


Flash Economics

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Euro zone: The "left-wing criticism" of monetary policy should be rejected

"Left-wing" economists have been criticising the monetary policy conducted in the euro zone since the crisis in many ways.

- 1- It is claimed that money creation has saved the banks (since they have been given money), but has not helped other economic agents. In reality, the liquidity injections have actually eliminated the liquidity risk for the banks, but their main effect has been to improve the situation of governments, households and companies by reducing the interest paid on their debt. In addition, the low interest rates have reduced the banks' profitability.
- 2- It is also claimed that "helicopter money" (money creation ex nihilo) would have been far more effective than the monetary policy that has been conducted in the euro zone. But in reality, this has been equivalent to helicopter money: governments have been able to carry out public spending financed by bond issuance, and the bonds issued have almost immediately been bought by the ECB against money creation: it is as if the public spending (for example government transfer payments to households) was carried out in the form of distribution of money.
- 3- Allegedly, contrary to the lessons of modern monetary theory, governments have not monetised their fiscal deficits to be able to conduct a more expansionary fiscal policy. But the ECB has bought a massive quantity of public debt, thanks to quantitative easing, which has made it possible to increase the public debt (except in Germany) without any impact on long-term interest rates, and therefore to use expansionary fiscal policy more intensely.

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First “left-wing” criticism of the ECB’s monetary policy since the crisis: It has helped only the banks, not other economic agents

Admittedly, banks have received a significant part of the liquidity created by the ECB (**Chart 1A**), which has **eliminated liquidity risk in the European banking system**.

But we should not forget that the ECB’s expansionary monetary policy **has driven down interest rates markedly (Chart 1B)**, which has led to a **sharp fall in the interest paid by governments, households and companies (Charts 1C and D)**, and therefore to a significant improvement in the situation of all economic agents.

Chart 1A
Euro zone: Monetary base and banks’ reserves at the ECB (EUR bn)

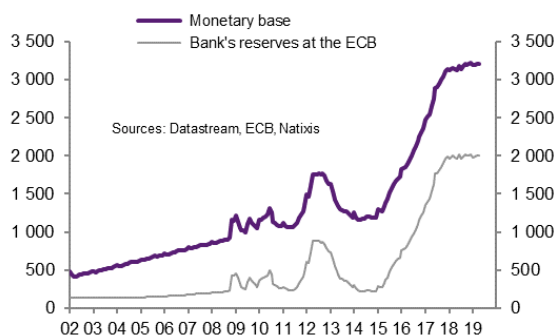


Chart 1B
Euro zone: Interest rate on 10-year government bonds (as %)

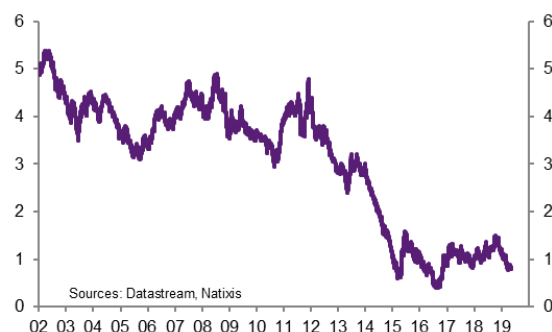


Chart 1C
Euro zone: Interest paid on the public debt (as % of nominal GDP)

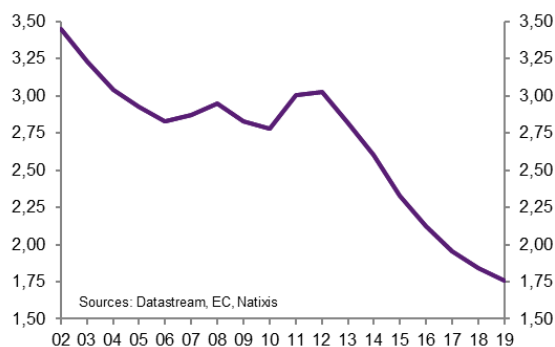
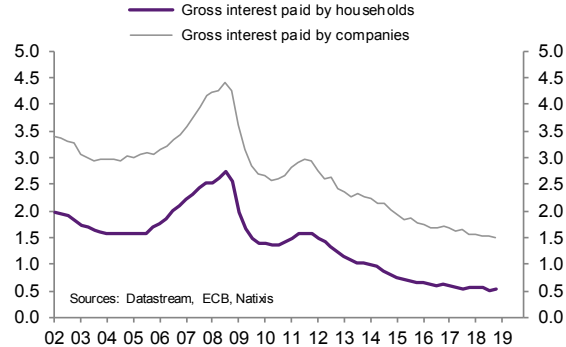
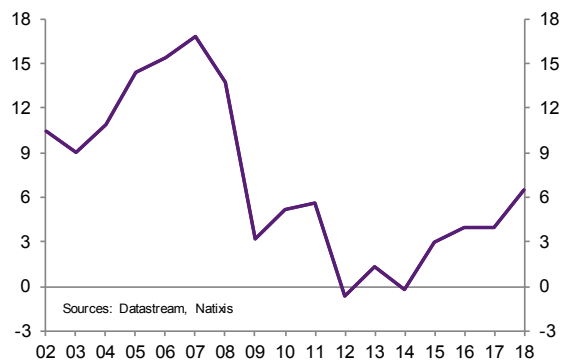


Chart 1D
Euro zone: Interest paid by companies and households (as % of nominal GDP)



Lastly, it is well known that the **persistently low interest rates have worsened banks’ profitability (Chart 1E)** due to the squeezing of intermediation margins.

