



# **Europe and Finland – 20 years of Monetary Union**

Turku Europe Forum 30 August 2018

Intervention of Francesco Papadia

## **Mistakes**

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Irrend lernt man  
(Learning through mistakes)  
Johann Wolfgang von  
Goethe

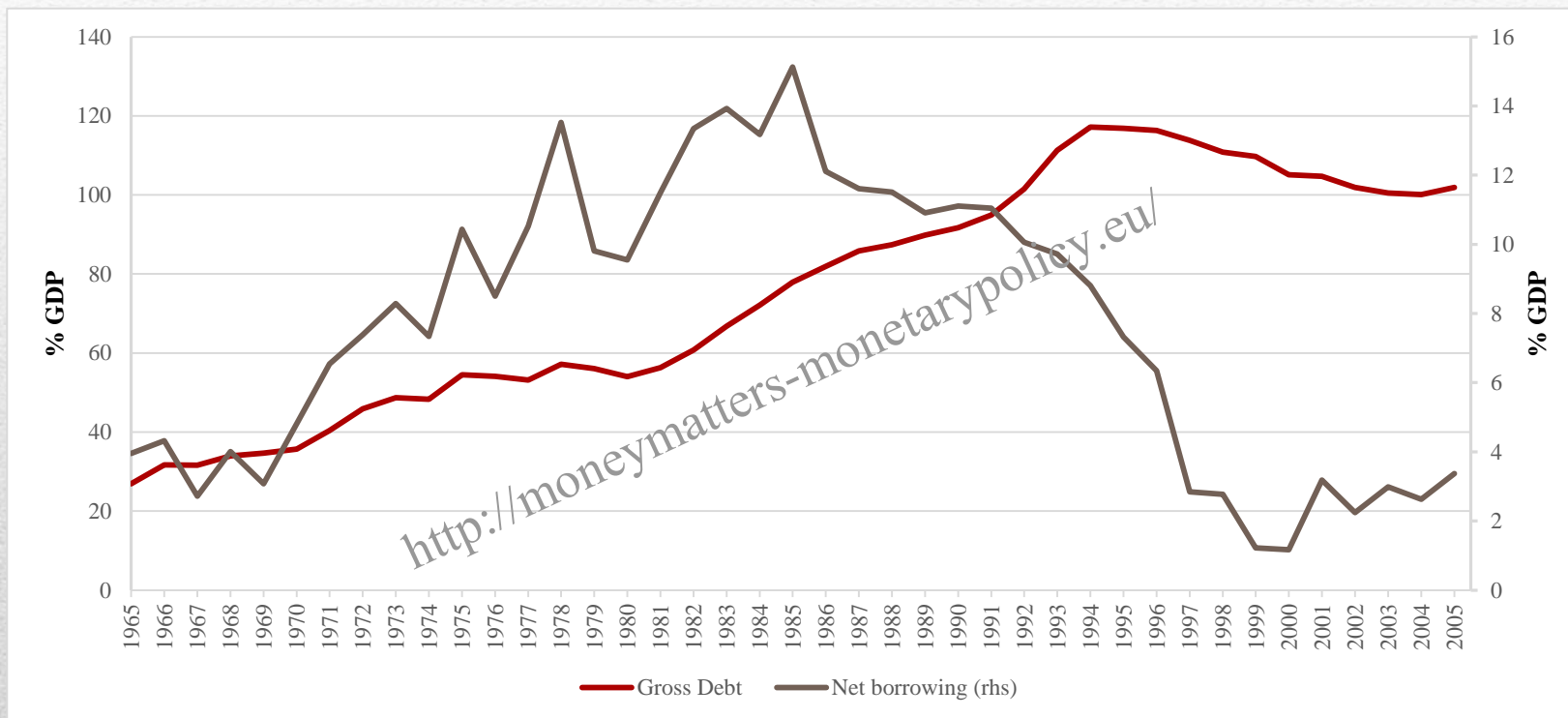


- **Rome Mistakes**
  - **Italian fiscal policy 1965-1994**
  - **Italian monetary policy 1972-1995**
  - **Squandering the € bonus 1995-2007**
- **Frankfurt/Brussels mistakes**
  - **ECB interest rate increases in 2011**
  - **Euro-area fiscal policy in 2011-2014**
  - **German current account surplus 2000-2018**

**Six mistakes: 3 in Rome and  
3 in Frankfurt/Brussels**

## Italian fiscal policy 1965-1994

Fiscal deficit and Government debt. Ratio to GDP. 1965-2005.



