



CROATIAN NATIONAL BANK

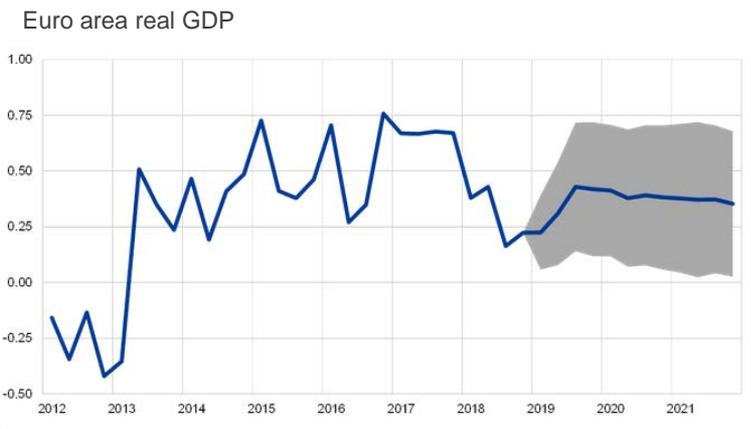
Fiscal and monetary issues under euro framework

June 3rd, Opatija, Efri

Boris Vujčić, governor

Euro area snapshot

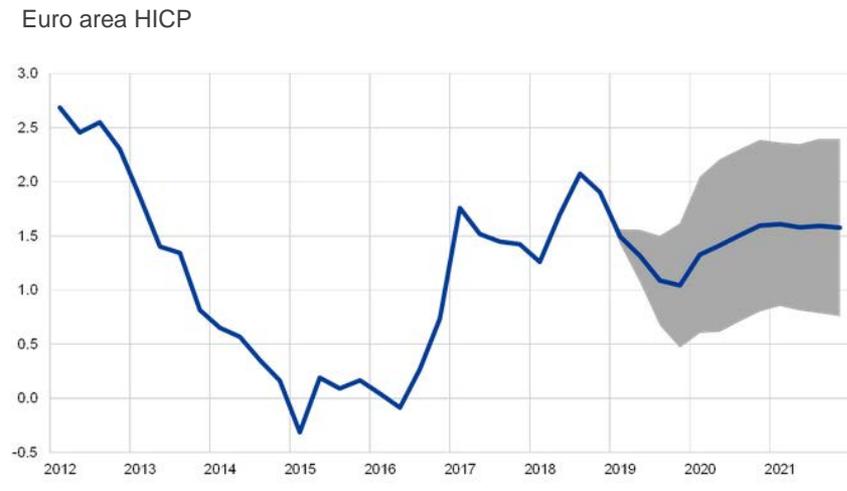
Growth weakened, strong headwinds



quarter-on-quarter percentage changes, seasonally adjusted

Source: ECB staff macroeconomic projections for the euro area, March 2019

HICP inflation expected to continue decreasing until Q4/2019



(year-on-year percentage changes)

Slowdown in euro area, downward risks are currently mostly political:



Brexit

Protectionism/US

Political risks in Europe

Financial market volatility/VIX

One-off effects (new car emission standards; unfavourable weather conditions)

Is there enough space to (out)manoeuvre next set of problems?

