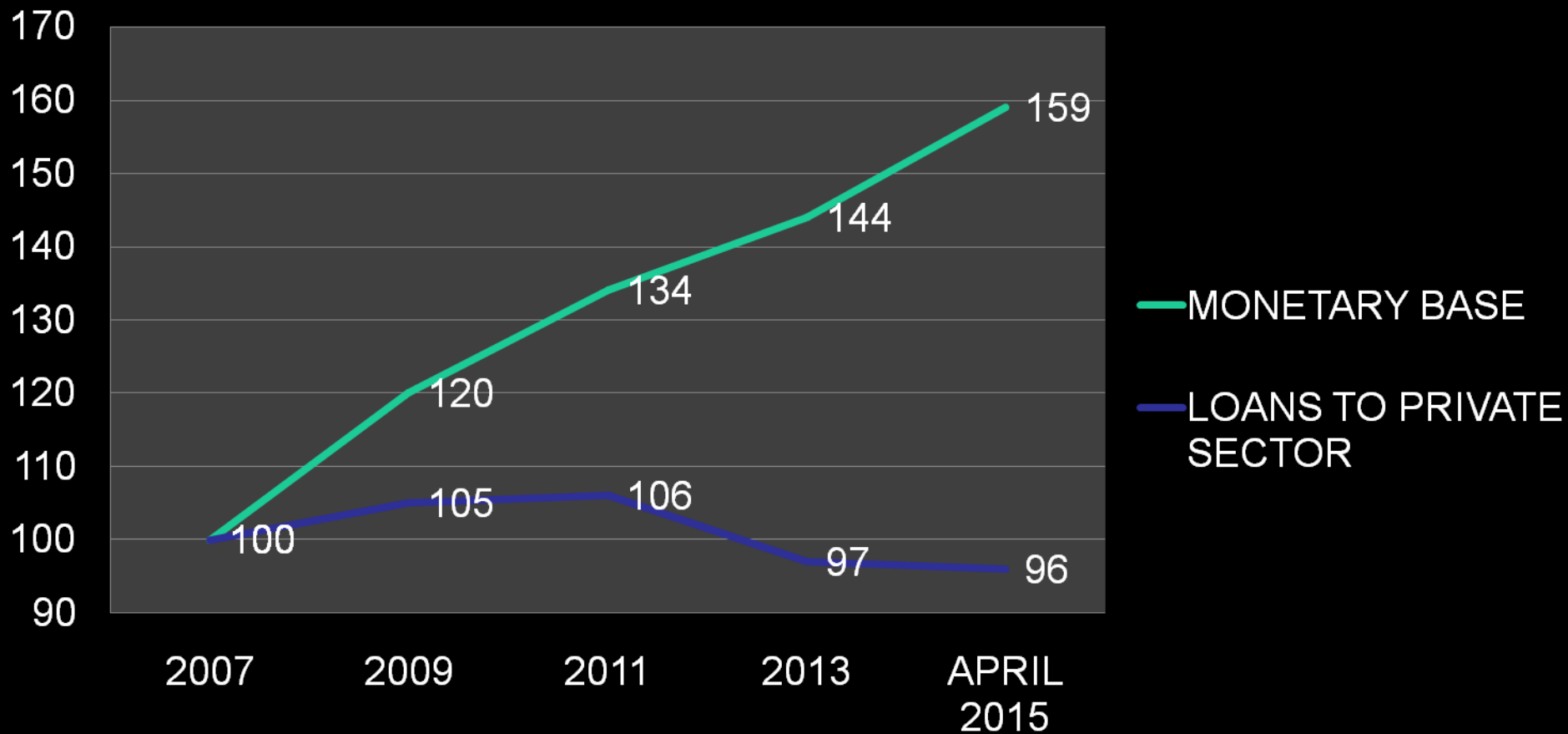
Eurozone: Monetary base and M3 2007-2015
(% / 2007) Source: ECB





Monetary Expansion is also less and less related to credit to private sector

**Eurozone: Monetary base and Loans to Private Sector
2007-2015
(% / 2007) Source: ECB**





There is no Price Stability Policy without Credit to Real Economy

- .. Monetary policy is not “a matter of the banking sector”, of providing liquidity to it. The financial sector is only an instrument.
- .. The effects on money supply are only achieved when –and if- the banks reinvest the funds in the real economy.



There is no Price Stability Policy without Credit to Real Economy

*EU Court of Justice
Advocate General
OPINION Jan 14 2015*

“Monetary policy transmission channels do not function as mechanisms producing immediate effect but as a framework through which the ECB sends out a series of ‘impulses’ or signals with a view to them reaching the real economy.”

(OPINION of Advocate General EU Court of Justice Jan 14 2015)



There is no Price Stability Policy without Credit to Real Economy

.. There are differing opinions about the extent to which the banking sector redirects the ECB funds into economic activity.

.. However, it is generally accepted that this redirection is only partial. A significant proportion of the resources remain stuck on banks balance sheets, are invested outside the eurozone or are channeled into speculative bubbles. In these cases, the objectives of money supply, stability of prices and monetary policy are not achieved.