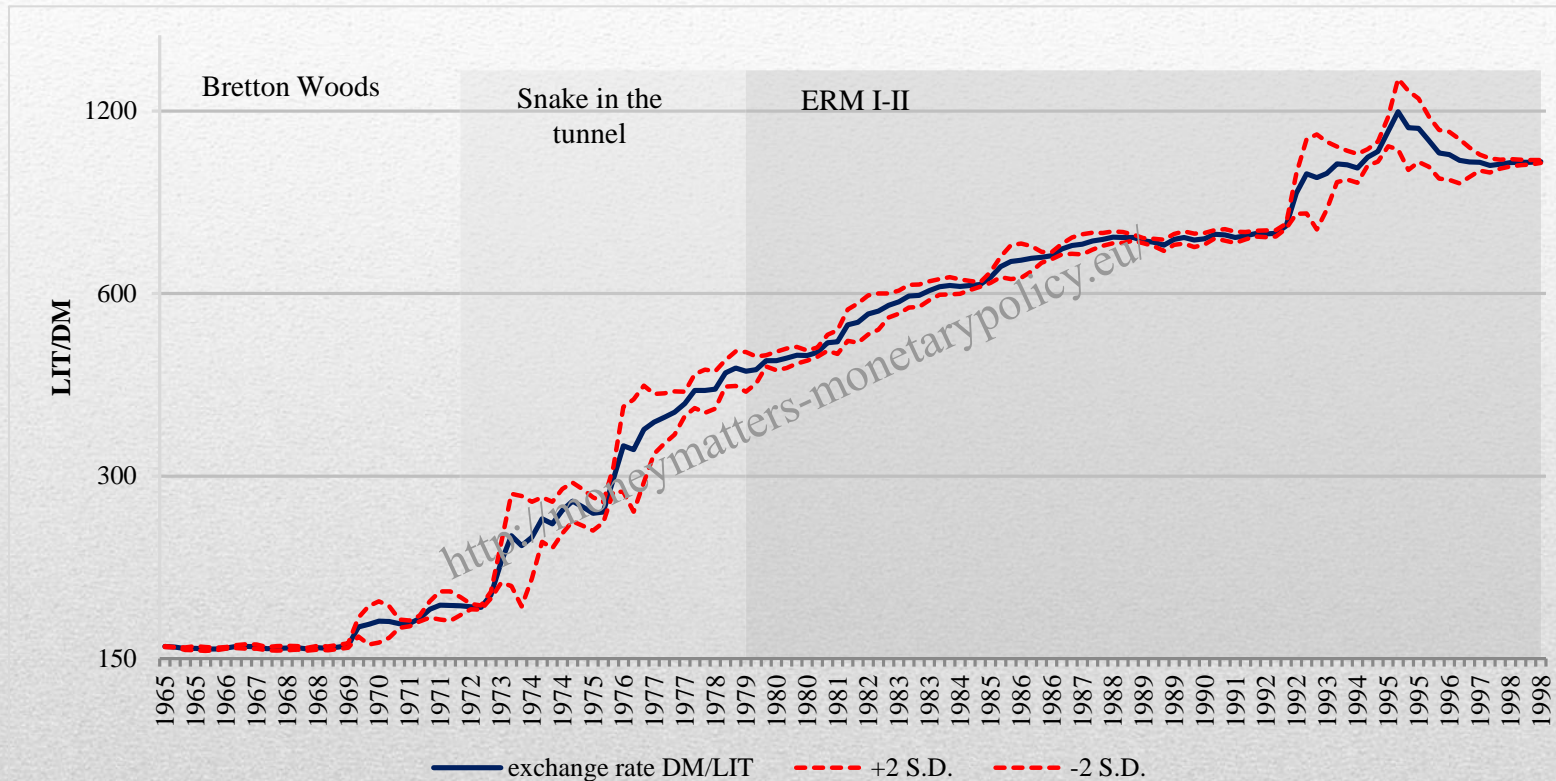
# Rome Mistakes I



- Italian monetary policy 1972-1995

## Rome Mistakes II

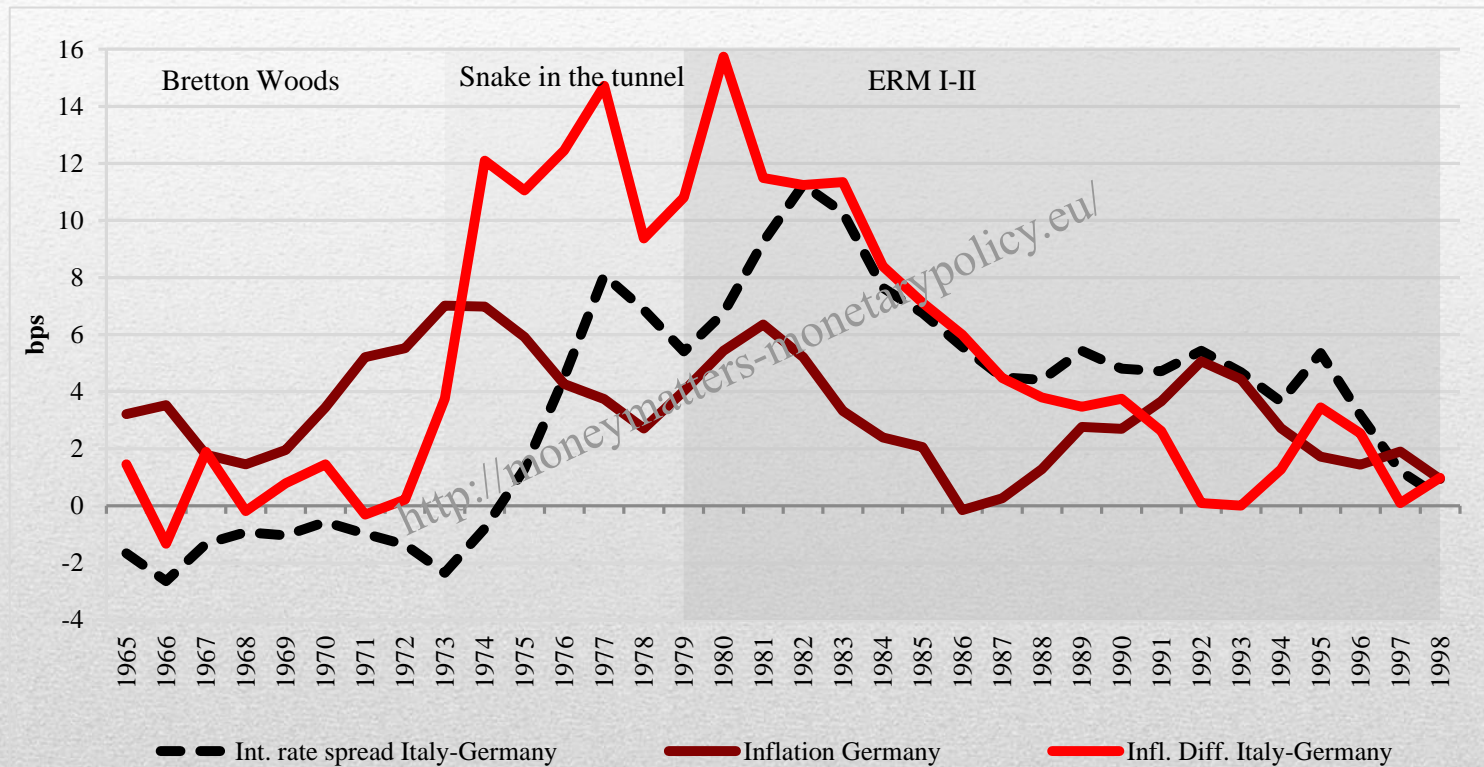
## An unrelenting devaluation of the lira. 1965-1998.



