Chapter 7: Monetary, Macroprudential and Fiscal Policy

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INTRODUCTION: subject, scope, limitations, approach, structure. (1,5 page)


Section 1 provides a detailed analysis of post Global Financial Crisis (GFC) central banking and fiscal policy in emerging EU member states. The GFC brought a shift from solely microprudential to macroprudential approach to banking regulation, and set new EU standards for fiscal frameworks and institutions. We investigate, whether central banks could successfully incorporate macroprudential goals, and whether fiscal and monetary policies could have been harmonized. One of the main issues of this section is to scrutinize the pro- or counter-cyclicality of these policies in different countries.

This section provides an overview of the following topics:

1.1 Monetary policy

- Monetary policy frameworks in different countries (Eurozone members, inflation targeters, currency board countries, exchange rate managers
- Monetary policy toolkit: declared and implicit policy rates, interest rate corridors, swaps and repos, nonconventional measures
- Monetary stance (real rates and real effective exchange rates): periods of tightening, periods of loosening. Different experience of different countries
- Emerging countries and exchange rate management (fear of floating?)
- Statistical background:
  - https://ec.europa.eu/eurostat/data/database (annual)
  - https://www.bis.org/statistics/oth_ind.htm?m=6%7C382 (monthly)
1.2 Macroprudential policy

- Emergence of macroprudential approach to financial regulation post-crisis, application of macroprudential regulatory tools in EEE even before the adoption of the related EU regulations in early 2010s

- The Capital Requirements Regulation’s and the Capital Requirements Directive’s (CRR/CRD) macroprudential framework in the EU and its implementation in EEE

- The central banks’ role in macroprudential regulation:
  - central banks as designated macroprudential authorities
  - the conflictions of central banks’ macroprudential mandate
  - the EEE’s central banks different role in macroprudential regulation

- Statistical background: ESRB and individual homepages of central banks

1.3 Fiscal policy framework

- Successive economic governance reforms at the EU level: strengthened Stability and Growth Pact
  - increased emphasis on public debt
  - reinforced sanction mechanisms
  - rules more adaptable to economic conditions

- National fiscal frameworks
  - number and coverage of numerical rules
  - design of medium-term budgetary frameworks
  - establishment of independent fiscal institutions

- Fiscal discipline: stylized facts on public finance
  - 3% of GDP SGP deficit criterion is mostly respected but diverging trends in structural balances
Section 2: Effects and aftermaths of the COVID shock (2020-2021) (10-12 pages)

In Section 2 the immediate monetary, macroprudential and fiscal measures will be enumerated and compared. Active role challenging credibility and independence of central banks will be scrutinized. For macroprudential regulation the COVID – crisis can be interpreted as the first test for the recently established regulatory framework. Fiscal stimulus measures were immediate, also underpinned by newly designed EU instruments; however, the evaluation of their short and long term effects is quite contested. All these challenges and debates will be surveyed.

2.1. Monetary policy

- Interest rate policy (policy rate, corridor): decisions of the individual central banks
- Liquidity provision and non-conventional measures
- Yield curve management by the central banks
- Credibility and independence of central banks during the Covid crisis

2.2. Macroprudential policy

- COVID-related macroprudential regulatory steps
- The role of governments and central banks in macroprudential regulation
- Similarities and differences of COVID-related macroprudential measures
- Evaluating the financial stability effects of macroprudential regulation

2.3. Fiscal measures

- Activation of the SGP’s general escape clause in March 2020
– Fiscal response measures to mitigate the immediate health and socio-economic crises. 

Analyzing the most typical components:

  o emergency spending on the immediate healthcare costs
  
  o short-time work schemes and extensions of sick pay and unemployment benefits (financed increasingly by the new European instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE))
  
  o subsidies to firms and public investment
  
  o tax relief by outright cancelling certain taxes and social security contributions

– Estimation of the total size of the support packages and the deficit / GDP paths: comparison of EU, Eurozone end emerging EU members

**SECTION 3: LONG TERM PROSPECTS, CONCLUSIONS AND RECOMMENDATIONS (10 PAGES)**

**Main issues to be discussed:**

– Fiscal and/or monetary policy: together or separately

– Macroprudential monetary policy: equal goals or financial stability is subordinated

– Monetary financing in the future

– Changing monetary policy frameworks and measures

– Independence of Central Banks

– Debt sustainability after loose rules – how to manage the return to a rules-based fiscal framework in the post-COVID era

– Fiscal policy – how the extra fiscal space provided by the Recovery and Resilience Facility was utilized, also to deal with the effects on recession, effects on income/wealth divergence. Rather economic or rather social

– Fiscal and monetary policy: potential role in avoiding the middle income trap

– How the doom-loop is affected by the COVID policy?
– Alternative theories (if they play any role in the region): Modern monetary policy, Non-inflation targeting etc.

Potential overlaps with other chapters (some coordination may be needed during the writing and after the first draft):

– Chapter 1 (Convergence)
– Chapter 2 (Globalization)

and as far as fiscal policy in general is concerned with all the other chapters – however, e.g., role of fiscal policy in infrastructure, education, health care etc., should be discussed in the relevant chapters, while in this chapter the fiscal framework and its interrelationship with monetary policy would be discussed