

Central Bank of Malta-QMUL Conference

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***The Euro: Voices from the Commonwealth***

**Monetary-Fiscal Interactions:  
A view from the UK**

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National Institute of Economic and Social Research

## Adjustment using Monetary and Fiscal policy

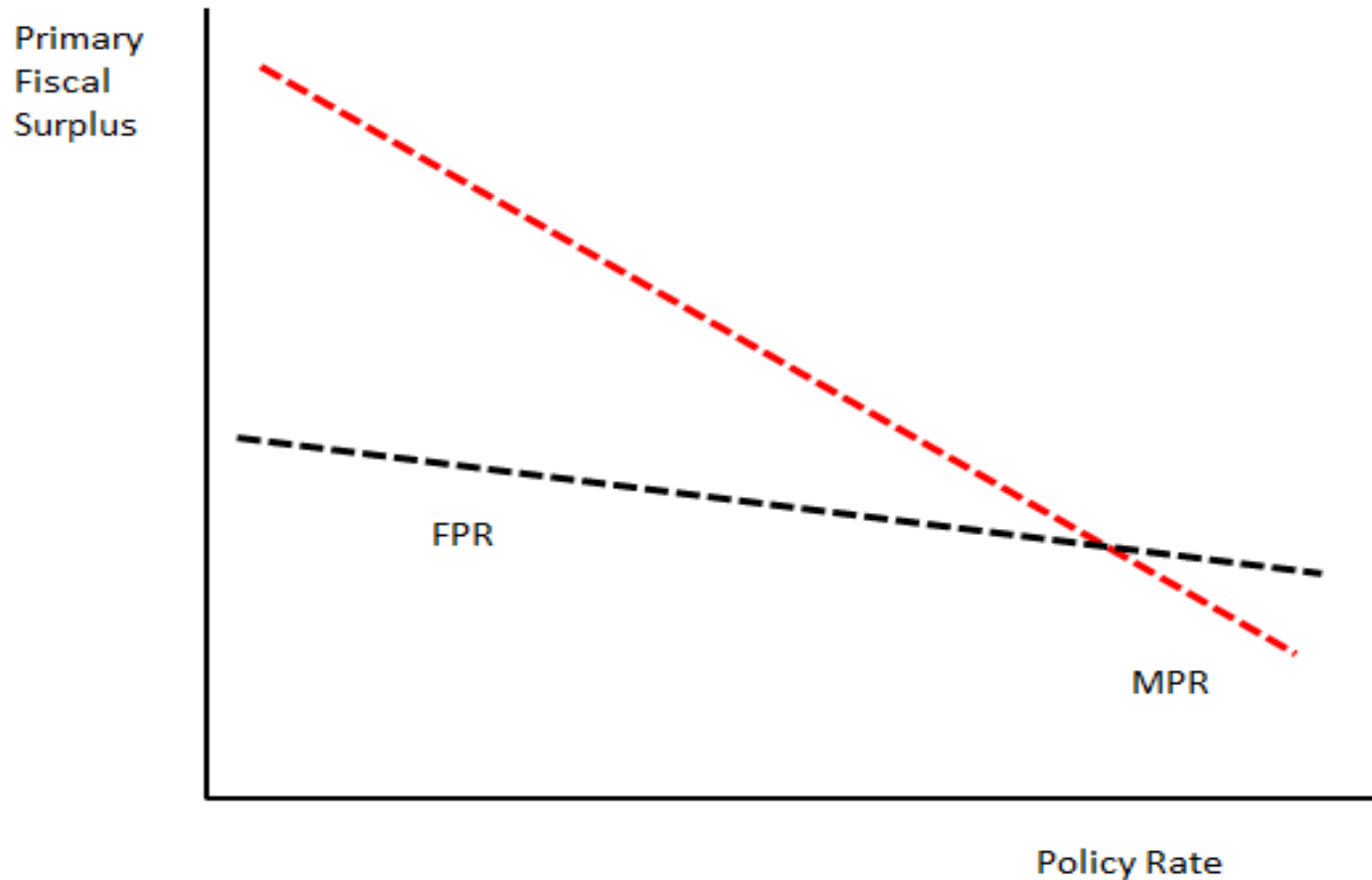
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- Asymmetric shocks within any monetary union imply use of fiscal policy: taxes, spending (or QE!)
- Problem of non-cooperative equilibrium for monetary and fiscal policy amplified in large currency zone
- Unstable monetary-fiscal outcomes more likely, particularly if debt prices reflect union-wide rather than national risk
- Monetary and fiscal policy in the UK was (arguably) more responsive to the crisis – both in terms of magnitude and timing
- Existential crisis in the Euro Area was only prevented by QE