# Rome Mistakes II

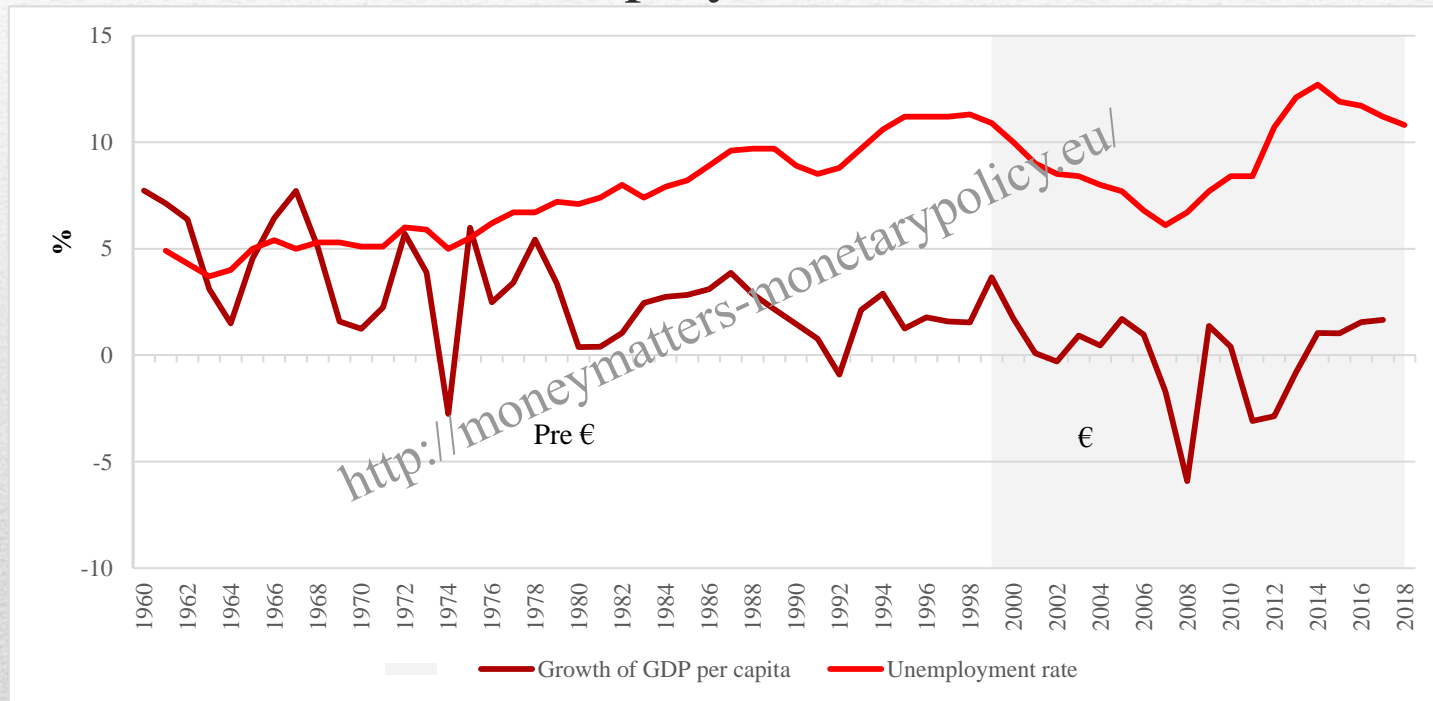


- High and unstable inflation and interest rates. 1965-1998.



