MONETARY POLICY STIMULUS: SPILLOVERS AND FINANCIAL STABILITY CONCERNS

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The ECB and Its Watchers
27 March 2019

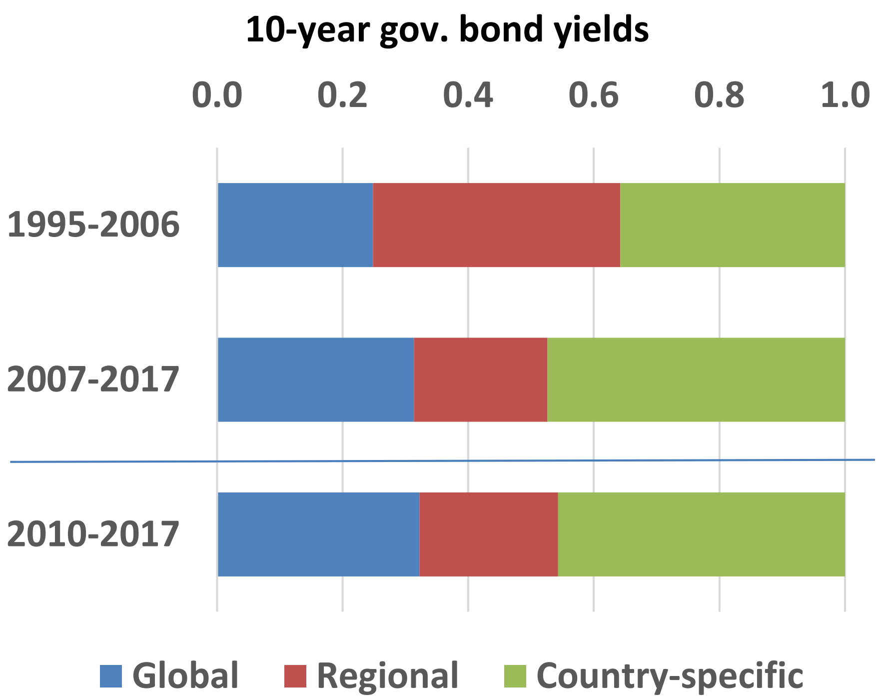
OECD
BETTER POLICIES FOR BETTER LIVES

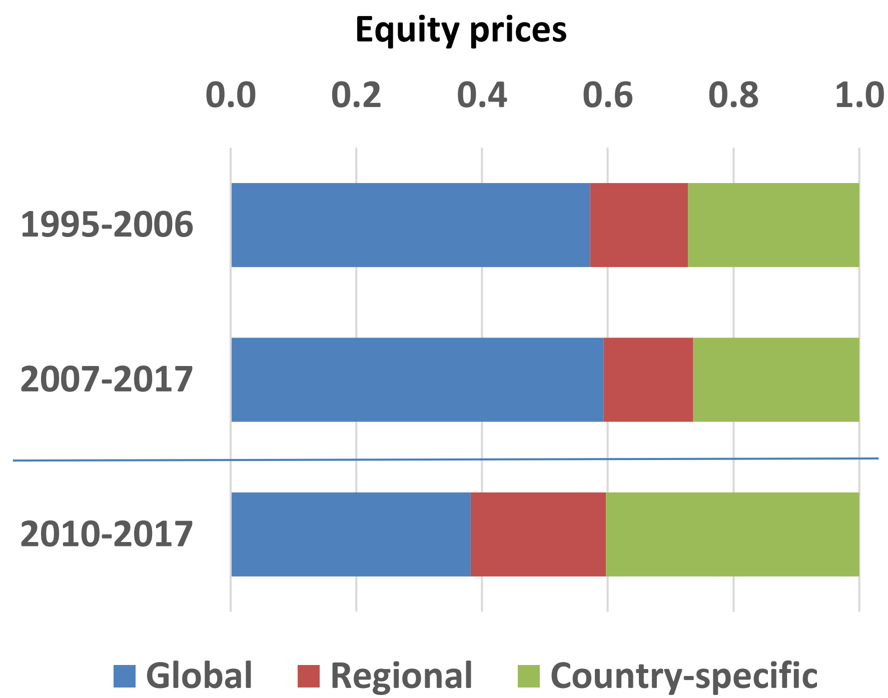
Key messages

- Financial stability issues or monetary policy transmission channels ?
  - ✓ Exchange rate and capital flows
  - ✓ Credit channel
  - ✓ Portfolio rebalancing
- What we should worry about
  - ✓ Faltering growth at the ZLB
  - ✓ Monetary policy has been left alone
- What governments should do
  - ✓ COORDINATE fiscal policies
  - ✓ Structural: demographics and productivity weigh on neutral real rates, everywhere
  - ✓ Macro-prudential

Spillovers in highly integrated financial markets with free capital flows are to be expected

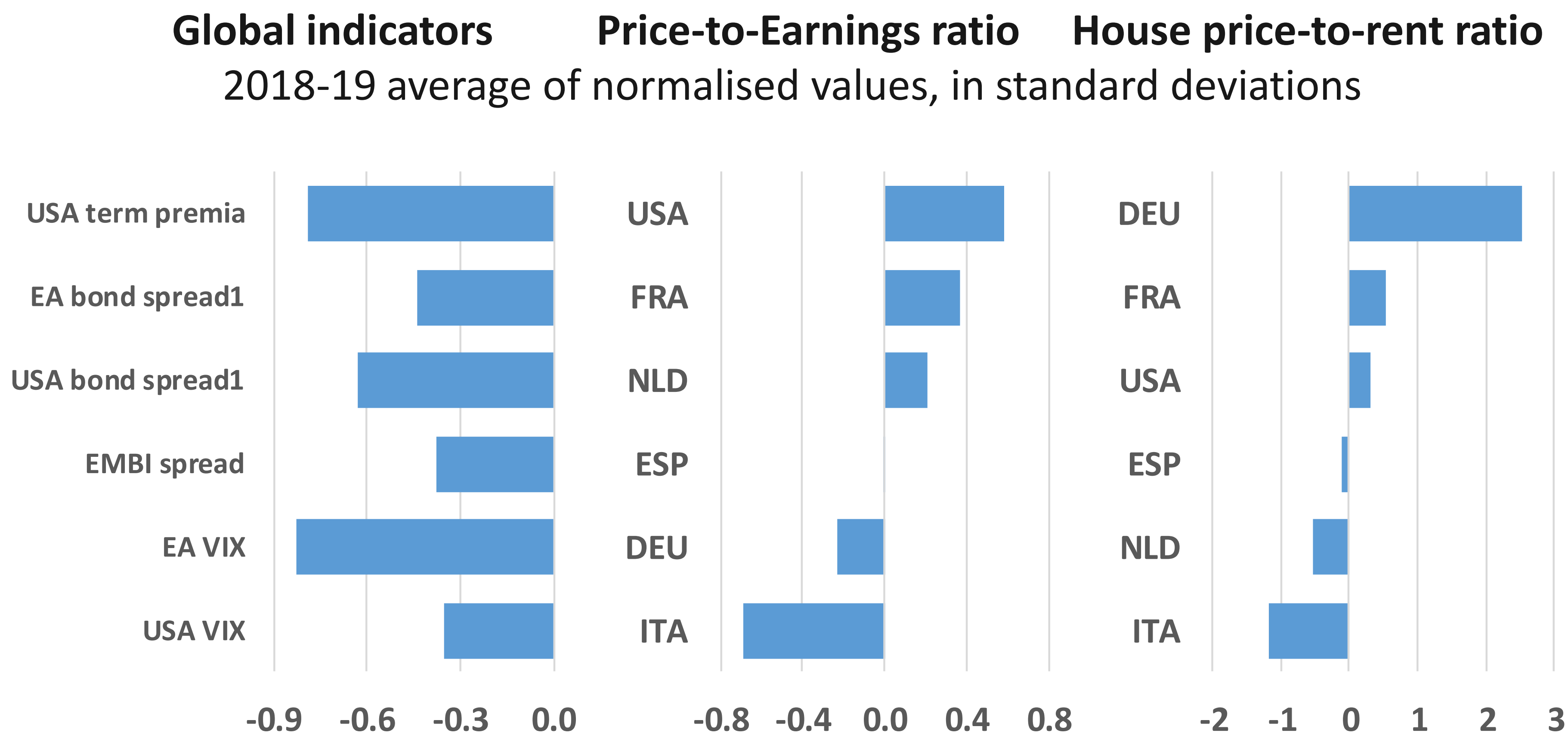
Average contribution of factors to the variance of variables, as a share





Note: Reported results refer to averages across countries. Factors are estimated in a dynamic two-factor model (global and regional) at annual frequency with one lag. All variables are transformed to ensure stationarity: 10-year government bond yields are first differenced. Covers 42 advanced and emerging-market economies.
Source: Maravalle & Rawdanowicz (2018).