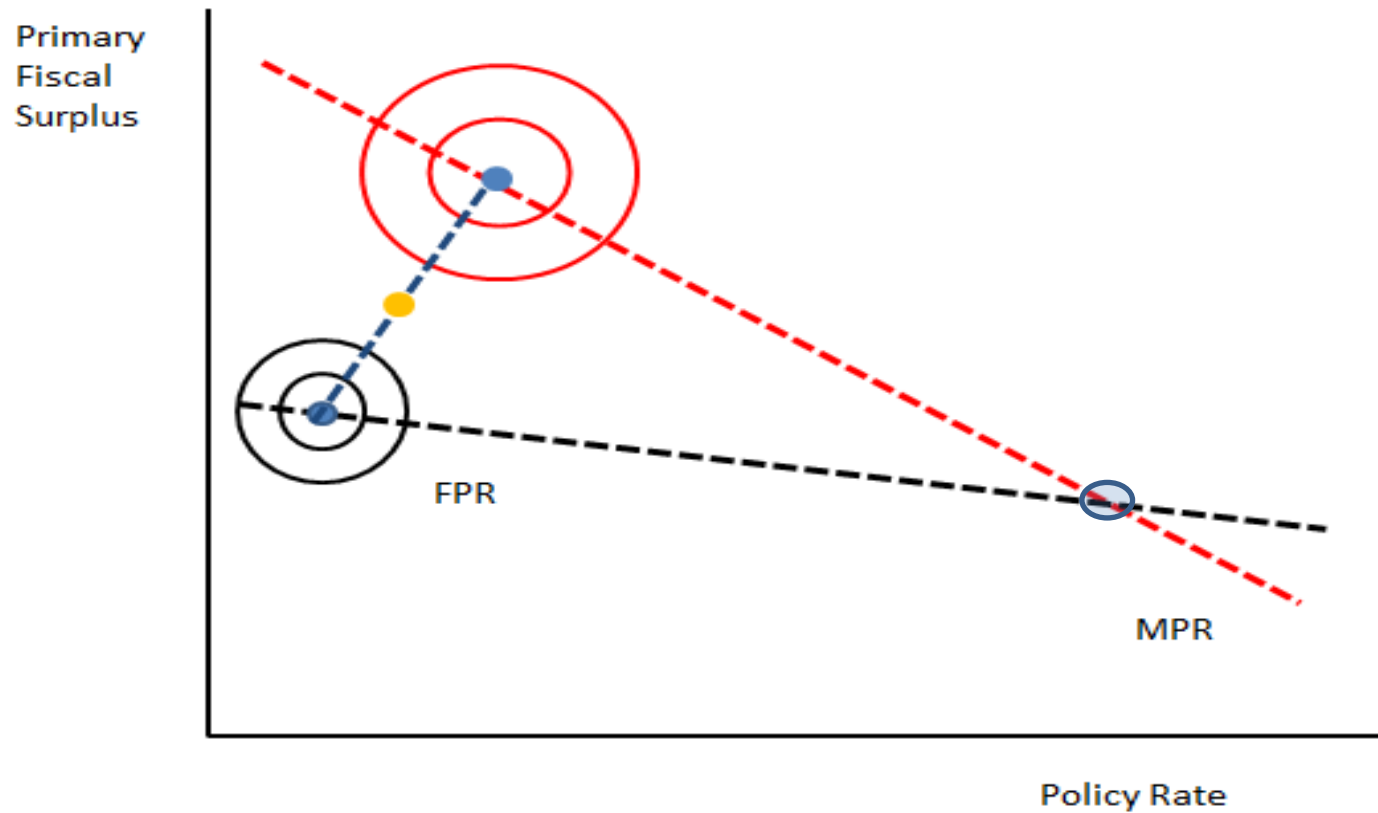


# Monetary and Fiscal Policy Reaction Functions

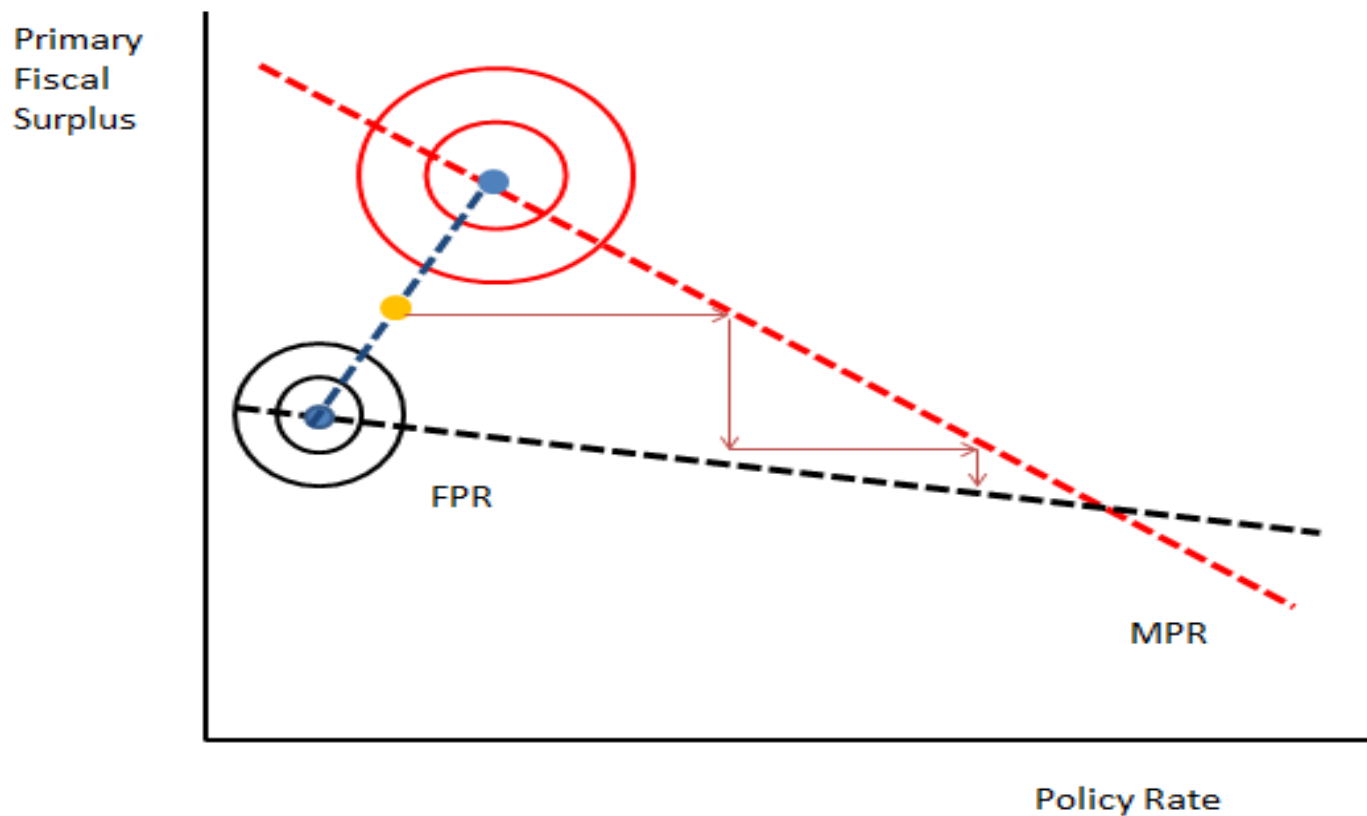
