THE ECB AND ITS WATCHERS XVI

Editorial

This year's "The ECB and Its Watchers" conference takes place against the background of an economic situation in the euro area that has unfortunately not significantly improved compared to the previous year. As the economic indicators presented on pages 6-7 show, the unemployment rate has only slightly decreased and still exhibits a level well above that of other major advanced economies. GDP growth has not picked up and inflation has further declined and has even fallen below zero in December 2014.

In light of these disconcerting economic developments, the Governing Council decided in its January meeting to launch an "extended asset purchase programme" involving monthly purchases of public and private sector securities totaling €60 billion until September 2016 or, alternatively, until a "sustained adjustment in the path of inflation" consistent with the ECB's inflation aim is achieved. While large-scale asset-purchase programs have been undertaken by other major central banks in recent years (see Figure 2) and the economies of these countries have been successful in substantially reducing their unemployment rates, there is considerable disagreement regarding the benefit-risk analysis of the ECB's planned measures (continue on page 4 to read the comments of ECB Watchers we asked about this topic).

In its second session, "The ECB and Its Watchers" conference will focus on potential monetary policy implications induced by the significant changes in the European financial architecture in recent years. One major issue which has been discussed in this context, and which will probably also be hotly debated during the conference, concerns the new dual role of the ECB as financial supervisor and monetary policymaker.

The third panel of the conference will take an explicitly global perspective and will scrutinize the international dimension of current and future mone-tary policy in the euro area. The recent turbulences in the Swiss franc-euro exchange-rate market (see Figure 4) are just one example that illustrates the timeliness of this topic. An important and open question likely to be discussed in this context concerns the potential effects of the recently launched extended asset-purchase program on the foreign-exchange markets, and their implications. As the comments on page 4 show, our ECB Watchers have fairly different opinions on this issue.

All in all, one can see that there are plenty of unre-solved and important issues to be discussed at this year's conference.

We are very much looking forward to the event and its open and potentially controversial debates.

Günter Beck (On behalf of the CFS and IMFS)

The ECB and Its Watchers Conference – Past, Presence, and Future

Otmar Issing

When the CFS invited to the first ECB Watchers Conference in 1999 who would have expected that 16 years later this conference not only continues to take place but is well established as a landmark in the field of monetary policy, central banking, and related topics.

As the member of the Executive Board of the ECB responsible for the Directorates General for Economics and Research I was personally confronted with the critique by several watchers on the monetary policy strategy of the ECB, even before the start of the Euro in 1999. It was especially the two pillar approach and its focus on money and credit which was criticized by different groups of academics. Two of these groups – separately – invited me for a discussion of their critical position. It was obvious that I could not respond to all present and potential requests (at different places across Europe) nor discriminate between different groups. On the other hand I did not wish to give the impression that we would shy away from engaging in serious discussions with our critics. On top of that we urgently needed a forum to explain our strategy and policy making to the public. The press conference of the President and the Monthly Bulletin were important communication tools. Yet, this was no substitute for an open discussion with academics, bank economists and the media. So, the idea of a conference inviting leading representatives from these audiences was born, and the CFS provided the adequate platform for such an idea.

The first meeting received great attention. The success was overwhelming and the request for a conference in the following year was a logical consequence. This has not changed over the years. Attendance and attention have anything but declined.

Looking back, there is a long list of outstanding speakers – from the President of the ECB and Members of the Executive Board to leading academics, bank economists and journalists. The monetary policy of the ECB has remained the major topic. But, many other aspects entered the agenda and there is probably no field of financial markets which has not been discussed.

The global financial crisis, the enlargement of the European Monetary Union and new tasks for the ECB have extended the spectrum of the conference.

Considering just the discussion on the monetary policy of the ECB – from the start the strategy, then the implementation, the changes in the operational framework, new measures such as LTRO, OMT, TLTRO, and now quantitative easing demonstrate how the policy has evolved bringing new topics to the agenda of the Watchers Conference. The same is true for all the other fields.

The conference has been a source of open, excellent discussion. For the ECB the conference has presented a unique opportunity for explaining its policy to an audience which is an important "multiplier" to a broader public. At the same time the central bank has always received critical feedback which is worthwhile to consider. And all watchers will hardly find another occasion at which information in such a condensed form comes from first hand.

There is no reason to assume that this mutual interest in the conference will decline or even disappear.

The ECB and Its Watchers XVI
Program

Goethe University Frankfurt
Festsaal Casino, Cas 823
Campus Westend
Frankfurt am Main

8:30 – 8.55 Registration and Coffee

8:55 – 9:00 Welcome
Günter W. Beck (CFS and IMFS)

9:00 – 9:30 President's Address
Mario Draghi (President of the European Central Bank)

9:30 – 10:45 **Debate: Low-interest-rate Policy and Non-standard Monetary Policy Measures: Effectiveness and Challenges.**

a) Will the non-standard monetary policy measures adopted be effective and contribute to a recovery of the real economy?
b) How do the potential costs of these measures (such as moral hazard problems for governments or increased risk-taking) compare to their (desired) benefits?
c) What will be potential downsides of the (inevitable) exit from the unconventional policy measures? How can it be managed to minimize the foreseeable negative effects?
d) Doesn't the situation of a (possibly) "secular stagnation" in the euro area call for alternative/additional, non-monetary-policy measures? If so: Which ones?

Chair: Otmar Issing (CFS President)
Speakers: Peter Praet (Member of the Executive Board of the ECB)
Jordi Galí (CREI)
Volker Wieland (IMFS and German Council of Economic Experts)
Lead questions: Kai Carstensen (University of Kiel)
Paul Sheard (Standard and Poor's)
Michael Wickens (University of York)

10:45 – 11:15 Coffee Break

11:15 – 12:30 **Debate: Monetary Policy within the New European Financial Regulatory Architecture.**

a) How has the ECB managed the challenges resulting from its dual role as monetary policy maker and financial supervisor?
b) What are the challenges of macroprudential policies for central banks? What (possibly new) role should financial stability play in the monetary policy strategy?
c) What are the likely effects of the new regulatory framework on the structure of the European financial system? Will the monetary transmission mechanism be affected by these changes? If so how?

Chair: Hans-Helmut Kotz (SAFE Policy Center and Harvard University)
Speakers: Erkki Liikanen (Bank of Finland)
Stephen G. Cecchetti (Brandeis International Business School)
Casper G. de Vries (Erasmus University Rotterdam)
Lead questions: Elga Bartsch (Morgan Stanley)
Luigi Buttiglione (Brevan Howard Investment Products)

12:30 – 14:00 Lunch

14:00 – 15:30 **Debate: International Challenges for Monetary Policy.**

a) How large are the international spillover effects (on advanced and emerging market economics) of unconventional monetary policy measures?
b) What are the likely consequences of the divergence of the ECB's monetary policy from the Fed's, BoE's, … monetary policy?
c) What challenges does the new international financial landscape pose for monetary policy?