# Rome Mistakes II

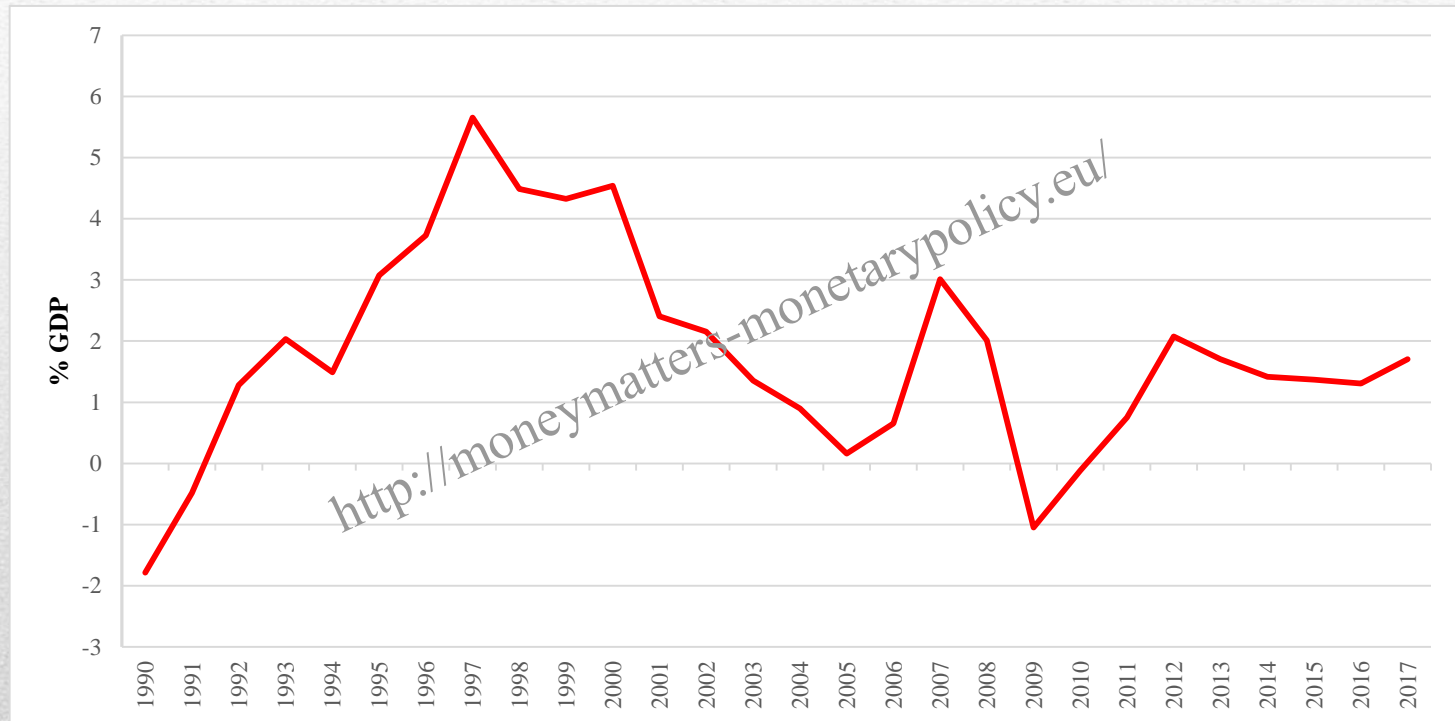
- Trend decrease of growth. 1960-2018.
- Trend increase of unemployment. 1960-2018.



