

GENERATION €URO STUDENTS' AWARD

TEACHER'S BOOKLET

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EUROPEAN CENTRAL BANK

EUROSYSTEM



BANQUE CENTRALE DU LUXEMBOURG

EUROSYSTEM

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FOREWORD



Dear teachers,

A new school year is beginning and I am pleased to inform you that the Banque centrale du Luxembourg (BCL) will organise the eighth edition of the Eurosystem Generation Euro Students’ Award school competition in Luxembourg in 2020-21.

This new edition will comply with the sanitary requirements to preserve the health of all high school students and teachers involved. Thus, if needed, the information and preparatory sessions, as well as the final event, will be organized through videoconference. We will take all the necessary measures to ensure a smooth unfolding of the competition.

The Generation Euro Students’ Award, which has been taking place at the Eurosystem level since 2011, has been hailed since its inception as a leading educational initiative. Not only does it provide high school students with the opportunity to learn about key concepts pertaining to the Eurosystem’s monetary policy and institutional framework, but it also encourages them to work as a team within well-defined deadlines and allows them to hone their writing and presentational skills. The motivating goal is to reach the national final – during which all finalists are awarded a prize - and perhaps even the European award ceremony at the European Central Bank, which we hope will be able to take place in Frankfurt for this year’s edition. If required by the sanitary situation, its format will be adapted. In addition, the finalists will be able to do an internship at the BCL, which represents an interesting opportunity to gain a better understanding of how a central bank works.

Through the organisation of this contest, the BCL continues its efforts to reach out to the educational world. We are eager to contribute to improving our young citizens’ understanding of essential economic mechanisms. I believe the skills the students will acquire by participating in this competition will be useful, not only in the pursuit of their studies, but also in their future professional life. As participating teachers, you will play a pivotal role in encouraging and mentoring your students during the competition.

The BCL will be at your disposal throughout the contest to answer your questions and provide you with the necessary educational material. This brochure includes the rules of the competition and provides you with the basic concepts that will be taught in the preparatory sessions.

I wish all the participants great success and many discoveries throughout the 2020-21 competition!

Gaston Reinesch
Governor of the Banque centrale du Luxembourg

1. INTRODUCTION

About the competition

The Generation Euro Students' Award (GESA) is an annual competition that aims to help secondary school students understand monetary policy and how it relates to the economy as a whole. Participating students will gain an insight into the role of a central bank by learning about the function of monetary policy instruments, in particular interest rate decisions, and by using some of the data available to the Governing Council of the European Central Bank (ECB). The competition will also raise students' awareness of the Eurosystem and deepen their knowledge of the world of finance.

National central banks (NCBs) of the euro area organise the competition for schools in their respective countries.

The competition consists of several rounds – an online quiz, an assignment and an oral presentation. The competitions will end with a joint award event at the ECB in Frankfurt am Main. Due to the sanitary crisis, all of these activities can be held remotely, depending on the restrictions in force.

Participation

The competition is for students aged 16 to 19 who live in a euro area country. The age of participating students may vary slightly from country to country (depending on the national education system), but they should be in their final years of secondary education. All students are entitled to take part, irrespective of the subjects they are studying. Students may participate on more than one occasion, as long as they are not part of the same team as in the previous year.

Students will need to form teams consisting of three or five members, and ask a teacher to support their entry. Each team should come from the same school, with the teachers and students themselves deciding on membership. Each team should also nominate one of its members as team leader. More than one team from the same school may participate. The teacher must work at the school taking part in the competition, and must teach at least one member of the team. The composition of the team should remain the same during the competition, except in the case of extraordinary circumstances such as illness.

Each team and its supporting teacher should register for the competition on the [Generation Euro website](http://www.generationeuro.eu). (www.generationeuro.eu - Luxembourg page).

Prize

All participants to the final round of the competition will receive a prize after the deliberation of the jury. Also, interested finalists will have the opportunity to do an internship at the BCL and discover how a national central bank works from within.

The winning teams of the national central bank competitions will be invited to the award event at the ECB in Frankfurt am Main, which will include an award ceremony with the President of the ECB and the governors of the national central banks if the sanitary situation allows it.