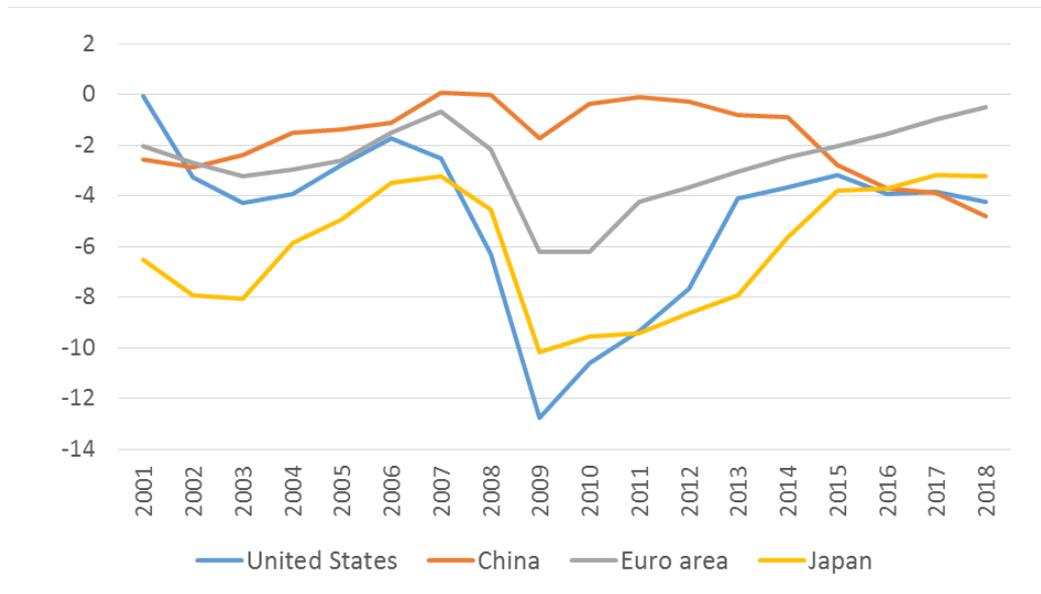
Fiscal space? Monetary policy space?



Fiscal policy space – (in)sufficient buffers for the next recession?

- Fiscal policy is expected to have a more pronounced role during the next economic downturn
- Strong improvement of budget balances in EA (and EU) over the last couple of years

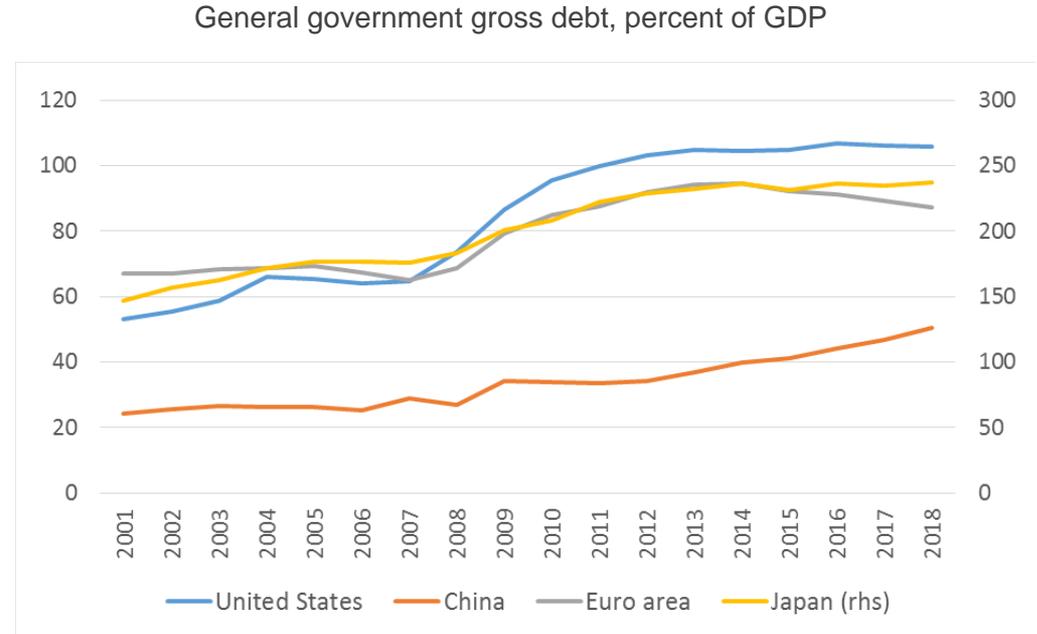
General government net lending/borrowing, percent of GDP



Source: IMF WEO Database, April 2019

Public debt evolution – strong growth due to the crisis, still elevated

- Indebtedness of the public sector increased after the Global Financing Crisis
- In EA (and EU) it reached a peak in 2014, and started declining thereafter due to improvement of budget balances

