



**MINISTÈRE  
DE L'ÉCONOMIE,  
DES FINANCES  
ET DE LA RELANCE**

*Liberté  
Égalité  
Fraternité*

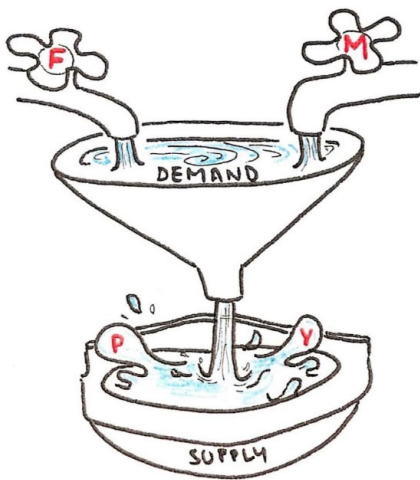
# **MONETARY AND FISCAL POLICIES: TOO CLOSE FOR COMFORT?**

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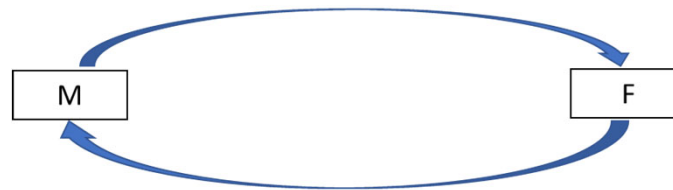
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M creates space for F:  
monetary backstop and  
low borrowing costs



F creates space for M: fiscal backstop,  
internalizing the risks of unanchored  
inflation and negative  $R^*$

M restricts space of F: monetary credibility  
is lost, no backstop, no control on  
borrowing costs



F restricts space of M: Balance sheet  
policies and monetary backstop not credible

# Post covid: How to normalize?

## Ordered deleveraging

- Corporations first
- High-debt countries first

## The policy mix

- F before M to avoid a financial crisis → **substitution** strikes back
- What if (core) inflation resumes? Depends on growth ( $r-g = i-n$ )
- Key role of a credible fiscal rule → **keeping M and F independent** (hence congruence rather than coord.)
- At some point, M and F may become complements again (double tightening)

## The mix of the mix (euro area)

- $F_1, F_2, \dots, F_{19}$ : Fiscal rules as substitutes for impossible fiscal stance? **F more often pro-cyclical than M**
- Discipline does not mean coordination, cf. 2011-2013
- A role for the Macroeconomic Imbalances Procedure

## Lessons from 22 OECD countries over 1986-2019

- **Congruence** is rare because M and F react to different determinants
- M and F do not seem give **space** to each other
  - E.g., high debt makes F more pro-cyclical but does not reduce the probability that M is also pro-cyclical
- This makes **constraints** to M or F more costly and destabilising



## Appendix: congruence is rare because F and M react to different variables

- **Fiscal policy** is more likely to be pro-cyclical when it is **constrained** (high debt, financial assistance programme, fixed exchange-rate regime) or in case of **low financial uncertainty**;
- **Monetary policy** is more likely to be pro-cyclical when **constrained** (ZLB, financial uncertainty, but not by the exchange-rate regime), in case of a **booming** economy, or when **long-term interest rates are high**;
- Constraints on monetary policy do not appear to translate into less fiscal procyclicality, and vice-versa.