

Money, interest, and prices.

Basics and current problems of **European monetary policy**

Guest lecture for Jade-Univ. of Applied Sciences (Prof. Köster); Wilhelmshaven, Dec 10 - 2024

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Introduction: *Monetary policy, back and forth*

1. Basics: Monetary policy between inflation und deflation

1.1 General aspects: money in the economy und monetary steering

1.2 E(S)CB, Bundesbank., ... – monetary policy in the Euro area

2. Current monetary policy: Where are we in the interest rate cycle?

2.1 Looking back: Monetary Policy Course after the Great Financial Crisis

2.2 Snapshot: Inflation, disinflation, and monetary policy shift(s)

2.3 Outlook: Normal times ahead?

3. ‘Green, digital, etc.’ – other challenges

Conclusion/Discussion: *Before/In/After the Crisis? What's Next?*

... any questions/remarks? You´re welcome!

Intro

Inflation issues

Modern economies are essentially **monetary economies**. Therefore, **stable money** represents an important public good for smooth operations; ensuring this is usually one, if not the core task of **central banks**.

After years of (too) weak price increases, **inflation** has meanwhile surged significantly and reached levels not seen in a long time. Finding the right monetary policy response was not easy in an environment characterized, among other things, by residual risks from the coronavirus and high levels of debt. The Eurosystem, for example, initially only cautiously corrected its previously very expansive course, but then made a significant course change from July 2022 onwards.

However, with the subsiding of inflation, the monetary policy environment has brightened again. There have already been initial interest rate cuts recently... – but will there be more?

Suddenly, inflation was there ...



Ökonomisch vorgebildet – Im Jahr 1976 erhielt Milton Friedman den Nobel-Gedächtnispreis für Wirtschaftswissenschaften. Inflation war das Thema seiner Zeit. Im selben Jahr erschien der letzte Asterix-Comic, den Texter René Goscinny zu Lebzeiten veröffentlichte. Darin erschuf

er ein kleines ökonomisches Weltmodell, in das durch einen exogenen Nachfrageschock nach Hinkelsteinen zuerst die Spezialisierung, dann Inflation einzieht. Denn es fehlte an Friedmans Geldmengenkontrolle. Was lehrt uns der Comic über die heutige Inflation? **Seite 18** Abbildung Egmont Ehapa Media

Quelle: FAZ, 11.02.2022 (i.O. "Obelix GmbH & Co. KG")

Insertion 1:
Introducing Deutsche Bundesbank



Deutsche Bundesbank, a *central* bank

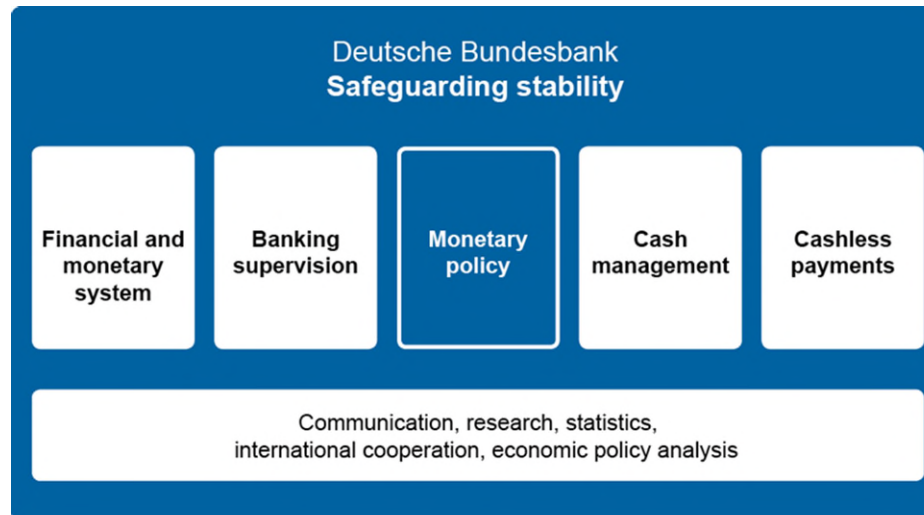
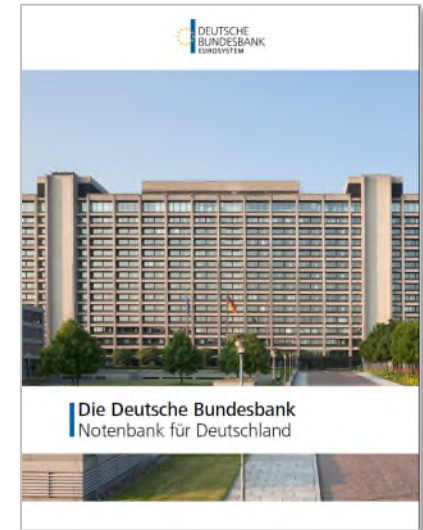
... not a 'normal' bank!

Bundesbank institutionally with a **double role**:

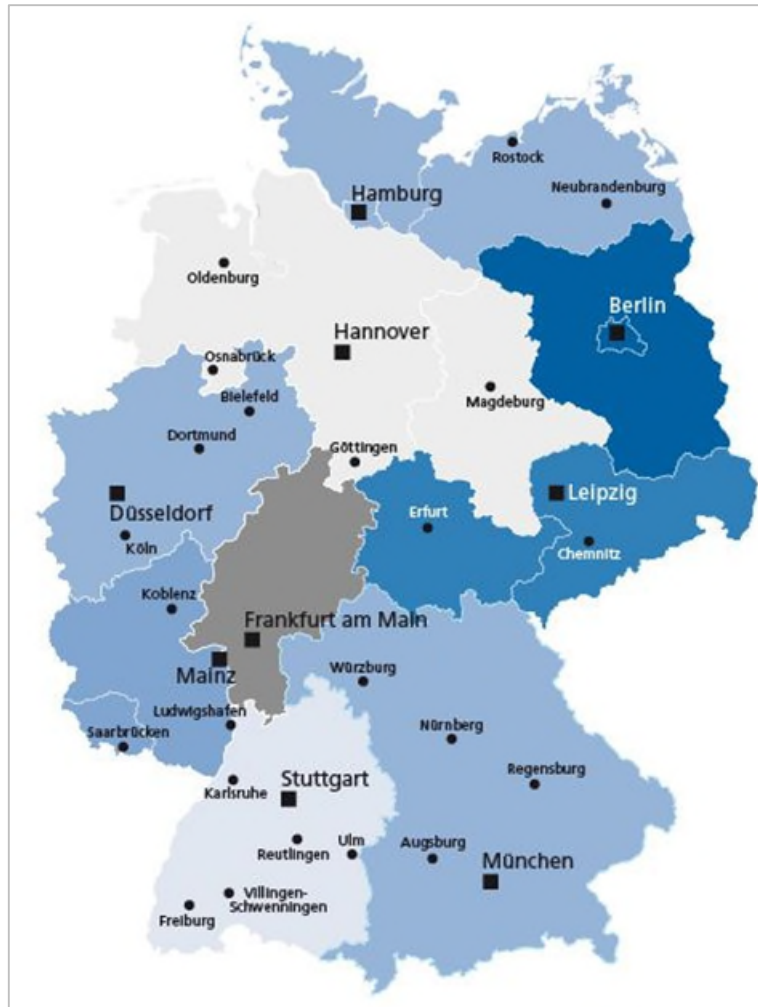
- central bank of the Federal Republic of Germany
- Part of the ESCB/the Eurosystem

i.e. tasks on a national and on an European level.

Five **core business areas**, main task: price stability.



Bundesbank's organization: Central Office, Regional Offices and branches



Central Office (Frankfurt/M.)



9 Regional Offices,
e.g. Hannover (for BNS area)



31 Branches (2024),
5 in BNS area: GÖ, Hann., MD, OL und OS.



... 'on site' in BNS

Regional Office + Branches

Bundesbank with three level **organisation**:
Central Office / 9 Regional Offices / 31 Branches;
of which: **Regional Office in BNS** with 5 branches

Central bank tasks within the region,
e.g.:

- Cash provision/management
via the five branches (GÖ, H, MD, OL, OS)
- Cashless payment services
- Banking supervision
- External factor audit
- Inhouse credit assessment system
- Financial literacy support / Public relations



Monetary policy: ...