# Rome Mistakes II

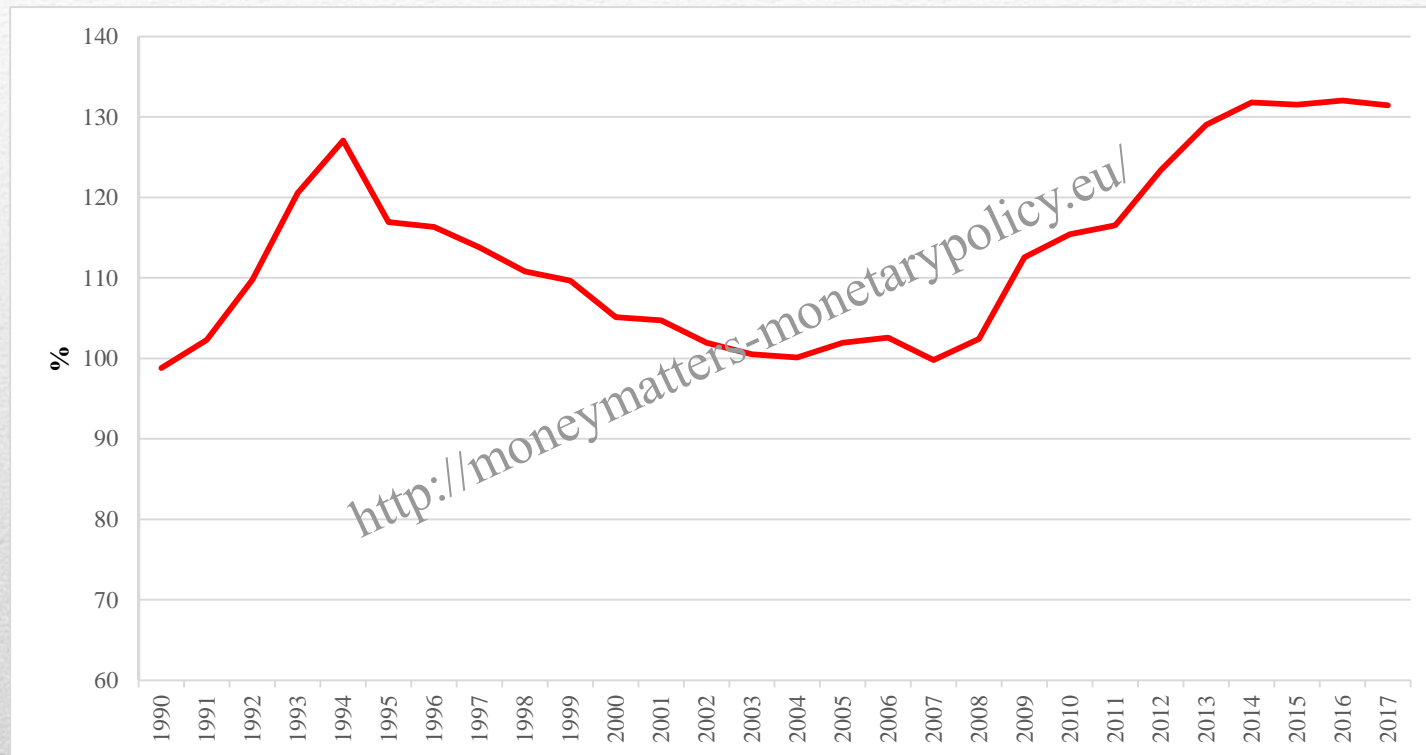


- Squandering the € fiscal bonus
- Primary surplus/deficit as a ratio of GDP. 1990 – 2017.



# Rome Mistakes III

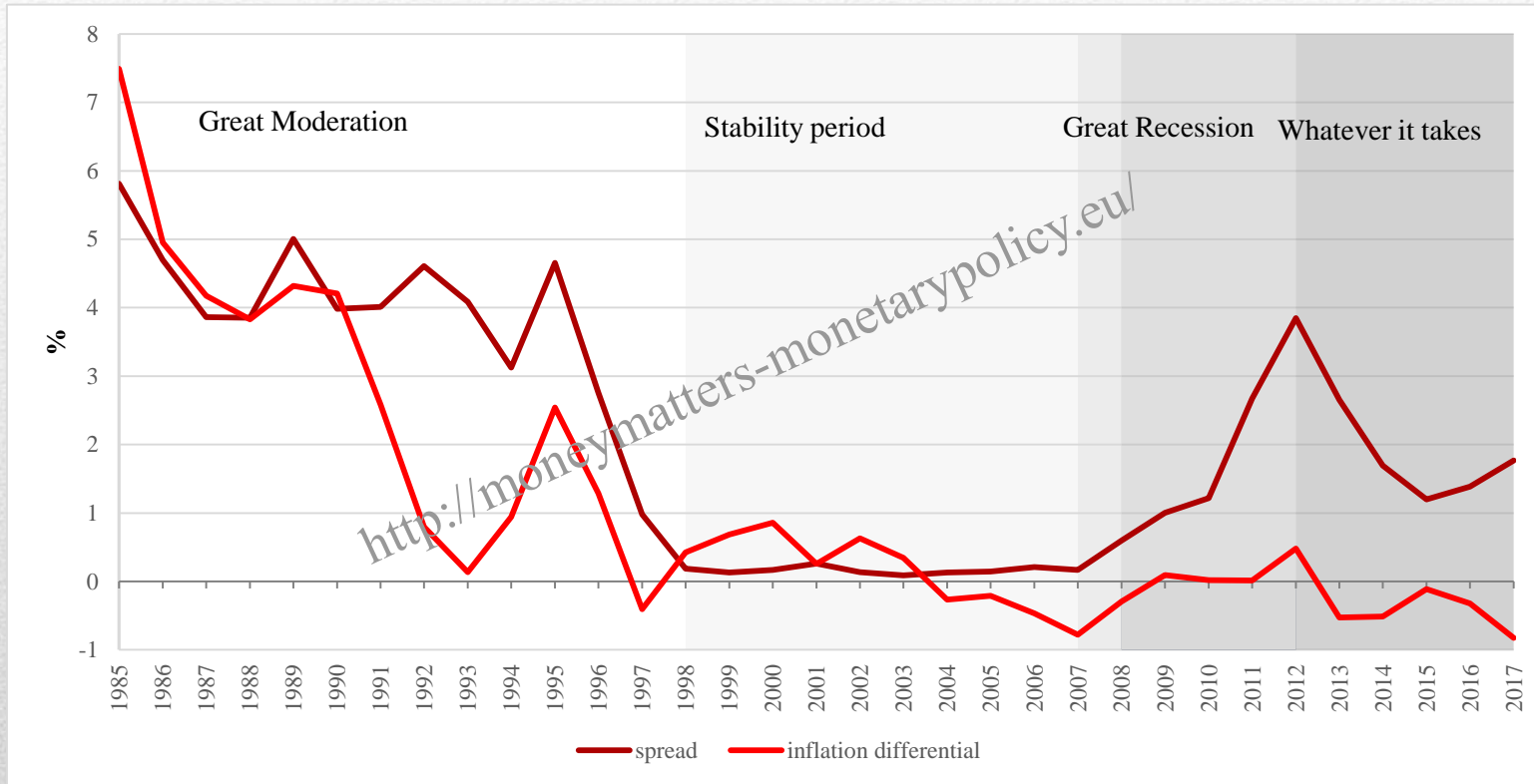
- Squandering the € fiscal bonus
- Debt to GDP ratio. 1990-2017.



