Living with Single Monetary Policy

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- A monetary union is an arrangement where several countries have agreed to share a single currency amongst themselves. The European Central Bank formulates their monetary policy – a single central bank and interest rates.
- The European Economic and Monetary Union (EMU) consists of three stages coordinating economic policy, achieving economic convergence (that is, their economic cycles are broadly in step) and culminating with the adoption of the euro, the EU's single currency.
- The Copenhagen criteria is the current set of conditions of entry for states wanting to join the EU. It contains the requirements that need to be fulfilled and the time framework within which this must be done in order for a country to join the monetary union.

Living with Single Monetary Policy

Pros

- a single European currency will save on transactions costs: the EC's economists estimate the savings at 1 percent of EC GNP
- removing the uncertainty created by exchange-rate fluctuations will encourage additional intra-European trade and investment
- Euro has become a premier currency in the international financial market
- Restrictions between member countries on trade and free competition have gradually been eliminated,

Cons

- deprive Europe's national governments of a policy tool traditionally used to address their own macroeconomic problems
- European countries experience cyclical expansions and contractions at different times
- While monetary policy is unified fiscal policy is not (taxation and social welfare)

Requirements to Join ECB

- Each EU country must meet the five convergence criteria in order to go to the third stage and penalties may be imposed. They are:
- **price stability**: the rate of inflation may not exceed the average rates of inflation of the three member states with the lowest inflation by more than 1.5 %;
- **inflation**: long-term interest rates may not vary by more than 2 % in relation to the average interest rates of the three member states with the lowest inflation;
- **deficits**: national budget deficits must be below 3 % of GDP;
- **public debt:** this may not exceed 60 % of GDP;
- **exchange rate stability**: exchange rates must have remained within the authorised margin of fluctuation for the previous two years.

Effects Devaluation of currency

- the devaluation makes foreign products relatively more expensive for domestic consumers, thus discouraging imports. This may help to increase the country's exports and decrease imports, and may therefore help to reduce the current account deficit.

- A significant danger is that by increasing the price of imports and stimulating greater demand for domestic products, devaluation can aggravate inflation

ECB vs Fed Mandate

The ECB's primary objective is "to maintain price stability"; only without prejudice to this may it then contemplate its secondary objective, "to support the general economic policies of the Community."

The Fed's objective is "to promote effectively the goals of maximum employment, stable prices and moderate long-term interest rates."

Germany vs. Eurozone

	Germany	Euro
GDP		
12 Q1	0.5	0
12 Q2	0.3	-0.2
12 Q3	0.2	-0.1
12 Q4	-0.6	-0.6
Unemp.		
Dec. 11	5.5	10.4
Mar. 12	5.9	10.8
Jun. 12	5.6	11.2
Sept. 12	5.3	11.5
Dec. 12	5.2	11.7
Jan. 13	5.9	11.7
Inflation		
Mar. 12	2.09	2.7
Jun. 12	1.72	2.4
Sept. 12	1.98	2.6
Dec. 12	2.0	2.2
Jan. 13	1.5	2.0

Germany opposes ECB?

- ECB initiated a bond buying program opposed by Germany
- Program was passed and in use anyway
- Additional risk is spread among Eurozone weakening stronger economies
- Lower interest rates can encourage additional sovereign debt

Is Germany's current economic trend due to single monetary policy?

Resources

http://en.wikipedia.org/wiki/Economic_and_Monetary_Union_of_the_European_Union

http://www.econlib.org/library/Enc1/EuropeanEconomicCommunity.html

http://www.uiowa.edu/ifdebook/faq/faq_docs/EMU.shtml

http://europa.eu/abc/12lessons/lesson_7/index_en.htm

http://www.newyorkfed.org/aboutthefed/fedpoint/fed38.html

http://findarticles.com/p/articles/mi_m2633/is_2_16/ai_85587550/

Questions?