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Local central bank history: Wilhelmshaven branch

‘Once upon a time’ ...

Wilhelmshaven as a central bank place

- Start: subordinate Reichsbank branch since ...
- Reichsbank branch since 1907...
- Branch of Land Central Bank in Lower Saxony since ...
- ...



Reichsbankgebäude (1906-1944)



LZB-Dienstgebäude 1950-1978



LZB-Dienstgebäude ab 1978
Parkstraße 23;
geschlossen ...



Monetary policy ...

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Career opportunities at Deutsche Bundesbank

With a school leaving certificate

Office management assistant

Position in the Bundesbank's Intermediate Service

Chef

Catering assistant

With a university entrance qualification

Bachelor of Science in Central Banking (dual study programme)

Bachelor of Science in Applied Computer Science (dual study programme)

With a university degree

The Bundesbank's civil servant training programme

Fast-track trainee programme

Direct entry

For more information, visit:

<http://www.bundesbank.de/Navigation/EN/Bundesbank/Career/career.html>

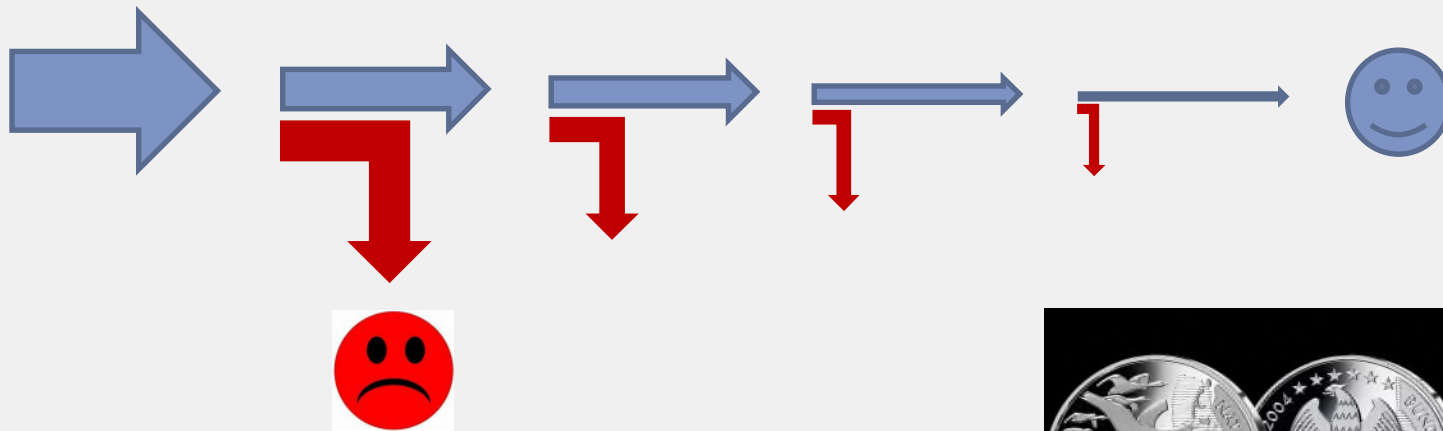
Insertion 2: Quiz



Quiz (Intro)

Testing your knowledge

→... elimination game!



The price:



Question 1 – Monetary union

How many countries – at present – are member of the European Monetary Union?

a) Eleven (11)

or

b) twenty (20)

or

c) twentyseven (27)



Question 2 – ECB personalia

Who is the chief economist of the ECB?

a) Christine Lagarde



or

b) Philip R. Lane



or

c) Isabel Schnabel



Question 3 – Gold

What's the weight of a standard gold bar in the Bundesbank safe?

A 1,8 Kilo

or

B 7,0 Kilo

or

C 12,5 Kilo



Frage 4 – Money market steering

Which one of the three ECB policy rates at present primarily steers the monetary policy stance?

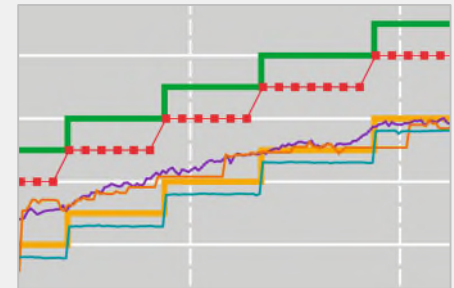
a) The deposit facility rate

or

b) the rate on the main refinancing operations

oder

c) the Euro Short-Term Rate (€STR)



Frage 5 – Anti-crisis policy

How much bigger was the Eurosystem's balance sheet at the end of 2021 in comparison with the end of 2006?

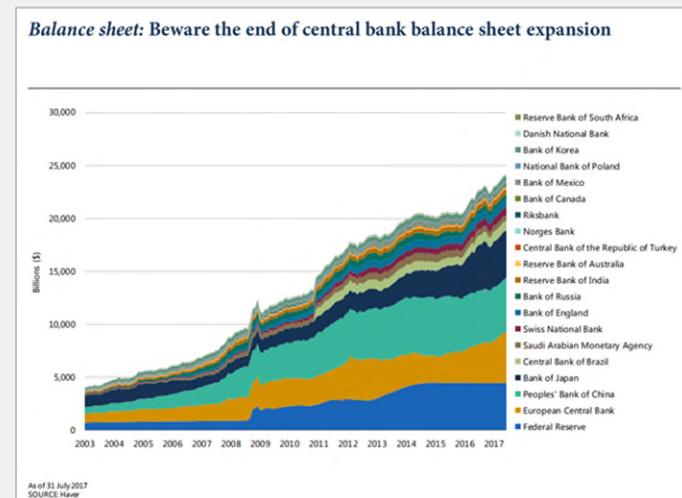
a) 5 times

oder

b) 7 times

oder

c) 9 times



Question 6 (final) – Cash

How many €uro banknotes in total circulated at the end of 2023?

[Open question: the one who is closest to the correct number, wins!]

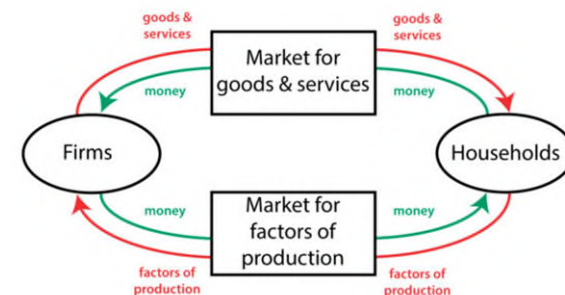
..... **Quantity (millions)**

1. Basics: Monetary policy between inflation und deflation



Money, monetary policy, central banks

Generally: Ensuring stable money



The very basic **core of all monetary policy**:

Central banks monitor and indirectly steer the amount of money in the economy.

Background: Modern economies as **monetized economies!**

(Costs of inflation/deflation!)

... money functions: unit of account / medium of exchange / store of value.

Modern money as *fiat* money unlike gold etc. without intrinsic value

→ Money creation potential:

Cash	}	„Outside“ money
Deposits with the Central Bank		
Loans by commercial banks		

→ Thus: Scarcity of money to be ensured ‘artificially’ *via* monetary policy
(restriction of potentially destabilizing money creation capabilities of banks).