# Rome Mistakes III

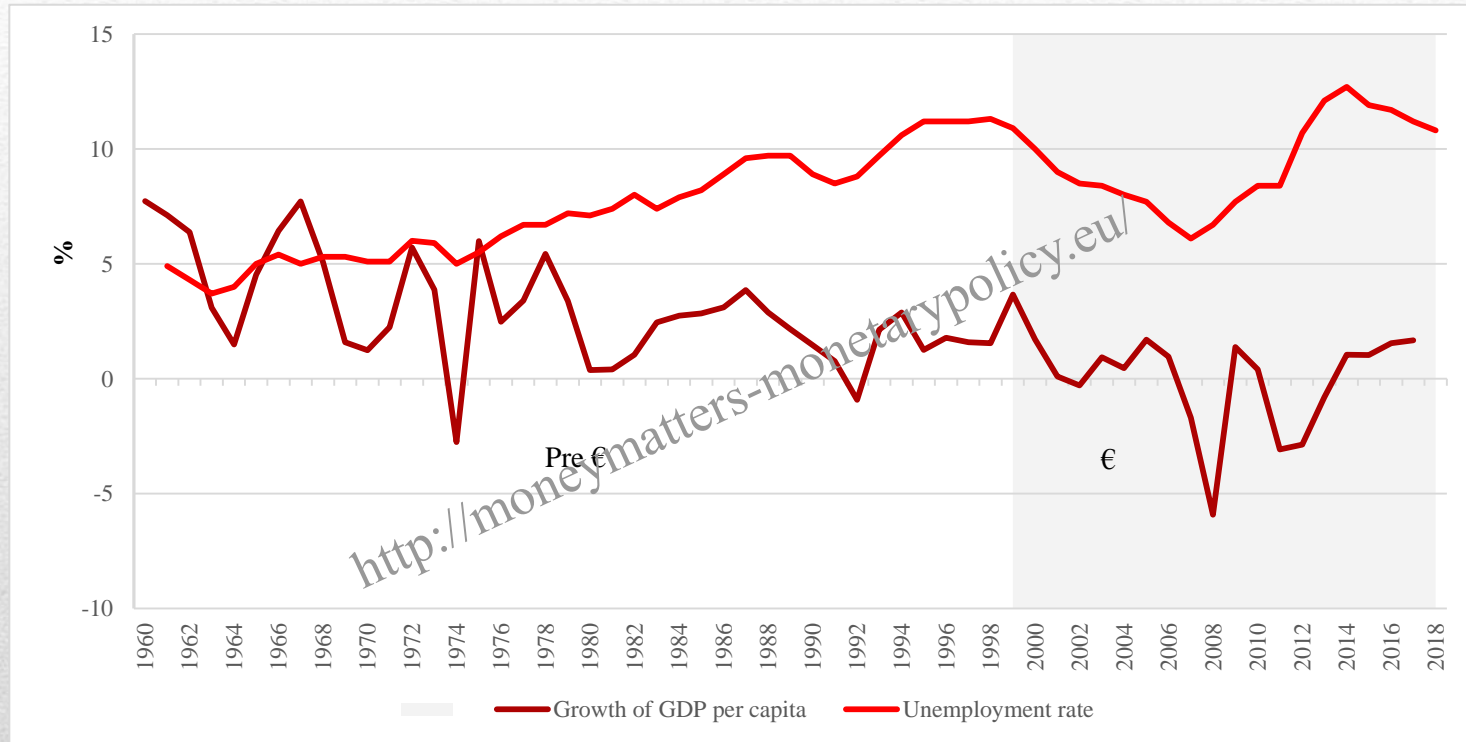


- Squandering the € bonus
- Perfect interest convergence, imperfect inflation convergence
- Differentials between Italian and German expected inflation and 10-year government bond yields. 1985 – 2017.



# Rome Mistakes III

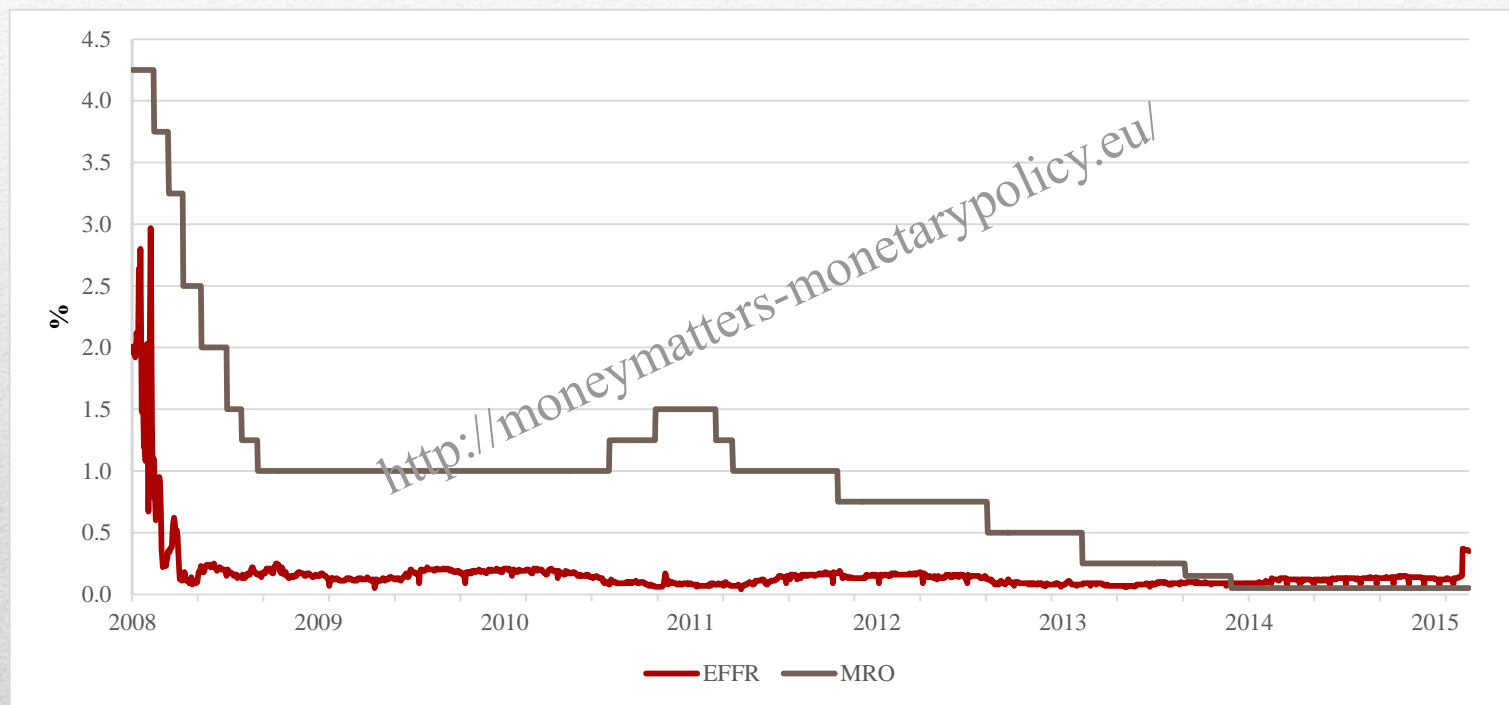
- Squandering the macroeconomic bonus
- Unemployment and economic growth in Italy. 1960-2018.