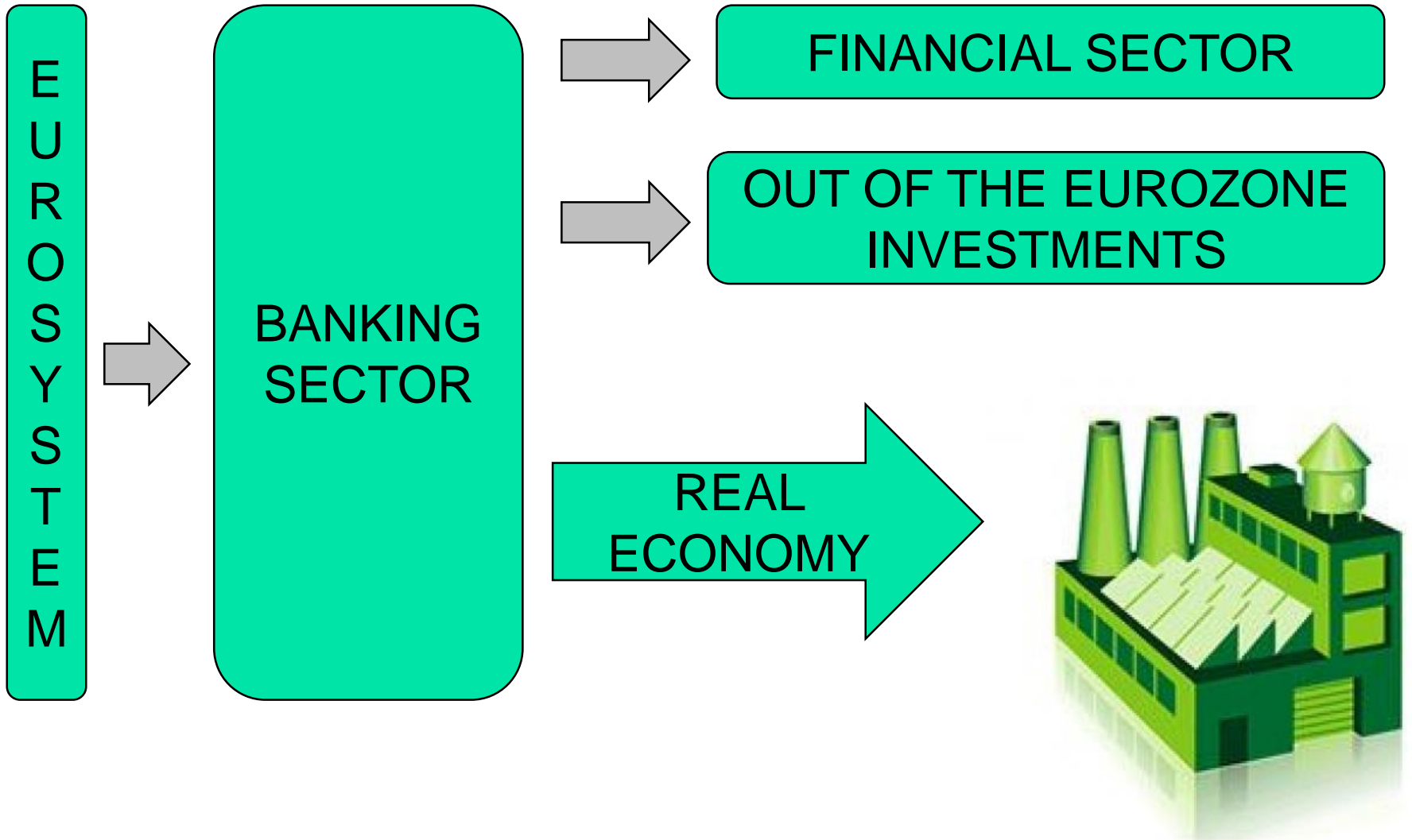
There is no Price Stability Policy without Credit to Real Economy

- .. So, as the EESC Project proposes, making sure that monetary expansion gets to real economy is not only good for investment policy but also for monetary policy.
- .. When funds channeled through the banking system don't arrive to the real economy, they become mere subsidies to the banks without purpose. Or, if we try to qualify it, they would be a result of "Banking Sector Stability Policy", but this policy should not be an objective of Monetary Policy according to the EU Treaty.