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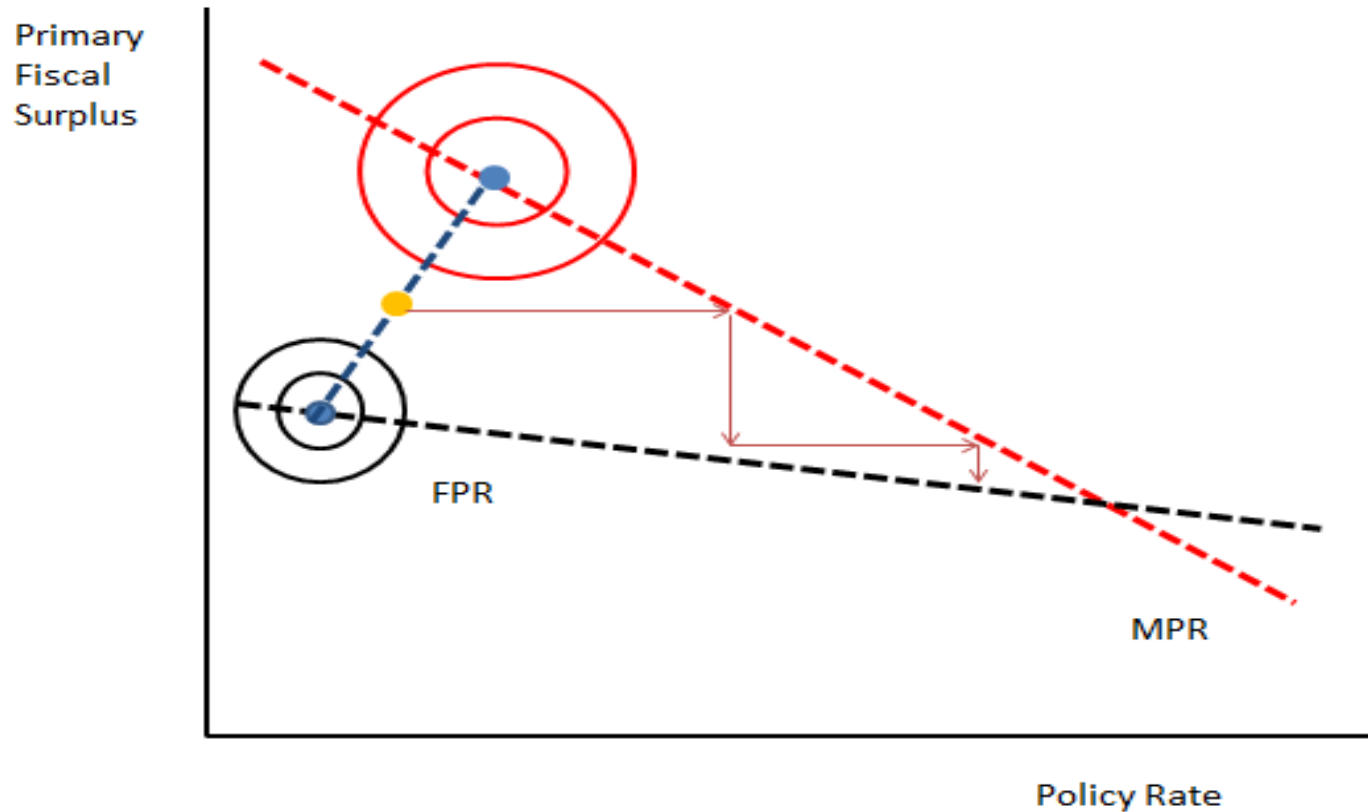
## Contract Curves beat Mr. Nash



