

Heterogenous effects of monetary policy in the Euro Area: a FAVAR approach

By Miguel Angel Gavilan-Rubio*

University of Essex, Wivenhoe Park, Colchester CO4 3SQ, The U.K., magavi@essex.ac.uk.

Abstract - 2007 financial crisis highlighted the lack of synchronisation of the business cycle in the euro area. This paper presents a quantitative assessment of the heterogeneous effects that a common monetary policy shock exerts on different economies in a currency area, and more specifically, in the euro area. To that end, a structural factor-augmented vector autoregressive (S-FAVAR) is used to trace out the effect of an increment in the ECB's intervention rate on industrial production, unemployment and harmonized prices in seven countries in the euro area. The results show that the effects of a contractionary monetary policy on the industry are homogenous across the selected countries, falling after the intervention - except for Greece, where monetary policy is neutral in production terms. However, unemployment responses are heterogeneous both in size and sign, suggesting that the lack of a common European regulatory framework for labour has prevented the integration of the labour markets in the euro area. Thus, a common framework would improve the synchronization of the business cycles among euro area countries. Finally, the effects on prices are heterogeneous in size but not in sign, showing a more moderate response than on production terms and not significant in many countries.

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