Monetary policy transmission : portfolio rebalancing

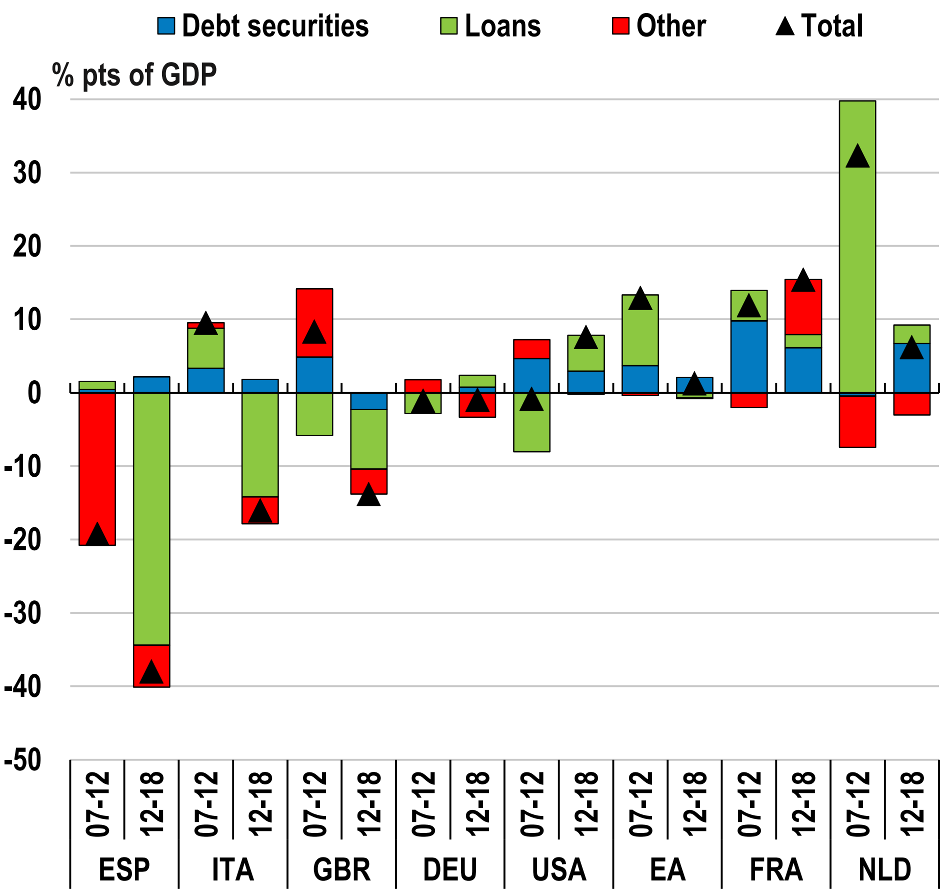


1. Spreads between corporate high-yield bond yields and government bond yields.

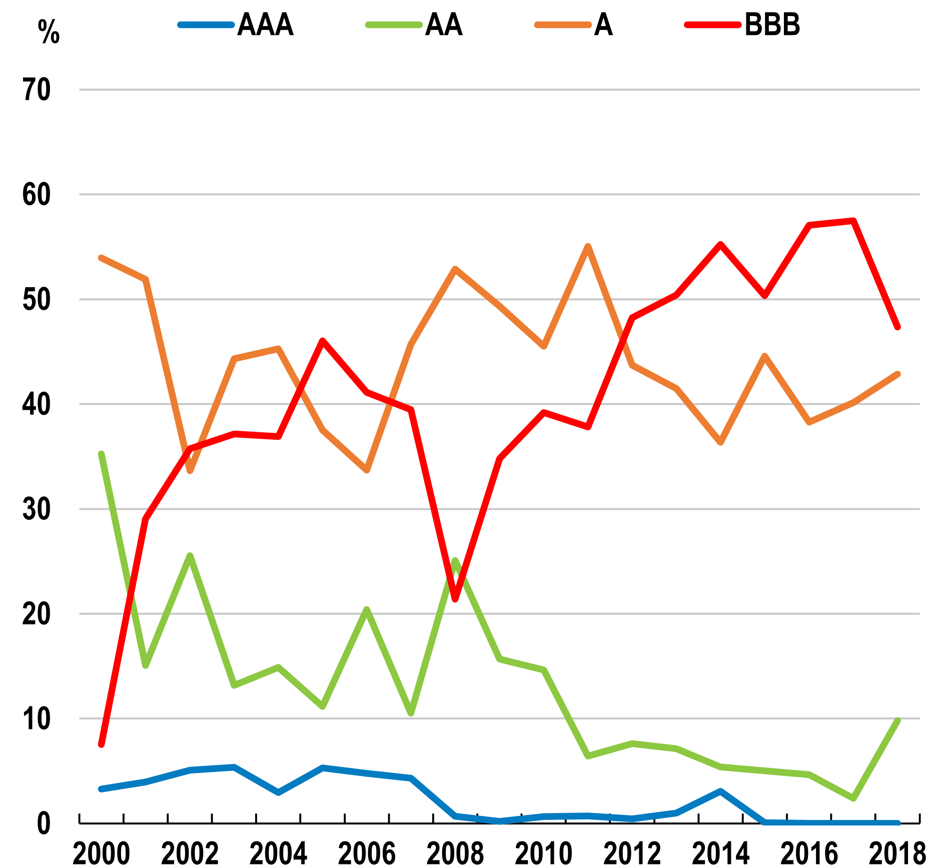
Source: Federal Reserve Bank of St Louis; Refinitiv; OECD House price database; and OECD calculations.