Chair: Michael Binder (IMFS, Goethe University Frankfurt)
Speakers: Ewald Nowotny (Oesterreichische Nationalbank)
Arminio Fraga Neto (Gávea Investimentos)
Richard C. Koo (Nomura Research Institute)
André Sapir (Université Libre de Bruxelles)
Lead questions: Erik Nielsen (UniCredit Bank AG)
Beat Siegenthaler (UBS)

15:30 – 15:40 Closing Remarks

Speakers

Günter W. Beck
(CFS and IMFS)
Günter W. Beck is Professor for European Macroeconomics at the University of Siegen and Research Fellow at the Center for Financial Studies and the Institute for Monetary and Financial Stability. Before his appointment in Siegen, Günter W. Beck was Interim Professor at the University of Mainz and coordinator of the program "Central Banking and Monetary Economics" of the Center for Financial Studies in Frankfurt. After gaining a Ph.D. from Goethe University Frankfurt in 2004, he worked as an Assistant Professor in Frankfurt.

His research interests include the study of national and international price-setting employing micro (scanner) data and the analysis of monetary-policy implications resulting from the obtained findings, causes and consequences of heterogeneities in monetary unions and the role of banks and other financial intermediaries („shadow banks") in the monetary transmission mechanism and for the real economy. He has published in leading academic journals including the Journal of Monetary Economics, the Journal of the European Economic Association and the Journal of Economic Dynamics and Control.

Mario Draghi
(President of the European Central Bank)
In his capacity as President, Mario Draghi is a member of the Executive Board, the Governing Council and General Council of the European Central Bank, as well as the Chair of the European Systemic Risk Board. He is also a member of the Board of Directors of the Bank for International Settlements.

From 2006 to October 2011 he served as Governor of the Bank of Italy. In April 2006 he was elected Chairman of the Financial Stability Forum (later the Financial Stability Board), and served in that function until November 2011.

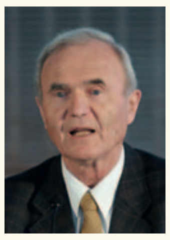
He graduated from the Sapienza University of Rome in 1970 and received his Doctoral Degree in Economics from the Massachusetts Institute of Technology in 1977. Between 1975 and 1981, he was Professor of Economics at the universities of Trento, Padua and Venice, and from 1981 to 1991 he served as Professor of Economics at the University of Florence.

Prior to taking the helm of the Bank of Italy, he was Vice Chairman and Managing Director at Goldman Sachs International, and a member of the firm-wide Management Committee (2002–2005). He was Director General of the Italian Treasury (1991–2001), Chairman of the European Economic and Financial Committee (2000–2001), and Chairman of the OECD's Working Party No 3 (1999–2001). In 1993 he was appointed Chairman of the Italian Committee for Privatisations and from 1984 to 1990 he was an Executive Director of the World Bank.

During his time at the Treasury, he chaired the committee that revised Italian corporate and financial legislation and drafted the law that governs Italian financial markets (1997–1998). He has also served on the boards of several banks and corporations (Eni, IRI, BNL and IMI).

He has been a member of the Board of Trustees of the Princeton Institute for Advanced Study since 2009. He was previously an Honorary Trustee of the Brookings Institution and an IOP Fellow at the John F. Kennedy School of Government at Harvard University.

M. Draghi has written and edited a number of publications on macroeconomic and financial issues.



Otmar Issing
(Center for Financial Studies)
Otmar Issing has been President of the Center for Financial Studies since 2006. From 1998 to 2006, he was a member of the Executive Board of the European Central Bank, responsible for the Directorates General Economics and Research. Until 1998 he was a Member of the Board of the Deutsche Bundesbank with a seat in the Central Bank Council. Prior to that he held Chairs of Economics at the Universities of Würzburg and Erlangen-Nürnberg. From 1988 to 1990, he was a member of the German Council of Economic Experts.

Otmar Issing has been the recipient of numerous economic awards and prizes and received honorary professorships from Goethe University Frankfurt in 2007 and the University of Würzburg in 1991 and honorary doctorates from the Universities of Bayreuth, Frankfurt and Konstanz.

Otmar Issing headed the Advisory Council on a New Financial Order appointed by German Chancellor Angela Merkel from 2008 to 2012. He also was a member of the High Level Group of the European Commission chaired by J. De Larosière.

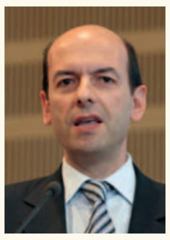
Peter Praet
(Member of the Executive Board of the ECB)
In 2011, Peter Praet joined the European Central Bank as Member of the Executive Board in 2011. He is responsible for Economics and Human Resources, Budget and Organisation.

Before joining the ECB, Peter Praet was Executive Director of the National Bank of Belgium (2000-2011). Here he was responsible for International Cooperation, Financial Stability and Oversight of Financial Infrastructures and Payments Systems. Between 2002 and 2011, he was also a Member of the Management Committee of the Belgian Banking, Finance and Insurance Commission (CBFA), where he was responsible for Prudential Policy for banking and insurance.

Peter Praet served as Chief of Cabinet for the Belgian Minister of Finance from 1999-2000, as Chief Economist of Générale de Banque and Fortis Bank from 1988-1999, as Professor of Economics at the Université Libre de Bruxelles from 1980-1987, and as Economist at the International Monetary Fund from 1978-1980.

He earned a Ph.D. in Economics from the Université Libre de Bruxelles in 1980.

Peter Praet served on several high-level international committees, including the Basel Committee on Banking Supervision, the Committee on Payment and Settlement Systems, the Committee on the Global Financial System, and the European Banking Authority. He was First Alternate of the Board of Directors of the Bank for International Settlements from 2000-2011.

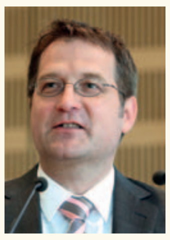


Jordi Galí
(CREI)
Jordi Galí is Fellow of the Econometric Society and member of the Council of the European Economic Association. He has served as Vice President of the

EEA and was President of that organization in 2012. Jordi Galí holds Research positions at the Centre for Economic Policy Research in London, and at the US National Bureau of Economic Research. Galí is a Research Professor at the Barcelona GSE and Professor at the Universitat Pompeu Fabra, in addition to that Prof. Galí is Director of the Centre for Research in International Economics.

His main areas of research are macroeconomics, monetary theory, and macroeconometrics. His influential findings have had a large impact on a variety of topics, particularly business cycles, inflation, exchange rates and the conduct of monetary policy.

