The ECB and Its Watchers XVII

Global challenges for monetary policy in the euro area

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BETTER POLICIES FOR BETTER LIVES

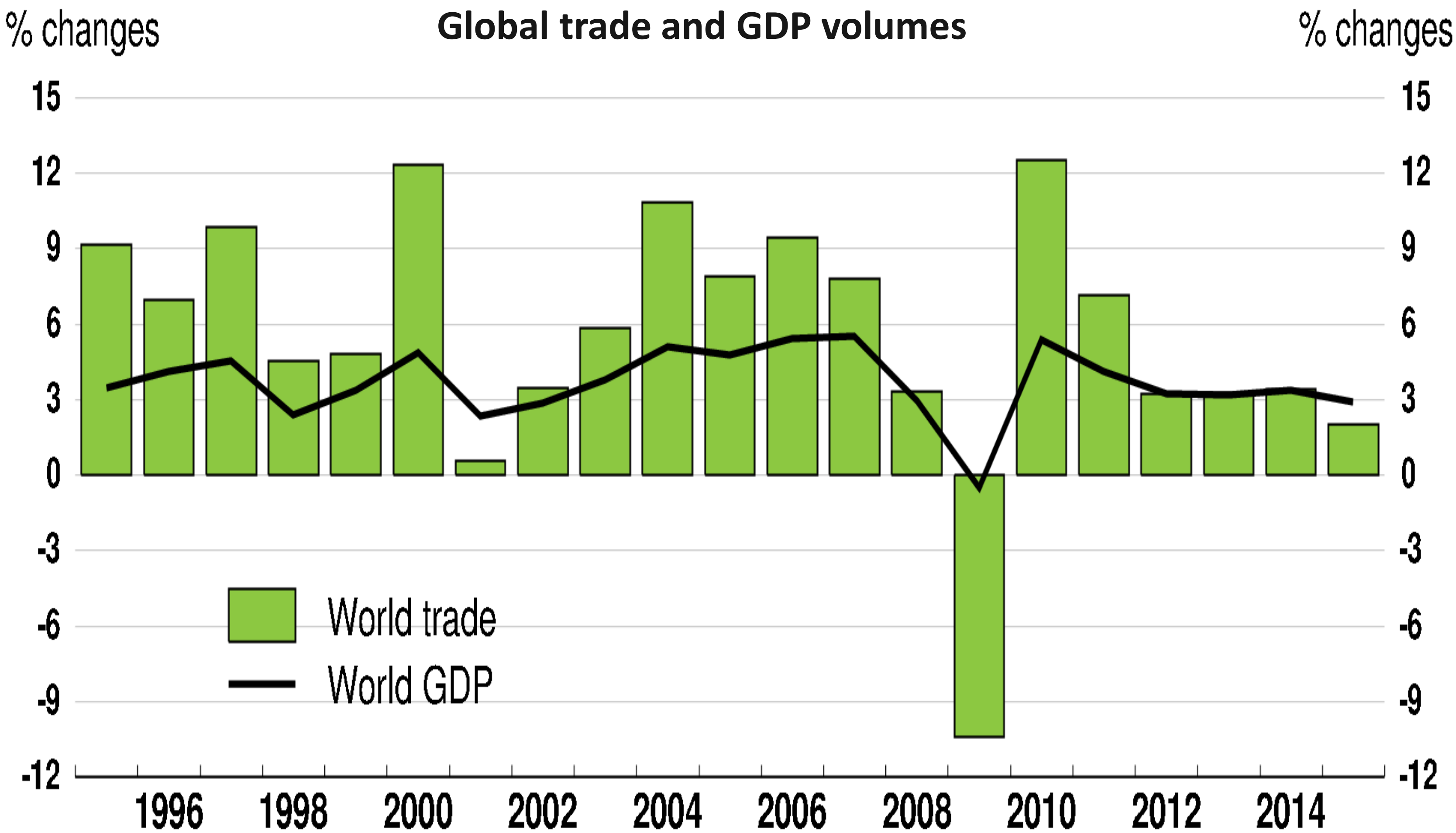
Challenges for Monetary Policy
International Lens