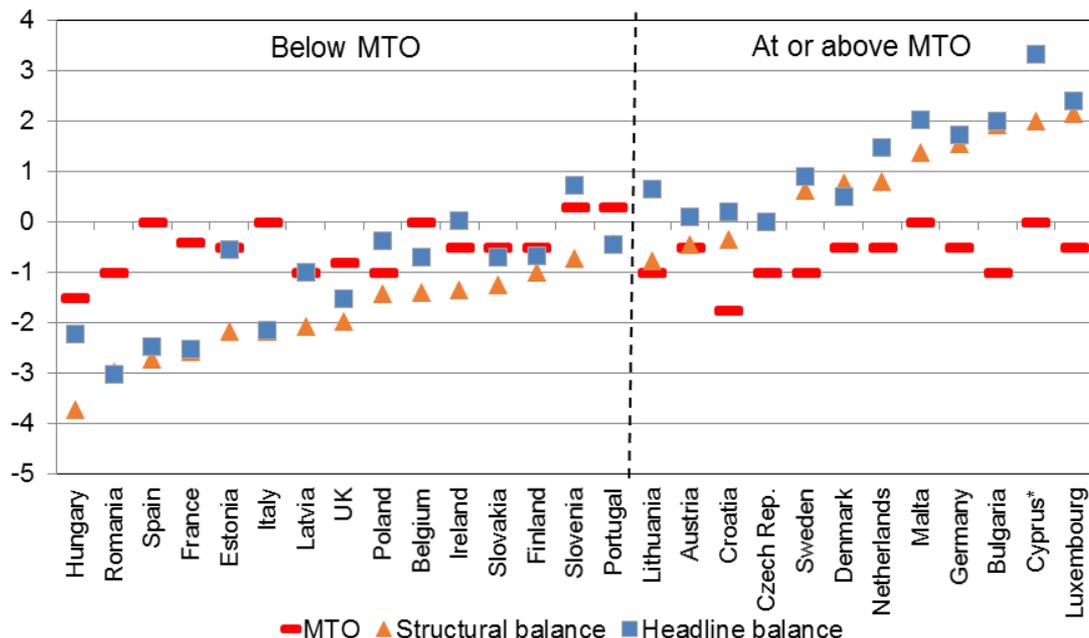


Source: IMF WEO Database, April 2019

Nominal improvements in Europe still leave somewhat to be desired when taking into account cyclical conditions

- Better performance in the EU due to the overhaul of its fiscal rules
- Central point is the so-called Medium-Term Budgetary Objective (MTO) – structural budget balance target set to ensure sound fiscal health
- Situation across individual countries less rosy – in many countries there is still a gap between MTO and structural balance

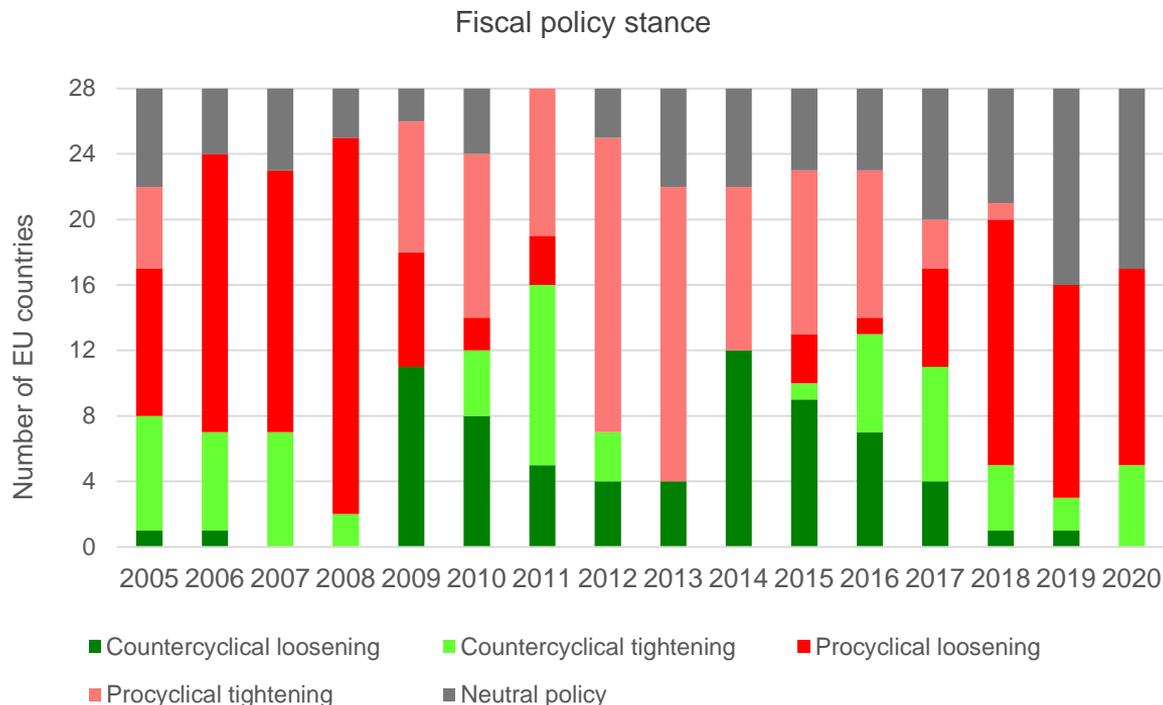
Fiscal balances and medium-term budgetary objectives (MTO) in 2018, percent of GDP