Monetary policy transmission: Credit and risk-taking channel

Change in NFCs' debt between 2007Q4 and 2018Q3

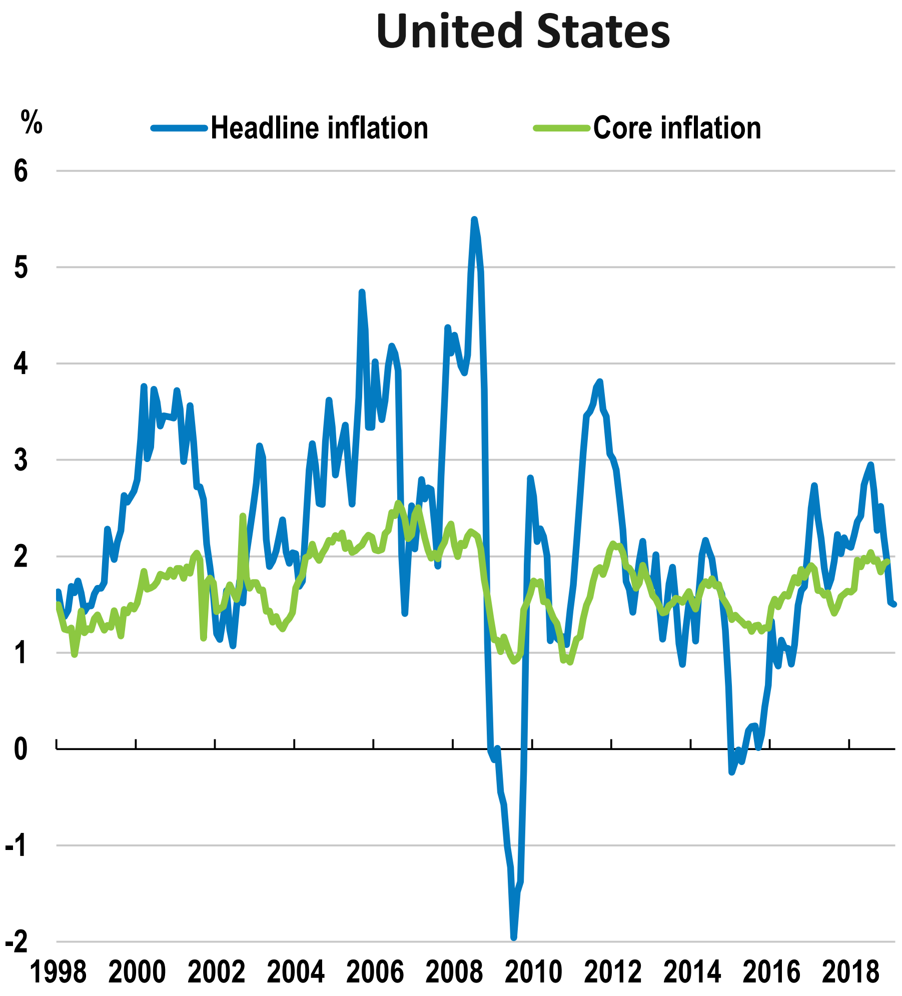


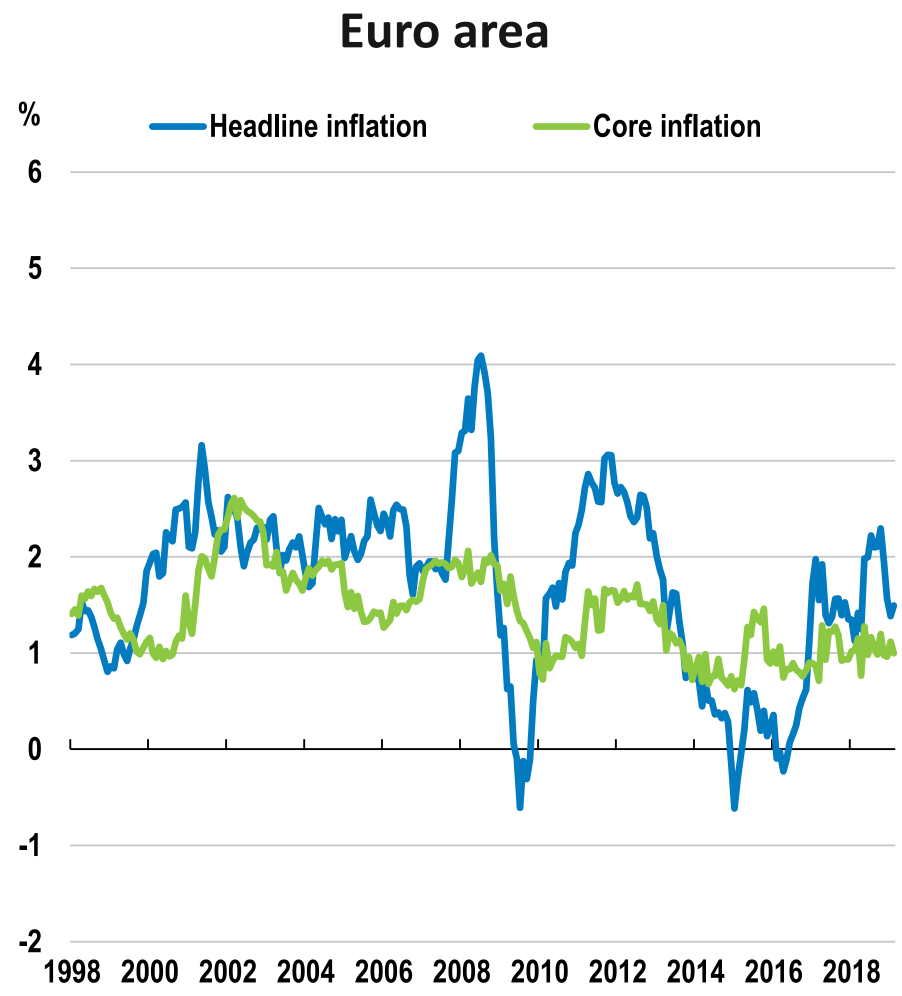
Composition of investment grade corporate bonds



Note: RHS panel: On non-consolidated basis.
Source: OECD National accounts database; Çelik, S., G. Demirtaş and M. Isaksson (2019), "Corporate Bond Markets in a Time of Unconventional Monetary Policy", OECD Capital Market Series ; and OECD calculations.

Inflation struggling to get back to target





Note: Core inflation excludes energy and food products and refers to harmonized data for the euro area.
Source: OECD Main Economic Indicators Database.

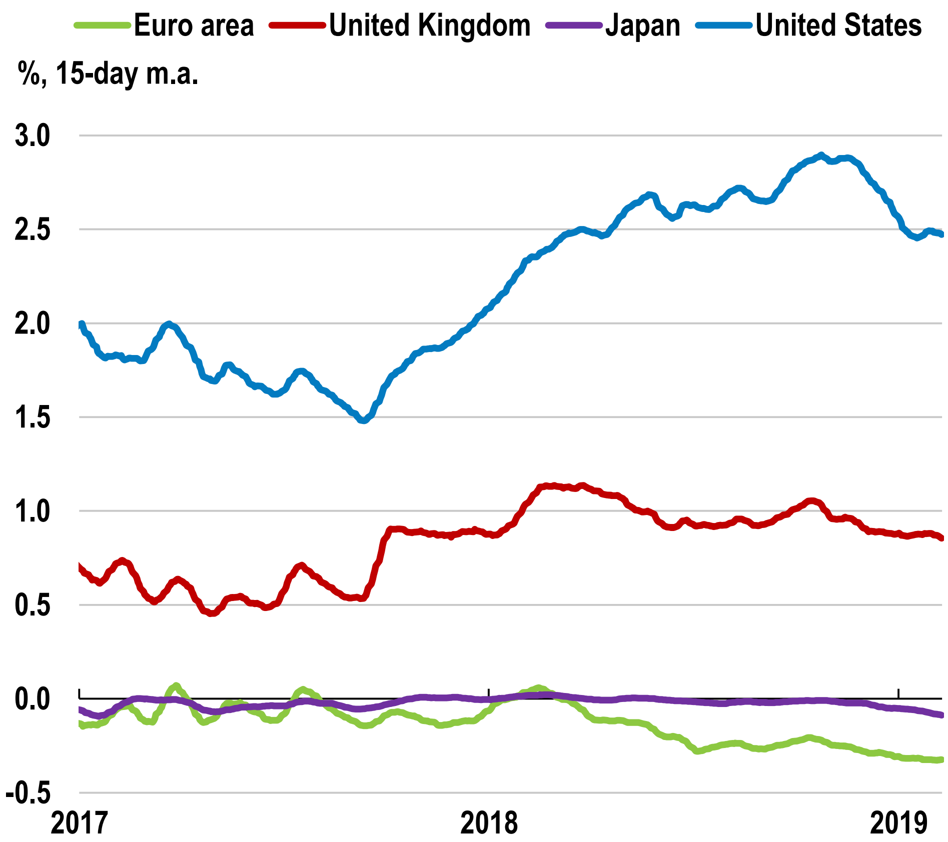
Looking forward

- More monetary stimulus?
  - ✓ Constraints (ZLB, …etc)
- Changing monetary policy framework?
  - ✓ Timing? not ideal
  - ✓ For what? No proven superiority of other framework
- Additional policies?
  - ✓ Fiscal: coordinated action urgently needed
  - ✓ Structural: demographics and productivity weigh on neutral real rates
  - ✓ Macro-prudential