Global growth weakness through the trade lens

Financial market volatility through asset price lens

Global rebalancing -- cyclical vs structural lens

Weak global growth and trade downshift

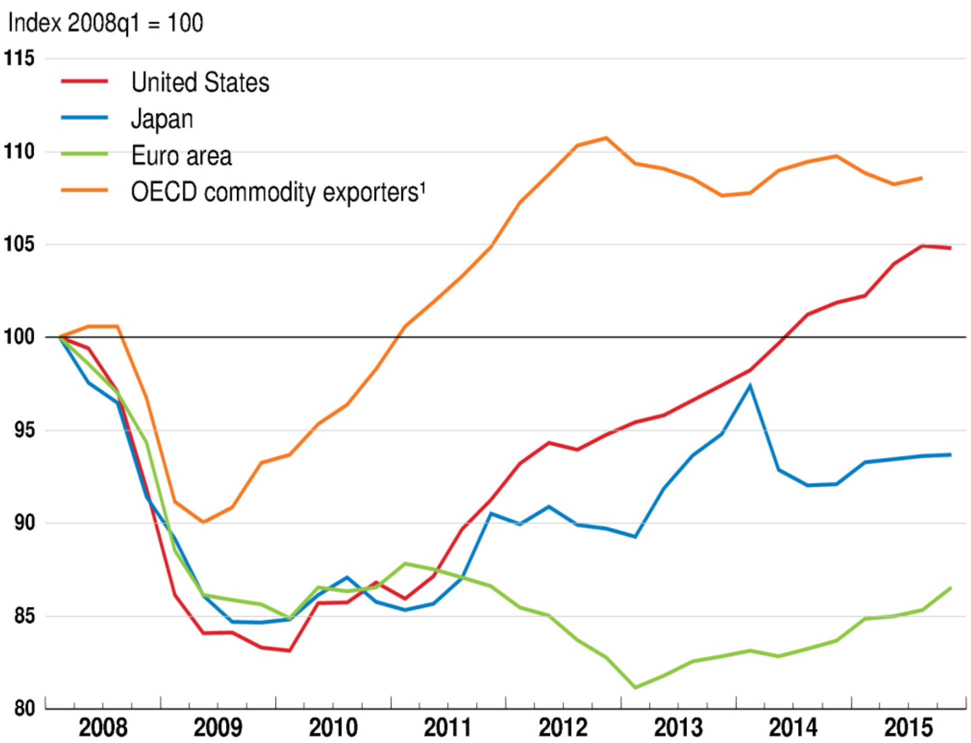


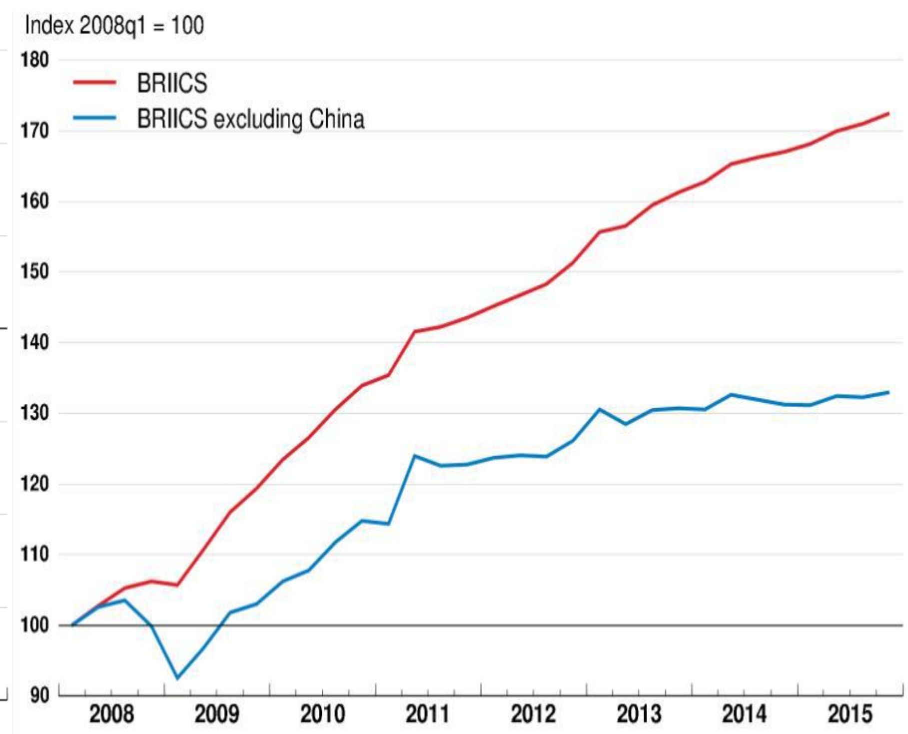
Source: OECD Economic Outlook database; CPB World Trade Monitor.

Weak investment outside China

flat for commodity exporters, terrible for euro area

Real fixed investment

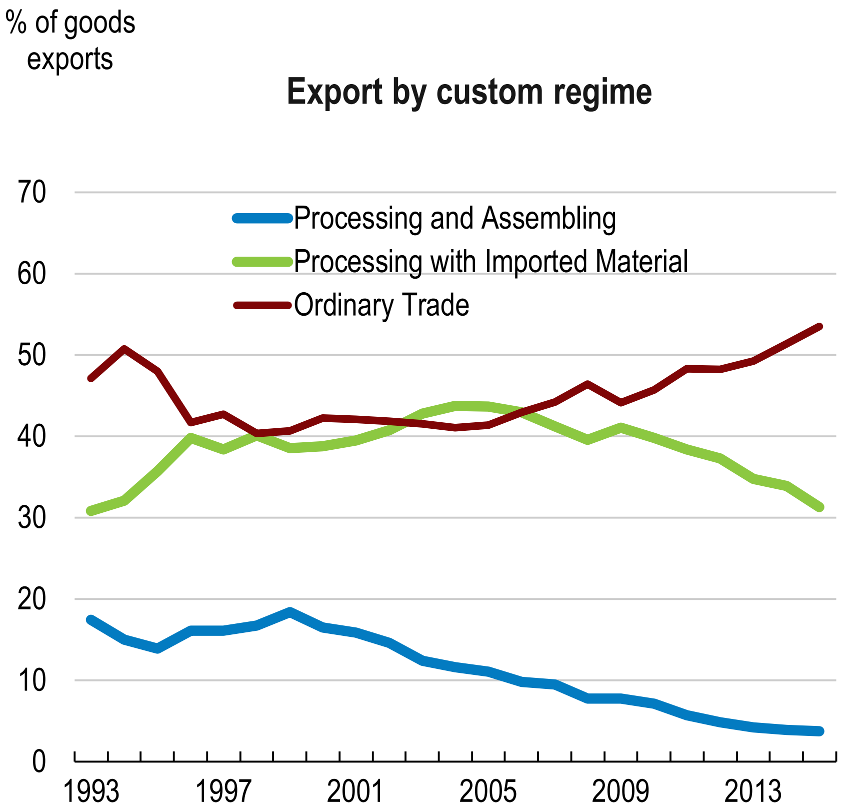


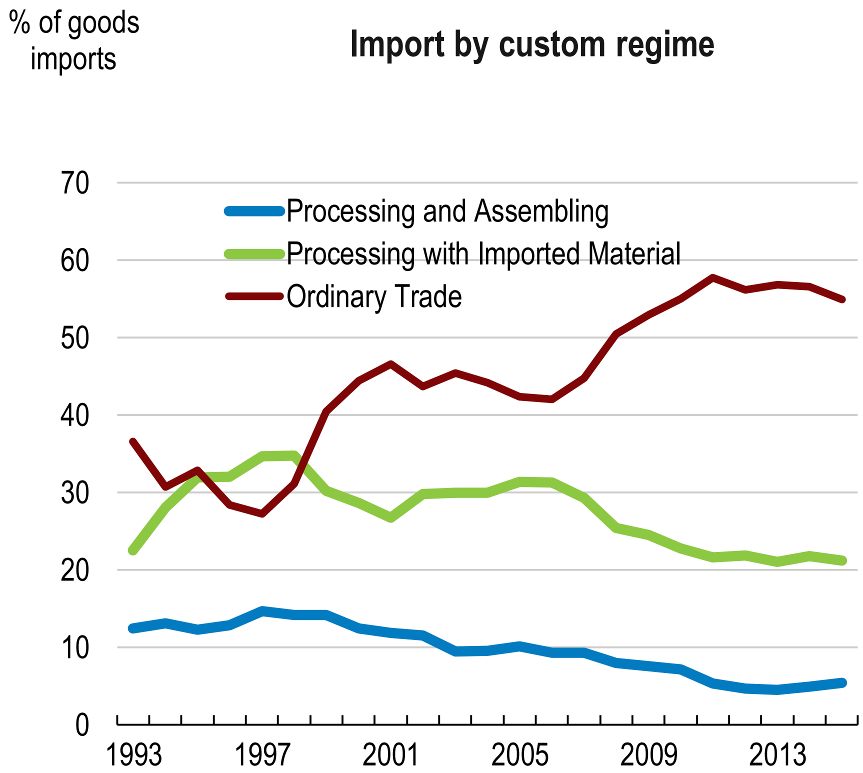


1. OECD commodity exporters includes Australia, Canada, Chile, Mexico and Norway.
Source: OECD November 2015 Economic Outlook database.