Jordi Galí earned his Ph.D. in Economics at the Massachusetts Institute of Technology (MIT) in 1989. Prior to joining the Barcelona economics community, he held academic positions at New York University and Columbia University, and was Visiting Professor at MIT.



Volker Wieland

(IMFS and German Council of Economic Experts)

Volker Wieland holds the Endowed Chair of Monetary Economics at the Institute for Monetary and Financial Stability (IMFS) and has served as Managing Director of the IMFS since 2012. Previously, he was Professor of Monetary Theory and Policy at Goethe University Frankfurt from 2000 to 2012 and a Founding Professor of the IMFS.

Volker Wieland is a member of the German Council of Economic Experts, a Research Fellow at the Centre for Economic Policy Research in London, a member of the Kronberger Kreis, that is the Scientific Council of the Market Economy Foundation, and a member of the Scientific Advisory Council of the German Ministry of Finance. He has organized “The ECB and Its Watchers” from 2004 to 2014.

In 2007 and 2008 he was a Visiting Professor at the Stanford Center for International Development. From 2003 to 2009 Volker Wieland was Director of the Center for Financial Studies.

Volker Wieland has served as a consultant to a number of institutions including, in particular, the European Central Bank, the European Commission, the Federal Reserve Board and the Reserve Bank of Finland.

In 1995, he received a Ph.D. in Economics from Stanford.

Hans-Helmut Kotz

(CFS; SAFE Policy Center and Harvard University)

Hans-Helmut Kotz has been a Senior Fellow at the Center for Financial Studies (CFS) since 2010. He is a Program Director of CFS’ and Goethe University’s SAFE Policy Center. He is also a Resident Fellow and Program Director at Harvard University’s Center for European Studies, teaching since 2010 in Harvard’s Economics Department. Moreover, he is a member of the Economics Faculty at Freiburg University, where he received the 2010’s University Teaching Award. He is also a Senior Advisor to McKinsey & Co., to UniCredit AG as well as a member of the Supervisory Board of Eurex Clearing AG.

Prior to that, Hans-Helmut Kotz has been a Member of the Executive Board of Deutsche Bundesbank from 2002 to 2010, inter alia in charge of Financial Stability, Markets and Statistics, a member of committees of the Bank for International Settlements, the Financial Stability Board as well as the OECD, where he was chair of the Financial Markets Committee. He was also the German Central Bank Deputy for the G7 and the G20 process.

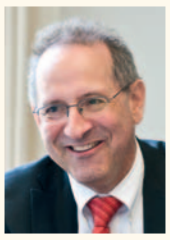
Erkki Liikanen

(Bank of Finland)

Erkki Liikanen has been Governor of the Bank of Finland since 2004. He is currently serving his second 7-year term. Erkki Liikanen, a former EU Commissioner, Ambassador and Minister of Finance, is one of the longest serving members of the Governing Council of the European Central Bank. He is Chairman of the ECB Audit Committee, with a mandate to enhance the corporate governance of the ECB and the Eurosystem. He is also Governor of the International Monetary Fund for Finland.

In 2012, Erkki Liikanen chaired a High-level Expert Group proposing structural reforms to the EU banking sector. At the European Commission, Erkki Liikanen was responsible for Enterprise and Information Society, and earlier for Budget, Personnel and Administration. In the early 1990s, Erkki Liikanen was head of the Finnish Mission to the European Union.

Before commencing his international career, Erkki Liikanen was Minister of Finance for Finland. Erkki Liikanen is an economist by training. He holds honorary doctorates from the University of Technology, Finland (2003) and Aalto University School of Economics, Finland (2011).



Stephen G. Cecchetti

(Brandeis International Business School)

Stephen G. Cecchetti is Professor of International Economics at the Brandeis International Business School. Before rejoining Brandeis in January 2014, he completed a five-year term as Economic Adviser and Head of the Monetary and Economic Department at the Bank for International Settlements (BIS) in Basel, Switzerland. During his time at the BIS, Stephen G. Cecchetti participated in the numerous post-crisis global regulatory reform initiatives.

Stephen G. Cecchetti’s academic appointments include being on the faculties of the Stern School of Business at NYU from 1982 to 1987, the Department of Economics at The Ohio State University from 1987 to 2003. In addition to these, he has served as Executive Vice President and Director of Research, Federal Reserve Bank of New York from 1997 to 1999 and as Editor at the Journal of Money, Credit, and Banking from 1992 to 2001. Stephen G. Cecchetti was Research Associate at the National Bureau of Economic Research from 1989 and has been Research Fellow, Centre for Economic Policy Research from 2008.

Professor Cecchetti coauthors with Kim Schoenholtz a blog at www.moneyandbanking.com.

Casper G. de Vries

(Erasmus University Rotterdam)

Casper G. de Vries holds the chair of Monetary Economics at the Erasmus School of Economics, Erasmus University Rotterdam, and co-heads the risk management program at the Duisenberg School of Finance. Casper is a fellow of the Tinbergen Institute, he is a member of the Sociaal Economsiche Raad (Dutch Council of Economic Advisors), the Wetenschappelijke Raad voor het Regeringsbeleid (Scientific Council of the Government) and is active as a consultant for pension funds. He headed national committee on insurance. His graduate training was received at Purdue University, after which he held positions at Texas A&M University and KU Leuven. He has been visiting scholar at several European and American research institutes and central banks. He has served as vice dean of research and education at the Erasmus School of Economics.

Casper De Vries’s research interests are focused on international monetary issues, like foreign exchange rate determination and exchange rate risk, the issues surrounding the Euro, financial markets risk, risk management and systemic risk and, last but not least, applied game theory. He has published widely in leading internationally refereed journals, like the Journal of Econometrics, the Journal of Economic Theory, the American Economic Review and the Review of Economics and Statistics.

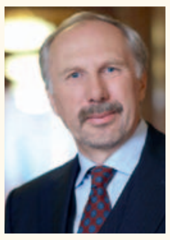
Michael Binder

(IMFS, Goethe University Frankfurt)

Michael Binder is Professor of Economics at Goethe University Frankfurt, holding the Chair for International Macroeconomics and Macroeconometrics since 2003. At Goethe University, he is also Founding Dean of the Graduate School of Economics, Finance, and Management, Vice-Director of the Goethe Graduate Academy, and Affiliated Professor of the IMFS.

Michael Binder received a Ph.D. in economics from the University of Pennsylvania in 1995. He has published on a variety of topics in macroeconomics and econometrics, has been associate editor of the Journal of Applied Econometrics, the Journal of Economic Dynamics and Control, and Empirical Economics, and has been the recipient of numerous publication and teaching awards. Michael Binder held prior appointments inter alia at the University of Cambridge, the University of Maryland, the University of Munich (CESifo), Xiamen University, the International Monetary Fund, and the World Bank.