Source: EC AMECO database, 2019 Spring; Stability and Convergence Programs

Recent fiscal policy stance in EU – procyclical expansion on the rise

- After strong deterioration in the wake of financial crisis, partly due to countercyclical loosening (dark green bars on the chart), fiscal deficits started to gradually improve
- However, estimates and projections for the 2018-2020 period start to resemble the pre-GFC period, due to more and more countries engaging in procyclical loosening (dark red bars on the chart)



Source: EC AMECO database, 2019 Spring

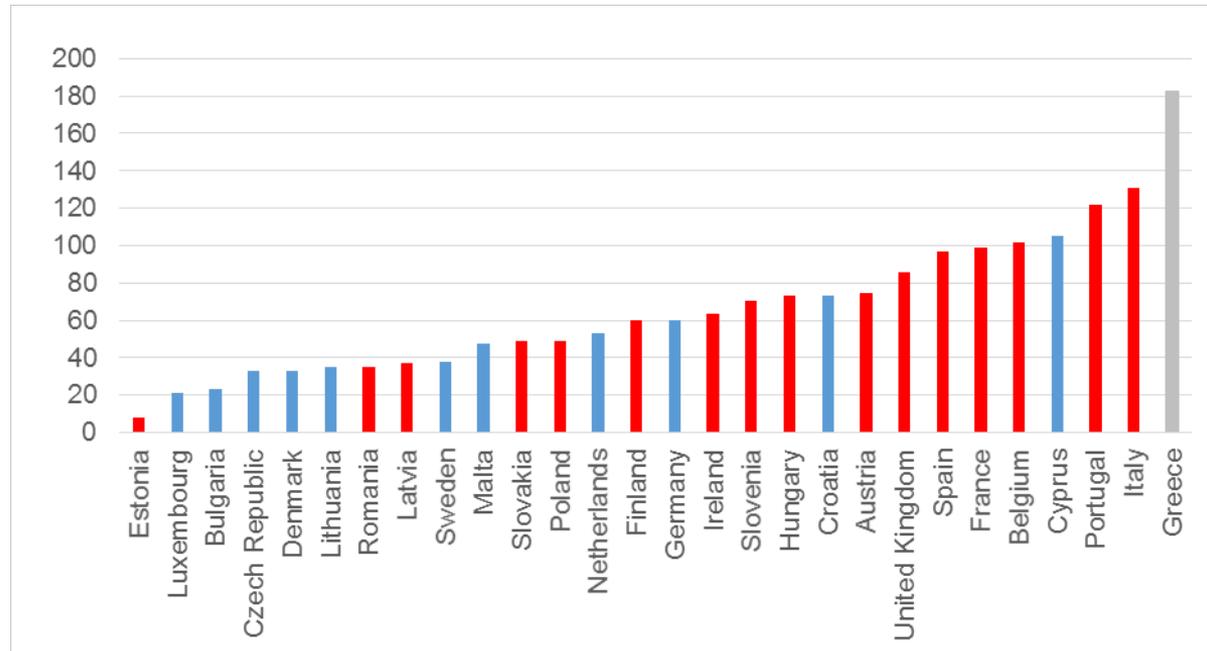
Still high debt level implies the need for further consolidation

