Secular Stagnation in Europe and Japan

Introductory remarks

Natacha Valla
CEPII

AEEF 2015
Monday 5 October 2015, 9:30-11am
Bruegel, Rue de la Charité 33, 1210 Brussels
One Way to Characterise « Prolongued » Stagnation

1. Macroeconomic conditions where S - I equilibrium at full employment can not be reached

2. Why? The natural rate (<0) is not attainable by the real market rate

3. Why? Central Bank stuck at ZLB

Per c. real GDP growth

Source: Aglietta and Brand in CEPII (2015). 10y m.a.
Symptom 1: Generalised Productivity Slowdown (Developed Economies since the 1970s)

Symptom 2: Secular Decline in the Natural Interest Rate

Trend estimate for advanced economies

Determinants of the long run equilibrium real rate in the euro area (%yoy)

Figure 1  Short- and long-term global real interest rates (% per year)

Note: 1 The sample consists of: United States, United Kingdom, Austria, Belgium, France, Germany, Italy, Netherlands, Norway, Sweden, Switzerland, Canada, Japan, Finland, Greece, Portugal, Spain, Australia, New Zealand. Global based on the GDP-weighted average.
Factors Behind Secular Stagnation: Prospects for Europe?

• Eggertson and Mehrotra (2014 NBER 20574)

• Persistent slump triggered by:

  • Deleveraging shock (➔ oversupply of savings)
  • Drop in population growth
  • Increase in income inequality
  • Fall in the relative price of investment
The Financial Momentum behind Secular Stagnation in Europe: Discrepancies

Estimates of the Financial Cycle « à la » BIS

Source: Brand and Aglietta in CEPII (2015). The financial cycle indicator is based on a smooth average of loans to GDP ratio, loan growth and real estate prices.
Financial Cycle after the « 2008 Turning Point »: Leverage Up Everywhere (but Discrepancies too)

Advanced Economies

Emerging Economies

Source: Aglietta and Brand in CEPII (2015).
Can the ECB Provide an Escape from Stagnation?

- ZLB complicates the situation (natural rate unattainable, etc)...

- ...but ZLB brought along non-conventional monetary polic(ies) (NCMP) at the ECB

=> Under which conditions can MP « derail » stagnation in Europe?

- By adopting an « asset manager » approach to monetary policy (integrate an « investment pillar » in the strategy)
- By becoming a proactive risk taker of last resort (choose risky assets over sovereign bonds)
- If accompanied by a « one-off » deleveraging (debt write-off)