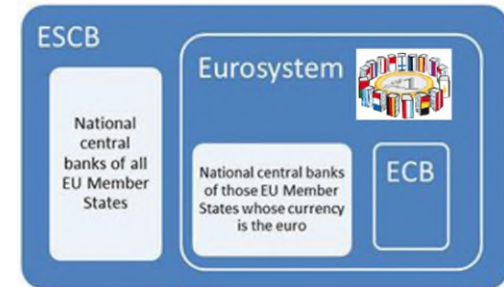
E(S)CB, Bundesbank., ... – monetary policy in the Euro area

Special case: the Eurosystem's monetary policy

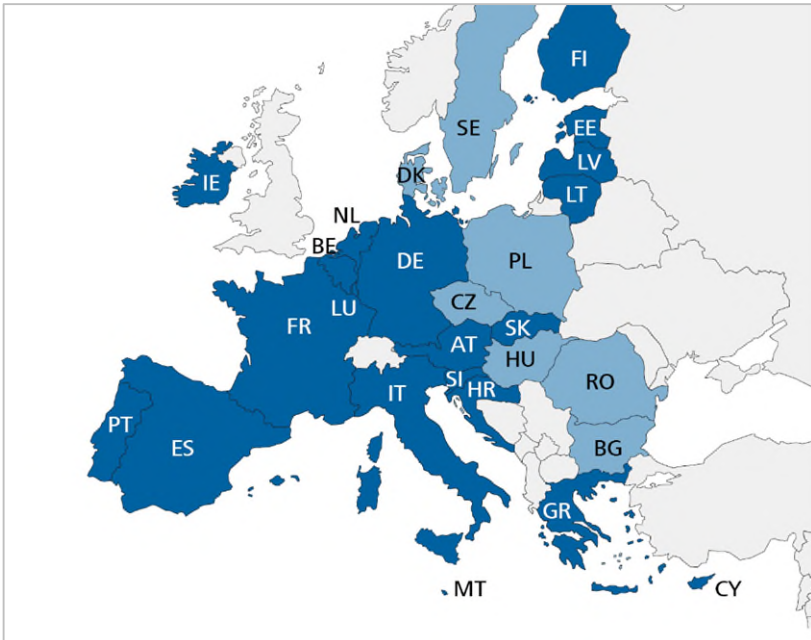
Among the variety of monetary policies worldwide **monetary policy in the Euro area** is specific.

Distinctive **features**:

- Institutional: E(S)CB/ Eurosystem, i.e. ECB + NCBs
Independence; Eurozone as area of operation
- Goal(s): Price stability as the main target;
only subordinate support of general economic policy
(prohibition of public sector financing by central banks)
- Strategy: quantitative definition of price stability [HICP '2%' (since 2021)],
and (since 2021) integrated analytical framework
(*economic analysis and monetary and financial analysis*, mutually dependent)
- Instruments: open market operations, standing facilities; minimum reserve requirements;
since 2009 several non-standard measures, e.g. asset purchases



Euro Area/EMU



‘Playground’ Euro area

European monetary policy acts in a specific ‘area of responsibility’: **Euro Area** (Attention: Europe \neq EU \neq EMU!); a very special design: a common monetary policy for 20 sovereign countries.

EMU start 1999 with 11 of 15 EU member states [UK, DK, SWE – to this day – not willing; GR (at first) not allowed],

At the moment 20 member states (latest accession: Croatia, Jan 1 - 2023)

Open accession process

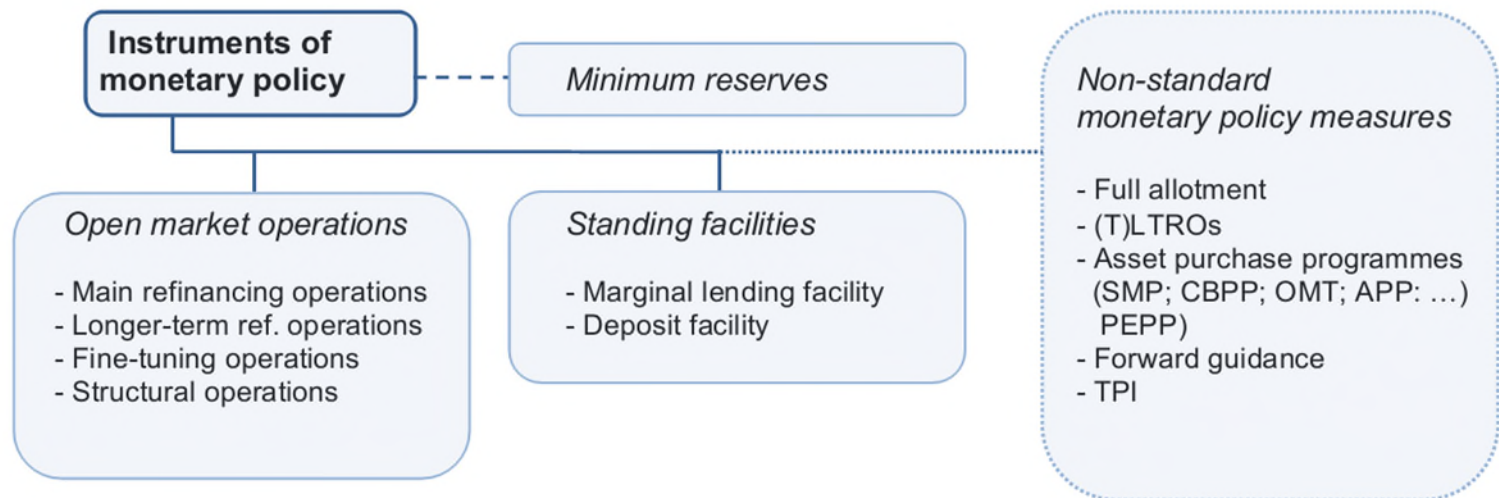
→ Convergence assesment / criteria for candidate countries (e.g. BUL); occasionally big **tensions** (esp. GR, ITA, ...; so called ‘Euro crisis’)!)

Eurosystem's operational framework

Monetary policy instruments

The Eurosystem uses a **set of monetary policy tools**, which influence financing conditions and the level of economic activity in the euro area which in turn affect inflation. All are to be seen in context.

The primary monetary policy instrument (apart from minimum reserves) is the set of ECB policy rates; since the financial crisis, the ECB has expanded its set of policy instruments by several non-standard measures, since in the wake of the financial crises short-term interest rates approached their 'effective lower bound'.



Transmission mechanism of monetary policy

Transmission (im)possible

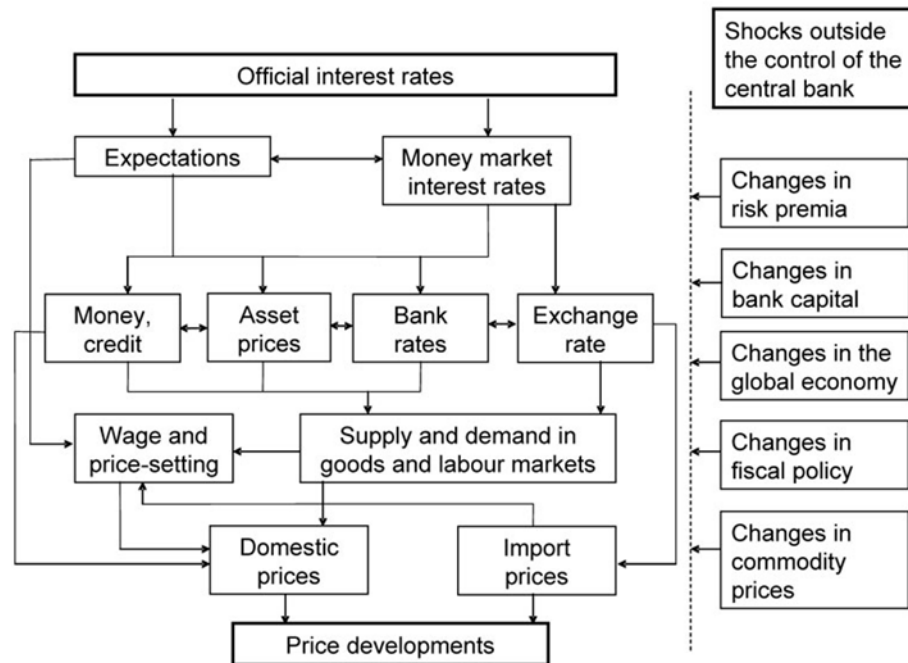
Attention: **indirect steering only** of central banks' monetary policy:

- no *direct* influence on prices,
- *indirect* effects only via impulses on financial conditions (pass-through through the economy)

The **transmission mechanism** is characterised by long, variable and uncertain time lags. Thus it is difficult to predict the precise effect of monetary policy actions on the economy and price level.