Michael Binder’s current research in part examines the implications of financial market structures for business cycle dynamics, output growth, and macroeconomic policy design. His research also involves the development of new econometric methods for panel data sets.



Ewald Nowotny

(Oesterreichische Nationalbank)

Mr. Ewald Nowotny is the Governor of the Oesterreichische Nationalbank (OeNB) and a Member of the Governing Council of the European Central Bank. He previously held several high-level positions in financial institutions, including as CEO of BAWAG P.S.K. banking group and Vice President and Member of the Management Committee of the European Investment Bank. He also served on the supervisory boards of several banks and corporations.

Mr. Nowotny was an elected Member of the Austrian Parliament during 1979-1999 and served as chairman of the parliamentary Finance Committee during 1985-1999. He received a doctoral degree from the University of Vienna, Faculty of Law and Economics, holds a PhD in Economics and held research tenures and professorships at Harvard University and other universities.

He has published several books and numerous articles in refereed journals.

Arminio Fraga Neto

(Gávea Investimentos)

Mr. Arminio Fraga is the founding partner at Gavea Investimentos, an investment management firm he founded in August, 2003, based in Rio de Janeiro, Brazil.

Mr. Fraga was the Chairman of the Board, BM&F Bovespa, Brazil’s securities, commodities and derivatives exchange, from April 2009 to April 2013, and was the President of the Central Bank of Brazil from March 1999 to December 2002.

From 1993 until his appointment as governor of the Central Bank, he was managing director of Soros Fund Management in New York. From 1991 to 1992, he was the director responsible for international affairs at the Central Bank of Brazil. Earlier in his career, he held positions with Salomon Brothers and Garantia Investment Bank.

Mr. Fraga has taught at the Catholic University of Rio de Janeiro, the Graduate School of Economics at Getulio Vargas Foundation, the School of International Affairs at Columbia University and the Wharton School.

He is a member of the Group of Thirty and of the Council on Foreign Relations, and serves on the boards of several NGOs. Mr. Fraga has published widely in the areas of international finance, macroeconomics, and monetary policy.

Mr. Fraga earned his Ph.D. in Economics from Princeton University in 1985, and his BA/MA in Economics from the Catholic University of Rio de Janeiro, in 1981.

Richard C. Koo

(Nomura Research Institute)

Richard C. Koo is the Chief Economist of Nomura Research Institute. He is best known for developing the concept of balance sheet recession which is now widely used around the world to explain post-1990 Japanese and post-2007 Western economies. Before joining Nomura in 1984, he was an economist with the Federal Reserve Bank of New York from 1981 to 1984. Prior to that, he was a Doctoral Fellow of the Board of Governors of the Federal Reserve System from 1979 to 1981.

A prolific author, he is currently serving as a Senior Advisor to the Center for Strategic and International Studies in Washington D.C., and as an Advisory Board Member of the Institute for New Economic Thinking in New York. From 1998 to 2010, Richard C. Koo was a visiting professor at Waseda University in Tokyo.

In financial circles, Richard C. Koo was ranked the first among over 100 economists covering Japan in the Nikkei Financial Ranking from 1995 to 1997, by the Institutional Investor magazine in 1998, and by Nikkei Newsletter on Bond and Money from 1998 to 2000.

André Sapir

(Université Libre de Bruxelles)

André Sapir is University Professor at the Université Libre de Bruxelles (ULB), Senior Fellow of Bruegel, the Brussels-based think tank and Research Fellow of the Centre for Economic Policy Research (CEPR). He is Vice-Chair (and was previously Chair) of the Advisory Scientific Committee and voting member of the General Board of the European Systemic Risk Board (ESRB), Europe’s financial stability oversight body.

Between 1990 and 2004, he worked for the European Commission, first as Economic Advisor to the Director-General for Economic and Financial Affairs, then as Economic Advisor to President Romano Prodi and Executive Director of his Economic Advisory Group. From 2005 to 2009 he was external member of President José Manuel Barroso’s Economic Advisory Group.

André Sapir has written extensively on various aspects of Europe’s Economic and Monetary Union, including banking, as well as on international policy coordination, international trade and globalisation. He holds a Ph.D. in Economics in from The Johns Hopkins University in Baltimore and is Member of the Academia Europaea and of the Royal Academy of Belgium for Science and the Arts.

> Do you think that additional non-standard monetary policy measures are necessary in the current economic situation of the euro area? If so: Will the expanded asset purchase program work?

1.

Michael Melvin

I don't think that any additional programs are required beyond the recently announced quantitative easing bond purchase program. This program should keep bond yields low for some time into the future and stimulate spending compared to what it would have otherwise been. While a clear goal of the program is to stimulate inflation, this effect may be more subtle than some might expect. As seen in Japan and the U.S., QE effects on inflation may not be obviously immediate and sustained. However, the issue is really the counterfactual – what would the inflation rate have been without the policy? In all cases, I believe that QE policies have supported higher inflation than otherwise would have occurred. One must keep in mind that there have been powerful forces of low growth and spending in the private and public sector – deleveraging and contractionary fiscal policies and lack of structural reforms – that have worked against enhancing conditions for economic growth and inflation and then recently, falling oil prices. All these effects have pulled inflation rates lower. The one modification of the program that makes sense to me is to purchase equities as well as bonds. This could be done in a rules-based and transparent manner to enhance the impact of the QE program and addresses some concerns that may exist regarding purchases of sovereign debt.

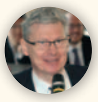
Daniel Gros

Given its inability to reach its own price stability target the ECB has to be seen to be doing something. However, monetary policy can only have very limited effects in a liqudity trap situation. The expanded asset purchase programme will have very limited overall effecs in a creditor economy like that of the euro area. The positive effects in the perifery are likely to be approximately offset by negative effects through lower interest income in the core.

The only important impact is likely to come through the exchange rate. But this leads to a level effect, not a permanent growth impulse.

Dirk Schumacher

Inflation will continue to undershoot the ECB's inflation target for a prolonged period of time and it is therefore understandable that a majority in the Governing Council saw the need to react and ease the policy stance further. While the expanded purchases will have only a little impact on growth (and hence inflation), one could argue that not responding could have damaged the ECB's credibility severely. The easing in financial conditions, mainly via the exchange rate, will support growth. But the decline in the oil price will be in the a lot more important for growth in the Euro area this year.



Julian Callow

Yes and yes. Core inflation is currently running at least one percentage point below the range of 'close to but below 2%'. Nominal GDP is running at just 1.6%. For me the 'lowflation' is much more worrisome than in other advanced economies because (a) the euro area still has vast slack, especially in its labour market, which therefore implies an ongoing substantial downward force on the inflation rate, and (b) the euro area may not be all that resilient by the time the next global downturn materializes (let's not forget that in Q2 the global economy will have completed six years of expansion, putting it into the mature phase by historical standards). I am confident that the EAPP will be effective because I take the view that the ECB will do what it takes to get inflation back to its price stability definition on a 2-3 year view, and because we have plenty of evidence from the UK, US and Japan that if central banks are forceful enough, and sufficiently impact on expectations, that QE can be effective at boosting economic expansion.