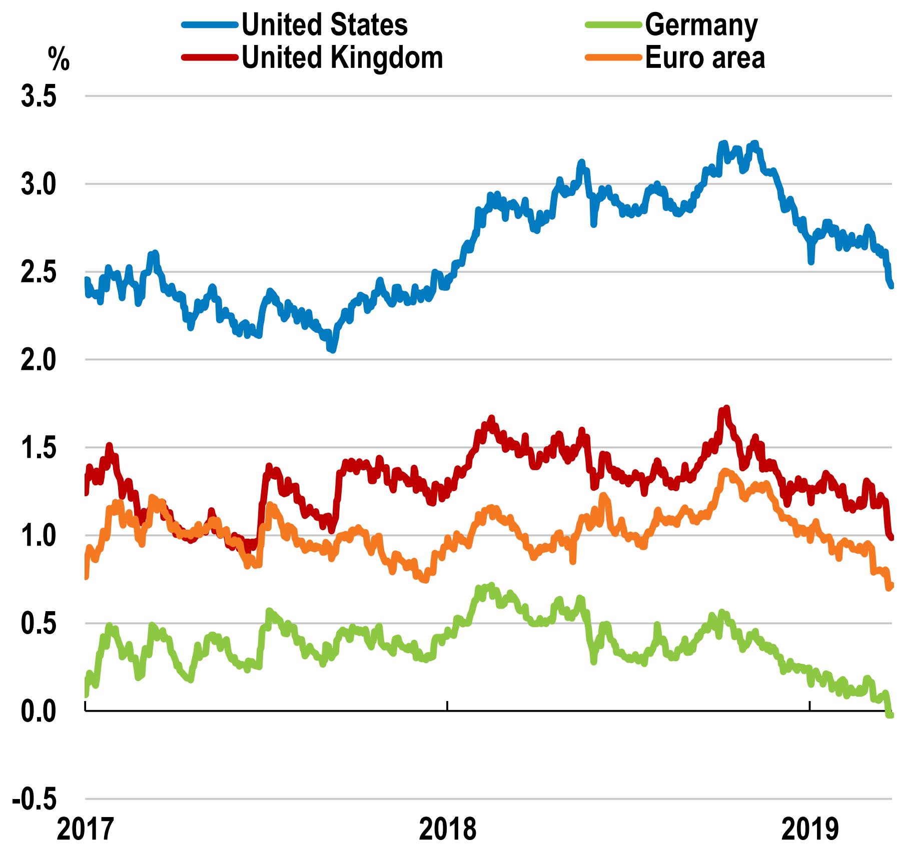
Interest rates are set to stay low for longer

Expected overnight interest rates for end-2019

Market expectations

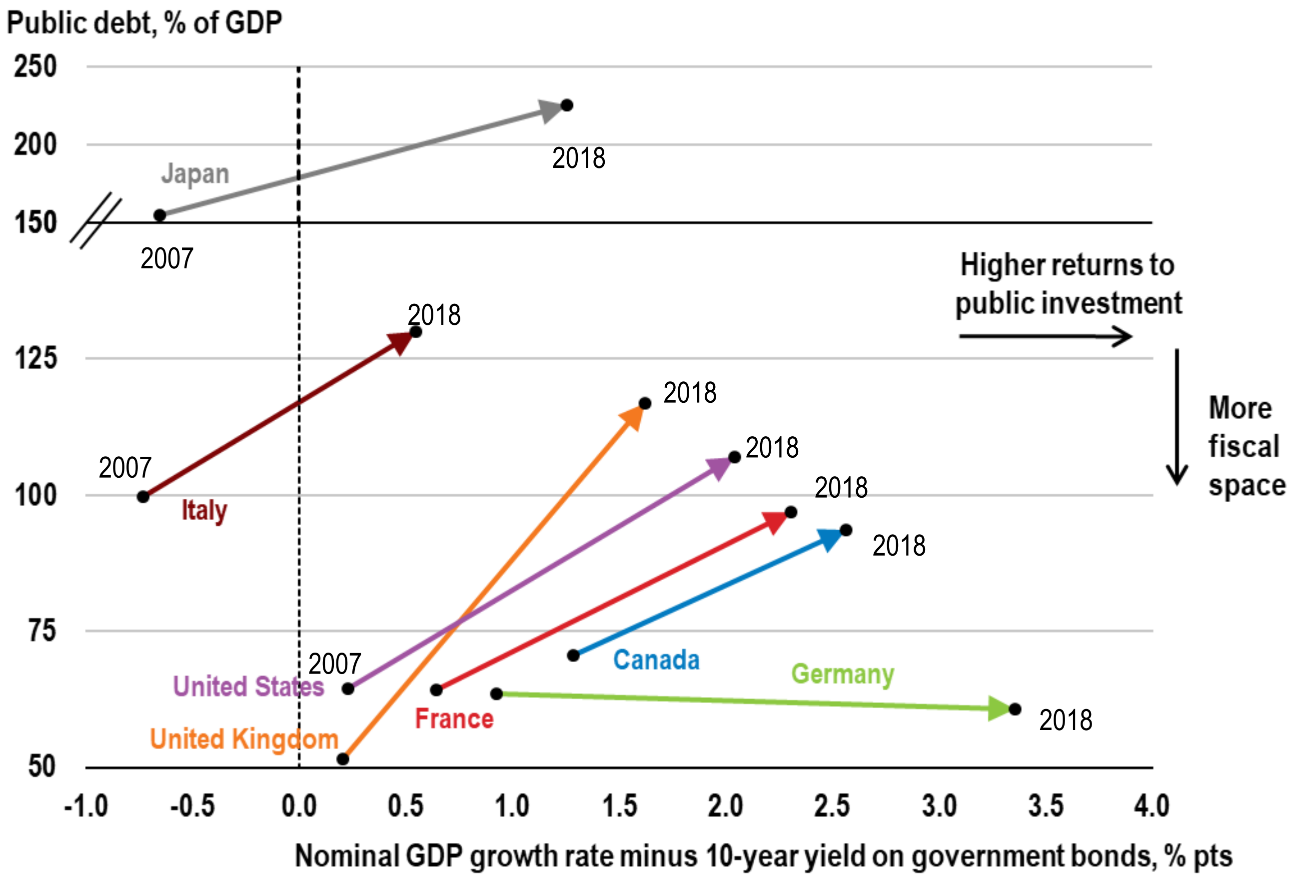


10-year government bond yields



Source: Refinitiv; and OECD calculations.