Important monetary transmission channels: *interest rate* channel / *credit (bank lending)* channel / *balance* channel / *asset price* channel / *exchange rate* channel / ... (difficult to isolate single effects).

Schematic illustration of the main transmission channels



Source: ECB.

Looking back: Monetary Policy Course after the Great Financial Crisis

‘Normal’ ≠ ‘exceptional’ times

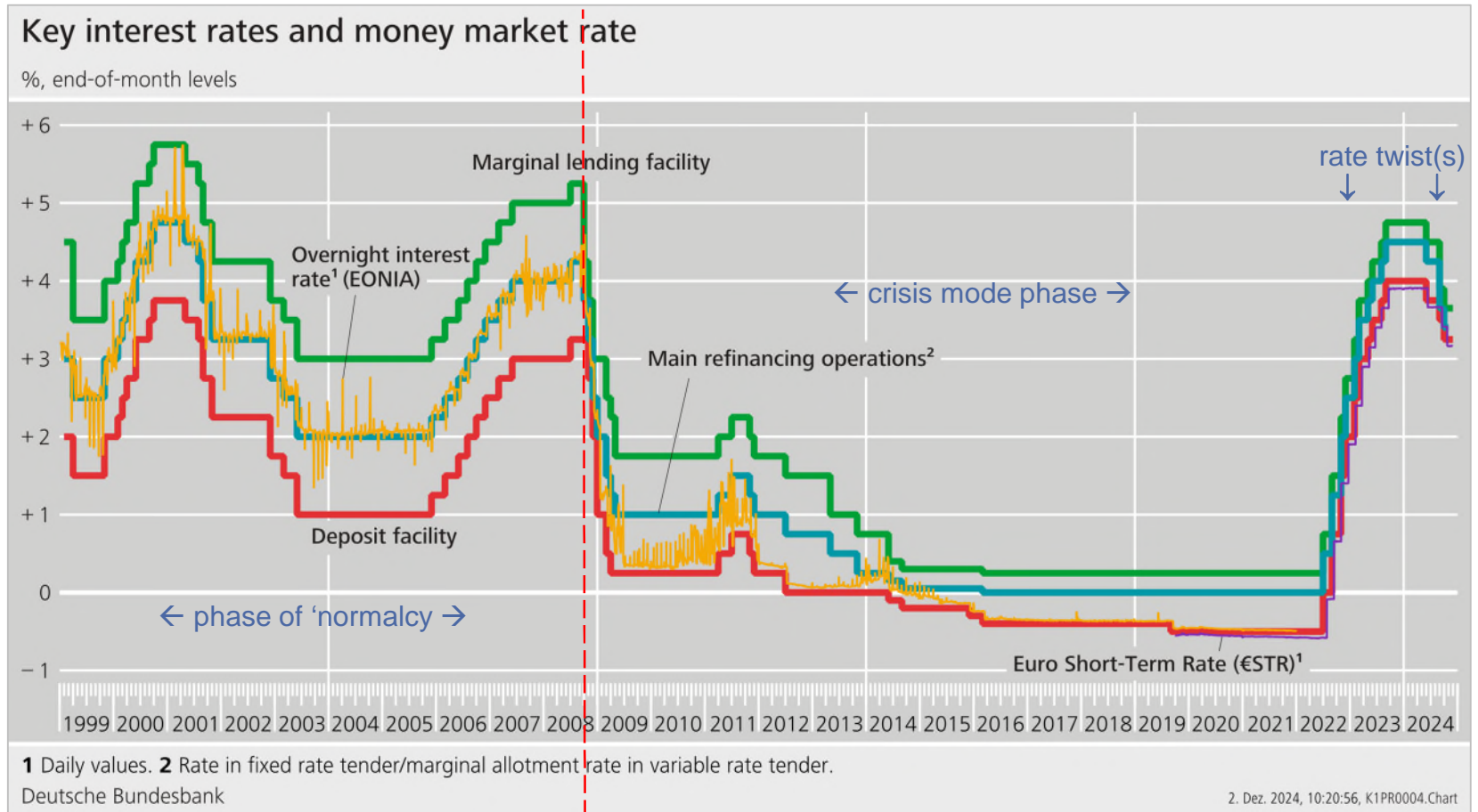
In retrospect monetary policy in the Euro area went through **different phases**, what amounted to a paradigm shift:

- up to 2007 EMU monetary policy without extreme tensions: **‘classical’ monetary policy** (up to GFC) following a normal cyclical pattern
 - dynamic economy (\approx inflation risk high) \rightarrow restrictive course
 - sluggish economy (\approx inflation risk low) \rightarrow expansive course
- from 2007/08 on completely changed setting due to the Great Financial Crisis and its aftermath : **Crisis mode** with sharp interest rate reductions and strongly relaxed liquidity policy, partly with ‘unconventional’ measures in order to support the financial sector/the economy.



... from summer 2022 on, however, **‘exit’ from crisis mode** through termination of several non-standard measures and interest rate increases.

Looking back: Policy rates of the Eurosystem over time (1999-2024)



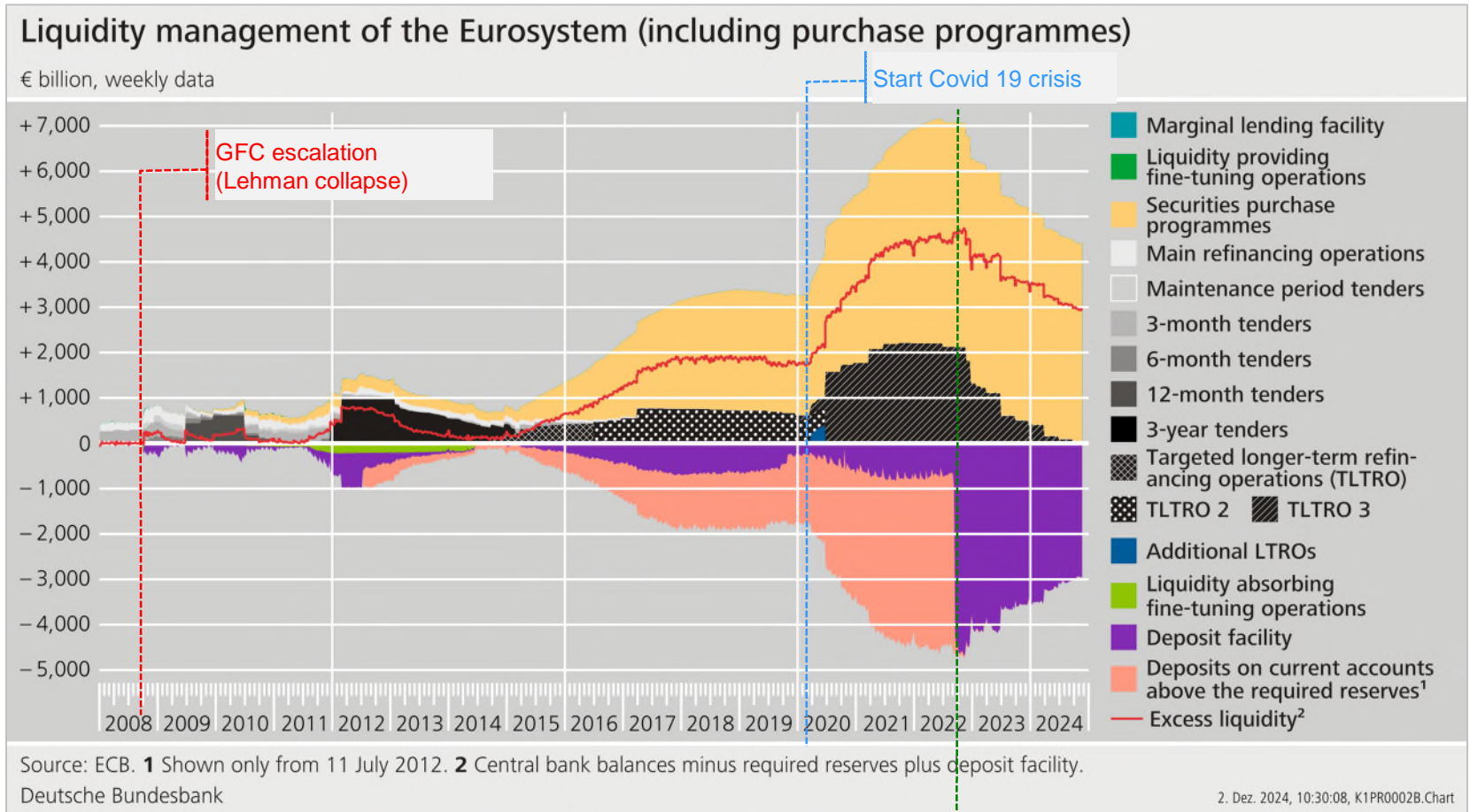
GFC escalation
 (Lehman collapse), 2008-09

Monetary policy: ...

