



OFF THE NEWS

The European Picture

I. THE ELEPHANT IN THE ROOM

It is hardly a secret that eurozone monetary policy is on autopilot, perhaps for as long as the next five years. True, there were concerns at the September 12 European Central Bank Council meeting that negative interest rates and quantitative easing bond-buying have not yielded the expected macroeconomic results. But out of loyalty to ECB President Mario Draghi, a majority of the Council agreed to lock in the central bank's long-term financing operation.

But the real discussion didn't take place in the official meeting, but in the hallways after the meeting. The chatter centered on one question: What if the eurozone falls into a deep recession? ECB strategists concede the likelihood is that policymakers would have no choice but to resort to the "nuclear option." The central bank essentially would become an agent of the finance ministries. Fiscal and monetary policy would become the same. Noted one participant in these discussions: "That's the real elephant in the room for the ECB."

II. LAGARDE'S EFFECTIVE SKILLS

During the recent IMF/World Bank meetings in Washington, D.C., Christine Lagarde presided as the great savior of the European project. That is not because of the incoming ECB president's intimate knowledge of monetary policy. It is because of Lagarde's international political skills and knowledge of fiscal policy.

Lagarde is described by colleagues as having "a huge reputation of respect in Germany." Indeed, they say, Lagarde was shrewdly chosen by the heads of state precisely for her political skills and charmingly persuasive personality. Her task, of course, is to convince the Netherlands and Germany to initiate

significant fiscal stimulus to help spur the eurozone economy. The monetary toolbox is nearly empty.

III. THE SAVIOR OF EUROPE

On the issue of eurozone fiscal stimulus, the Netherlands has come forward with a plan. Germany has significant room for further stimulus, but there are complications. Most of the fiscal spending needs to occur on the state and local levels where infrastructure is in severe need of modernization. But the political complications at the state and local levels are formidable.

Germany also has severe limits to its capacity in the construction sector. Policymakers will have to look to mobilizing resources from other countries to help with construction. The share of foreign investment in German infrastructure is only 10 percent and can clearly go higher.

Another complicating factor is that Germany has also promised to produce a climate change package totaling €56 billion, financed supposedly by a wealth tax. In the 1990s, a similar wealth tax was deemed unconstitutional. Note that nothing can happen on the tax front until the 2021 start of the next parliamentary term.



Mario Draghi



Christine Lagarde

Times Have Changed

To paraphrase a Roman proverb, times are changing, and central banks are changing with them. This is nowhere more evident than in banks' moving from secretiveness to transparency. Active communication has become a favorite tool of most central banks.

The so far most effective example was delivered by Mario Draghi, president of the European Central Bank. On July 26, 2012, he made his magical statement: "Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough."

These words were followed by the announcement of the Outright Monetary Transactions (OMT) program. Immediately after Draghi's speech, the spreads of ten-year government bonds in Spain, France, and Italy relative to Germany's declined from their temporary peak to previous levels. Until today, not a single euro has been spent to intervene under this program. Words, communication alone, did the work. However, this effect cannot be separated from the person and the position of the originator.

Impressive as this case is, the fact that announcements of actions that may lie in the near or distant future may have an immediate effect can be observed

many times in the course of history. A remarkable historical example dates back to Roman times. In 67 BC, when pirates in the Mediterranean Sea posed an ever-greater threat to the supply of grain, the Roman authorities assigned command of a huge naval force to Gnaeus Pompeius. Pompeius delivered on his command and rid the sea of pirates within forty days. A day later, in his first political speech, "De imperio Gnaei Pompeii," Marcus Tullius Cicero remarked that on the same day that Pompeius was assigned to this command, the price of grain fell suddenly from its highest level, thanks to the hope placed in this man, to a level that could hardly have been achieved through a long period of peace and outstanding crop fertility.

—O. Issing



An excerpt from the notable new book **The Long Journey of Central Bank Communication** (MIT Press, 2019) by **Otmar Issing**, founding member of the executive board of the European Central Bank.



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