Monetary Policy

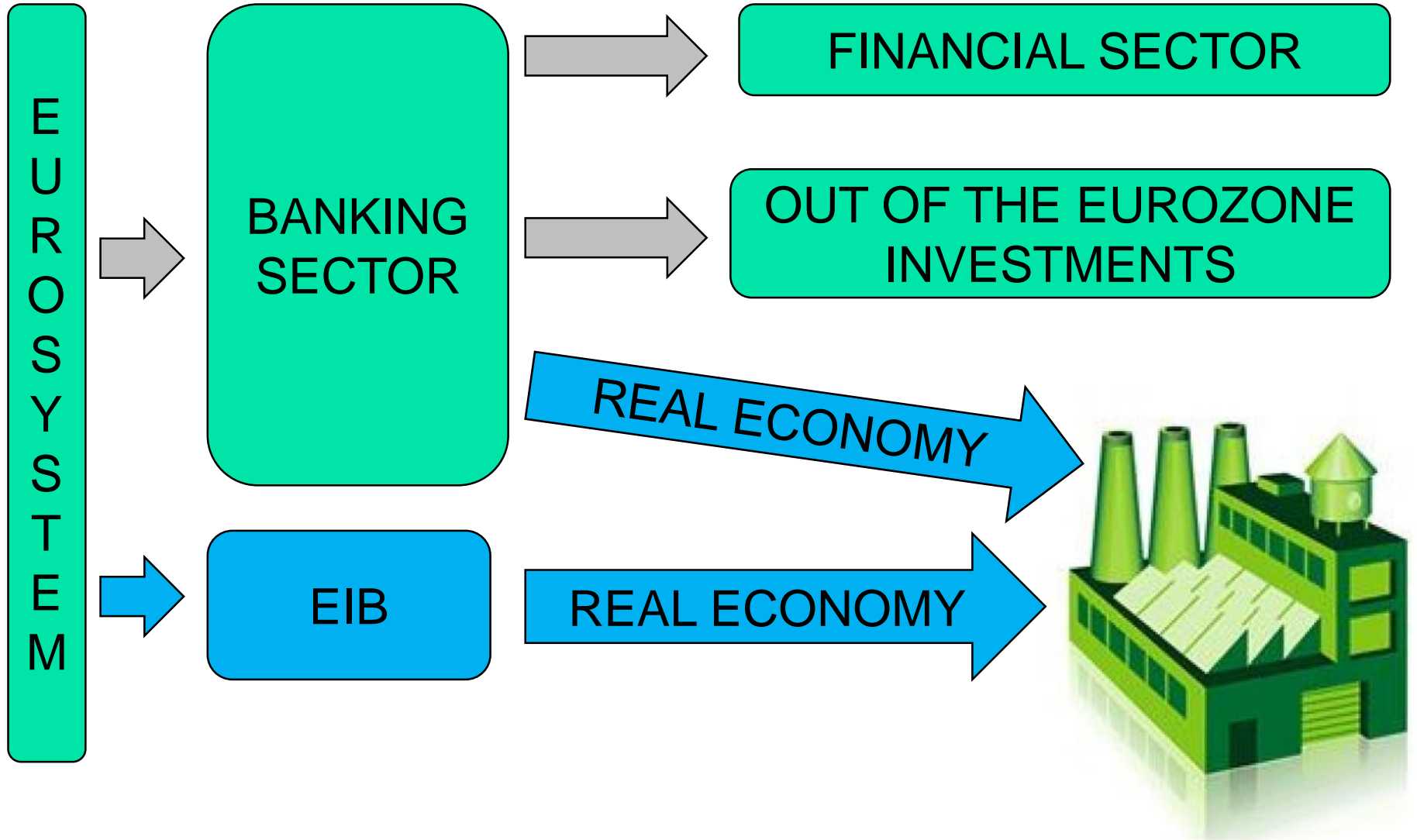
FROM EUROSISTEM TO REAL ECONOMY






Monetary Policy

FROM EUROSISTEM TO REAL ECONOMY



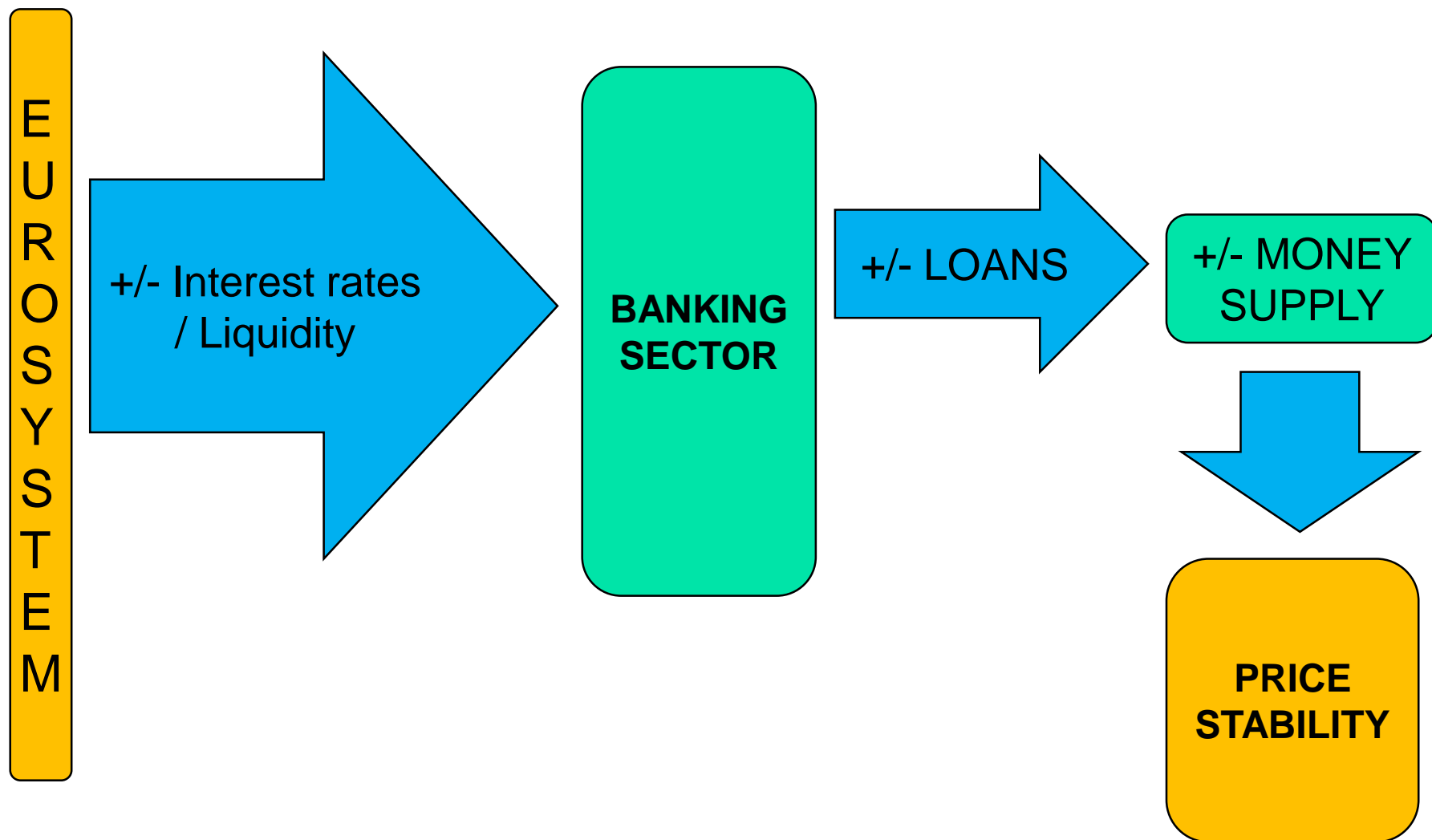


Money Supply does not evolve through expansionary impulses. Only through bank credit.

- .. Price Stability (Fight against deflation at the moment) is achieved through the increase /decrease of Money Supply
- .. The increase in Money Supply is achieved not through ECB expansionary impulses (low interest rates / QE) but only when these impulses are transmitted to the real economy through bank credit.