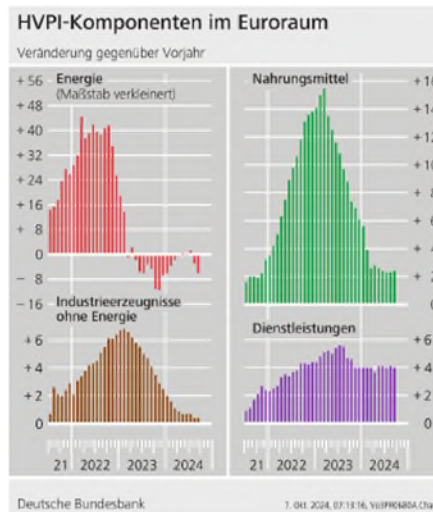
Dec 2024

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Looking back: Liquidity provision of the Eurosystem over time (2008-2024)



2. Current monetary policy: Where are we in the interest rate cycle?



Changed setting in 2021/22: revived inflation worries

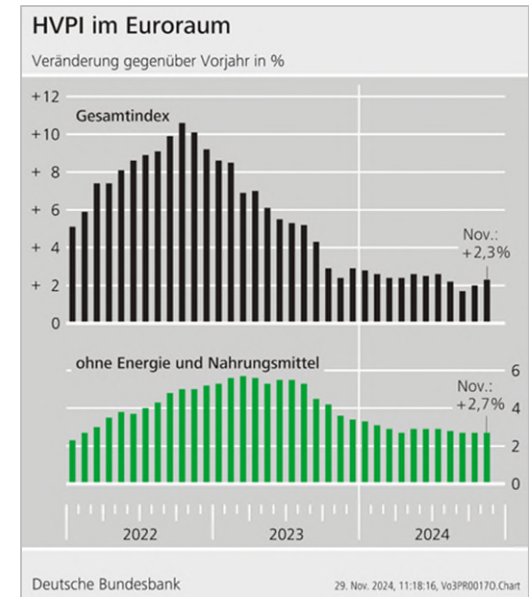
Inflation comeback

Ending a long period of (overly) moderate inflation a sharp turnaround in price developments occurred in spring 2021; causing **inflation worries**.

Core questions for monetary policy:

- Inflation surge only *temporary*,
- or *permanently* higher inflation path?

Risk of long and high inflation, ECB at first optimistic for a quick return to low inflation rates and hesitant with respect to a policy change; by and by, however, more worried and finally with a strong reaction.



Growth and inflation projections for the euro area

(annual percentage changes, revisions in percentage points)

	September 2024				Revisions vs June 2024			
	2023	2024	2025	2026	2023	2024	2025	2026
Real GDP	0.5	0.8	1.3	1.5	-0.1	-0.1	-0.1	-0.1
HICP	5.4	2.5	2.2	1.9	0.0	0.0	0.0	0.0
HICP excluding energy and food	4.9	2.9	2.3	2.0	0.0	0.1	0.1	0.0

Quelle: ECB, Sept. 2024.

Nevertheless, return to lower inflation rates always expected (now materializes).

... inflation picture now [autumn 2024]

At present: *disinflation*

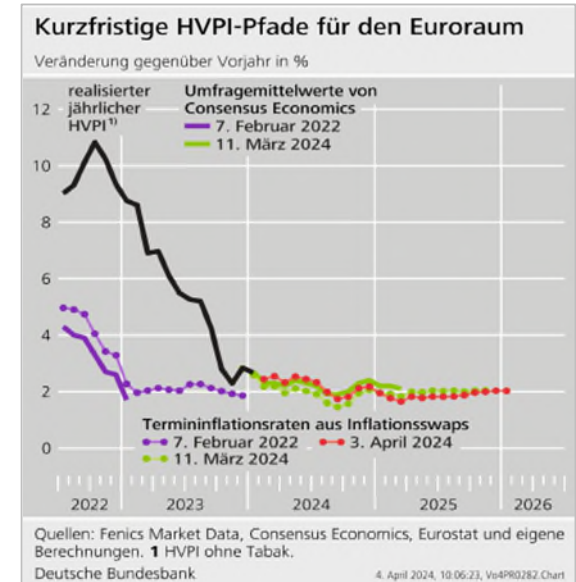
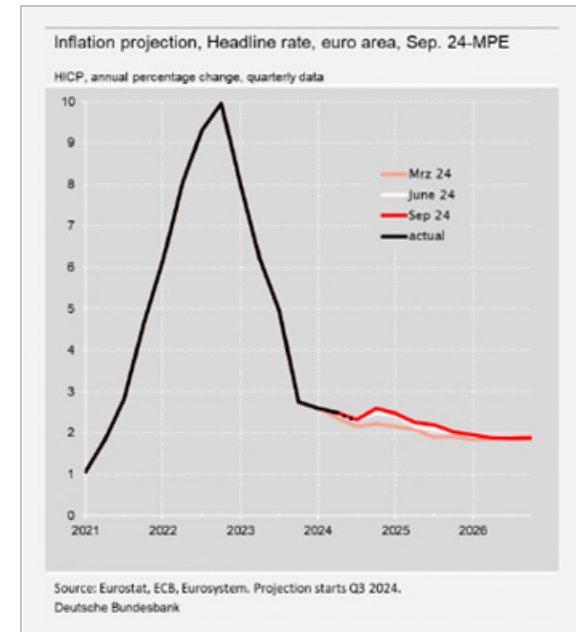
After the strong inflation surge of two years ago now significantly **moderated price developments** :

- October 2022 as peak, since then reduction,
- ... but still not firmly on target.
- Near term Inflation expectations as well still slightly above 2% inflation target
- ... however, compared with inflation peak low.
- Somewhat higher inflation level expected in the long run (due to labour shortages, ...), but concerning this matter uncertainty prevails.

Monetary policy ...

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Quelle: ..

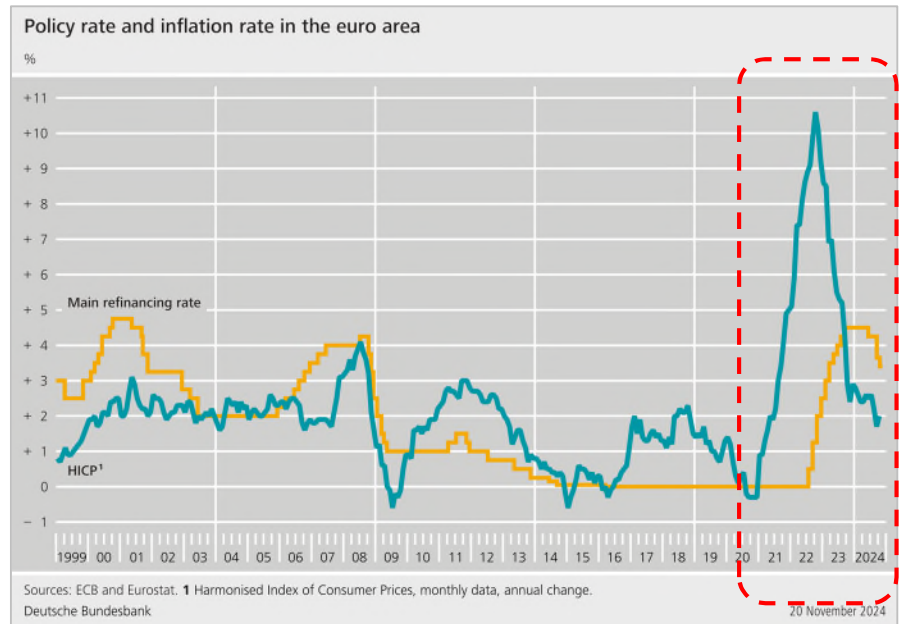
Monetary policy answer(s)

Bye, bye, crisis mode

Actual course still slightly restrictive, reflecting the recent inflation surge: policy rates still high, although not very high; refinancing conditions stricter, but not much.