Chart 1E
Euro zone: Banks' RoE (as %)



Second “left-wing” criticism of the ECB's monetary policy since the crisis: It would have been better to use "helicopter money"

Helicopter money consists in distributing money directly to certain economic agents for the purpose of boosting their income; the argument is that helicopter money is **targeted money creation** (the central bank chooses what money creation should be used for) and not random money creation like quantitative easing.

But in reality:

- Governments can choose additional types of public spending (**Chart 2A**): transfer payments to households, public investments;
- They can finance this public spending by issuing bonds (**Chart 2B**);

Chart 2A
Euro zone: Public spending
(as % of nominal GDP)

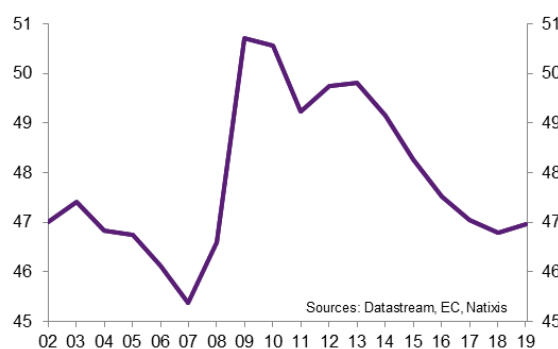
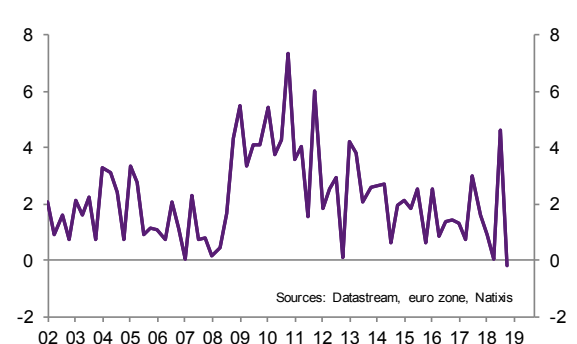
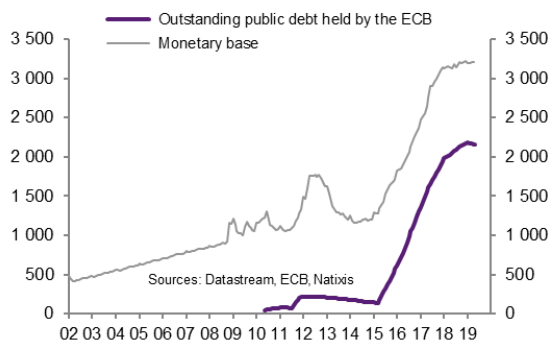


Chart 2B
Euro zone: Net issuance of government bonds
(as % of nominal GDP)



- And these bonds can be immediately bought by the ECB against money creation (**Chart 2C**).

Chart 2C
Euro zone: Outstanding public debt and monetary base (EUR bn)



In that case, it is as if the additional public spending was carried out through the distribution of money to economic agents, and therefore as if there was helicopter money.

Third "left-wing" criticism of the ECB's monetary policy since the crisis (criticism of modern monetary theory): Fiscal policy has not been used to run up larger fiscal deficits.

Modern monetary theory says that it is possible to conduct a very expansionary fiscal policy provided that the fiscal deficits can be monetised. The euro zone's fiscal policy is often criticised for remaining too restrictive (Chart 3A).

But this cannot be blamed on monetary policy: the ECB's government bond purchases (Chart 2C above) have kept interest rates low (Chart 1B above), and this has reduced interest payments on the public debt (Chart 1C above) and enabled the public debt to be higher.

If fiscal policy has remained quite restrictive afterwards, it is because of the choice of a very restrictive fiscal policy in Germany (Chart 3B), not an over-restrictive monetary policy.

Chart 3A
Euro zone: Fiscal deficit and public debt (as % of nominal GDP)

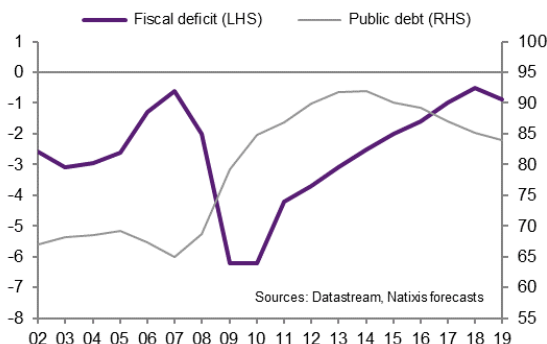
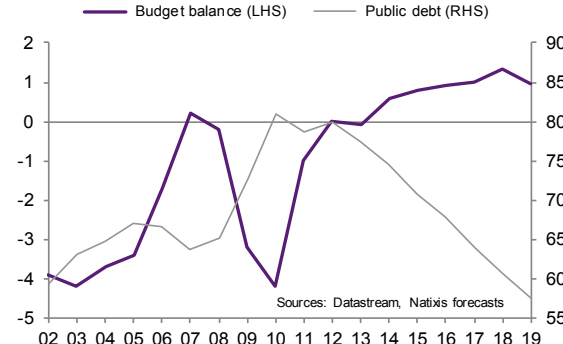


Chart 3B
Germany: Budget balance and public debt (as % of nominal GDP)



Conclusion: The "left-wing criticism" of the ECB's monetary policy should be rejected

The ECB's monetary policy:

- Has been positive for governments, households and companies, but not for banks given the squeezing of intermediation margins;
- Has been equivalent to "helicopter money", i.e. using money to carry out the desired government transfer payments;
- Has enabled the governments that wanted to do so (not Germany) to conduct a very expansionary fiscal policy.

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