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Sacrifice ratio dispersion within the Euro Zone: what can be learned about implementing a single monetary policy?

Jean-Jacques Durand, Marilyne Huchet-Bourdon 🔽 & Julien Licheron

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structural e sacrifice n reduction, as well as al evidence d to the nip between fication for

the choice of an inflation objective close to 2% for the European Central Bank (ECB)

rather than a target of perfect price stability, potentially very damaging. Second, we cannot provide evidence of any reduction in European sacrifice ratio dispersion, which would suggest that the nominal convergence triggered by the Maastricht Treaty did not involve a true reduction of structural differences. It is likely to be a problem in the stance of a single monetary policy, because structural differences imply asymmetric responses of real national economies to the same monetary impulse.

Keywords:

sacrifice ratio	monetary policy	convergence	Economic and Monetary Union (EMU)
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C22 E32	E52 E58		

Acknowledgement

We are indebted to two anonymous referees for insightful comments. We also wish to thank the participants at seminars at the 22nd Symposium on Banking and Monetary

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Notes	
1. Two k	e ratio. First,
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2. As Fila	n and King's
(<u>1982</u>), a	ssumption
that is quite restrictive and questionable. We will see later on that this as	sumption of

linearity is also one of the limitations of the structural VAR methodology. However, unlike the Phillips curve approach, structural modelling allows for a distinction between exogenous shocks and endogenous reactions of the system.

3. Ball (<u>1994</u>) applies his episode-specific methodology to 19 OECD member countries using annual data over the period 1960–1991, and then to a sub-group of nine of these countries using quarterly data over the same period.

4. See, for example, Jordan (<u>1997</u>), Neely and Waller (<u>1997</u>) or Zhang (<u>2005</u>).

5. As emphasized by an anonymous referee, assuming the demand disturbance to be a monetary shock for the considered period is a strong assumption. However, preliminary attempts using a three-variable model (including the short-term nominal interest rate) have reached the same conclusions as with our bivariate model. Besides, Cecchetti and Rich (2001) however show that the imprecision in sacrifice ratio estimates increases with the number of endogenous variables. For these reasons, we concentrate solely on a two-variable system, and associate shifts in monetary policy with the aggregate demand shock.

6. Demand shocks, especially monetary policy shocks, should distort the path of potential output and thus have an impact on the Nairu (Non-Accelerating Inflation Rate

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Blanchard and Quah (<u>1989</u>). However, the cumulative response of output to the demand shock appears to be significantly positive in most countries, which would entail the existence of 'hysteresis effects'.

10. Provided that we assume symmetry in the real short-run effects of monetary policy, i.e. equivalence between the positive effects of monetary expansion and the negative effects of restrictive monetary policy. This questionable assumption represents one of the limitations inherent in the VAR modelling approach.

11. If we employ the short-run constraint described above, we get higher estimates of the average sacrifice ratio as well as higher values for their standard deviation. However, the evolution of the average sacrifice ratio and the dynamics of the standard deviation of rolling estimates over the period 1972:1-2003:4 are very similar to the conclusions reached with the long-run constraint.

12. We have also used other indicators to evaluate the degree of dispersion within euro area sacrifice ratios: the simple spread (which measures the difference between the highest and lowest estimates of the sacrifice ratio at each date), or the spread between the average of the three countries with the highest and lowest sacrifice ratios (in order to adjust for the sensitiveness of the simple spread to outliers). Results are not reported herein, but these two alternative dispersion indicators broadly exhibit the same

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