Harald Uhlig

The ECB has a problem: inflation is too low, there may even be deflation, and the main tool, the EONIA, cannot realistically go lower to combat that. The ECB must find ways to return inflation to the just-below-two-percent target. For that, non-standard monetary policy measures are needed. That does not mean that all of them are wise or effective. The devil is in the details.

Ulrich Kater

Within the ruling paradigm of inflation targeting the ECB has no other choice but to add further stimulus, even if the QE-instrument will prove by far less efficient than in the U.S. Euroland financing relies much more on the banking sytem than the U.S.-system. Low interest rates an negative real rates are a necessary condition for more dynamics in the real economy. But they are not sufficient. Financial health of financial and non-financial sectors are also decisive as well as appropriate supply side conditions.

Michael Hüther

The ECB's policy rate near the zero lower bound does not only constrain the conduct of monetary policy but it also endangers financial stability. The ECB's large scale asset purchases are necessary for preventing deflationary dynamics; they are, however, no substitutes for structural reforms in the Eurozone economies.

What ECB Watchers Say About the Current Mo

ANSWERS FROM

Julian Callow, *Founder, Catalyst Economics, Ltd & Economist to Element Capital Management LLC*
Daniel Gros, *Centre for European Policy Studies*
Michael Hüther, *Cologne Institute for Economic Research*
Ulrich Kater, *DekaBank*
Michael Melvin, *BlackRock*
Dirk Schumacher, *Goldman Sachs*
Harald Uhlig, *University of Chicago*

> How do the potential costs of the taken non-standard monetary policy measures (such as moral hazard problems for governments or increased risk-taking) compare to their (desired) benefits?

2.

Daniel Gros

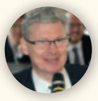
I do not see large costs since the moral hazard problems are mere conjecture and could be going the other way (lower interest expenditure means more money to do long term reforms which have a short term cost).

Dirk Schumacher

There is, I think, an implicit moral hazard problem. Quantifying this problem ex ante seems impossible. Given the small direct impact of QE on growth/inflation the risk/reward balance, however, does not look optimal.

Ulrich Kater

I do not very much believe in wealth effects or portfolio substitution effects in the european context. My main concern is how the now widely used risk loaded assets will react in the next economic downturn and how this will hurt balance sheets.



Julian Callow

The biggest moral hazard problem is that by undertaking this dramatic additional ease, the ECB lets governments off the hook for undertaking challenging reforms. With developments in France, Greece and Italy during the past year, we are reminded once more that some EU governments find it very hard to summon the strength to thwart powerful vested and non-public interests. Fortunately, the fiscal framework appears to be holding well, which means that the EAPP doesn't seem likely to be accompanied by a major fiscal stimulus by countries that have existing public debt or deficit problems. On risk-taking, I am less concerned, as I think the Eurosystem risks are tightly bound together (and I think the way markets have responded to the January 22nd press conference underscores this perspective). If having some notional risk-sharing is the cost of achieving consensus to undertake substantial additional QE, then it is a small price to pay.

Harald Uhlig

Monetary policy practically always also has fiscal implications, but monetary policy must not be about them. The focus must be on getting inflation back to the just-below-two-percent target and it is urgent that the ECB does it soon. As far as government bond purchases are concerned, it is key that they are done at a secondary market price, for which a sufficient share of each bond issue will be held by private market participants until maturity, without additional interference by Eurozone government-financed fonds or institutions.

Michael Hüther

The risks arising from large scale asset purchases are real. Nevertheless, non-standard policy measures are unavoidable in the current situation. These risks can, however, be curtailed by governments sticking to their reform plans. The ECB's possibilities to exit early from non-standard policy measures crucially depend on the fulfillment of their reform agenda.

Michael Melvin

Moral hazard in the Eurozone is a threat, but not sufficient to outweigh the benefits of the extraordinary monetary policy actions. If a government used the QE environment of very low interest rates as an opportunity to expand their borrowing and relax fiscal discipline, the ECB can respond accordingly by reducing their bond purchases below the capital key guidelines as a sanction. One effect (in fact, a goal) of a large QE program is to stimulate risk-taking among investors, as yields on safe government securities are pushed still lower by ECB purchases and portfolio rebalancing effects occur. I suppose that some might consider this to be "collateral damage" of such a program, but the beneficial effect is to lower yields on riskier private assets across the Eurozone to further stimulate spending and asset price appreciation. This should, in turn, create positive wealth effects which further increase spending. A potential threat which exists in all exceptional monetary policy episodes is keeping the rate of interest too low for too long, and potentially stimulating asset price bubbles. We have seen such episodes in other cases where the nominal interest rate is held below the nominal output growth rate for a prolonged period of time. Of course, we are a long way from that in the Eurozone and the QE program is the right policy for now. Eventually, it must be carefully exited in a timely manner, as the potential effects on market volatility of the exit from QE are larger than the volatility associated with the launch of the program.

Daniel Gros

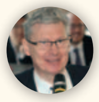
The overall thrust of the European (and indeed global) financial regulatory architecture is to reduce risk at the level of each individual bank or financial institution. At the same time there is a lack of investment and thus risk taking at the macro level. Regulators and supervisors thus keep the foot on the brake whereas central banks keep the foot on the accelerator. This creates a lot of heat in financial markets, but the recovery remains weak as a result.
(The large non performing loans now coming to light in the Italian cooperative banking system are the latest example of this: national forebearance is no longer tenable, but cleaning up these balance sheets will result in the short run in a deflationary impulse in a country where the recession seems to be never ending.)

Michael Hüther

Conflicts between monetary, macroprudential and microprudential policy will challenge the ECB. To avoid this, the macroprudential mandate should be defined more narrowly. Otherwise the ECB has to continuously trade off the price stability goal against the financial stability goal.

Harald Uhlig

It is important to keep responsibilities separate, while sharing information. I find it dangerous that an institution like the ECB is so far removed from the sovereign, the voter, yet is given so much additional power. The ECB needs to be extremely vigilant to not cross the threshold of abusing that power. It will be tempting and it will be easy. And it will be important to separate these powers as soon as possible.



Julian Callow

We already see with the case of ELA for Greek banks how the ECB has to undertake careful appraisal from both a supervisory and monetary perspective. Ultimately, if the ECB is robustly independent in both wings, and governments are prepared to enforce well-capitalised financial institutions, then the system should be sustainable. I think, however, that in the longer term it is preferable to consider whether the supervisory functions should be hived off from the ECB. I can see that it was expedient to expand the ECB for this purpose given the urgency to create the long-overdue SSM, but I would be concerned that in the longer term senior ECB officials are in danger of overburdening themselves and the institution. Even though in some countries (like the UK) the separation of regulator and central bank did not work out, this does not mean that we should throw out the importance of clearly identifying and separating mandates with institutional architecture.