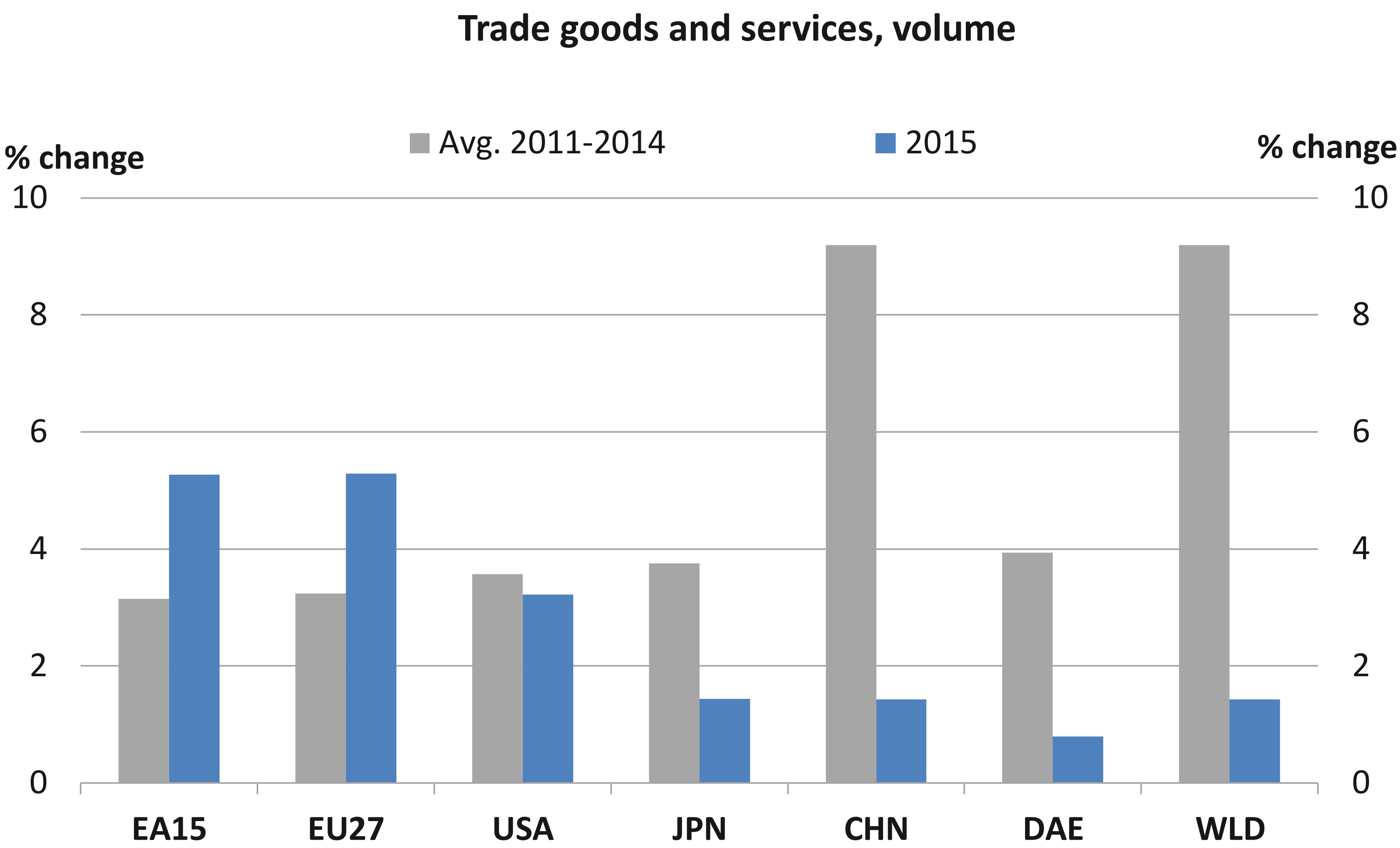
Nature of GVC trade may be changing

China less processing/assembling, more at home





Investment, GVCs, and China Slowdown *accentuates trade slowdown in East Asia*



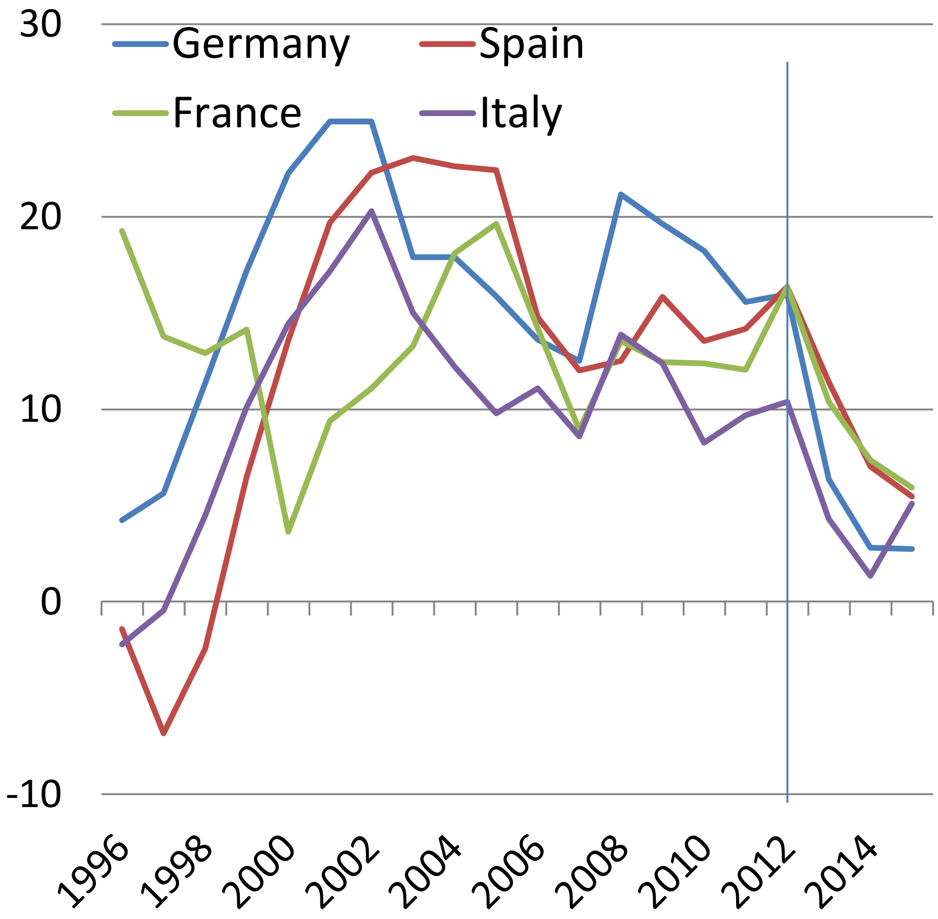
Source: OECD Economic Outlook Database