# Rome Mistakes III



- ECB interest rate increases 2011
- A surprising move
- Effective Federal Fund Rate and MRO rate. 2008 –2015.



Frankfurt/Brussels mistakes I <sub>13</sub>

- With difficult to find motivations
  - With hindsight
  - With real-time information

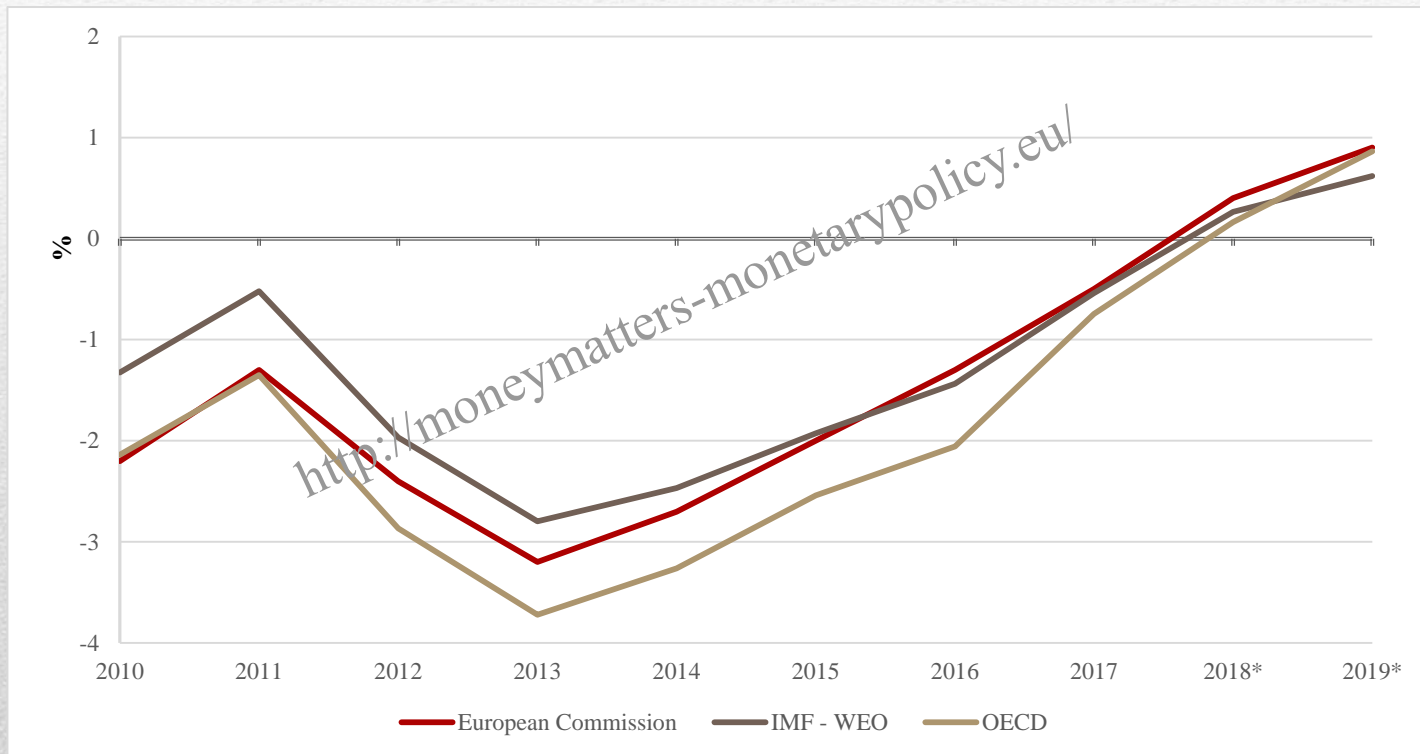
Frankfurt/Brussels mistakes I <sub>14</sub>