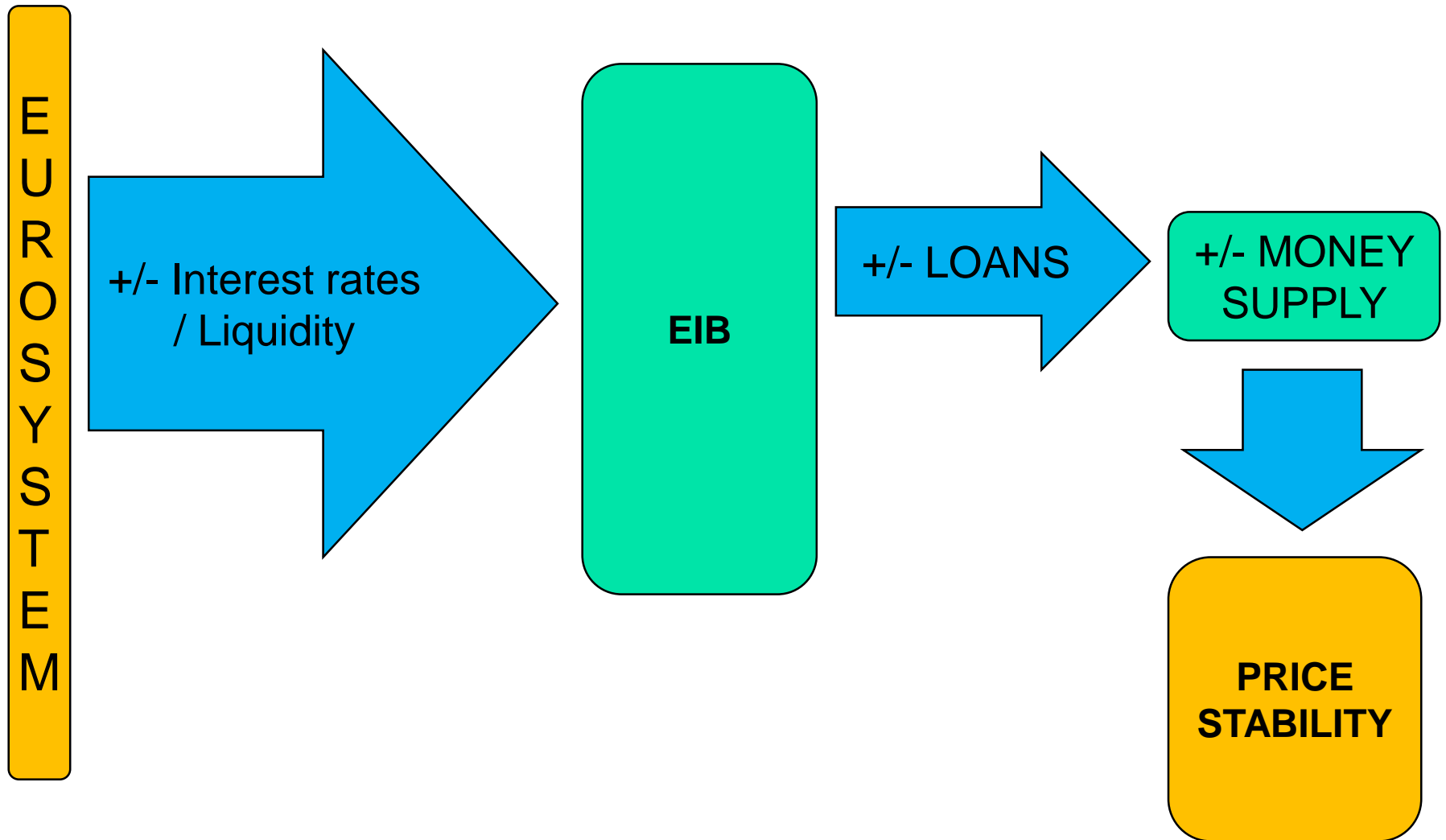


Bank credit is the link between Monetary Policy and Price Stability





The link between Monetary Policy and Price Stability AND WHAT ABOUT EIB?



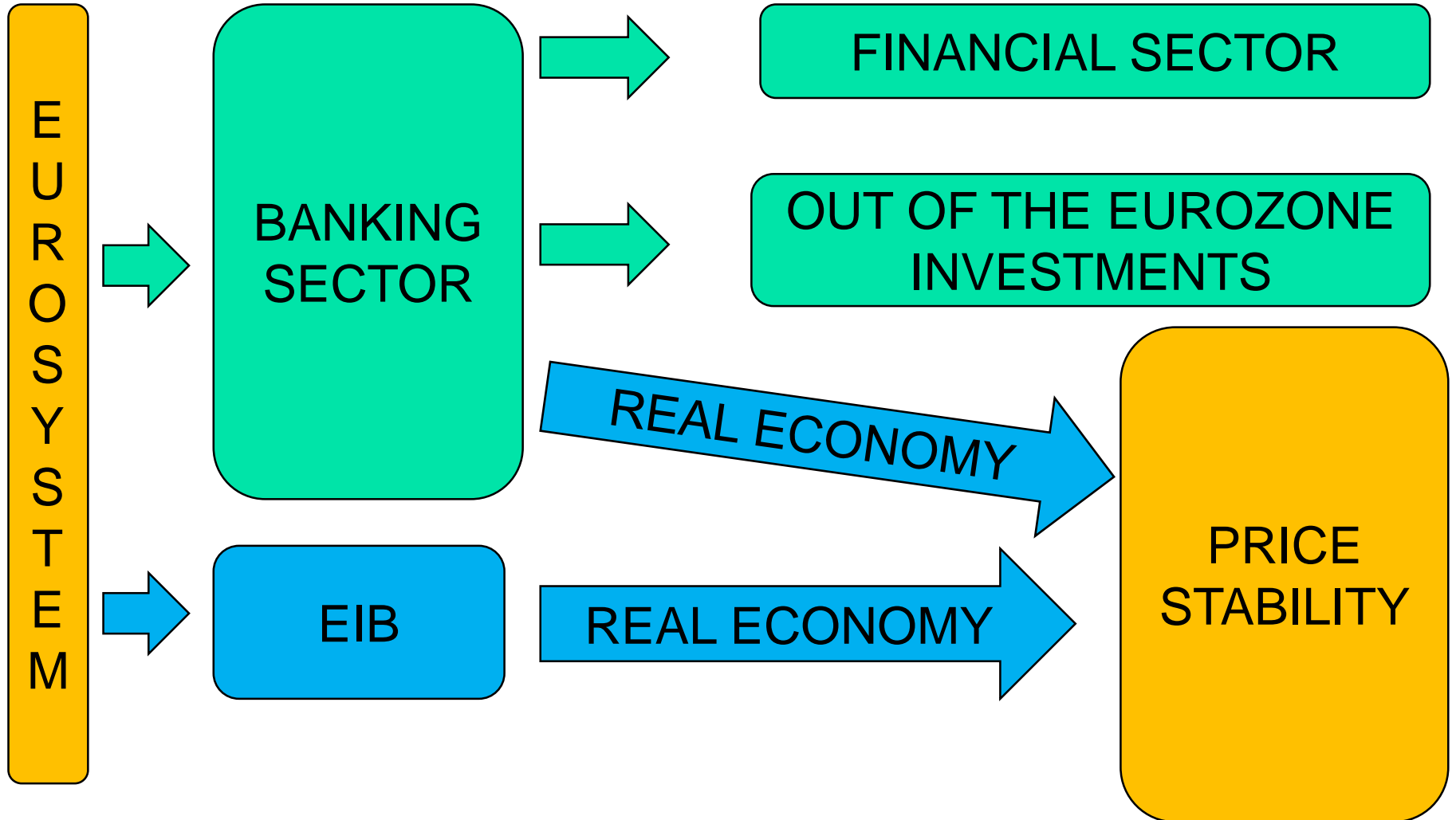


EIB role and Price Stability Policy

- .. From a qualitative point of view, the link between Monetary Policy and Price Stability works IN THE SAME WAY through the Banking Sector or through the EIB.
- .. As we'll see, the impact on Price Stability through the EIB would be, anyway, far more efficient.



EIB role and Price Stability





EIB role and Price Stability

The main difference is:

- .. Through the EIB, resources are ALWAYS channeled to real and productive economy
- .. Through the Banking Sector, sometimes it's so and sometimes not.