China and European Trade Links

Slowdown in European exports to China

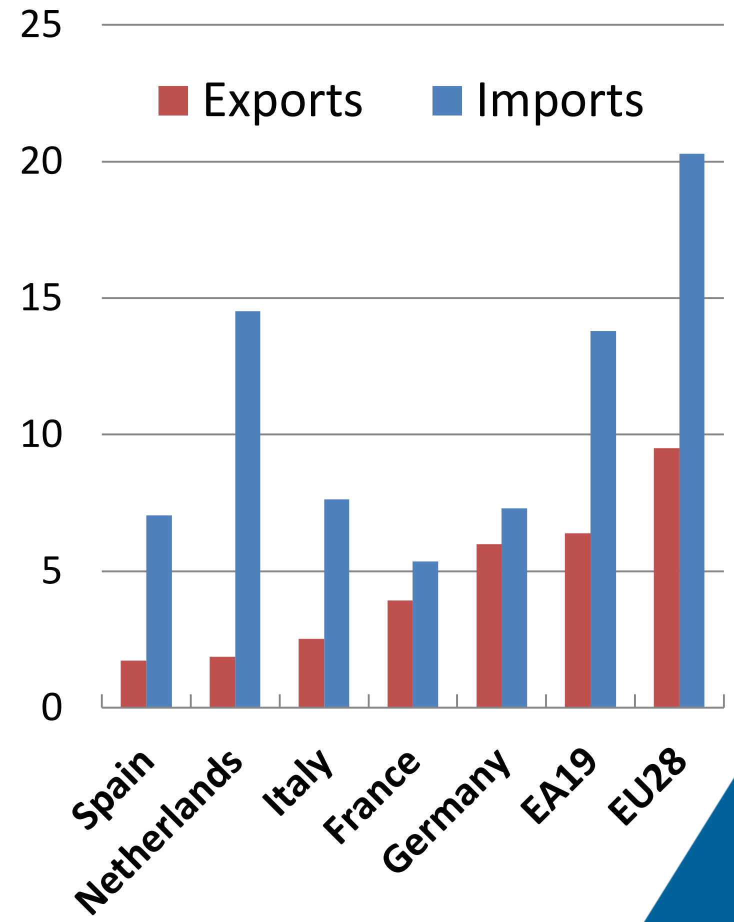
Annual Chinese exports growth, values

5-year moving average (%)



Share of total merchandise trade

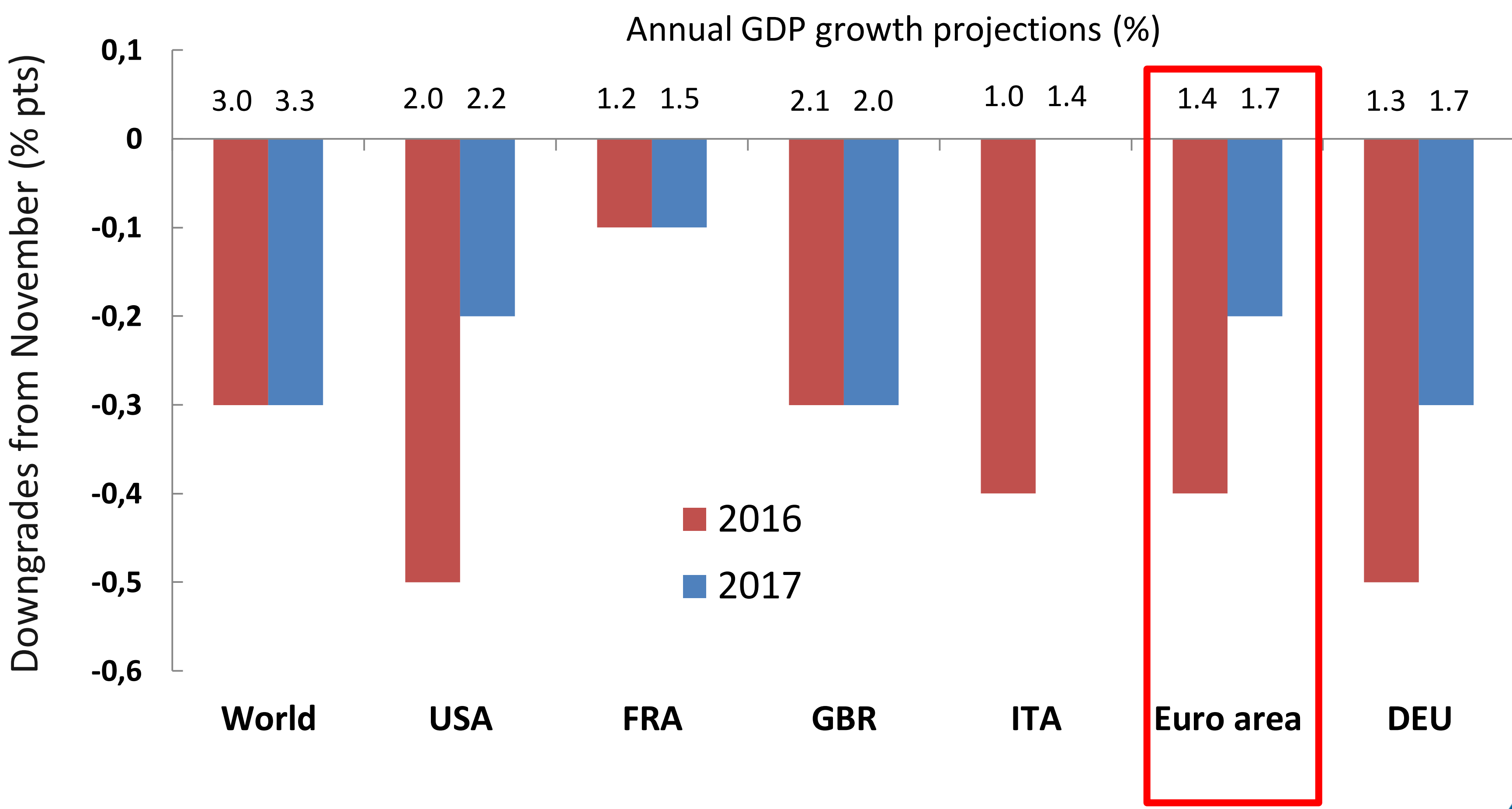
Per cent, 2015



Source: Eurostat.