Background ('path dependency'):

- Starting point: long time ultra-loose policy in the aftermath of the GFC (only hesitant departure from that due to worries about negative effects), ... amplified by measures against Covid19 shock 2020/21 (PEPP, PELTROs etc.).
- Changed setting with first policy reactions from 2021/22 on; since **summer 2022** enhanced Inflation worries and **significant policy shift**;
- ... later (see next slide)



What's next? (Autumn 2024)

Outlook: 'How low how fast'?!

Another change of the setting: ongoing disinflation process induced an end of the policy tightening in autumn 2023 and first easing steps in summer 2024.

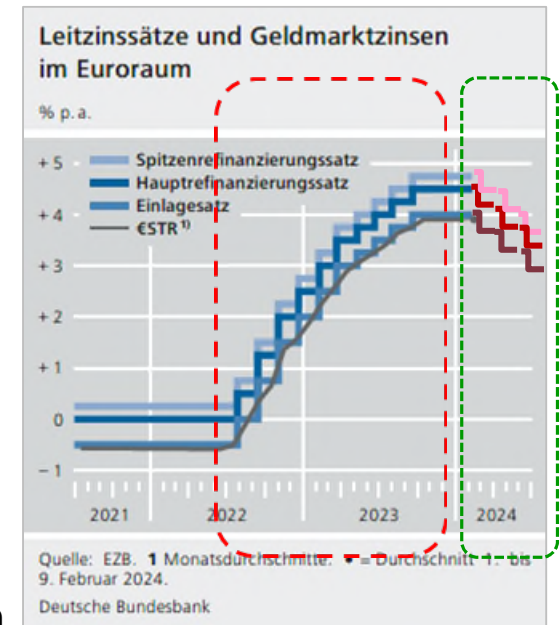
Remaining question: speed and degree of relaxation.

Recap: **Elements of tightening 2022/23:**

- ten interest rate since summer 2022, policy rates within one year 450 bp higher (deposit facility rate peaking at 4,00%).
- End of net asset purchases / start of balance sheet reduction.
- But, overall, not yet fully 'normalized' monetary policy.

At present: Disinflation and **start of easing**

(--> 6/6/2024: first policy rate lowering by 25 bp, again 12/09 and 17/10), future course, however, not predetermined due to uncertainties.



Quelle: Dt. BBk.: MB Febr. 2024, S. 25.

Environment of monetary policy (real economy)

Delayed recovery

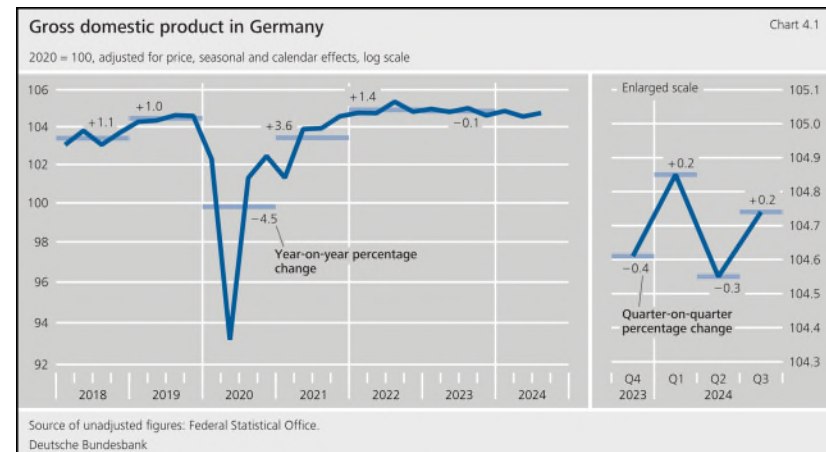
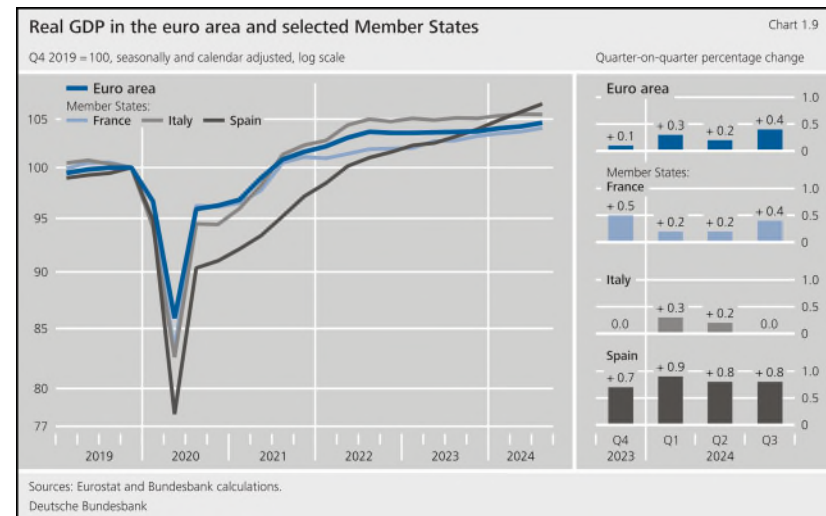
European and German economies at present sluggish.

Restraining factors especially:

- weak external demand of industrial products and hesitant private consumption
- more restrictive financing conditions due to the monetary tightening 2022/23
- higher financing costs for investment.

Next year, however, a slightly more dynamic economic development is expected.

Attention: looming *long term* growth problems more serious than *short term* cyclical problems!



Monetary policy, which way?

In a nutshell:

- The last years have seen monetary policy in intensive motion not seen for a long time
- ... first, economic stabilization and the inflation surge prompted an exit from the crisis mode in form of a sharp tightening, then, with disinflation, the setting changed again, inducing a new easing process.
- ... the further course is not predetermined but will be fixed data-dependent.
- On the whole, monetary policy appears somewhat more, but not totally 'normalized'.
- Apart from current issues the central bank faces structural challenges in several areas.

Monetary policy ...

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Global economy

OECD warns central banks against hasty rate cuts while threats persist

SAM FLEMING — LONDON

The OECD has warned central banks against cutting interest rates too fast, flagging the threat posed by "persistent" inflation in the price of services.

The Paris-based organisation said in its latest global outlook that the world economy was showing "remarkable resilience", as it welcomed a continued retreat in overall price pressures following the severest bout of inflation for a generation.

Its growth forecast for the US, the world's largest economy, was sharply upgraded to 2.4 per cent next year, compared with 1.6 per cent in its September outlook, driven by solid consumption and underpinned by "brisk" wage growth.

Central banks in most of the OECD economies have cut rates in response to the fall in price pressures, with headline inflation in October back at target levels in about two-thirds of advanced economies covered by the report.

But with services price inflation at a median of 4 per cent across the group of rich nations, central banks could not afford to loosen their grip too much, the report said.

"Failing to durably contain inflation would only increase the risks to growth and real incomes," said Álvaro Pereira, the OECD's chief economist. "Even though the global economy is expected to remain resilient, risks and uncertainties are high."

The OECD added in its outlook: "Persistent services inflation may jeopardise the ability to meet inflation targets."

Many countries still had rates of core inflation — a measure that excludes changes in the price of food and energy, and is seen as a better gauge of underlying price pressures — that were higher than desirable, the OECD warned.

The prices of half the items in the inflation baskets of the US and UK were still growing at an annual rate that exceeded 3 per cent in October, the OECD found.

While the organisation predicted global growth of 3.3 per cent in 2025 and 2026, up from 3.2 per cent this year, it warned that rising protectionism and geopolitical conflicts threatened to weigh on growth.