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POLICY QUALIFICATION



Policy Qualification



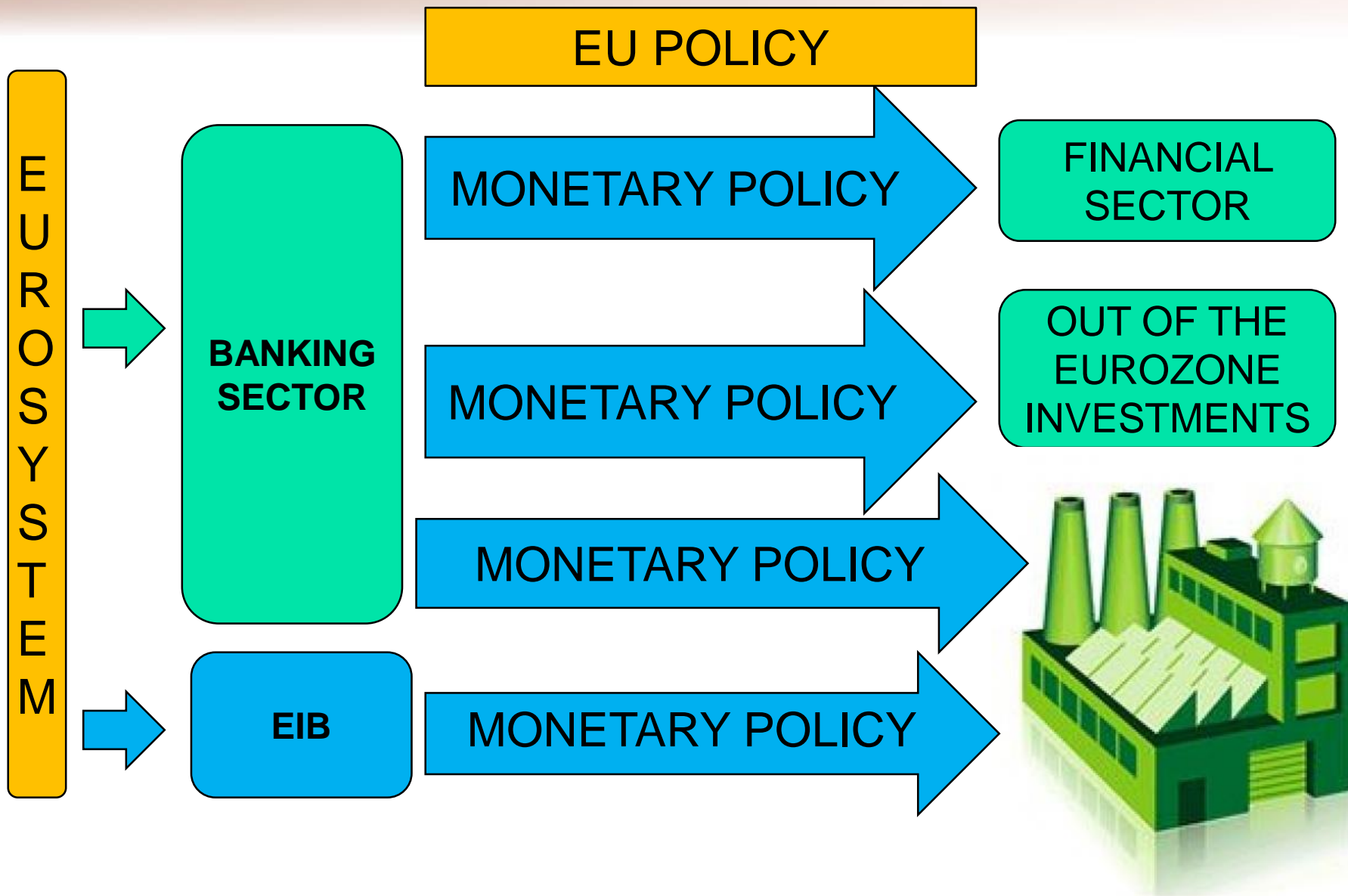
TWO MAIN REQUISITES OF MONETARY POLICY

- A. INSTRUMENT: Credit / Asset acquisition

- B. GOAL: Price Stability

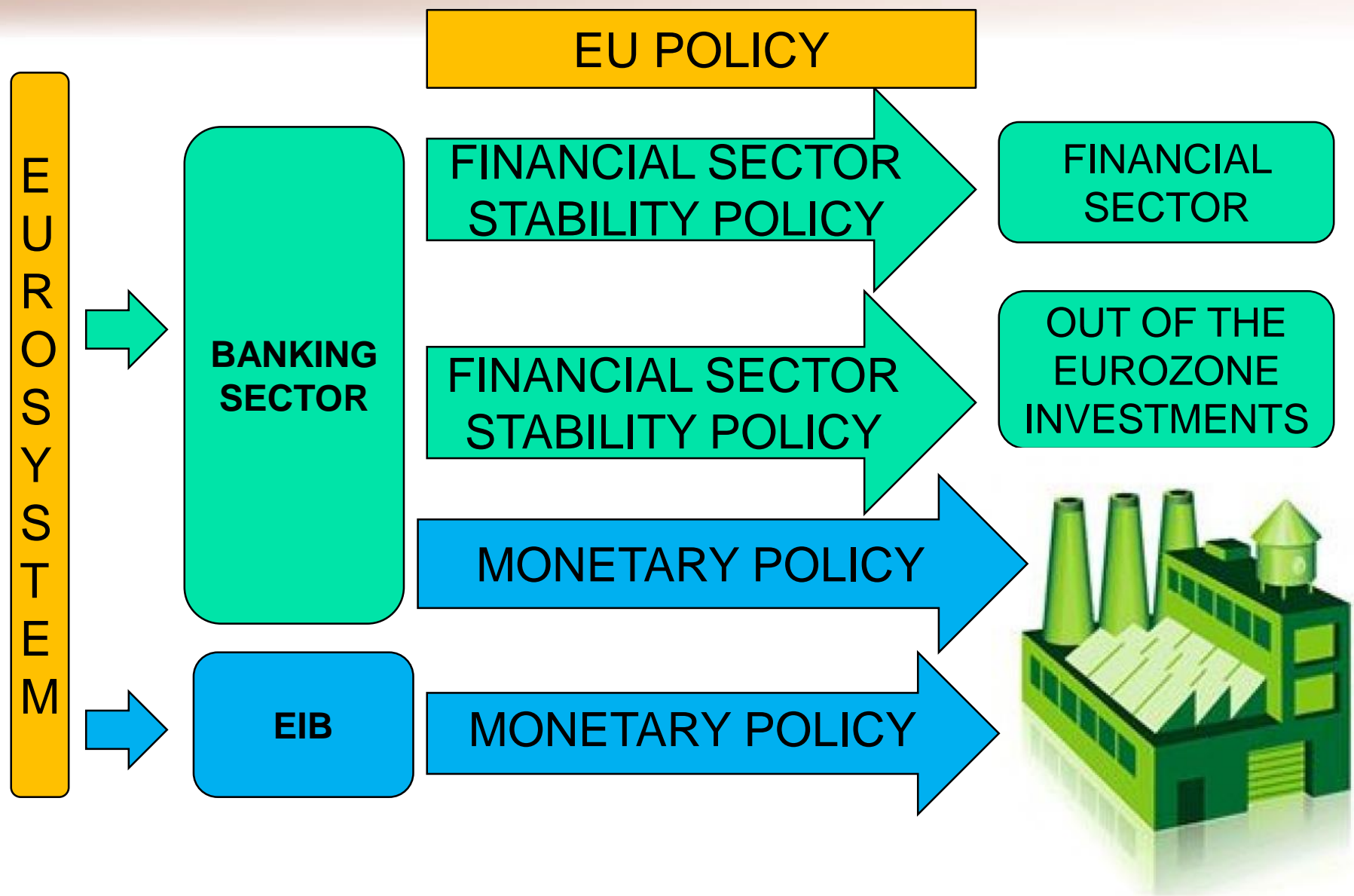


Policy Qualification. POINT OF VIEW OF THE INSTRUMENTS





Policy Qualification. POINT OF VIEW OF PRICE STABILITY





POLICY QUALIFICATION

From the point of view of the instruments:

- .. The EIB channel is Monetary Policy in the same way as the Banking Sector channel