Adds up to downward revisions to projections *(downgrades: Nov 2015-Feb 2016)*

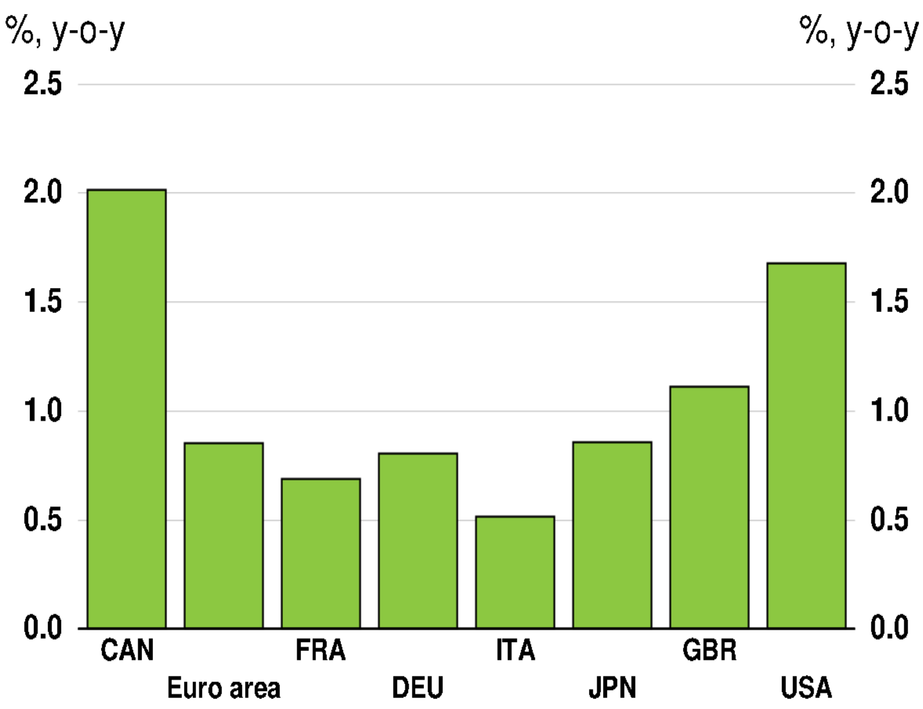
Forecasts in Feb 2016



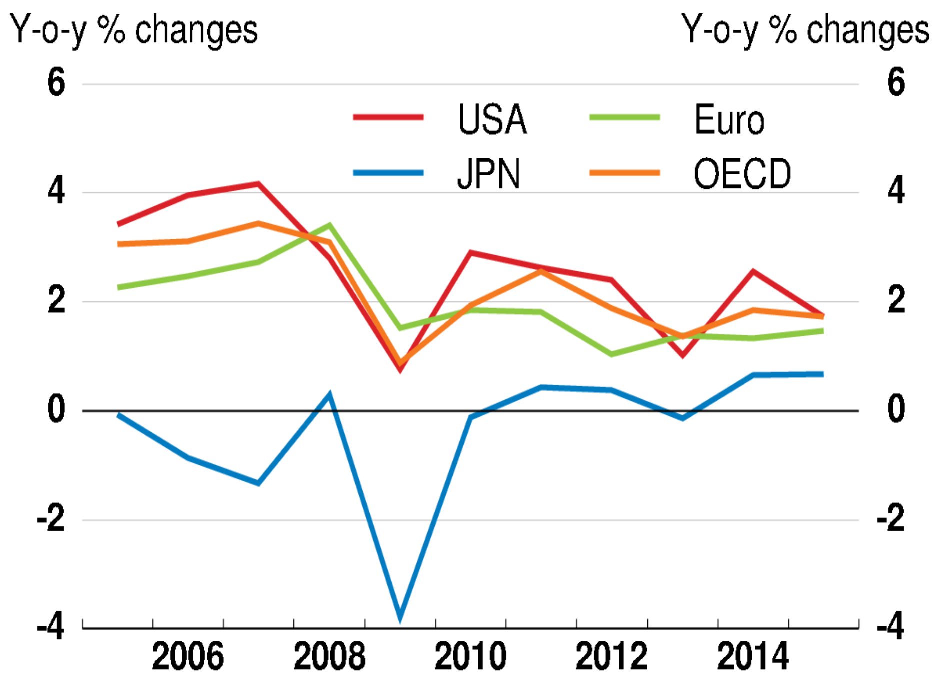
Source: OECD Economic Outlook databases; and OECD calculations.

Adds up to: Inflation below targets and weak wage growth

Core inflation

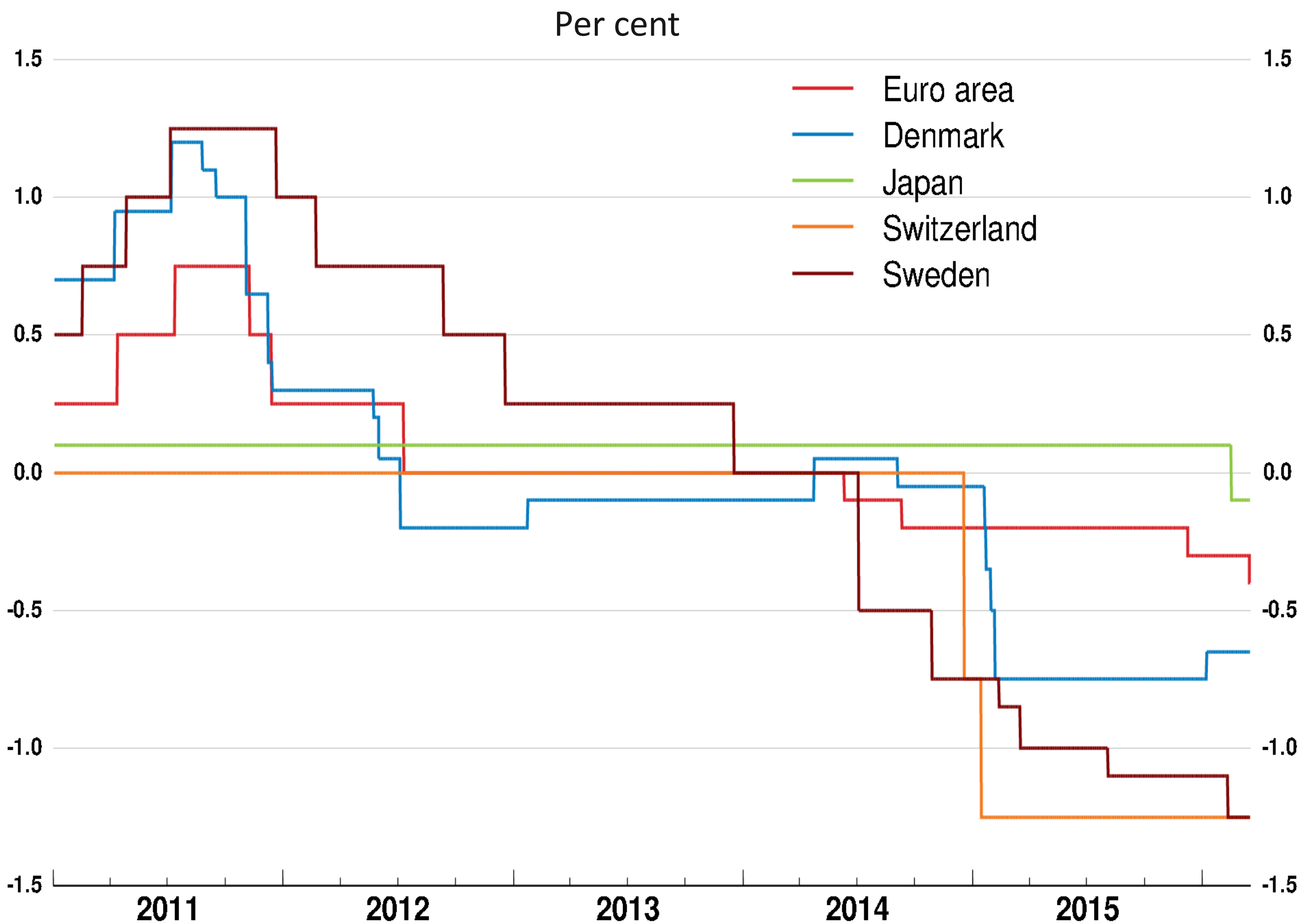


Compensation per employee



Note: Latest month available. Core inflation is for consumer prices excluding food and energy. The private consumption deflator is used for the United States.
Source: OECD Economic Outlook databases.

