

Defining a Macroeconomic Framework for the Euro Area

Monitoring the European Central Bank 3

Alberto Alesina

Harvard University and CEPR

Olivier Blanchard

Massachusetts Institute of Technology

Jordi Galí

Universitat Pompeu Fabra, Barcelona, and CEPR

Francesco Giavazzi

Università Bocconi, Milano, and CEPR

Harald Uhlig

Humboldt Universität zu Berlin and CEPR



CITIBANK

SCHRODER SALOMON SMITH BARNEY
Members of citigroup



GRUPPO MONTE PASCHI
ASSET MANAGEMENT SGR



The research underlying this publication was supported by Citibank, a member of Citigroup, MPS Finance Banca Mobiliare SpA, and Gruppo Monte Paschi Asset Management SGR. The opinions expressed in this report are, however, those of the authors. Neither CEPR, Citibank, MPS Finance Banca Mobiliare, nor Gruppo Monte Paschi Asset Management take any institutional policy positions.

Contents

<i>MECB Statement of Purpose</i>	vii
<i>List of Figures</i>	viii
<i>List of Tables</i>	ix
<i>List of Boxes</i>	ix
<i>Acknowledgements</i>	x
<i>Foreword</i>	xi
<i>Executive Summary</i>	xiii
1. Introduction	1
2. Monetary and fiscal policy coordination in EMU	6
2.1 Introduction and summary	6
2.2 Coordination when the ‘houses are in order’	7
2.3 The political economy of coordination	9
2.4 Coordination without inflation targeting	11
2.5 Multiple fiscal authorities	11
2.6 Meetings between the ECB and the Eurogroup	13
3. Country adjustments within the euro area: lessons after two years	14
3.1 Relative growth and inflation performance	14
3.2 Equilibrium inflation rates and the Balassa–Samuelson effect	16
3.3 How to adjust when adjustment is needed?	18
3.4 Overheating in Ireland	21
3.5 Spain	23
3.6 Tentative conclusions	25
4. How does the ECB set interest rates?	26
4.1 A first look at the numbers	26
4.2 A benchmark interest rate rule	27
5. Monitoring the ECB	36
5.1 Inflation	36
5.2 The exchange rate	37
5.3 The ECB and the exchange rate of the euro	40
5.4 Projections, benchmarks and forecasts	41
5.5 Transparency	46
5.6 The M3 pillar	47
<i>References</i>	49