From the point of view of the goals (Price Stability):

- .. As part of a program of monetary expansion, its purpose is linked to price stability in the same way as credits to the financial system or buying assets owned by it.
- .. Furthermore: Involving the EIB would make monetary policy far more efficient, as it would ensure the link between the impulse of monetary expansion (Monetary Base) and real economy (M3).



MONETARY POLICY AND GROWTH POLICY

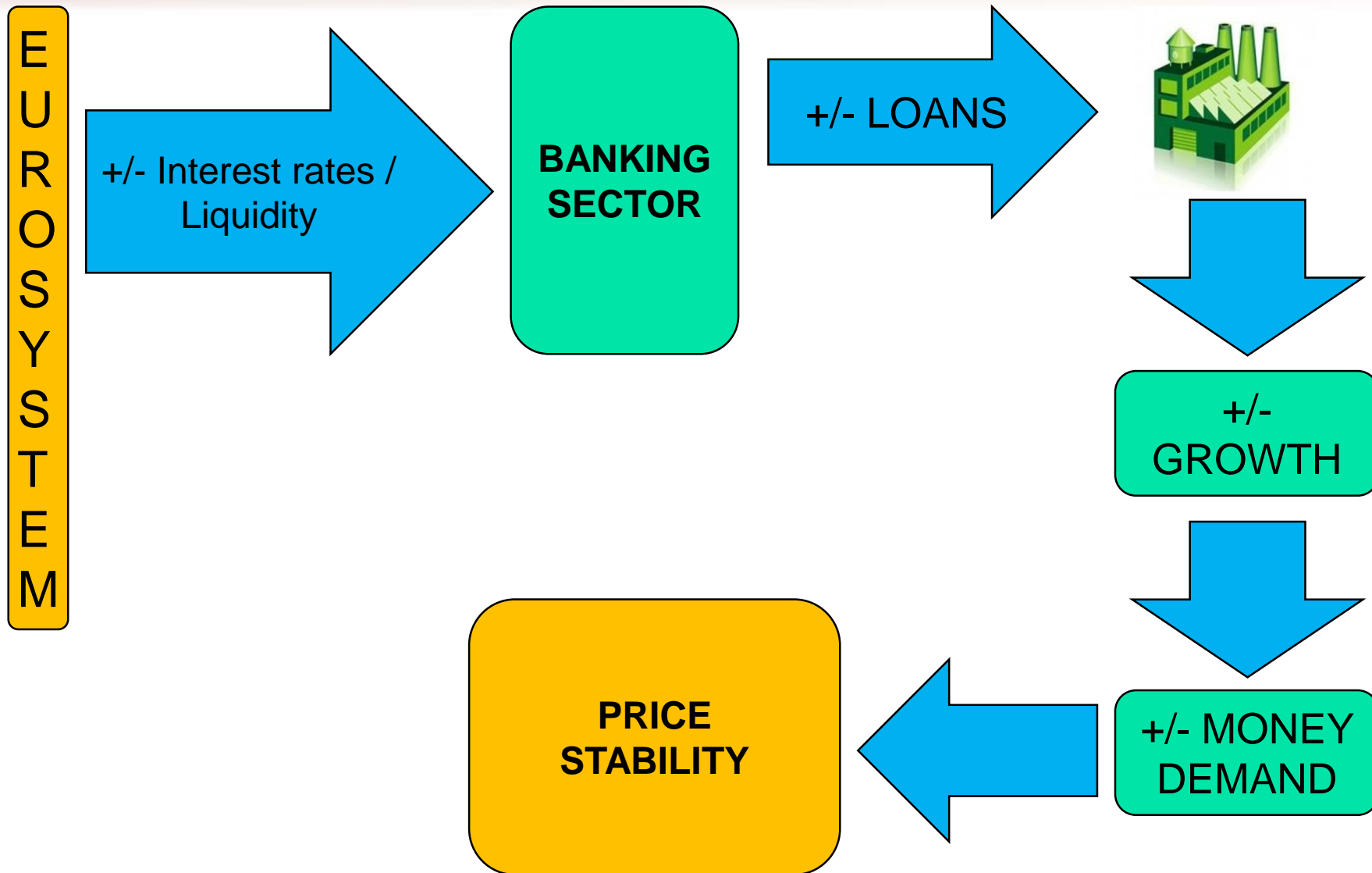


Monetary Policy is not only related to Money Supply but also to Money Demand.