## But Instability draws us to Nash



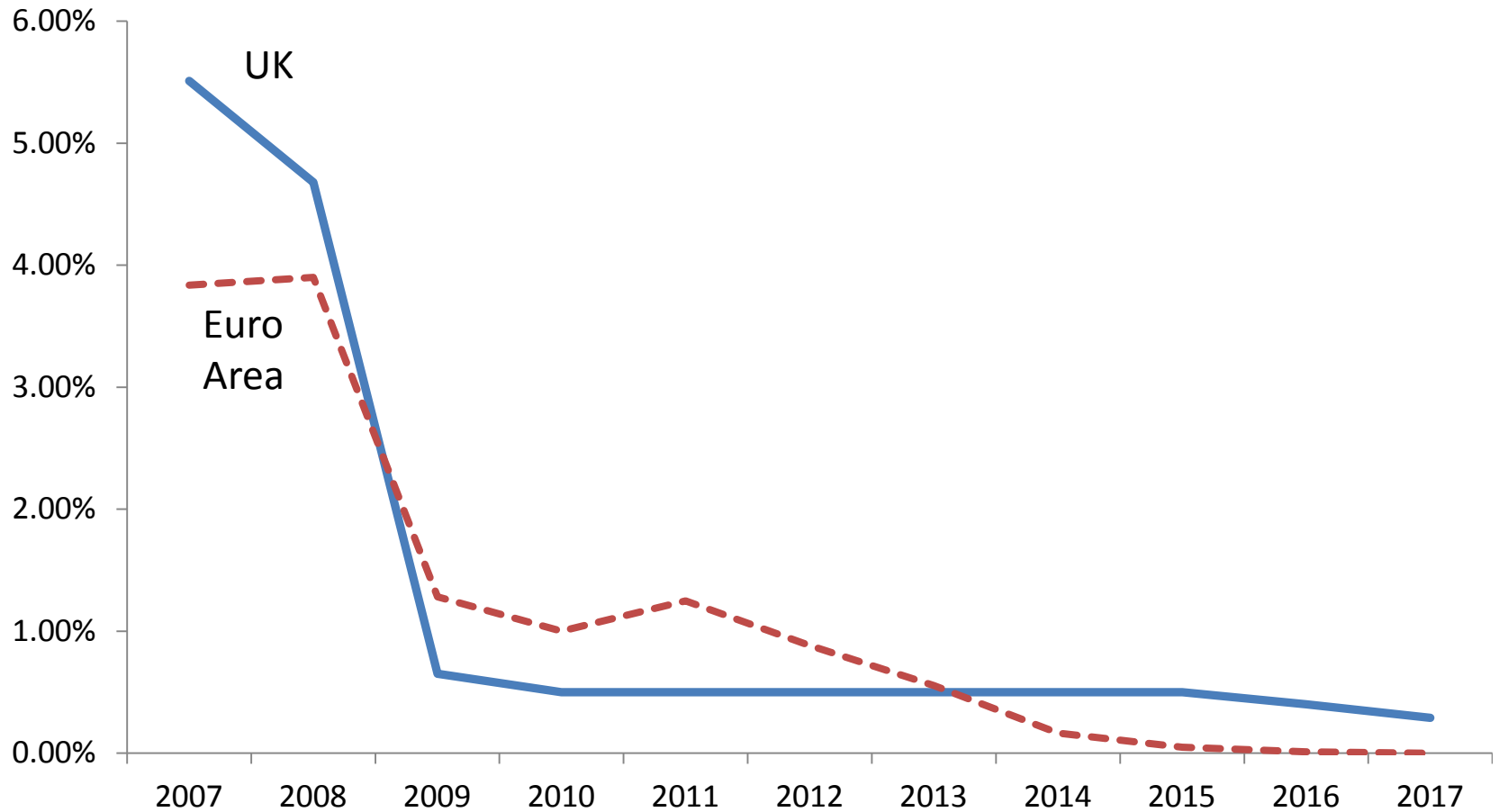
## But Instability draws us to Nash



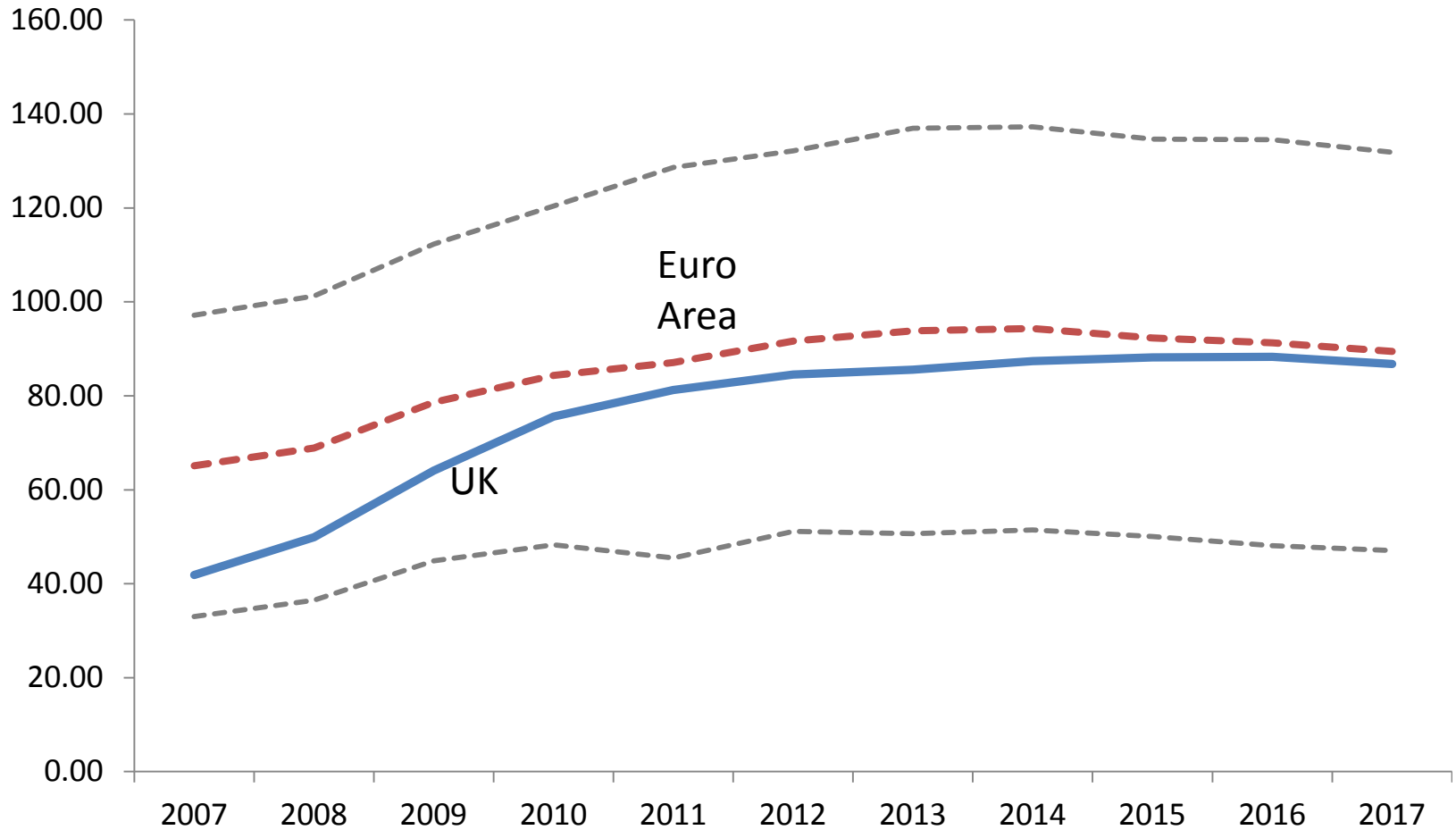
Now imagine 19 different FPRs → pressure for higher rates and fiscal deficits!



