



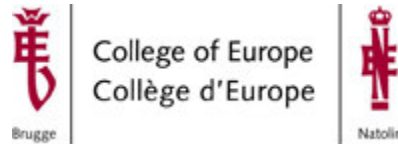
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**”The monetary policy of the European  
Central Bank is too conservative.”  
Discussion.**

Mico, Apostolov  
College of Europe

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**COLLEGE OF EUROPE**  
**COLLEGE D'EUROPE**

**European Economic Integration**

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**“The monetary policy of the European Central Bank is too conservative.”**

**Discussion.**

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*Work of:*

**APOSTOLOV MICO**

*words 871*

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## 1. INTRODUCTION

1999 - *European Central Bank (ECB)* started enforcing the single monetary policy for the euro area. The *Treaty of Maastricht* constituted the **European Union** and monetary system of the European Union - **Eurosystem** with:

**“The primary objective of the ECB’s monetary policy is to maintain *price stability*. The ECB aims at inflation rates of below, but close to, 2% over the medium term.”**<sup>1</sup>

>>> **THE BUNDESBANK REACTION TO POLICY CONFLICTS**

The *symmetric conflict concept* used by **Frey, B. S. and Schneider F.**<sup>2</sup> is questioned - what happens if conflicts only occur in cases where the *Bundesbank* planes a contractionary course and the government - expansion? - “the results **do not stem** from the fact that the definition of policy conflicts is a symmetric one”<sup>3</sup>.

There are more or less similar conclusions for conflicts on “*too conservative*” *monetary policy* as well as falling fiscal surpluses. “The German Central Bank might have been the world’s *most conservative* monetary authority, **but it did not act in a political vacuum**” (1998)<sup>4</sup>. - (political context) evolution prediction for ECB ?

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<sup>1</sup> Available at: <http://www.ecb.int/mopo/html/index.en.html>

<sup>2</sup> **Frey, B. S. and Schneider F.** (1981), ["Central Bank Behavior: A Positive Empirical Analysis", *Journal of Monetary Economics*, 7, 3: 291–316]

<sup>3</sup> **BERGER Helge** (CES, University of Munich) & **SCHNEIDER Friedrich** (Johannes Kepler University, Linz)

“The Bundesbank’s Reaction To Policy Conflicts” ,\_Freie Universität Berlin , 1998, p.1-12  
Available at: [http://www.wiwiss.fu-berlin.de/berger/publications/Bundesbank\\_reaction.pdf](http://www.wiwiss.fu-berlin.de/berger/publications/Bundesbank_reaction.pdf)

<sup>4</sup> **BERGER Helge** (CES, University of Munich) & **SCHNEIDER Friedrich** (Johannes Kepler University, Linz)

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## 2. EXPERTS CONCERNED ABOUT THE USED MONETARY POLICY OF THE ECB

The implication on welfare while targeting the inflation, wants the policy makers to "learn" the laws of motion of the inflation ("sticking" the economy on domestic price -> shocks influencing productivity, exports and foreign price). "We find that a **switch** from an "asymmetric" inflation targeting strategy to a "symmetric" makes little difference in welfare payoffs, but it comes at a cost of much higher interest-rate variability." <sup>5</sup>

Svensson, Lars E.O.<sup>6</sup> claim that ECB has modified its asymmetric strategy to an inflation target - "below but close to 2%", but this "move in the right direction" is "not good enough". De Grauwe, argues that ECB has missed an opportunity "to thoroughly modernize its strategy, remove the ambiguity, and explicitly and transparently adopt flexible inflation targeting". <sup>7</sup>

"The ECB *held* its benchmark interest rate at 2.00 percent on Thursday, but *analysts expect it to adopt a more hawkish tone due to high oil prices and rising overall inflation*." <sup>8</sup>

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<sup>5</sup> G.C.Lim & Paul D. McNelis

"Learning and the Monetary Policy Strategy of the European Central Bank", *Georgetown University in Washington DC*, February 3, 2004 , p.1

"We also find that there are practically **no welfare gains** from switching from an inflation-targeting strategy based on the Harmonized Index of Consumer Prices (HICP) to a strategy based on the domestic price component of the HICP"

Available at: [http://www.georgetown.edu/faculty/mcnelisp/JIFM\\_Euro\\_Feb3.pdf](http://www.georgetown.edu/faculty/mcnelisp/JIFM_Euro_Feb3.pdf)

<sup>6</sup> SVENSSON, Lars E.O.