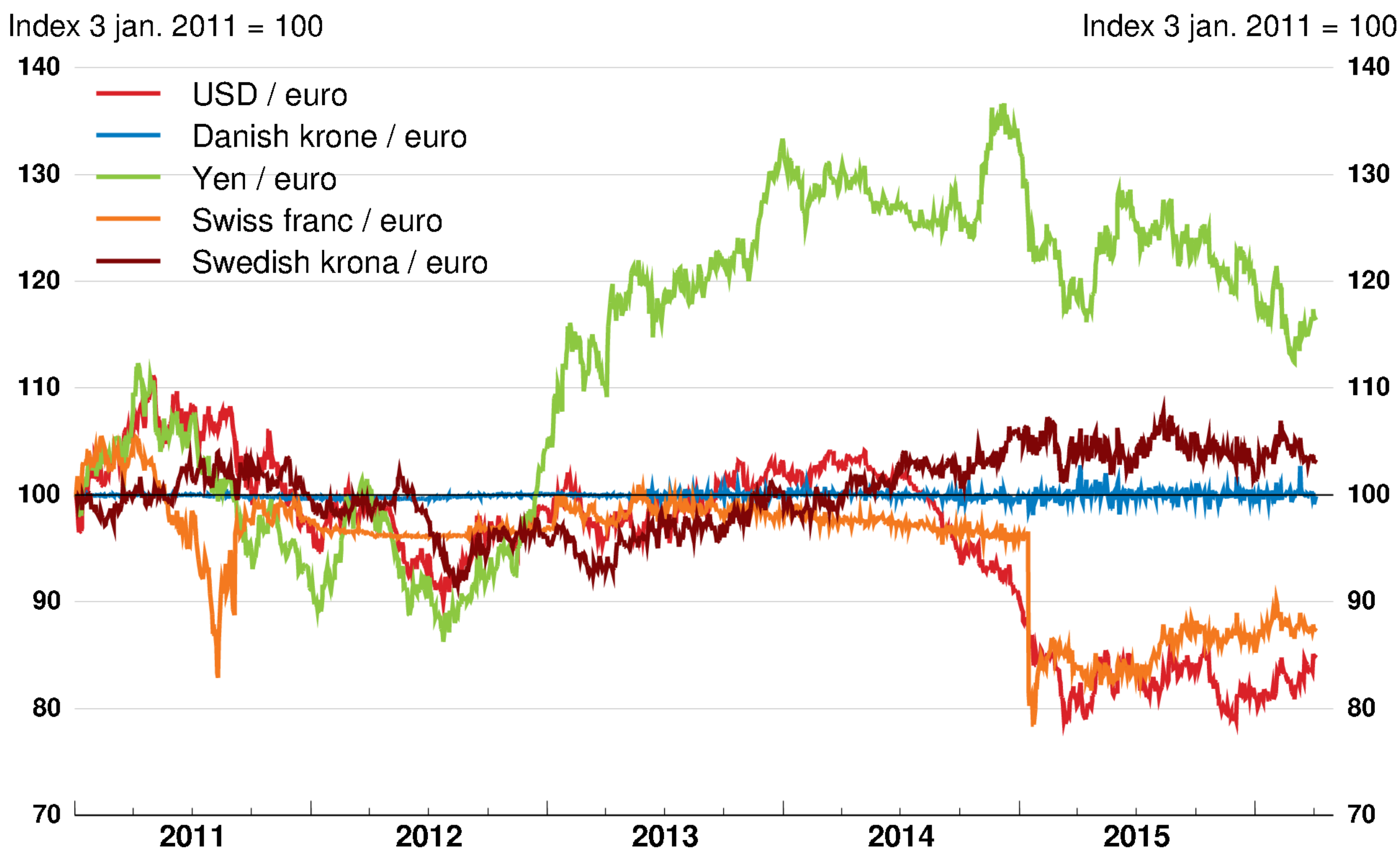
A number of central banks have introduced negative deposit rates



Cumulative Δ / # of Δ
<u>since negative interest rate in 2014:</u>
CHE: 125 bps / 2
SWE: 125 bps / 6
DNK: 70 bps / 2
EA: 40 bps / 4
JPN: 20 bps / 1

Source: Thomson Reuters.

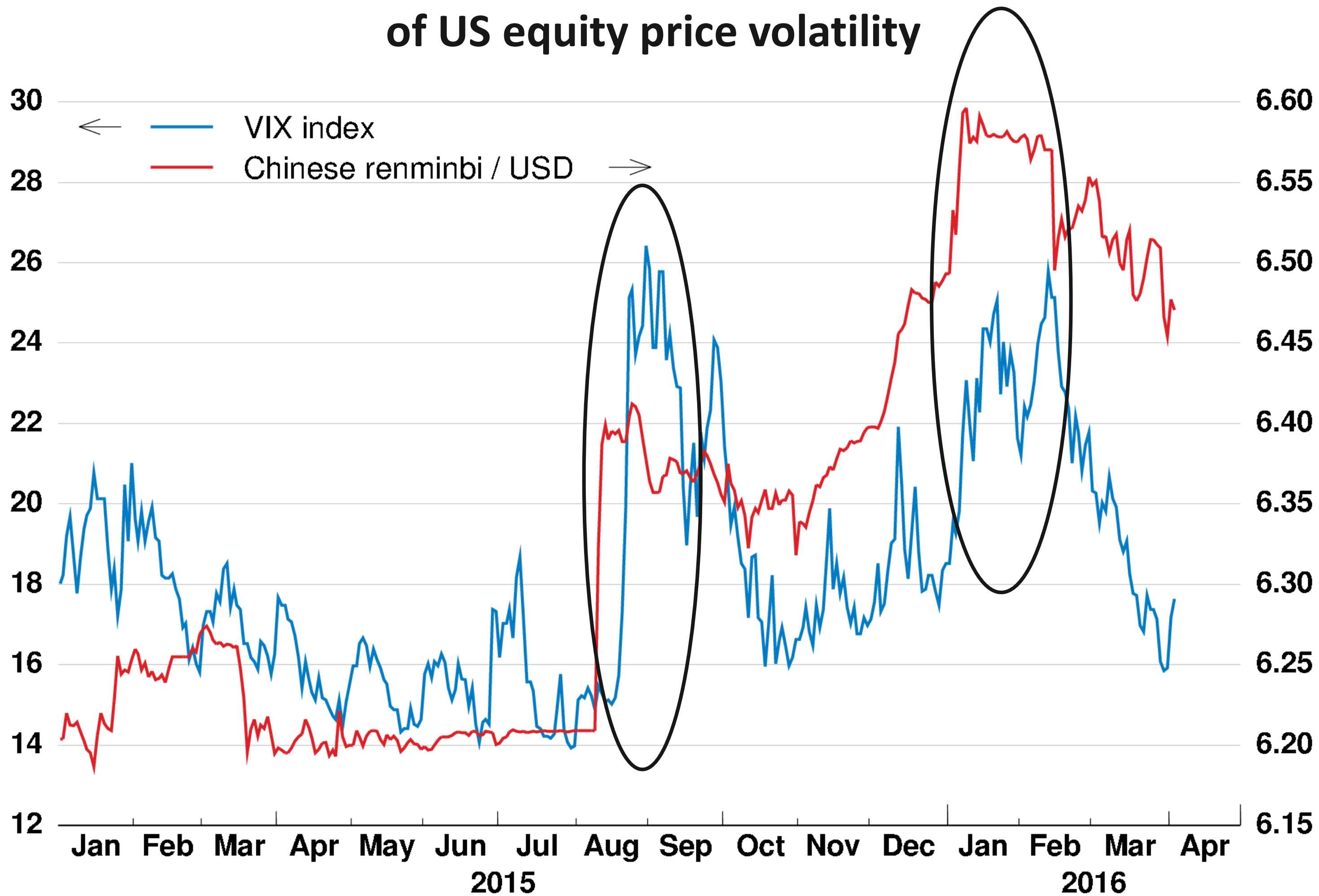
Interest rate differentials still move exchange rates