## Policy Rates – post crisis

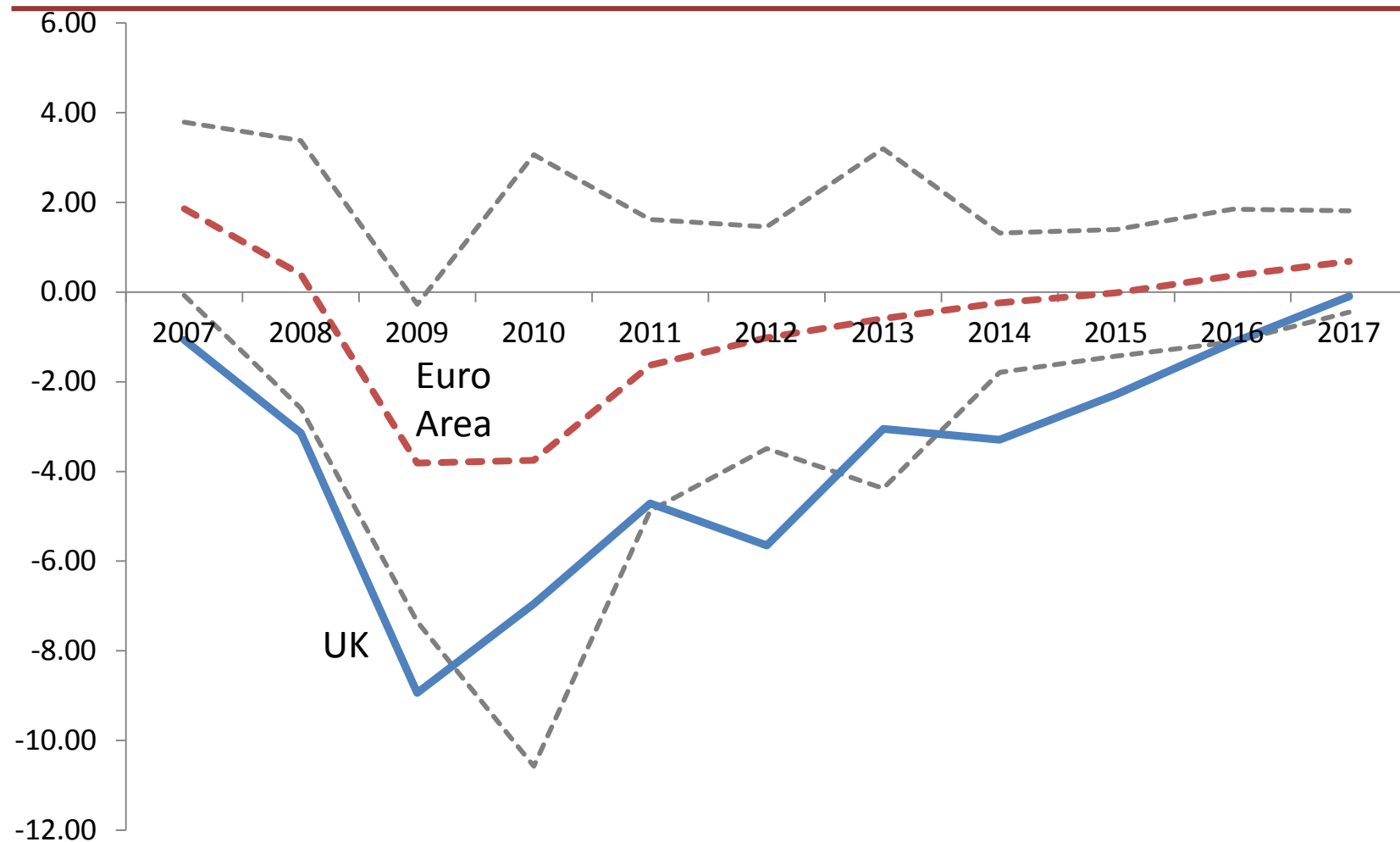


## Gross public debt (percentage of GDP)