Fiscal space exists



Strong case for more public investment in some countries

Other countries could benefit but lack fiscal space

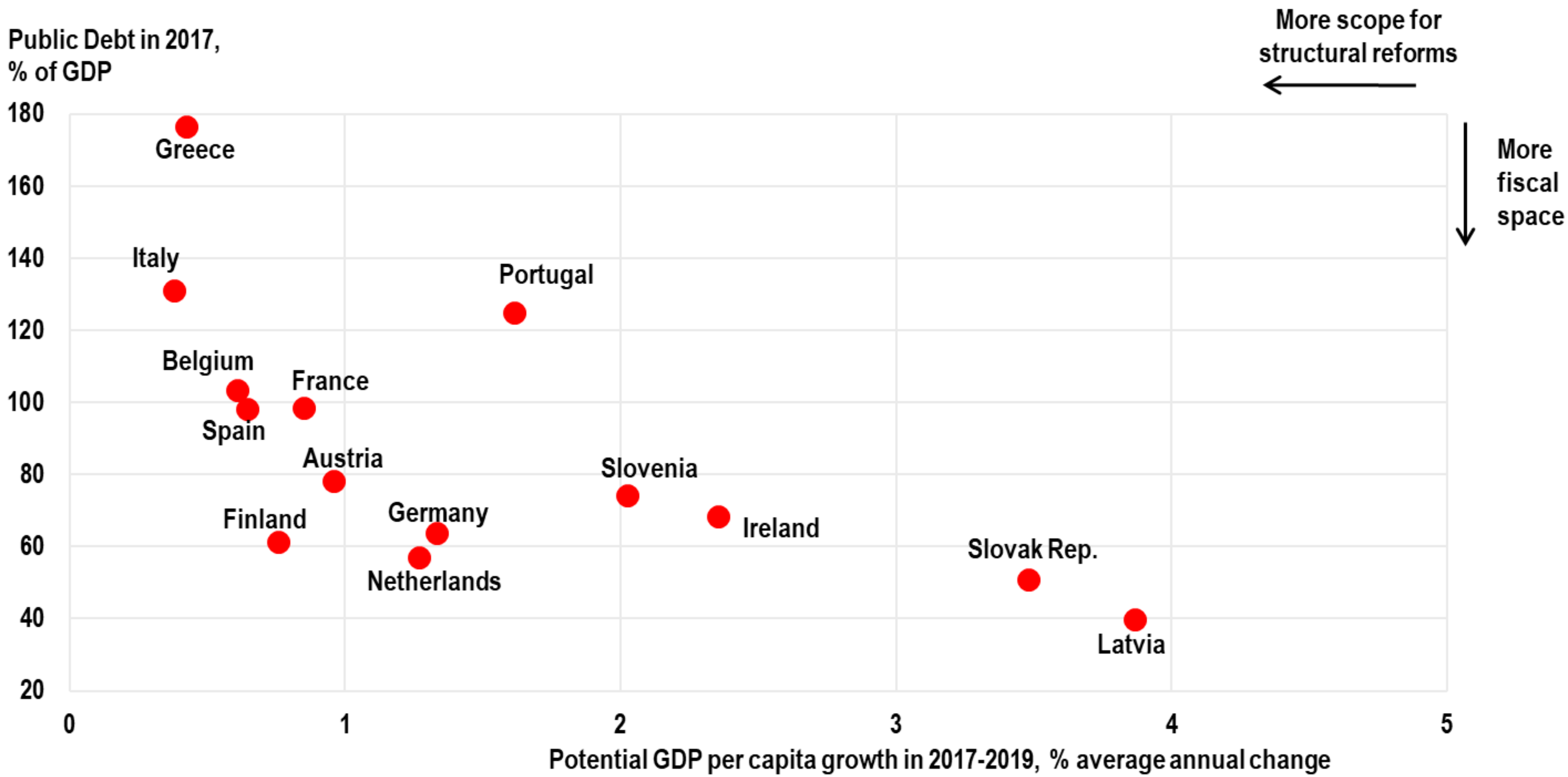
Priorities: rebuild buffers and invest in future growth

Coordinated fiscal action yields larger gains

Note: Public debt based on the national accounts definition except for EU countries where public debt based on Maastricht criteria is shown. Therefore, debt numbers are not fully comparable between EU and non-EU countries.
Source: OECD Economic Outlook database; and OECD calculations.

Trend growth is low in most euro area countries

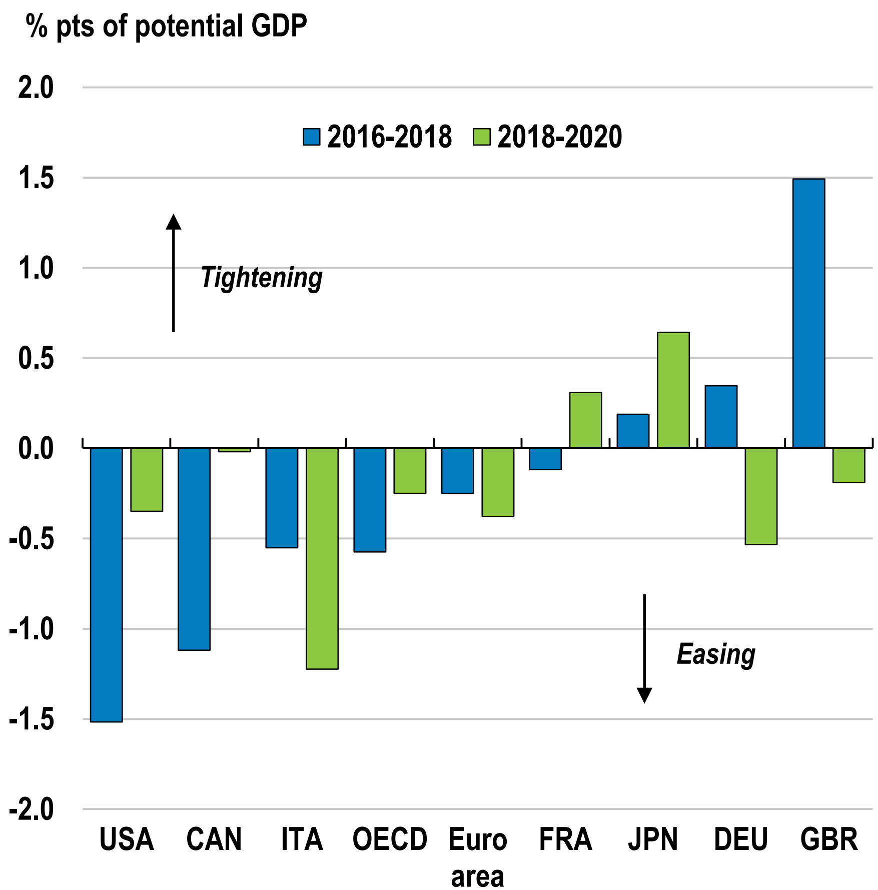
Potential GDP per capita growth and public debt



Note: Public debt is based on Maastricht criteria.
Source: OECD Economic Outlook database; and OECD calculations.

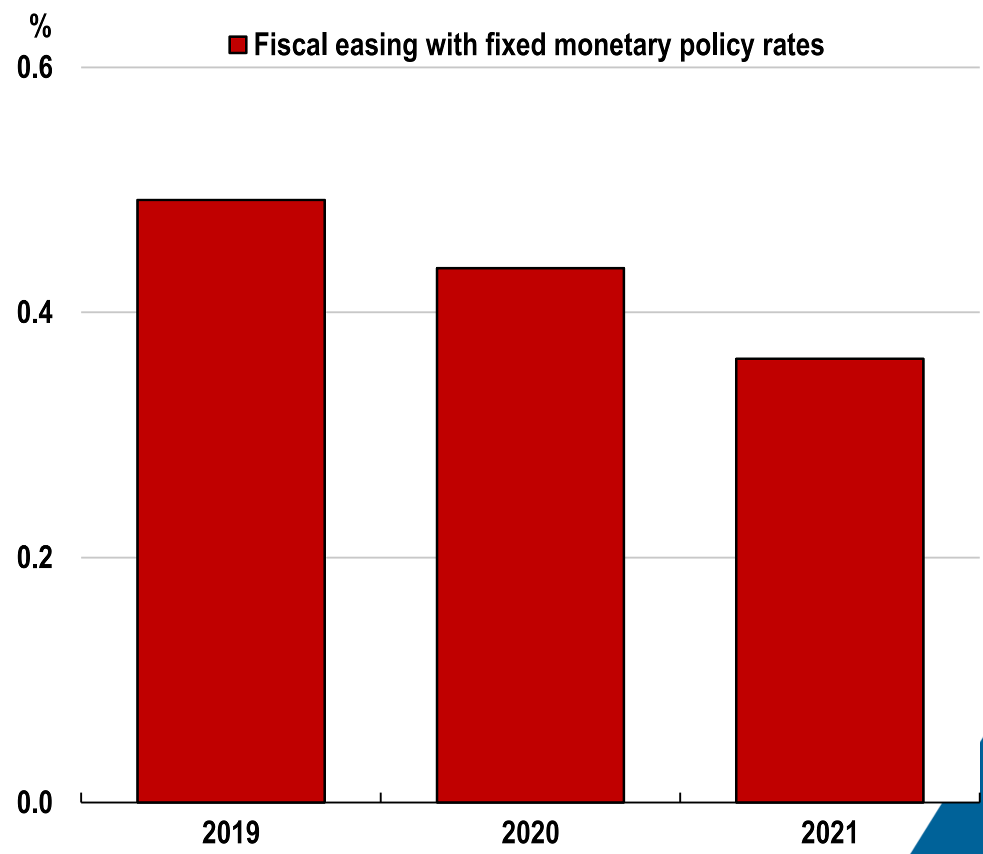
Fiscal stimulus on its way: but uncoordinated and uneven

