How can fiscal policy contribute to price stability?

Institute of International Monetary Research

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Global growth: monetary & fiscal policy

1 Monetary policy
- Will continue to lead the countercyclical effort…
- …despite its reduced effectiveness in the current context.

2 Fiscal policy
- Should play a bigger role…
- …but the political environment and high levels of debt restrict its use.
Monetary policy and inflation

Innovative (non-standard) tools

Quantitative Easing (QE)

Yield Curve Control (YCC)

Negative Interest Rates Policy (NIRP)

Forward Guidance

EUROZONE: INFLATION (% Y/Y)

Source: BBVA Research, based on IMF, ECB and Eurostat
Monetary policy cannot do all on its own, fiscal policy should play a role

In the past, reputation of fiscal policy as a stabilization tool was low

Discretionary fiscal policy takes time to operate on the economy

Fiscal stabilization was often used as an excuse for political goals, and fiscal stimulus are difficult to withdraw once they are implemented

1. Measured fiscal stimulus with low or zero interest fiscal
2. Helicopter money
3. MMT (Modern Monetary Theory)
Helicopter money

*The key word here is permanent increase as this is the way to manage expectations*

1. Monetary policy would remain independent and subject to an inflation target, while fiscal policy is subordinated to monetary policy.

2. A more effective alternative in extreme cases to non-standard measures such as QE or negative rates.

3. Set up the appropriate governance structure without questioning neither the independence of the CB nor achieving a nominal anchor.

4. There is always risk of overuse due to political pressures.
MMT (Modern Monetary Theory)

“More extreme use of fiscal policy, supported by the increase in the monetary base to finance increased spending (or lower taxes)"

1. Lack of a well founded theoretical corpus to support it
2. Risk of inflation and hyperinflation
3. Difficulties to stop the dynamics of higher spending and lower taxes
Conclusions

There is an ongoing debate over economic policies and the relative importance of monetary and fiscal policies.

We must keep rules for fiscal policy, even if they are designed differently.

Central banks should maintain their independence, and not be subject to fiscal dominance.

Monetary and fiscal policies are not a substitute but a complement of appropriate long-run growth policies.
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