"*In the Right Direction But Not Enough: The Modification of the Monetary Policy Strategy of the ECB*", Princeton University ,2003

Available at: [www.princeton.edu](http://www.princeton.edu) ; <http://www.princeton.edu/~svensson/> )

<sup>7</sup> G.C.Lim & Paul D. McNelis

"Learning and the Monetary Policy Strategy of the European Central Bank", *Georgetown University in Washington DC*, February 3, 2004 , p.2

Available at: [http://www.georgetown.edu/faculty/mcnelisp/JIFM\\_Euro\\_Feb3.pdf](http://www.georgetown.edu/faculty/mcnelisp/JIFM_Euro_Feb3.pdf)

<sup>8</sup> CNN , Thursday, October 6, 2005; Posted: 8:01 a.m. EDT (12:01 GMT)

Available at: [www.cnn.com](http://www.cnn.com) ; <http://edition.cnn.com/2005/BUSINESS/10/06/ecb.rates.reut/>

### 3. PRESIDENT OF THE ECB CLEARES UP THE COURT

>>” TRICHET, Jean-Claude:

- Our transparent definition ..., you help all decision makers if you are clear what your anchor is. I would call that an **“effective deterrent”**..., our posture of *credible vigilance* has permitted us in the past to regain and preserve control of *inflationary expectations* without having to move. The paradox is that we did not need to move because everybody knew that we could have moved anytime.<sup>9</sup>

### 4. ECB - The medium-term orientation

On medium term **some flexibility with regard to the exact time frame** depends on the specific nature and size of the shocks affecting the economy:

- ***prompt reaction*** (e.g. demand shocks, that move output and prices in the same direction)  
 - ***gradual response*** (e.g. of a cost-push nature, like oil price hikes) that move output and prices in opposite directions - an *aggressive* policy in short time risk “*a significant cost in terms of output and employment volatility which, over a longer horizon, could also affect price developments.*”<sup>10</sup>

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<sup>9</sup> “With its clear monetary strategy dimension and quantitative definition of “price stability” the ECB differs from the US approach of “policy activism”. What justifies this difference approach?”

TRICHET, Jean-Claude - Interview at :

- Marc Coleman (*Irish Times*), Jean-Pierre Robin (*Le Figaro*) Silvia Román (*El Mundo*) and Patrick Welter (*Frankfurter Allgemeine Zeitung*), 21 September 2005

Available at: <http://www.ecb.int/press/key/date/2005/html/sp050921.en.html>

<sup>10</sup> THE MONETARY POLICY OF THE ECB 2004 - *European Central Bank, 2004*

Available at: <http://www.ecb.int/mopo/html/index.en.html>

## 5. CONCLUSION

*It is obvious that one central bank should fallow the specific conditions for the economy which it “dirige”. So, the ECB cannot be characterized as “too”, because it has to cope with rather unfamiliar phenomenon that has not been seen nor explored before (theory of Optimum Currency Areas). Therefore, it must be said that the ECB has” different preferences leading to react differently to broadly similar economic shocks”<sup>11</sup> .*

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<sup>11</sup>De GRAUWE, Paul :

“ The Economics of Monetary Union”, Oxford Press ,(2005), p.176

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- Marc Coleman (*Irish Times*), Jean-Pierre Robin (*Le Figaro*) Silvia Román (*El Mundo*) and Patrick Welter (*Frankfurter Allgemeine Zeitung*), 21 September 2005

INTERNET

>> **European Central Bank** - <http://www.ecb.int>

>> **CNN** - [www.cnn.com](http://www.cnn.com)

>> **Freie Universität Berlin** - <http://www.wiwiss.fu-berlin.de>

>> **Georgetown University in Washington, DC** - <http://www.georgetown.edu>

>> **Princeton University** - [www.princeton.edu](http://www.princeton.edu)