

Immediate challenges for the European Central Bank

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SUMMARY

Immediate challenges for the ECB

Issues in formulating a single monetary policy

This paper discusses a number of issues that the newly constituted board of the ECB will face early on. Conducting a European monetary policy will be very different from living under the protective umbrella of the Bundesbank. We discuss voting on the ECB board, and argue that the ability to communicate with the public will be critical for the success of the new institution. We also ask how a single monetary policy – a common change in the interest rate controlled by the ECB – is transmitted to the economy of each member country. We show that the monetary process differs significantly inside EMU: initially, at least, the cost of a disinflation episode could fall disproportionately on a few member countries, those with both a financial structure that spreads a monetary contraction widely and a wage-price structure that is relatively inflexible. This process, moreover, is sure to evolve, in part as a result of financial industry restructuring already under way, but in part accentuated by the common money. Furthermore, as the ‘Lucas principle’ suggests, the wage-price process itself will adapt to the changing focus of European monetary policy.

—Rudi Dornbusch, Carlo Favero and Francesco Giavazzi

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