Change in the fiscal stance



Impact of a coordinated fiscal stimulus

Global GDP, % difference from baseline



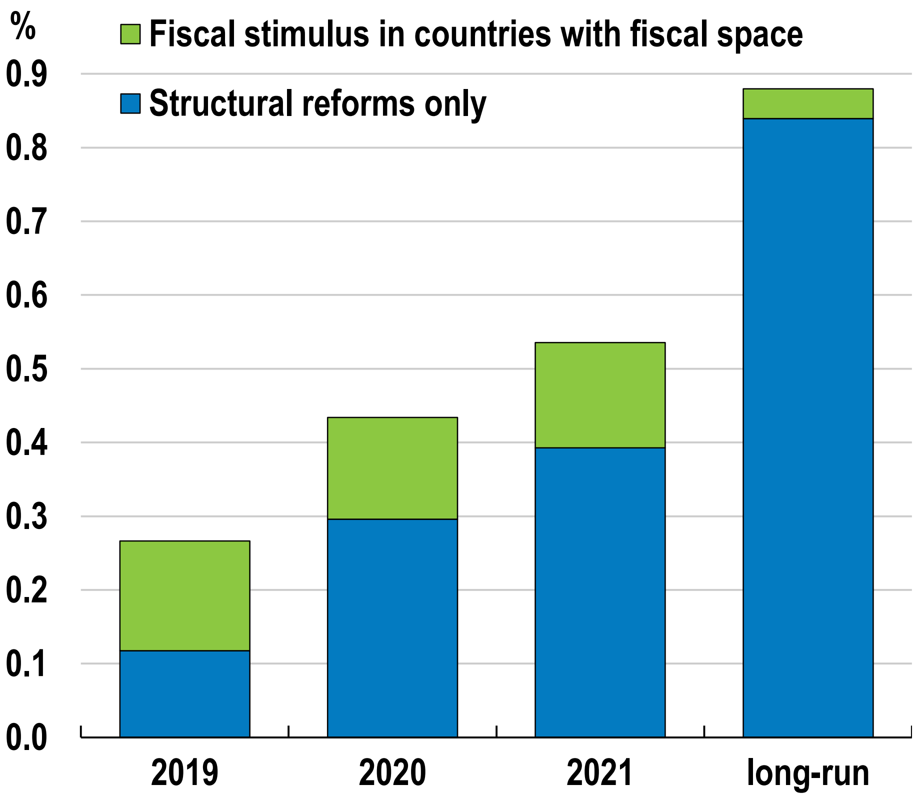
Note: LHS panel: the fiscal stance is defined as the underlying government primary balance. RHS panel: The fiscal scenario is a coordinated global fiscal easing of 0.5% of GDP sustained for three years, with policy interest rates held fixed for three years. Simulations on the NiGEM global macroeconomic model, with model-consistent expectations.
Source: OECD Economic Outlook database; and OECD calculations.

Euro area: coordinate fiscal support and structural reforms to avoid a downturn and spur wages

Impact of structural reforms and a coordinated 3-year fiscal stimulus in countries with fiscal space in the euro area

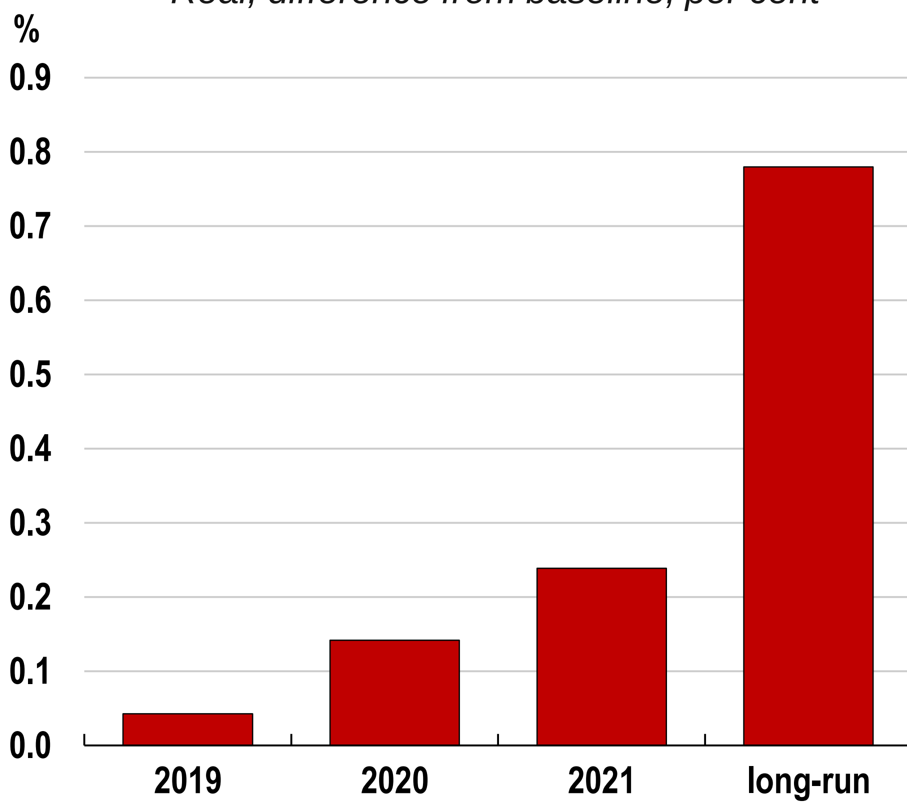
GDP

Real, difference from baseline, per cent



Wages per employee

Real, difference from baseline, per cent



Note: The level of technical progress is gradually raised by 1% by the fifth year in all countries, and countries with fiscal space also increase government investment by 0.5% of GDP for three years. Euro area monetary policy is assumed to be set in a way that takes into account the eventual long-run improvement in output. Countries with fiscal space here include Germany, the Netherlands, Austria, Finland, Ireland, Slovak Republic, Slovenia, Estonia, Latvia, and Lithuania.

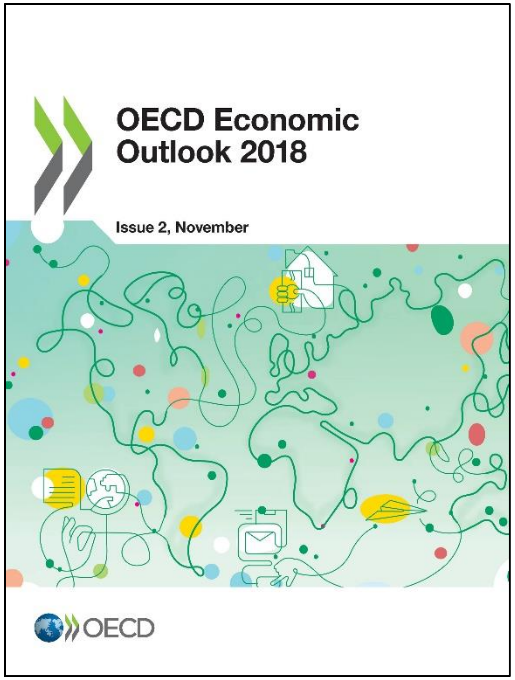
Source: OECD calculations.