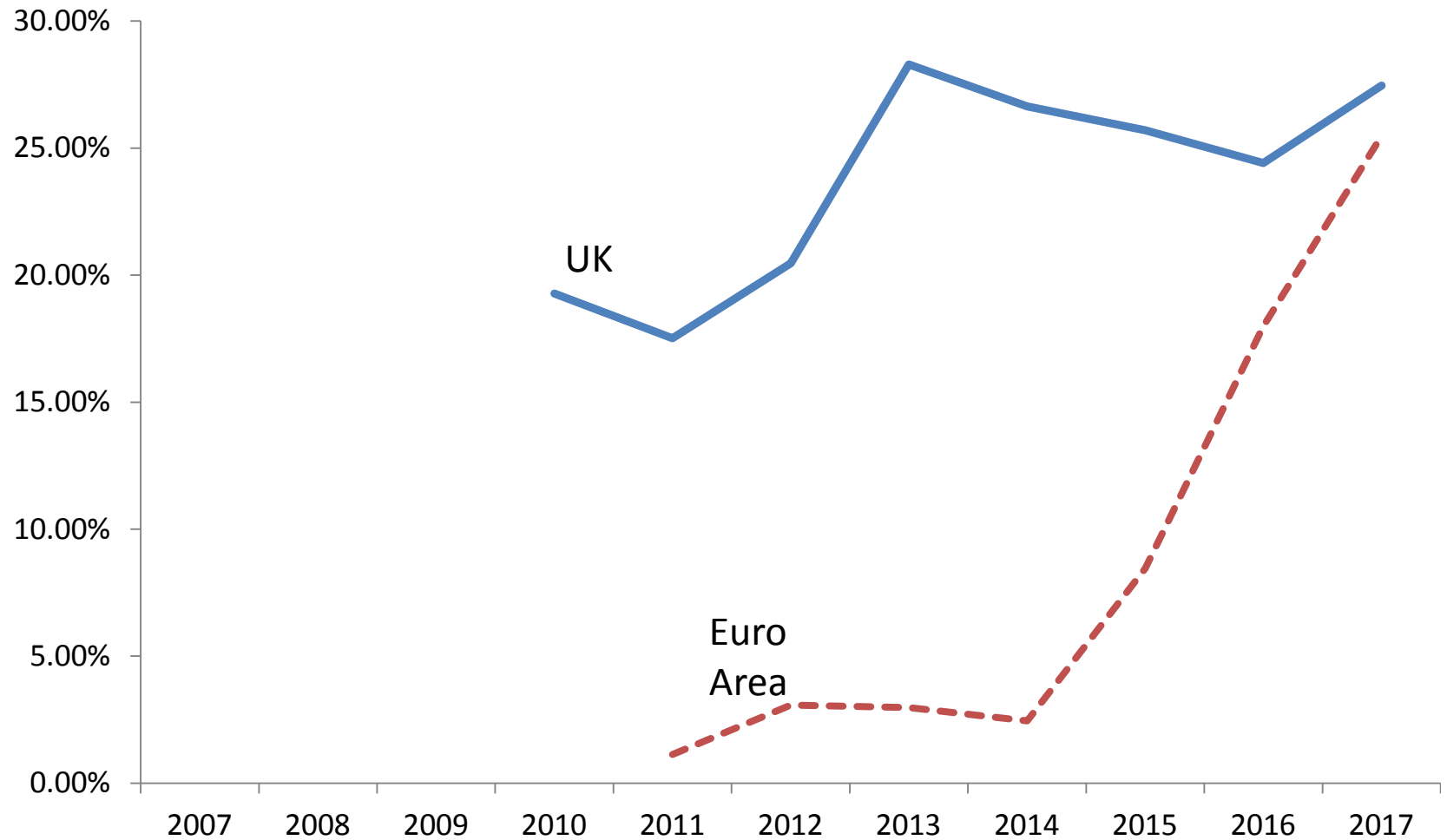




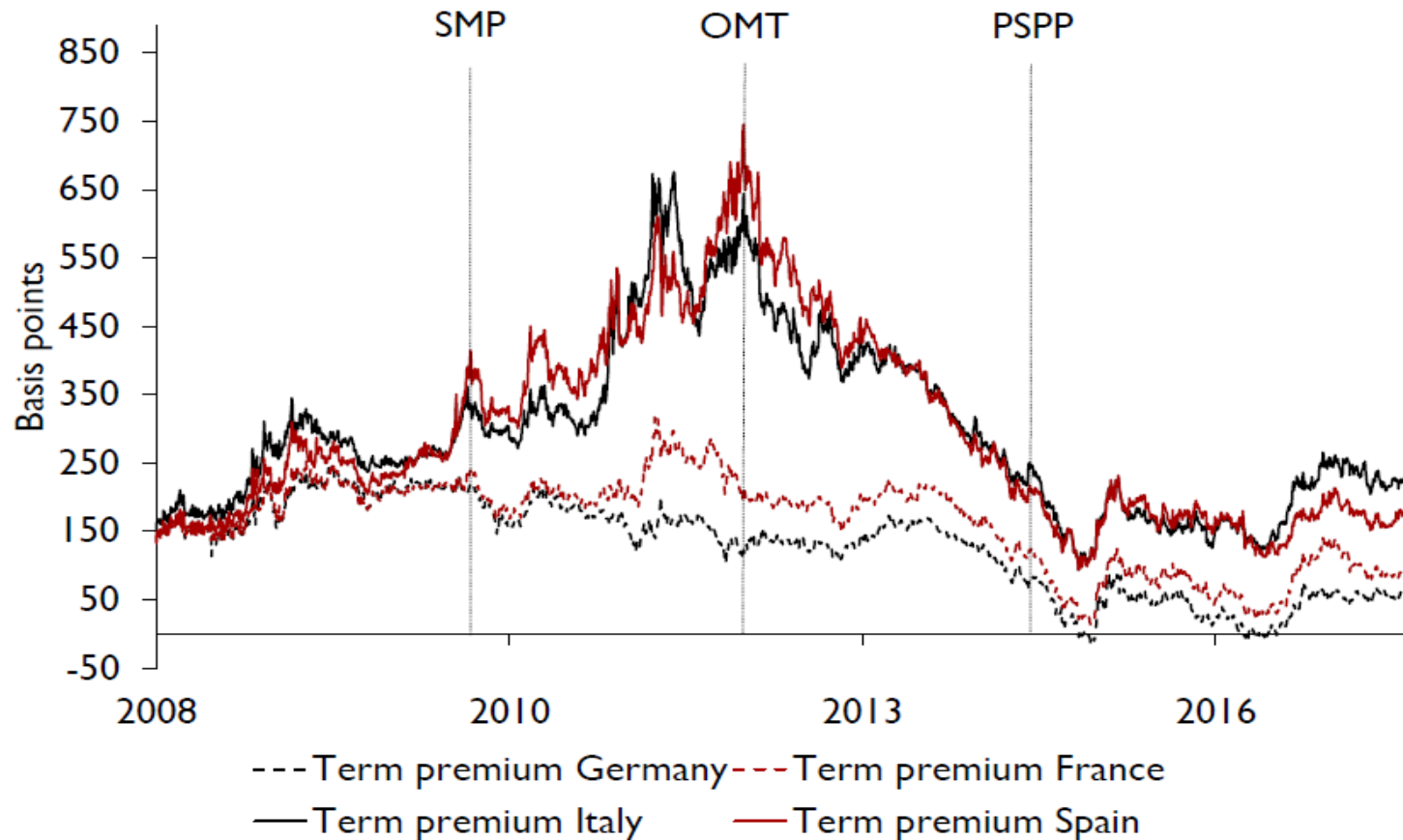
## Government primary balance (percentage of GDP)



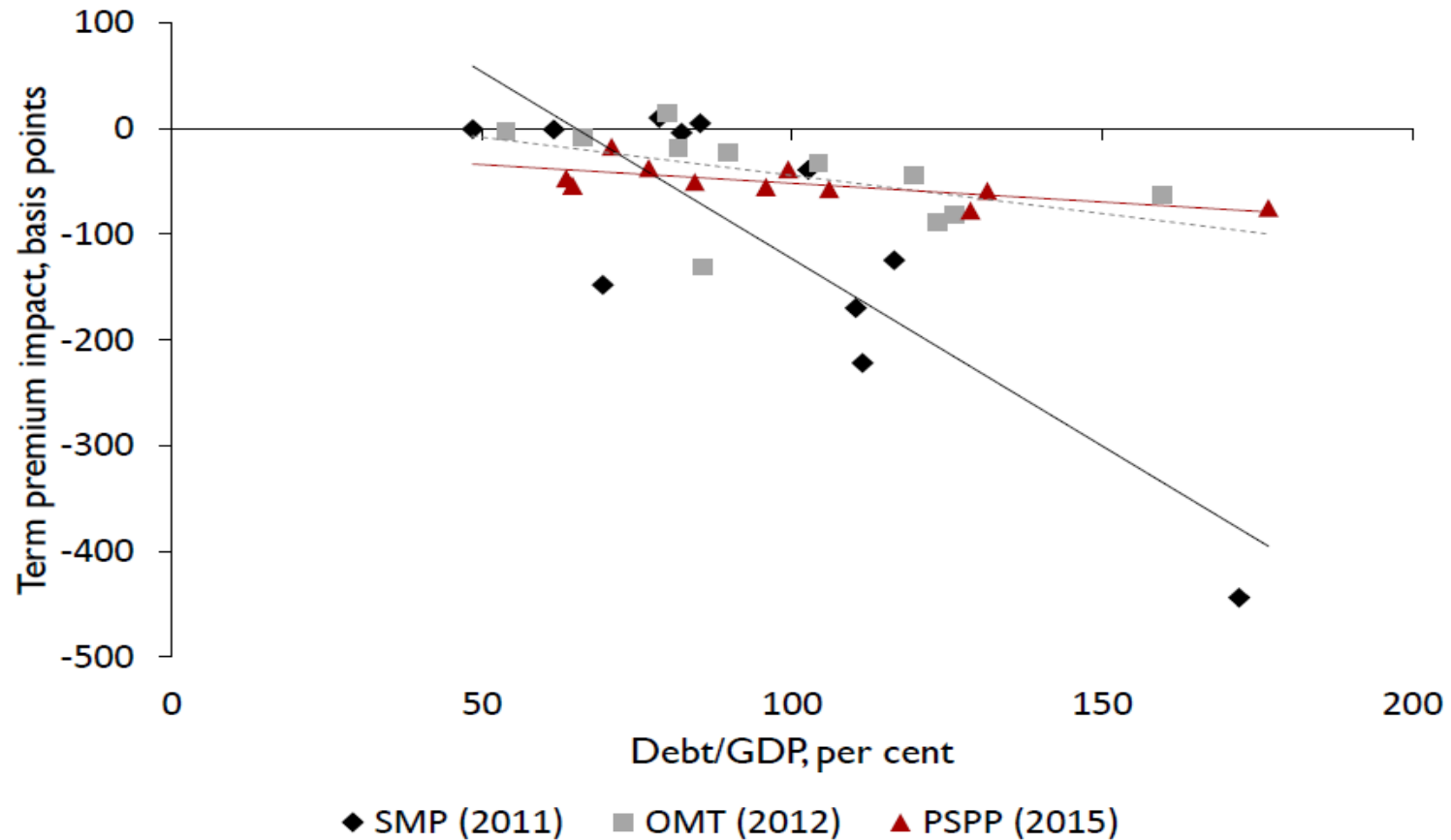
## Percentage of public debt held by Central Bank