Growth in China was also upgraded to 4.7 per cent for next year, while India was poised for a stronger than expected expansion of nearly 7 per cent in 2025, the OECD said.

Central banks are expected to continue cutting rates into 2025 and, in some cases, 2026 in all the major advanced economies other than in Japan, where borrowing costs are heading higher.

The European Central Bank's benchmark deposit rate, now 3.25 per cent, should bottom out at 2 per cent towards the end of 2025, said the OECD. The US Federal Reserve's target range would be lowered from 4.5-4.75 per cent currently to between 3.25-3.5 per cent by the first quarter of 2026, it forecast.

The OECD also flagged a rise in housing costs in several member countries, led by the UK, Canada, Australia and Latvia.

Labour shortages, meanwhile, were particularly severe in healthcare and information technology, the organisation said.

Latest interest rate decision of the Eurosystem

... 'data-dependent'!

“The Governing Council today decided to lower the three key ECB interest rates by 25 basis points. (...) The incoming information on inflation shows that the disinflationary process is well on track.

(...)

The Governing Council is determined to ensure that inflation returns to its 2% medium-term target in a timely manner. It will keep policy rates sufficiently restrictive for as long as necessary to achieve this aim. The Governing Council will continue to follow a data-dependent and meeting-by-meeting approach to determining the appropriate level and duration of restriction. (...) The Governing Council is not pre-committing to a particular rate path.“

[EZB: Declaration on monetary policy / Ljubljana, October 17 - 2024]

Supplement: ECB 'ornithology'



ECB 'centre of power

Members of the ECB council as perceived (dovish/neutral/hawkish) by financial market actors.

Taube	Neutral	Falke
<p>Philip R. Lane, EZB-Direktorium</p> <p>Fabio Panetta, EZB-Direktorium</p> <p>Ignazio Visco, Italien</p>	<p>Isabel Schnabel, EZB-Direktorium</p> <p>Frank Elderson, EZB-Direktorium</p> <p>Gediminas Šimkus, Litauen</p>	<p>Robert Holzmann, Österreich</p>
<p>Pablo Hernández de Cos, Spanien</p> <p>Giannis Stournaras, Griechenland</p> <p>Konstantinos Herodotou, Zypern</p>	<p>Edward Scicluna, Litauen</p> <p>Boštjan Vasle, Slowenien</p> <p>Peter Kažimír, Slowakei</p>	<p>Joachim Nagel, Deutschland</p> <p>Klaas Knot, Niederlande</p> <p>Pierre Wunsch, Belgien</p>
<p>Tendenziell Taube</p> <p>Christine Lagarde, EZB-Präsidentin</p> <p>Mário Centeno, Portugal</p> <p>Olli Rehn, Finnland</p> <p>Gabriel Makhlouf, Irland</p> <p>Luis de Guindos, EZB-Vizepräsident</p> <p>François Villeroy de Galhau, Frankreich</p>	<p>Gaston Reinesch, Luxemburg</p>	<p>Tendenziell Falke</p> <p>Mārtiņš Kazāks, Lettland</p> <p>Madis Müller, Estland</p>

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Quelle: BöZ, 15. Juli 2022 ("Tauben in der Mehrheit – Falken am Drücker").

3. 'Green, digital, etc.' – other challenges



New challenges in a changing environment

Structural challenges

Beyond current issues of monetary policy in the narrow sense, the Eurosystem faces **structural challenges** in other areas due to changes in the broader environment.

Important developments, e.g.:

- **long term trends** of economic growth, interest rates and inflation and new experiences (reason for the 2020/21 strategy review)
- intensified debate on crypto currencies or central bank digital currencies due to financial innovations and progressing **digitalization**,
- rising awareness of sustainability questions in response to more urgent **ecological problems**.

Changing environment, changing strategy

Strategy review

In recent economic history ‘news‘ for monetary policy especially in form of:

- suspected lower equilibrium real interest rate in conjunction with low inflation (thus less room for manoeuvre for conventional interest rate policy);
- experience of several heavy shocks (GFC, Covid 19 pandemics) and the use of unconventional policy measures related to that.

Reason for the Eurosystem’s **strategy review** 2020/21

Results: Slightly adapted strategy:

- clearer inflation target (2%, symmetric);
- stronger focus on financial stability in the integrated analytical framework;
- new monetary policy instruments in the ECB’s toolkit
- ...

but overall not very revolutionary against the background of an already changed practise.

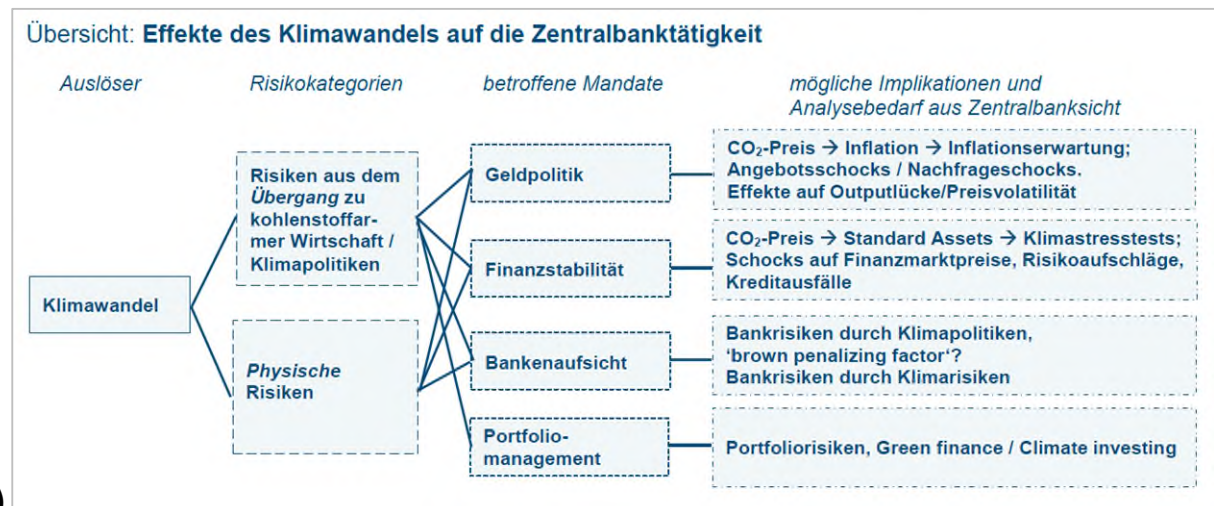
Climate change etc. ... – a task for central banks?

‘Green’ central banks?

Both climate change and climate policy with far-reaching implications for macro-economic developments, constituting *physical* and *transitory* risks, which will affect different sectors to varying degrees. Thus, ecological problems affect central banks too.

However, an *explicit* consideration of climate aspects in central bank policy is not trivial:

- practical problems (complex modelling, ...)
- restricted mandate of central banks as independent institutions (climate policy mainly as a task of democratically legitimized actors); but, supporting services of central banks can be helpful.



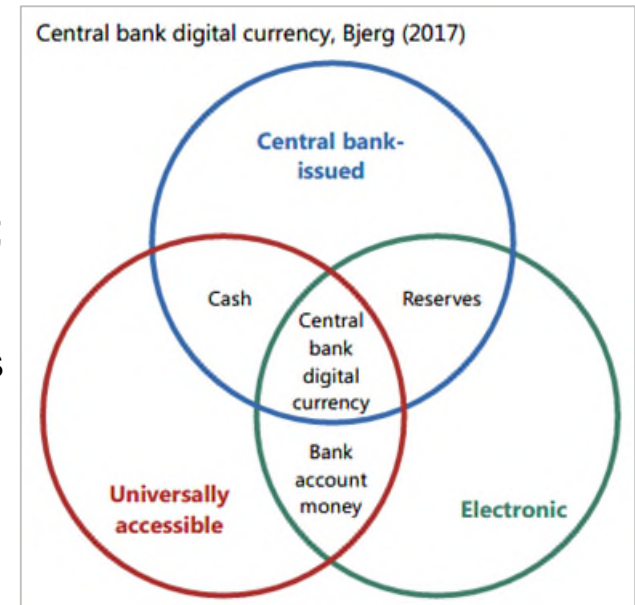
Digital challenge?