Conclusion

- Financial stability issues or monetary policy transmission channels ?
  - ✓ Tinbergen : there are several instruments for several objectives
  - ✓ Macro pru, fiscal and structural policies have not been enough used
- What we should worry about
  - ✓ Faltering growth at the ZLB
  - ✓ Monetary policy has been left alone
- What governments should do
  - ✓ COORDINATE fiscal policies
  - ✓ Raise trend growth with structural reforms
  - ✓ It is urgent: do it now

Sources

[Economic Outlook](#)



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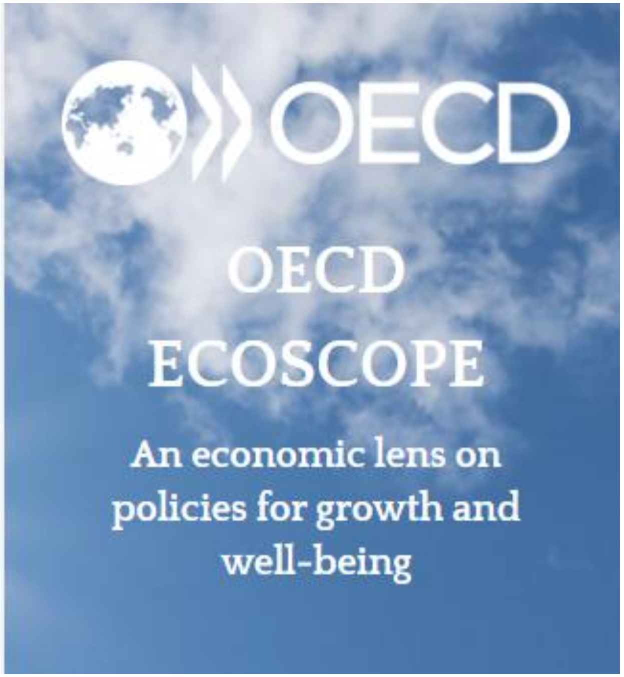
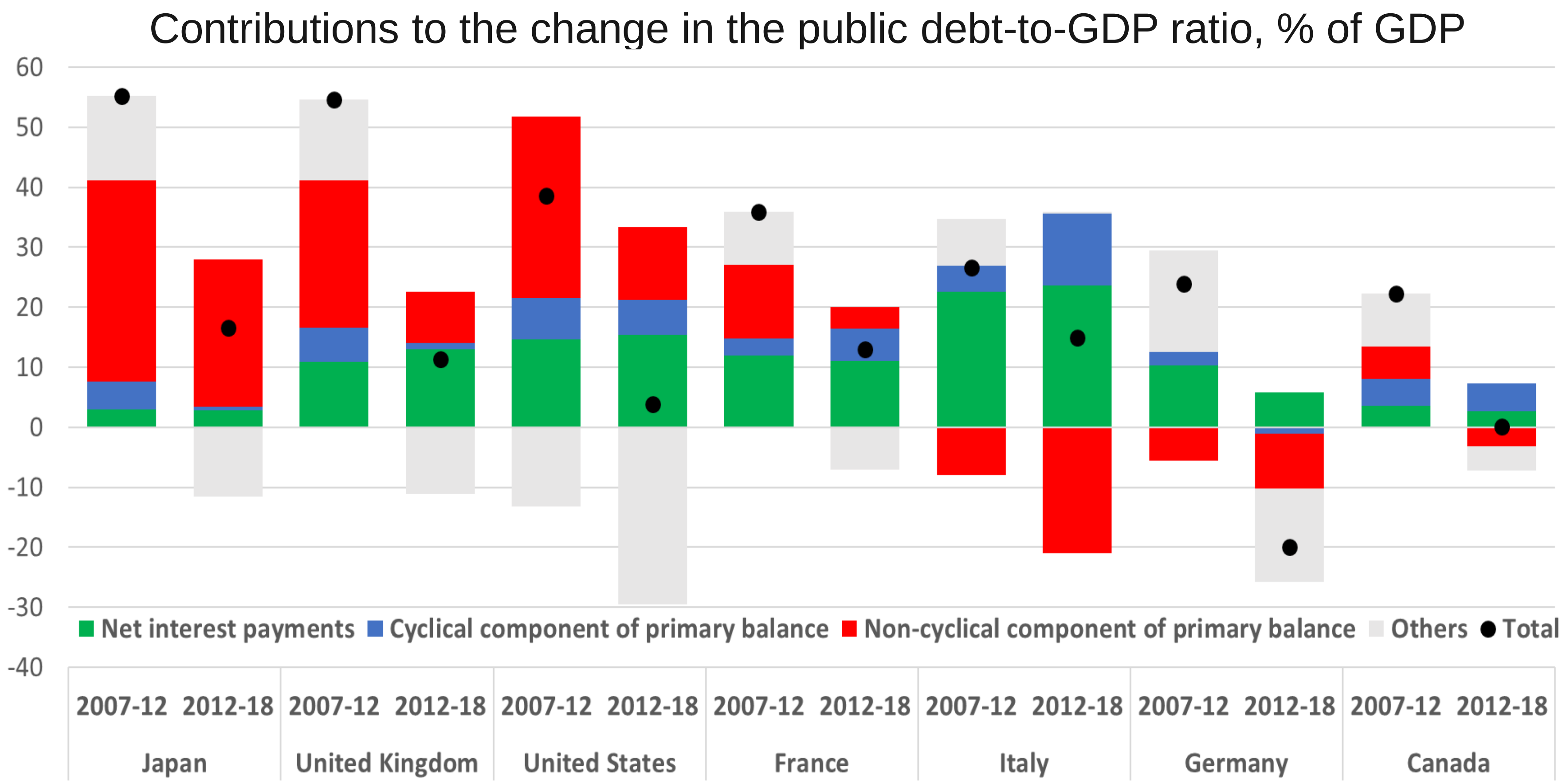