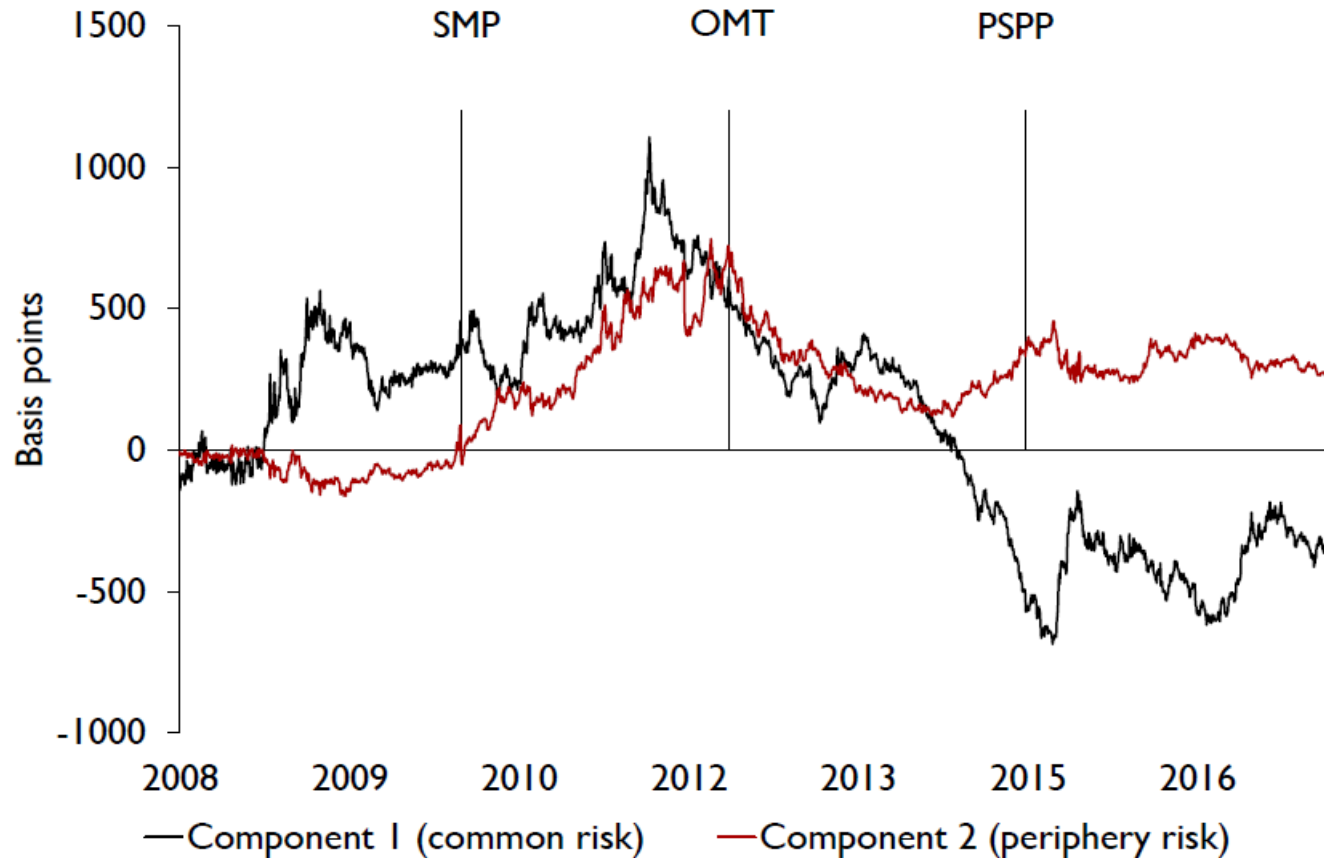
## Estimate of Term Premia in Euro Area Big Four



## Alleviation of Fiscal Risk by Unorthodox Monetary Policies



## Common versus Periphery Risk



## Fiscal Compact

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**A balanced budget** – where a balanced budget is defined as a general budget deficit of 3% of GDP,

**A Debt brake** – Specifies the rate of the reduction of the debt/GDP ratio.

**Automatic Correction Mechanism** – requires member states to specify automatic mechanisms that will come into force

**Economic Partnership Programmes** – outlining the structural reforms they plan to implement.

**Debt Issuance Coordination** – Submitting public debt issuance plans to the commission and council

- **Member states to embed the balanced budget rule and automatic correction mechanism into domestic law.**

**CANNOT EXPECT MONETARY UNION TO PERSIST WITHOUT FISCAL FLEXIBILITY AND THE ABILITY TO CREATE AND THEN USE FISCAL GAPS**