Increasing **digitalisation** as a challenge for central banks;
mainly for two reasons:

- Changes in payment systems und financial innovations (new suppliers: PayPal etc.; new techniques/products: DLT, NFC, ...);
relatively decreasing usage of cash
- Emergence of crypto currencies, claiming to offer a private (!) payment system alternative (Bitcoin, Ether etc.; Libra-/Diem stable coin project);

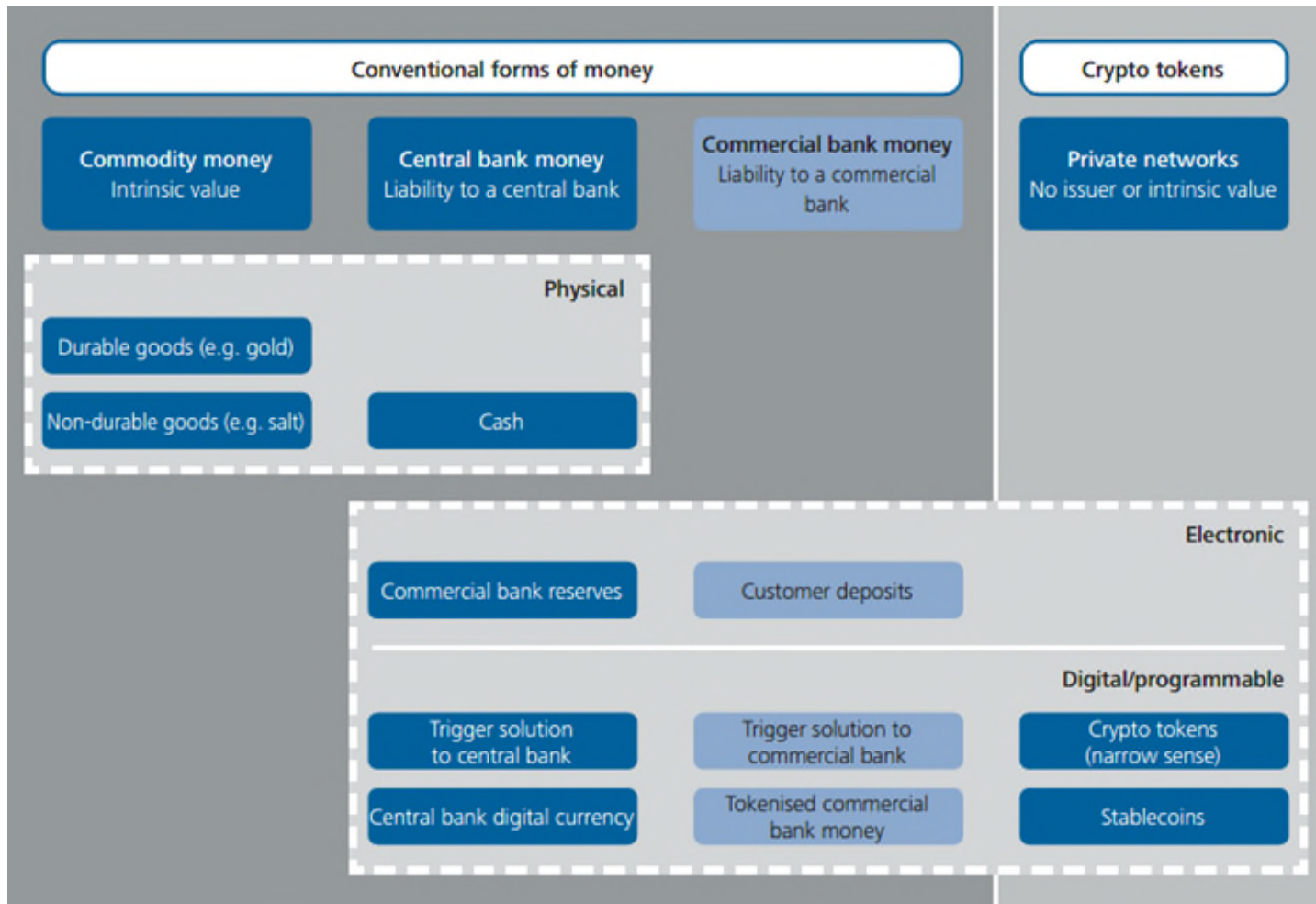
(Possible) **Implications for central banks**: reduced efficiency of monetary policy, financial stability risks; worries about monopoly of money provision.

→ Starting point for **CBDC initiatives** (e.g. dig€ of the Eurosystem);
still many open questions: which features, risks for banks, ...



Aus: BIZ: Quarterly report, Sept. 2017, p. 59

Forms of money



Discussion impulse: Monetary policy in the headlines [Autumn 2024]



Global economy: [_Financial Times , 5 Dec 2024_](#)

OECD warns central banks against hasty rate cuts while threats persist

Central banks: ***Good policy, not good luck*** [_The ECONOMIST, 14.08.2024_](#)

Though its workings have been obscured, monetary policy deserves the credit for bringing down inflation

Transatlantic divide on rates likely as US outpaces Europe [_Financial Times , 26 Nov 2024_](#)

Trump's plans for taxes and tariffs expected to stoke growth and inflation

Europe:

EU central bankers warn of decline [_Financial Times , 23 Nov 2024_](#)

French, German and ECB heads point to political paralysis stifling economy

Central bank:

ECB says high deficits risk fresh debt crisis [_Financial Times , 21 Nov 2024_](#)

French, German and ECB heads point to political paralysis stifling economy

Monetary policy:

ECB plans strategy switch as inflation falls [_Financial Times , 5 Dec 2024_](#)

Policymakers to ditch post-pandemic focus on short-term economic data

End

Thanks / Contact data

Thank you very much for your attention!

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End
Cartoon



Quelle: <https://www.bundesbank.de/resource/blob/908900/2048c2a2d68dc116343029ae6be5dd88/mL/geld-in-karikatur-und-satire-data.pdf>.

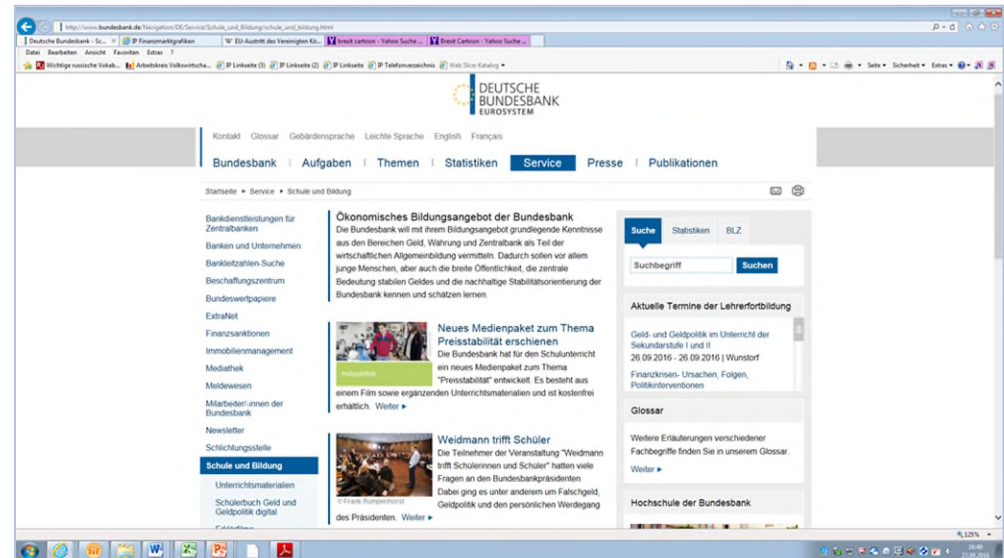
Concluding remarks

Information sources

More information ... ?!

More information available via e.g.:

- **publications**
(z.B. “Monthly reports“ etc.)
- **Bundesbank website**
incl. social media: Youtube etc.
- direct **contact** to Bundesbank employees
- lectures (“Forum BBk.“, ...) etc.
within the public relations or the financial literacy
framework



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