Literature suggests large challenges

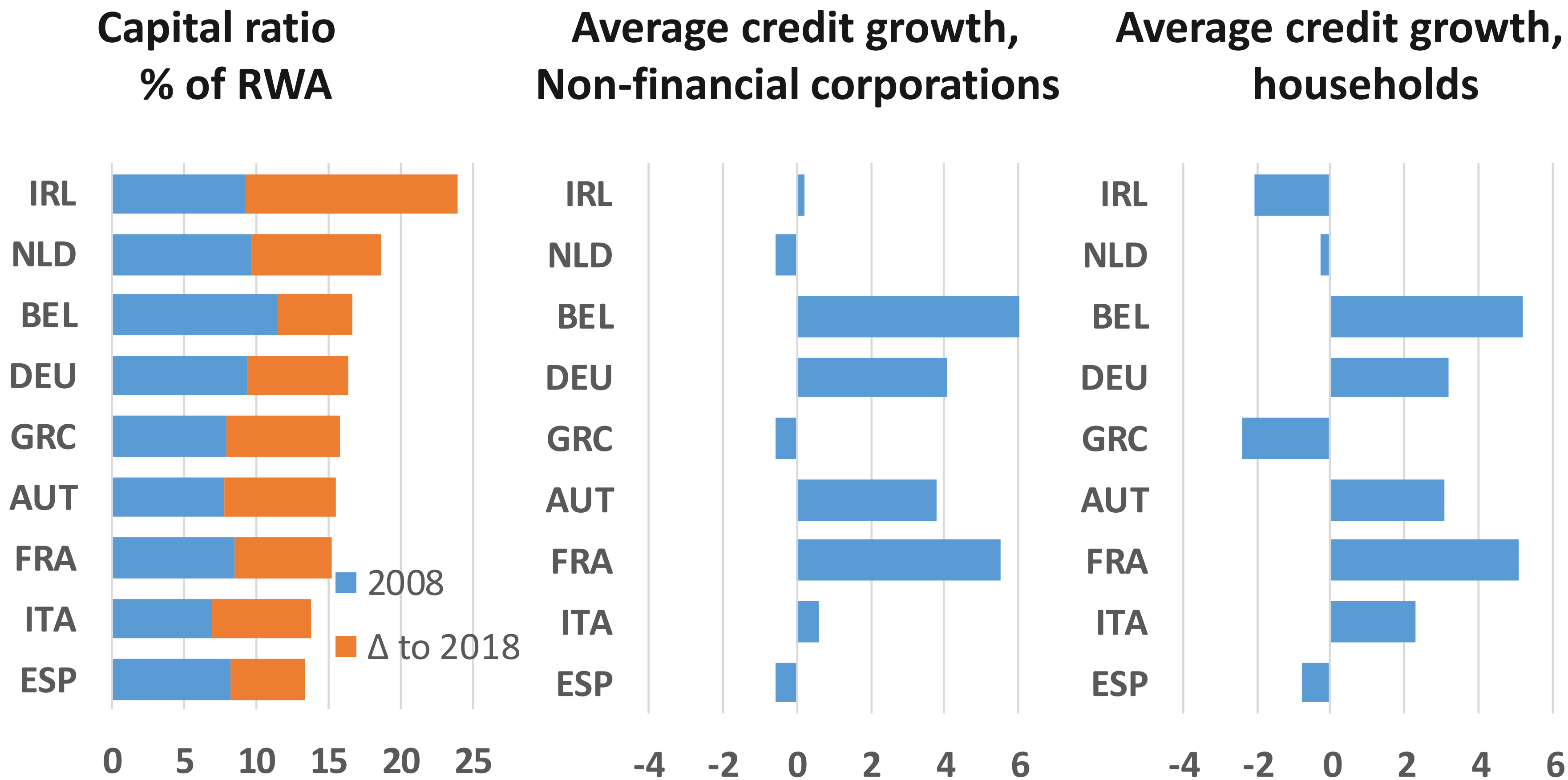
Papers	Originating country	Affected variables
Georgiadis (2015), Fukuda, Kimura, Sudo and Ugai (2013), Kim (2001), Ammer, De Pooter, Erceg and Kamin (2016)	United States	GDP growth
Chen, Filardo, He and Zhu (2012), Bowman, Londono and Sapriza (2015), Takáts and Vela (2014), Glick and Leduc (2015), Rogers, Scotti and Wright (2014), Bluedorn and Bowdler (2010),	United States	Equity prices, bond yields, term premia, exchange rates
Chen, Mancini-Griffoli and Sahay (2014)	United States	Capital flows, asset prices
Gilchrist, Yue and Zakrajsek (2018), Curcuru, Kamin and Rodriguez (2018)	United States	Bond yields
Ter Ellen and Midthjell (2018), Potjagailo (2017), Falagiarda et al. (2015), Georgiadis (2015)	Euro area	Bond yields

Discretionary increase in public debt took place mostly during the crisis



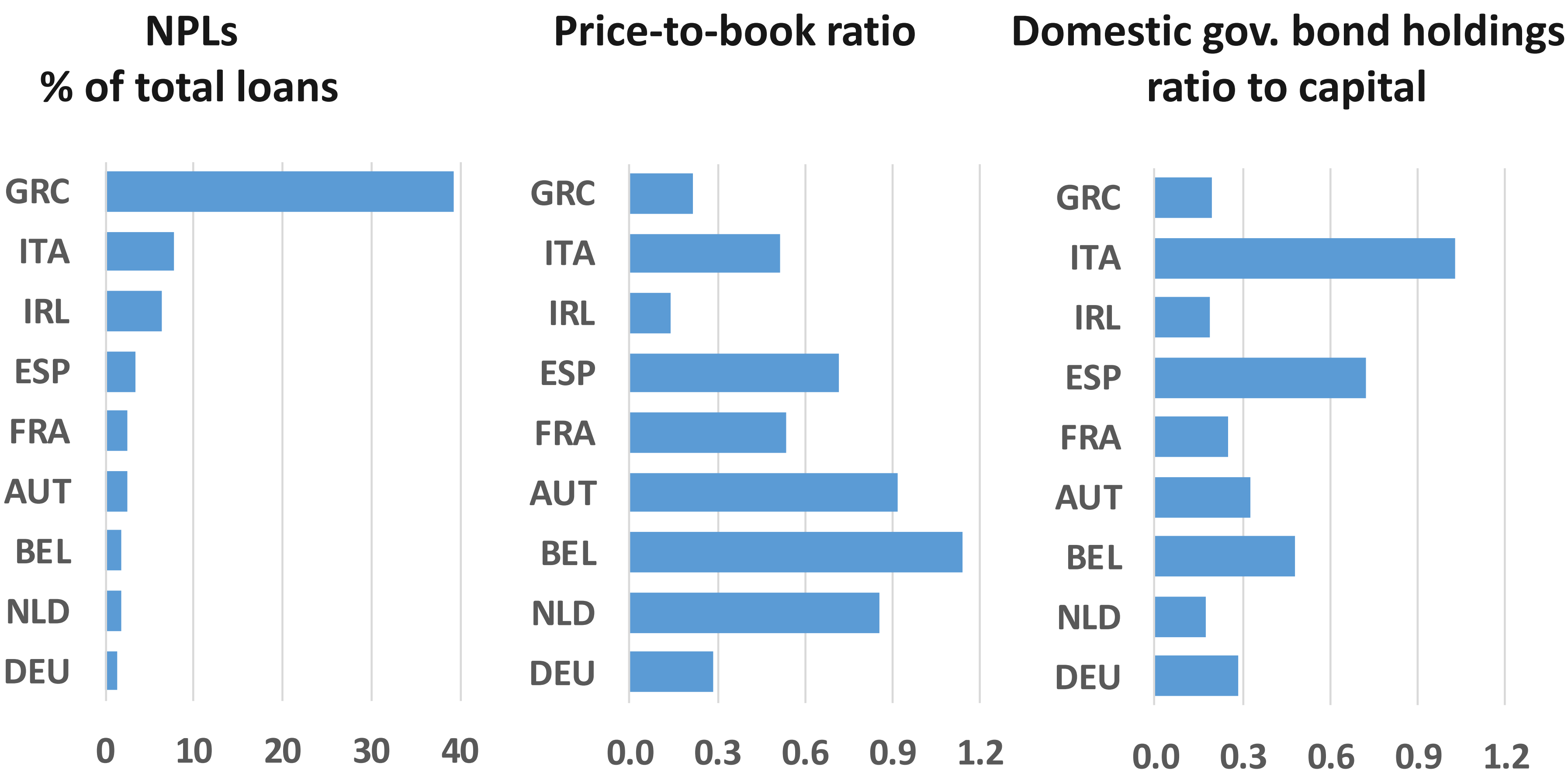
Note: The cyclical component of the primary balance captures the role of automatic stabilisers, while the non-cyclical component of the primary balance captures discretionary measures. The component "Others" comprises the change in debt-to-GDP ratio due to nominal growth (snowball effect), changes in the stock and valuation of government financial assets and one-off measures.
Source: OECD Economic Outlook database; and OECD calculations.

Euro area banks are better capitalised



Note: Average year-on-year credit growth between January 2016 and January 2019.
Source: ECB Statistical Data Warehouse; and OECD calculations.

But several vulnerabilities still persist



Source: ECB Statistical Data Warehouse; and OECD calculations.