Source: Thomson Reuters.

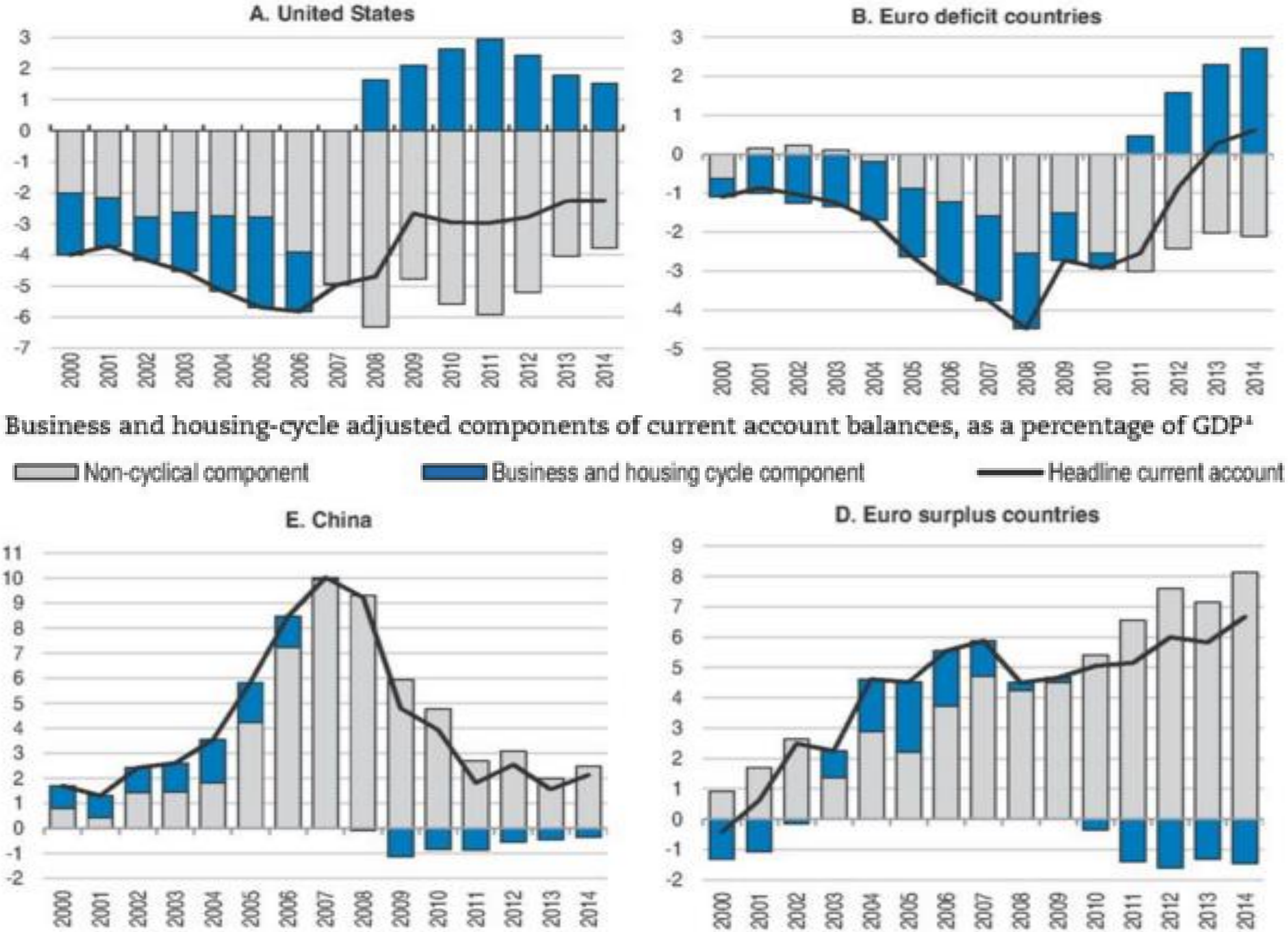
China as a player in financial markets turmoil from RMB/$

RMB/USD exchange rate and VIX Index of US equity price volatility



Source: Thomson Reuters.