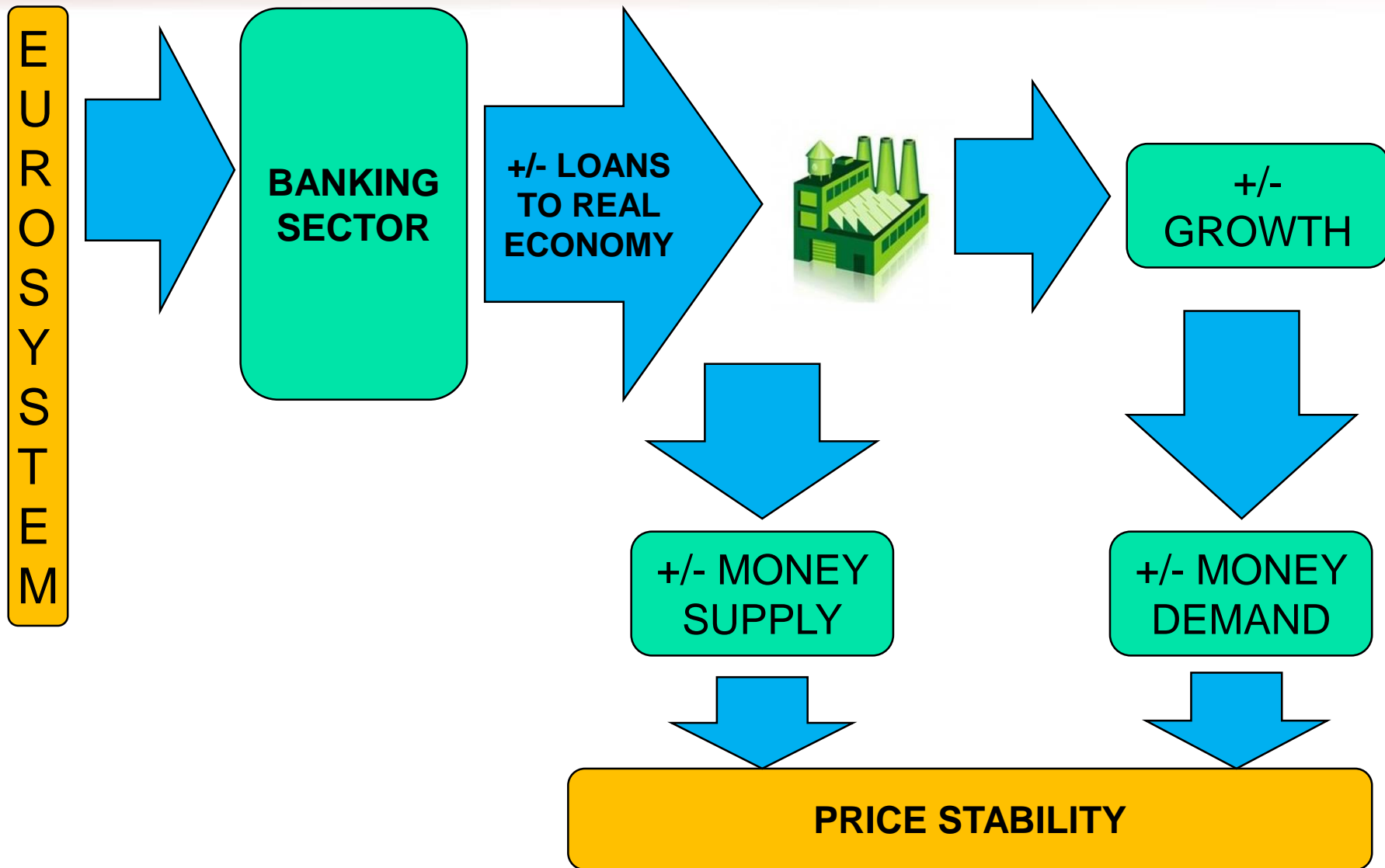
- .. Price Stability, of course, is a result not only of the evolution of Money Supply but also of the evolution of Money Demand.

- .. So, it would be also part of Monetary Policy any policy:
 - a) Making use of monetary policy tools (monetary expansion ...).
 - b) Having the purpose of increasing money demand.

Bank credit is also the link between Monetary Policy and Money Demand



Bank credit is also the link between Monetary Policy and Money Demand





Monetary Policy is not only related to Money Supply but also to Money Demand.

- .. In the middle / long term, growth is the most important factor in the evolution of money demand.
- .. So taking account of the impact of policies in growth is not only an option for monetary policy. It's a need.



Monetary Policy and Growth Policy

- .. It has been said that monetary policy should be linked only to price stability and, so, it cannot be linked to growth policy.

- .. But:
 - The EU Treaty indicates that price stability is the first but not the only goal of monetary policy,

 - Price stability itself is not only related to money supply but also to money demand and, so, it is also related to growth.