- Most countries with public debt level at or above 60% are still below their MTO (red bars), meaning they need to further consolidate

CONCLUSION:

- Judging by the gap to the MTO, recent fiscal policy stance and still high debt levels, it appears that many countries failed to exploit current favourable cyclical conditions
- Therefore, in many of these countries fiscal space is very constrained, let alone sufficient to perform expansionary fiscal policy in case of the economic downturn

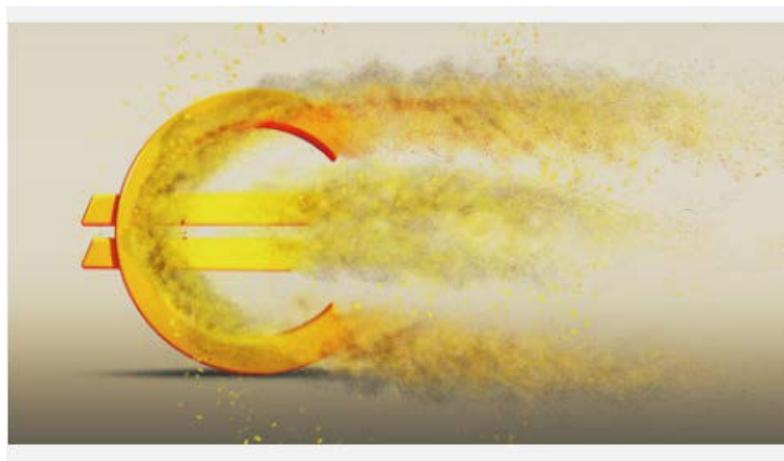
Public debt in 2018, percent of GDP



Source: Eurostat

Note: Greece was in the adjustment programme and therefore did not set the MTO.

Is relying on the ECB a solution?



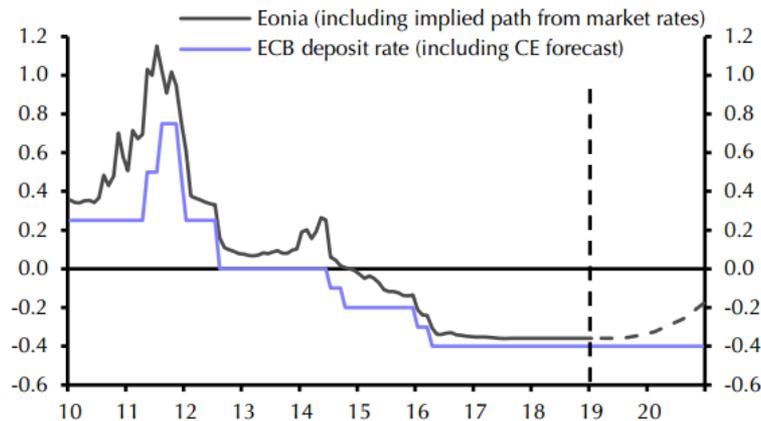
ECB monetary policy evolution



Eurosystem total assets, EUR bn



Source: Deutsche Bank, ECB, Haver Analytics LP



Sources: Thomson Reuters, Bloomberg, Capital Economics

EU/EMU after the GFC/sovereign debt crisis...



The Euro Area is more stable than before the GFC!

ESM , renewed Stability and Growth pact, EDP and EIP, Banking union...but still incomplete monetary union

...what next?



Monetary policy space?