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- Euro-area fiscal policy 2011-2014
  - A Diamond-Dybvig interpretation
  - Liquidity and solvency
  - An aggregate countercyclical fiscal policy

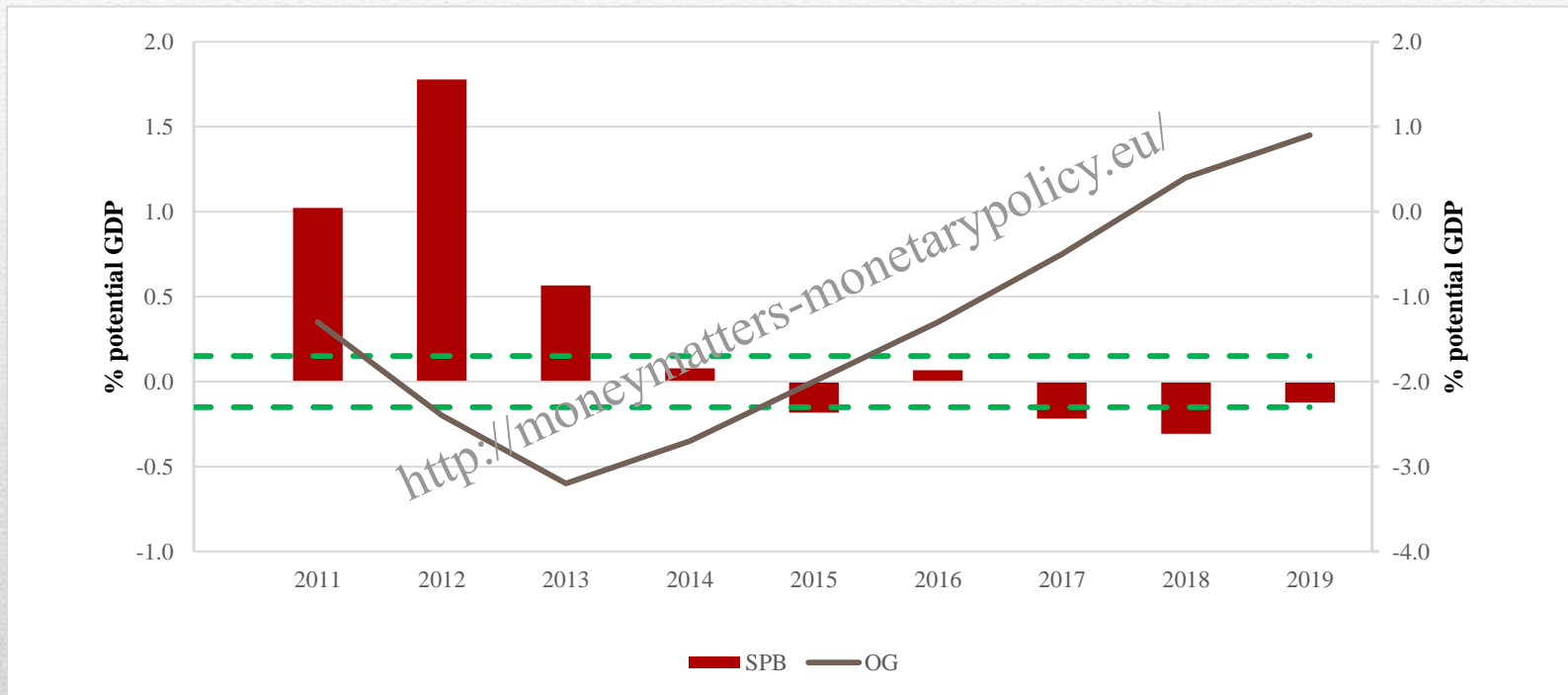
- And instead
  - Just coinciding with a serious recession
  - Output gap in the euro area, 2010-2019.



# Frankfurt/Brussels mistakes II<sub>16</sub>



- And instead
  - A strong pro-cyclical fiscal policy



# Frankfurt/Brussels mistakes II

- German current account 2000-2018
  - Exceptionally high and persistent
  - **Too** high and persistent, according to the IMF and the EU Commission
  - Caused by too low investment and too low wages
- An insouciant attitude?



- Two unanswered questions
  - Genuine mistakes or something else?
  - Worse South or North of the Alps?

# Symmetric mistakes

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- My Alpine/Suomi tenets:
  - Insufficient (excessive) demand should be countered by countercyclical policies
  - Hysteresis and super hysteresis can make recessions very damaging
  - Shifts from “good” to “bad” equilibria require liquidity and solvency measures
  - Sustainable fiscal policies and stability oriented monetary policy favour growth and welfare
  - Long term growth and welfare depend on appropriate structural policies

Setting in the Alps, or maybe in  
Finland



- Are my tenets trivial or unattainable? Or both?
- Will we be able not to repeat the same old mistakes?

# Conclusions

**Table 1. Average 10-year government bond yield, average inflation expectations and average real interest rates (%).**

	1985-1997		1998-2008		2009-2016	
	Germany	Italy	Germany	Italy	Germany	Italy
10-year yield	7.7	11.6	4.4	4.5	2.4	4.3
Inflation Expectations	2.0	4.0	1.1	1.7	0.9	0.8
Real interest rates	5.7	7.6	3.2	2.8	1.5	3.5

Source: Author's calculations based on European Commission Business and Consumer Survey and OECD (2017), Main Economic Indicators (database). doi: <http://dx.doi.org/10.1787/data-00052-en> (Accessed on 31 May 2017).

# Lower real rates as macroeconomic bonus