3. "What do you think are the largest challenges for monetary policy resulting from the new European financial regulatory architecture?"

Ulrich Kater

It will be difficult to raise interest rates before the banking system has fully acknowleged the losses of the crisis.

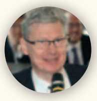
Dirk Schumacher

Monitoring to what extent the excess to bank lending for SME's will be affected.

Michael Melvin

Monetary policymaking should be separate and independent from the ECB's regulatory responsibilities. Proper monetary policy will contribute to financial stability. With regard to financial stability in the particular case of ECB QE, a key challenge is to manage expectations of the wider public and market participants so that their actions help to reinforce the monetary policy actions in order to achieve the goals of greater growth and an inflation rate close to 2 percent. Central banks have often been a source of volatility since the financial crisis. I think that the forward guidance practiced by the ECB has been better than that of other central banks in that it has been used to indicate a commitment to low rates, but also has been suitably vague so that the ECB is better able to guide the market with time-consistent policy statements. The conditional statements of some central banks' forward guidance have proven to be time-inconsistent and have contributed to market volatility. So statements of the Governing Council members must be supportive of the actions taken without forward-looking commitments beyond something like "our future decisions will be determined by economic conditions." This challenge regarding expectations will be most important when the program is within reach of achieving its goals and it is time to start preparing for an exit from the extraordinary policy. As seen in the experience of the Federal Reserve, exiting QE and preparing the market for policy rate hikes requires great skill on the part of the central bank's communications. The market hangs on every word and is continuously updating expectations as reflected in market pricing. In this environment, the ECB will face a risk of adding greatly to volatility of asset prices if the exit process is not carefully managed and communicated.

NETARY-POLICY CHALLENGES: FOUR QUESTIONS, FOUR ANSWERS



Julian Callow

The next two years will be very interesting as the Fed and Bank of England take their first steps gingerly along the road to monetary normalization, while the Bank of Japan most likely starts to prepare to dial back its aggressive stimulus, and other central banks in emerging economies probably seek some loosening. As China's PBOC has observed, it will be essential to have very clear communication to ensure that markets and the monetary institutions themselves fully understand the reaction functions of policy makers, especially under conditions when developments do not turn out in line with the baseline. Clearly for the ECB's QE to be most effective on activity and inflation will require a significant further depreciation in the euro. I can see how this might happen, though there is a significant support still for the euro in the form of a chunky current account surplus (~2.3% of GDP last year). I think the ECB will have to be prepared to be relatively nimble in its readiness to adjust policy in case its forceful actions prove to be too much or too little.

Ulrich Kater

Emerging economies financial markets are evolving fast. Preventing this credit cycle from turning out as desastrous as the one in the developed countries is one of the main tasks of international monetary and regulatory policies.

4. "What do you think are the largest international challenges resulting from the ECB's expanded asset purchase program?"

Daniel Gros

The euro area has become the largest source of global current account imbalances, thus exporting its internal problems to the rest of the world. This can go on only as long as the excess savings in China are bottled up via a domestic investment boom which now only the Chinese government can keep going. At the scale of the European neighbourhood the important role of the small Northern European excess savers is now becoming more apparent. The external surpluses of Switzerland, Denmark, Sweden and Norway are larger than those of the euro area and collectively relevant at the European scale. The currencies of these countries might have to leave the umbrella provided so far by the euro.

Michael Hüther

Ultra-expansive policy measures will weaken the Euro, especially when the Fed starts to exit from QE. Governments will be tempted to conduct beggar-thy-neighbor-policies and they will pressure their central banks to depreciate their currencies. It will be challenging for central banks to withstand political pressures.

Dirk Schumacher

To the extent that the main effect will come via the exchange rate, it is clear that this is a zero-sum game on the global level. Other central banks may very well react to an Euro depreciation, depending on the speed of the depreciation, which can create (see the case of Switzerland, for example) its own problems.

Harald Uhlig

The US, the Eurozone and Japan are all in near-deflationary territory. We do not have much experience or knowledge how this will all play out worldwide. Luckily, the US economy seems to be resurgent now, so that these international interdependencies may be currently of less concern.