„It’s **not true** that the ECB has run **out of fuel** or has run out of instruments. We have all our **toolbox still available.**”

(Draghi, 2019)

Forward guidance

LTRO III

Maturity twist

Cutting negative rates further

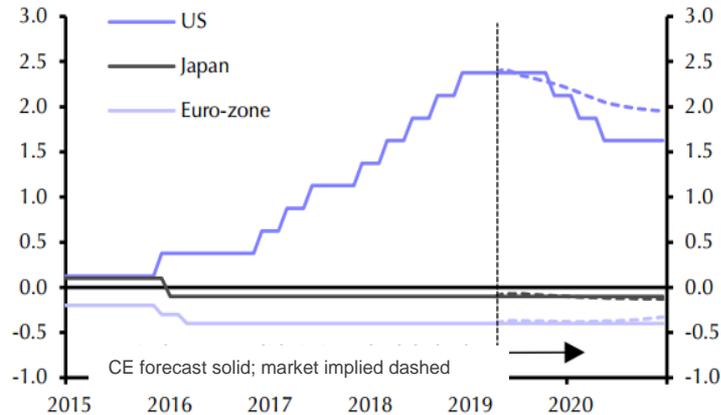
Tiered deposit rate

APP or PSPP

However.....

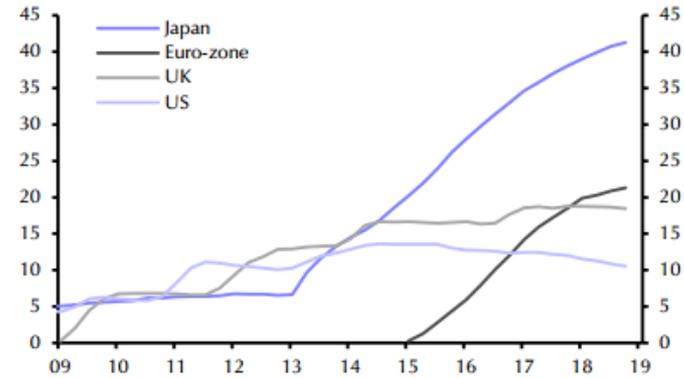
... is there still enough of a monetary policy space?

Interest Rate Expectations (%)



Sources: Bloomberg, Capital Economics

Assets Held under QE (% of GDP)



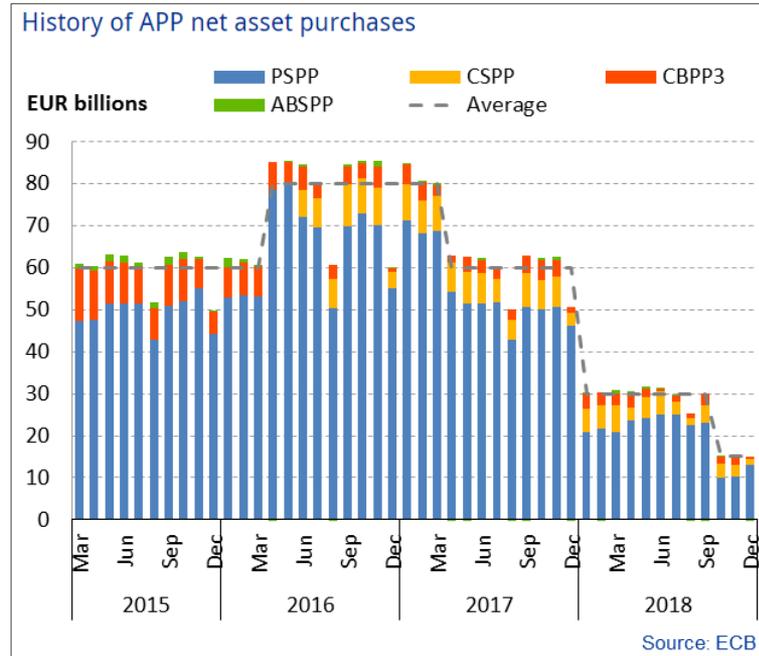
Sources: Thomson Reuters, Capital Economics

Net asset purchases under APP ended in December 2018

ECB to reinvest the principal

European Court of Justice (ECJ) supported the ECB's purchase programme as it does not go beyond its mandate in 2018

Without (more elements of a) fiscal union – capital key





HNB

Thank you!