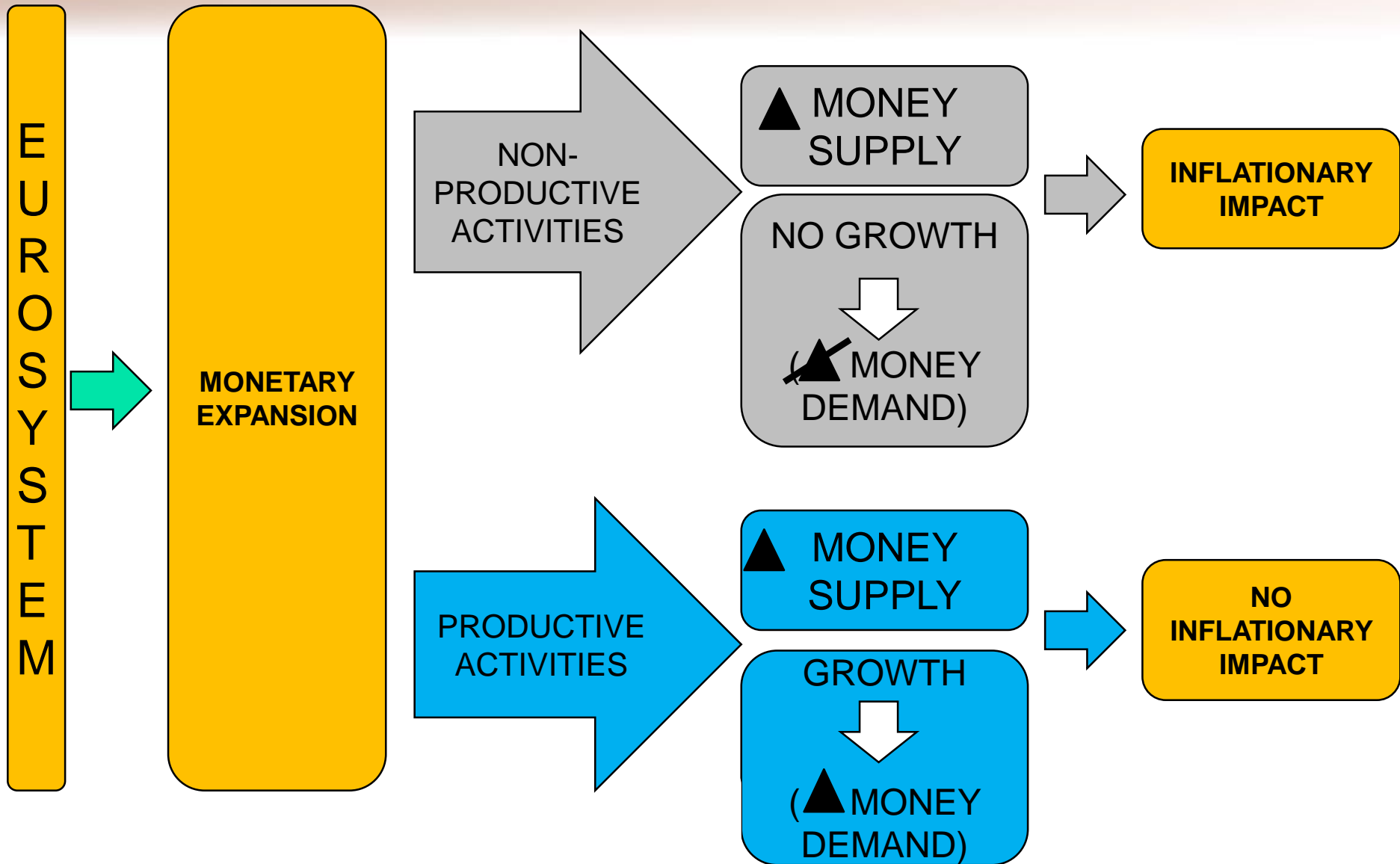
Monetary Policy and Growth Policy

.. So:

- If credit reaches real economy (consumption, expenditure ...) but no productive activities, the result will be money supply expansion but no money demand expansion and so, we'll achieve an inflationary impact
- By contrast, if credit reaches not only the real economy but also productive activities –as EIB operations do- the result will be expansionary both in money supply and in money demand. So, the inflationary impact will be neutralized.



Monetary Policy and Growth Policy





Monetary Policy and Growth Policy

- .. So, if monetary expansion achieves its objective of increasing money supply (M3) in, let us say, a 10% but not achieving growth in the economy, then the result will be clearly inflationary.
- .. In the opposite way, if this increase of a 10% in money supply is matched by a 10% growth in the economy, then there will be no inflationary impact in the economy.
- .. So, the impact of monetary expansion in growth should be one of its main purposes.



FINAL REMARK



Final remark

- .. Improving the link between monetary expansion and productive economy through the structural collaboration between the Eurosystem and the European Investment Bank seems coherent with the main objectives of both the ECB and the EIB and with different EU policies:
 - Investment Policy
 - Growth Policy
 - Monetary Policy

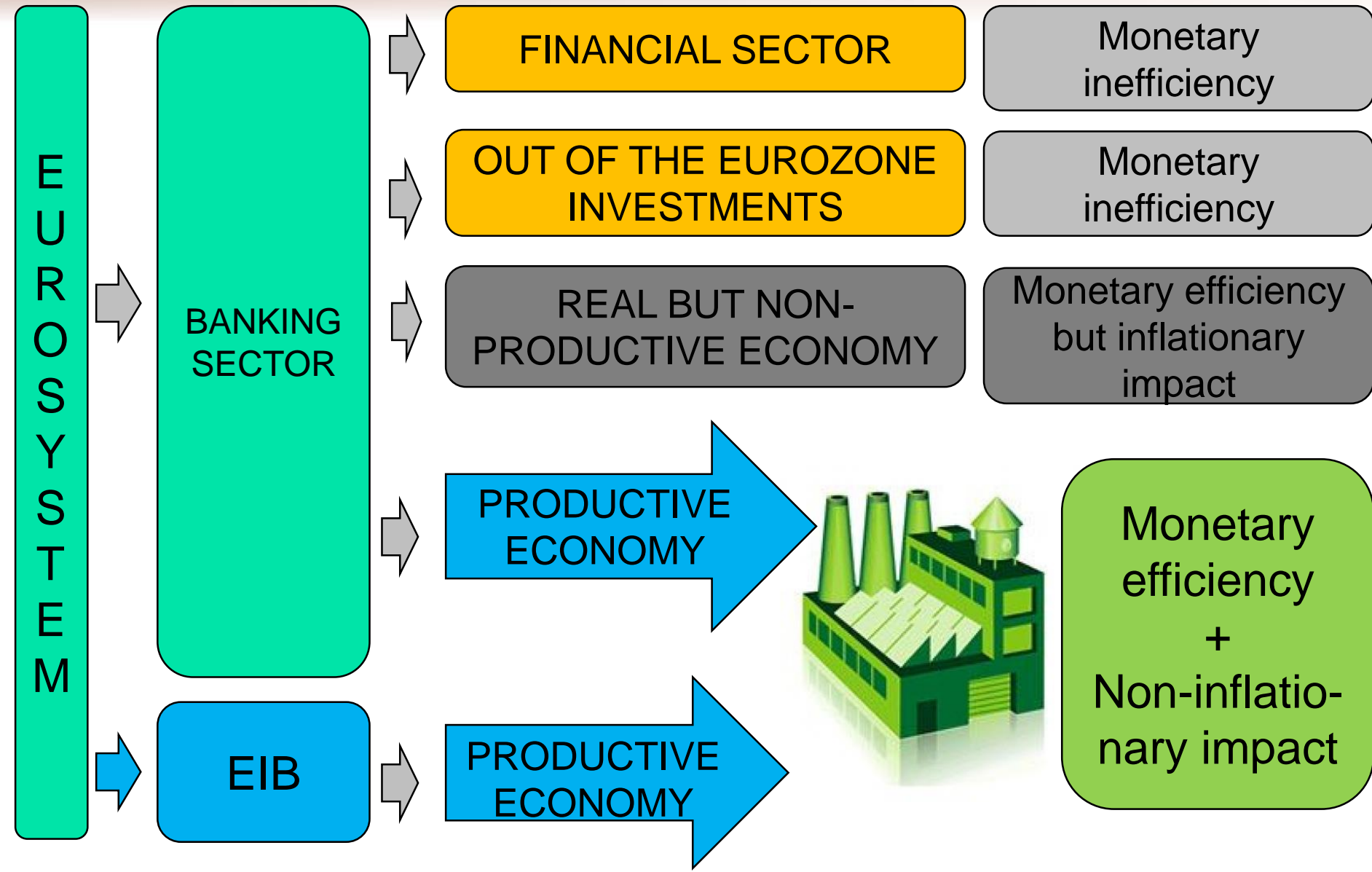


Final remark

- .. Furthermore, it seems that the structural collaboration between the Eurosystem and the EIB would be a significant instrument to improve the efficiency of monetary policy, clarifying the link between monetary policy and broad money supply, real economy and price stability.



Efficiency of Monetary Policy





Final remark

- .. All these objectives can be achieved through different procedures. The specific collaboration tools between the Eurosystem and the EIB should maximize the efficiency of the assignment of resources, either
 - a) achieving better results (more investment in productive activities) with the same resources or
 - b) achieving a similar impact in the real economy with a lower investment of resources.



REFERENCE AND SOURCE

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Thank you for your attention