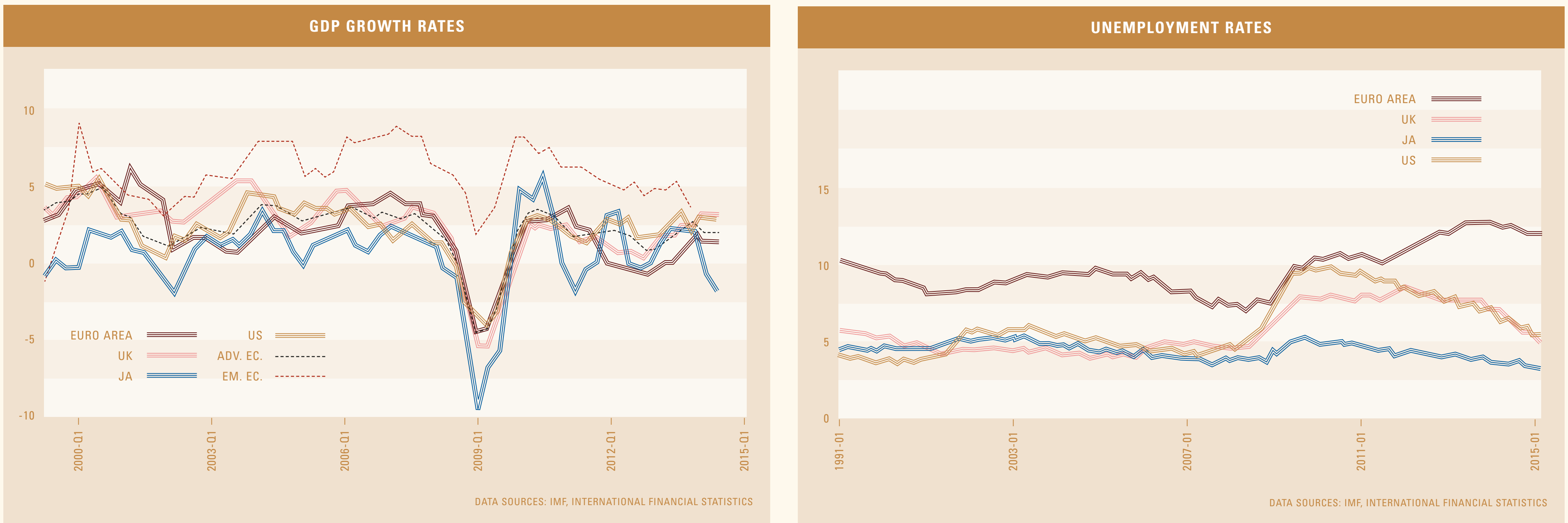
Michael Melvin

One effect of a massive QE program, in addition to lower yield curves, should be further depreciation of the euro exchange rate. This is a welcome effect for the Eurozone and will help to achieve the inflation and growth objectives. But this may create some tensions internationally, as other currencies appreciate in value. The talk of "currency wars" is back with us again in early 2015, and we have seen several central banks implementing surprise interest rate cuts. So we are in a low-growth, low-inflation regime globally where most countries would like to have a depreciating currency to help stimulate their global competitiveness and help in the fight against low inflation. In the case of the ECB, one can safely argue that the extraordinary monetary policy actions are aimed at domestic economic conditions and the exchange rate will be free to float with no official intervention in the foreign exchange market. There will, no doubt, be some who argue that we have entered a time of competitive currency depreciations given the rate cutting so far this year and now QE by the ECB. This is a challenge that is best addressed by simply focusing on domestic goals and expressing the policy intent that the extraordinary policy ends when the goals are achieved. Once the Federal Reserve begins to signal that rate hikes are coming, the attention will shift to the Fed and Fed policy will become the major driver of further euro depreciation.
Another potential international challenge is with regard to increased funding in euros that will occur as euro-denominated yields fall and countries and firms find borrowing in euros increasingly attractive. The threat is with regard to the "currency mismatch" problem that arises when debt service is denominated in a foreign currency and then that currency undergoes a surprise appreciation. The euro will not depreciate forever, and rest-of-world borrowers must manage the risks of euro-denominated debt exposure carefully.

Some key economic parameters of the

The following collection of graphs gives a short and selective overview of some major euro area economic indicators and monetary policy developments. This overview is purely descriptive in nature, the selection of the variables is not meant to be suggestive but to provide some hopefully useful background illustrations for some of the major issues to be discussed at the conference. To put current developments into perspective, the graphs show longer time horizons and include references to other countries/country groups.

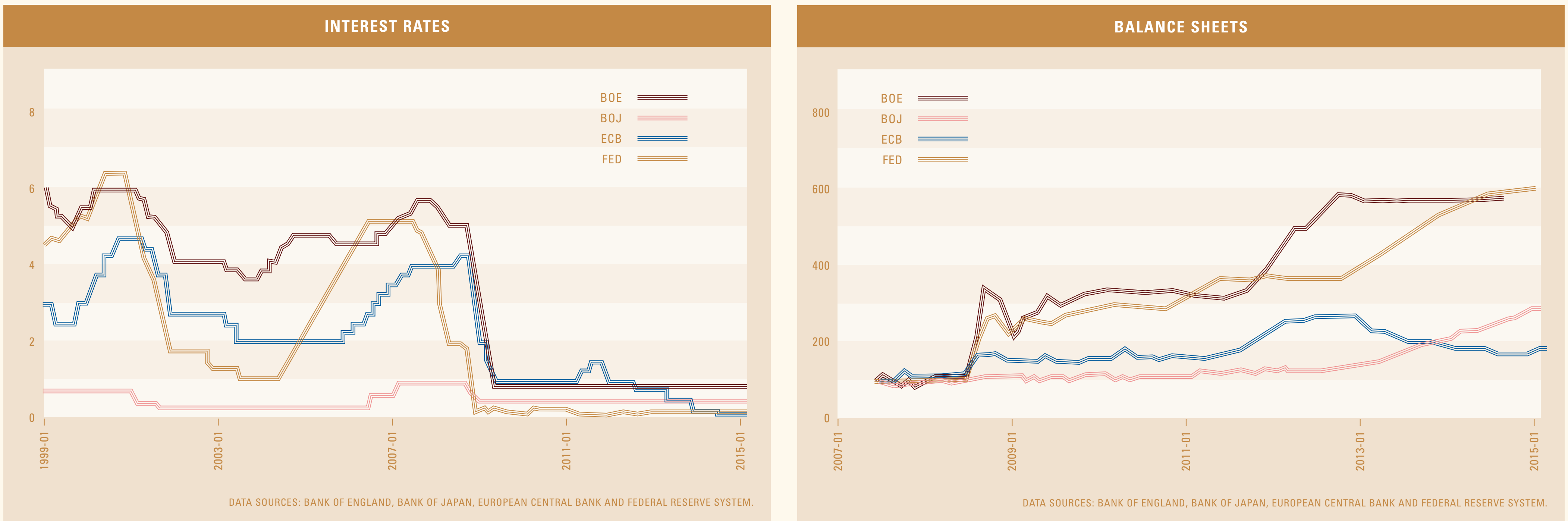
Figure 1: GDP growth and unemployment



Notes: The left panel of Figure 1 plots real GDP growth (year-on-year change) for the euro area, the United Kingdom (UK), Japan (JA), the United States (US), major advanced economies (as defined by IMF, "Adv. ec") and emerging and developing economies ("Em. ec."). The right panel plots unemployment rates for the euro area, the United Kingdom, Japan and the United States. Data source: IMF, International Financial Statistics

Figure 1 plots in its left panel the real GDP growth rates of the euro area, the United Kingdom (UK), Japan (JA), the United States (US), major advanced economies (as defined by the IMF, "Adv. ec") and emerging and developing economies ("Em. ec."). While it is clear that growth rates of all considered countries (and country groups) tend to move together over time, there are considerable differences in the relative sizes of the individual growth rates. In particular, the euro area has exhibited a relatively weak growth performance in recent years. While there has been a fairly sizeable decrease in unemployment rates in the other three considered major economies in recent years, the unemployment rate in the euro area has more or less stagnated at a very high level, i.e. well above 10%.

