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European Macro: Buba Rides Again

"Monetary policy is no instrument of cyclical economic policymaking,"

"The ECB differs fundamentally from the U.S. central bank, the Fed, in terms of its task and strategy."

"In Europe we have a clear focus on a macroeconomic goal: the stability of the value of money. Price stability is the primary goal for the ECB."

"The ECB could never argue in the way the Fed did in justifying its most recent rate cuts, by citing markets and the economy."

"The upward risks are not as big as they were a few months ago but they have not disappeared." Ernst Welteke, Bundesbank President - April 25,2001 quoted in Die Zeit

Many have been misled during the past month by signs that the rate of growth in Euroland has receded and that the ECB would soon begin cutting short-term interest rates. The statement quoted above suggests attributing to the ECB a mode of analysis more suitable to the Fed can produce an errant forecast. Welteke's statement seems to clearly reject the notion that the ECB is likely to move its rates soon.

In fact, further statements by Welteke taken together constitute a clear restatement of the Bundesbank's view of the proper role for the ECB. In particular, it restates **Buba's** view that the long-term rate of economic growth cannot be positively influenced by changes in monetary policy. (In fact, the pre-ECB Bundesbank had the view that price stability was the pre-condition of achieving long term, sustainable economic growth.

In laying out that case, Welteke has reminded observers that the 'classical' case for the 'neutrality of money' is alive and well at the ECB. This posture puts the ECB somewhat athwart that of the Fed that has adopted a monetary policy that clearly takes into account the effects of asset price changes on real economic variables such as spending and investment

The ECB's refusal to be herded into a more relaxed monetary posture, in the face of persistent pressures on prices that have taken their barometric price indices well above the level desired by the ECB, highlights the distinction between a regime of inflation targeting and one that has multiple goals, such as the Fed ('maximum sustainable growth and price stability').

Clearly, this strongly worded statement from the President of the Bundesbank, who is also a board member of the ECB, is a response to criticism by U.S. Treasury Secretary, Paul O'Neill, that European growth will be affected by the U.S. slowdown. The President of the ECB, Wim Duisenberg, already made the case that Euro was largely insulated from US macro-economic disturbances. **Welteke has taken the argument one step further in that one could infer that even if the U.S. slowdown affected European growth, it is the movement of prices that should be the singular concern of the ECB.**

At the end of the day, it appears that the ECB has lashed itself to its mast of price stability, at least according to Welteke. Whatever 'hope' the U.S. might have that a more aggressive macro policy could come out of Europe seems to have been dashed...at least in the short run.

Before the Fed's last rate cut, there was a rumor in Europe that the Fed had been greatly disappointed by the failure to ease by the ECB on February 11. Perhaps, that was a principle element in the Fed's decision to intervene on an inter-meeting basis? It would not appear that the ECB position is likely to change unless the rate of change of EU prices fall within its stated criterion (not more than 2%). And, then? Perhaps, Euroland prices have to show a clear path toward deflation before monetary easing? How much must they move?