External rebalancing through the cycle and Prospects for Global Growth

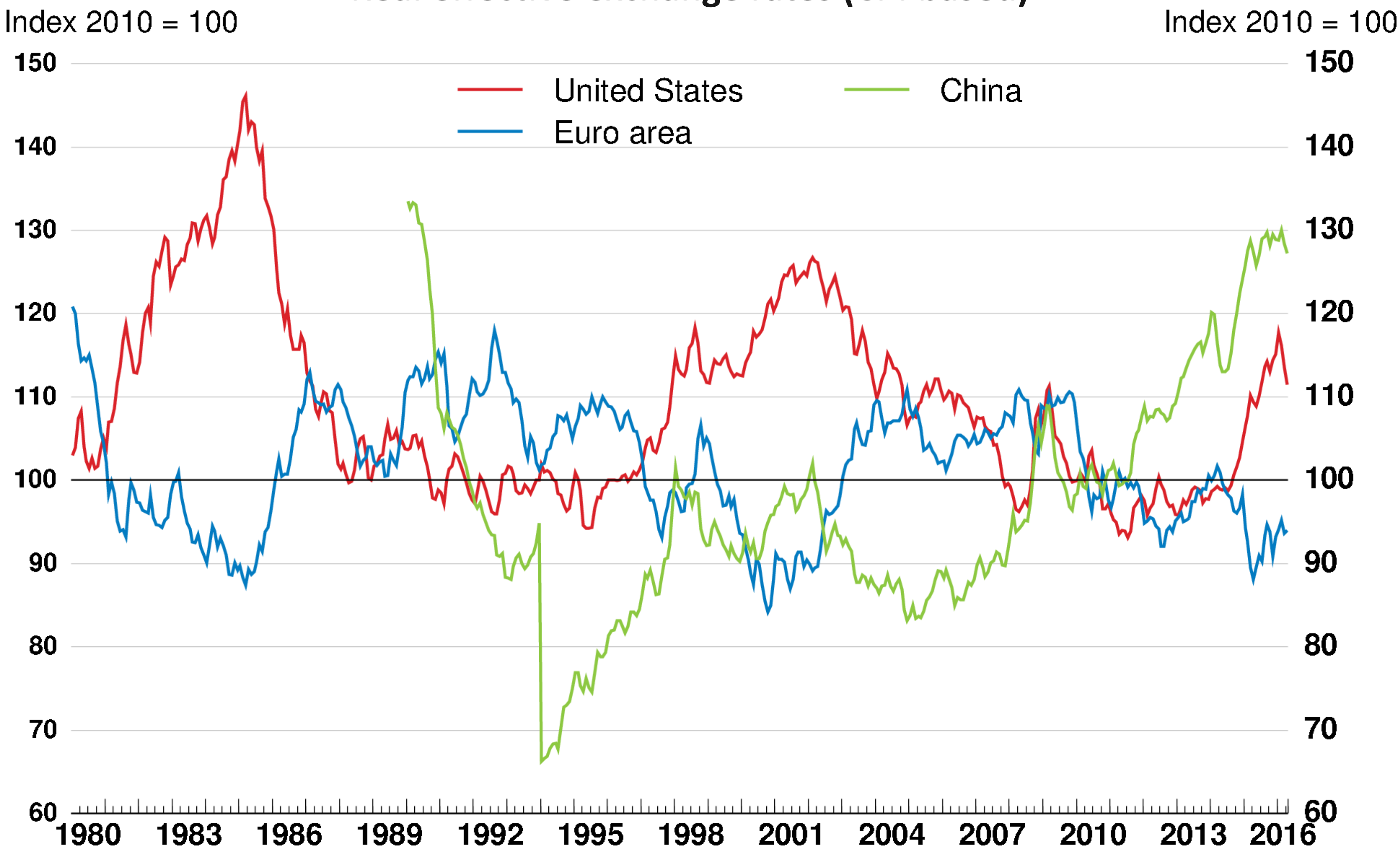


Business and housing-cycle adjusted components of current account balances, as a percentage of GDP[1]

Long-term equilibrium real exchange rates

Headwind or tailwind for monetary policy?

Real effective exchange rates (CPI based)



Source: OECD exchange rate database.

Challenges for Monetary Policy International Lens

Global growth weakness through the trade lens

- Recent trade weakness and reverberations centre on China
- China internal rebalancing changes GVCs with implications for Europe

Financial market volatility through asset price lens

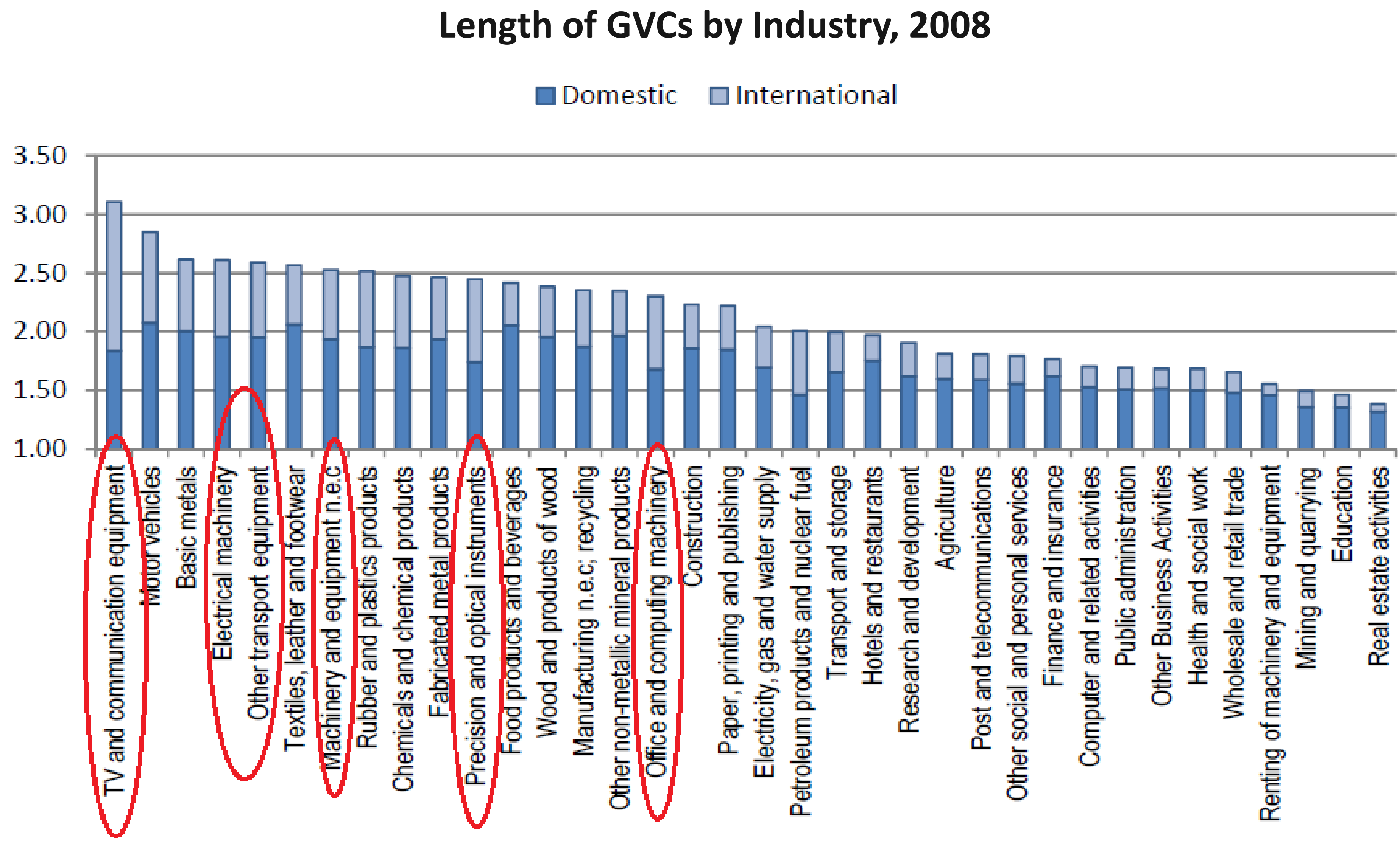
- Negative deposit rates by a number of central banks
- Large asset price and exchange rate movements
- Recent volatility associated with the RMB

Global rebalancing – cyclical vs structural

- Will the US return to being the global buyer?
- Will China, after internal rebalancing, be like the US or like Germany?

Prepared by William Witheridge with assistance from Jérôme Brezillon, Thomas Chalaux, Ane Kathrine Christensen and Elena Rusticelli.

Investment is GVC intensive
accentuates trade slowdown



Source: Authors' calculations based on the OECD ICIO model, December 2012 release. The minimum value of the index is 1 when no intermediate inputs are used to produce a final good or service.

External Rebalancing
Cyclical vs. Structural *(global effect)*