Figure 2: Interest rates and balance-sheet dynamics of major central banks

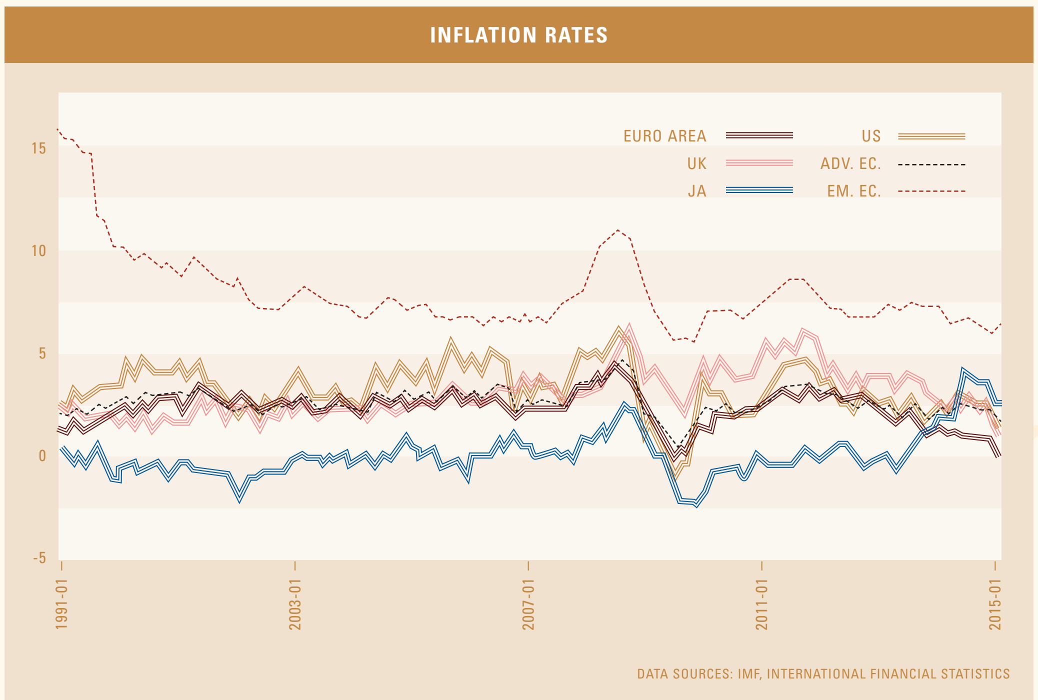


Notes: The left panel of Figure 2 plots the key policy interest rates of the Bank of England (BoE), the Bank of Japan (BoJ), the European Central Bank (ECB) and the Federal Reserve (FED). The right panel plots the total assets of these central banks balance sheets where all numbers are normalized such that the corresponding figures for August 2007 correspond to 100. Data sources: Bank of England, Bank of Japan, European Central Bank and Federal Reserve System.

Figure 2 plots the key policy interest rates and the balance-sheet dynamics of the Bank of England, the Bank of Japan, the European Central Bank and the Federal Reserve. The left panel indicates that before 2007 decisions of the considered central banks tended to move together over time but exhibited partly considerable differences with respect to their size. Since around 2009 essentially all considered central banks have reached the zero-lower bound (with the exception of the ECB which kept its main interest rate slightly above this bound for some more years). As the right panel of Figure 2 illustrates, the balance sheets of all four considered central banks have experienced significant increases since that time. However, this expansion has occurred to very different degrees and has shown very different dynamics across central banks: While the Bank of England and the Federal Reserve have expanded their balance sheets very swiftly and very sizably, the Bank of Japan has done so only gradually. The European Central Bank took an intermediate position in the first years and has reduced its balance sheet after 2012.

EURO AREA

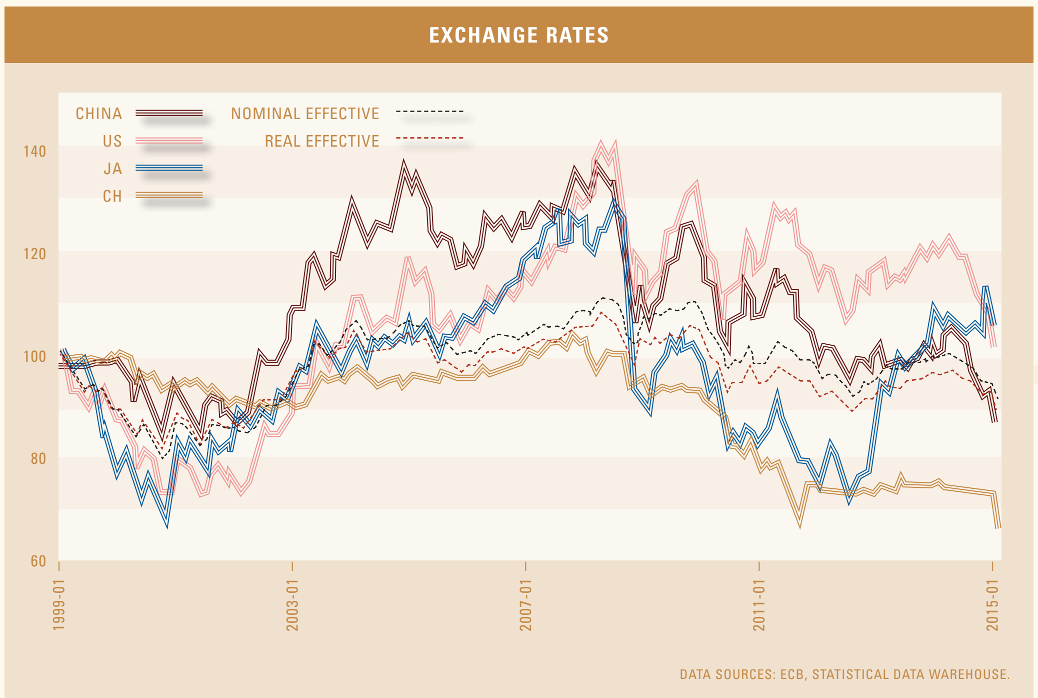
Figure 3: Inflation rates



Notes: Figure 3 plots inflation rates (year-on-year change) for the euro area, the United Kingdom (UK), Japan (JA), the United States US), major advanced economies (in the terminology of the IMF, "Adv. ec") and emerging and developing economies ("Em. ec."). Data sources: IMF, International Financial Statistics

In **Figure 3**, inflation rates (year-on-year change) for the euro area, the United Kingdom, Japan, the United States, major advanced economies and emerging and developing economies are plotted. As for growth rates, the inflation rates of all considered countries (and country groups) move parallel over time but exhibit sizeable differences in levels. The euro area has experienced the lowest inflation rate of all considered countries/country groups in the recent year, its inflation rate falling below zero in December 2014.

Figure 4: Exchange rates



Notes: Figure 4 plots monthly average exchange rates for the euro area with respect to some of its major trading partners (China, the United States (US), Japan (JA) and Switzerland (CH)). Moreover, the nominal and real effective euro-area exchange rates (Reference countries are 38 major trading partners of the euro area) are plotted. Data are normalized such that January 1999 corresponds to 100. Data sources: ECB, Statistical Data Warehouse.

Figure 4 plots exchange rates for the euro area with respect to some of its major trading partners. Moreover, the nominal and real effective euro-area exchange rates with respect to 38 major trading partners of the euro area are plotted. The figure shows that the euro has tended to depreciate relative to almost all other currencies in recent years (apart from Japan). However, the extent of this development has been fairly distinct with respect to different countries. The plots for the effective exchange rates, which take a broader perspective, confirm the depreciation trend of the euro area in recent years.

Topics and Speakers 1999-2014

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The ECB's Monetary Policy Strategy
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