What's in it for the students?

Participating students will deepen their understanding of the economy. They will also have the opportunity to develop their core skills, such as analytical and critical thinking. The competition will give students a chance to improve their ability to work as part of a team and hone their communication and presentation skills. In addition, the knowledge and skills gained during the competition may benefit their university studies or be helpful when applying for internships. All finalists will receive a certificate.

Rules

The rules and organisational procedures for the competition are set out in this booklet, and in the [Terms and Conditions](#) and the [Privacy Statement](#) published on the Generation Euro website.

2. TEACHERS

Your role

As a teacher you will play a key role throughout the competition. Your main task is to be the team coordinator, guiding your students through each round of the competition, in particular the assignment round, in order to ensure their work is consistent and of a good standard.

Resources

You will have access to a number of resources to guide and support your students through each round of the competition. Your main resources will be:

- this booklet;
- the [Generation Euro website](#), which provides all competition-related information and materials to make it easier for you to teach the core concepts of monetary policy-making;
- documents and information regularly transmitted by the BCL;
- presentations organised by the BCL to help students and professors participating to the competition to prepare the different rounds.



Preparation session at the BCL

3. ROUNDS

Round 1: online quiz (deadline: 22 November 2020)

Before taking the quiz to enter the competition, teams must first register to ensure that their scores are saved. After registering, students can practise with the trial version of the quiz as often as they wish, but they can do the complete quiz (30 questions) only once. Students are expected to answer the questions as a team. The quiz consists of ten easy questions, ten of medium difficulty and ten harder ones. The 30 questions will be selected at random from a pool each time a team starts the quiz. At the end of the quiz, all participating teams will receive an electronic certificate showing their scores. The teams with the best scores and the fastest completion times will be invited by the BCL to register for the second stage of the competition, the assignment round.

Round 2: assignment (deadline: 20 January 2021)

Task

Teams are required to:

1. propose a monetary policy decision of the Governing Council on the interest rate of the main refinancing operations;
2. base their decision on their assessment of the key economic indicators available, economic and monetary conditions in the euro area, and the inflation outlook.

Teams may also where appropriate report downside risks or potential upside risks weighing on the medium-term inflation outlook, and make reference to non-conventional monetary policy measures.

Format

Teams must write analysis presenting their own research and indicating the reasons that led them to make their decision on the key interest rate. **The format is free.**

It is not necessary to present or explain the ECB's institutional functions and governance.

All team members are expected to participate in the

production of the assignment. The output should ideally reflect the opinion of the majority of the team. Teachers are expected to actively coach and advise their students.

The written assignment must conclude with a clear decision on the interest rate and it must not exceed 2,000 words (or approximately 2 A4 pages). Graphics are very welcome. The jury can lower the note if the maximum length is passed.

Final round: presentation at the BCL (deadline: March 2021, to be determined)

The teams that reach the final round will have to present a new monetary policy decision to the BCL jury. This presentation will be made at the BCL, if the sanitary conditions allow it. The teams' task will be twofold.

A) Presentation

Task

The teams :

1. have to draft an upcoming decision of the Governing Council on the interest rate of the main refinancing operations;
2. have to explain their decision by assessing the main economic indicators, economic and monetary conditions in the euro area, and the inflation outlook;
3. can, where appropriate, indicate potential downside and upside risks to the medium-term inflation outlook and mention unconventional monetary policy measures.

Format

Students are encouraged to present their decision in the form of an economic and of a monetary analysis followed by a cross-check of both components, which are two essential parts of the introductory statement at the press conference at which the President of the ECB explains the Governing Council's monetary policy decisions. Teams are invited to be creative in their presentation and each of their members (with the exception of the teacher) must participate equally to the presentation. Teams will provide members of the jury a copy of their presentation in order to facilitate taking notes during the presentation.

Presentations will not exceed 20 minutes. Exceeding the time limit will be penalized by the jury.

Preparation

The "Generation Euro" website provides further information on the preparation of the final round.



Mr Reinesch, Governor of the BCL, with finalists and members of the jury in 2019.

B) Question and answer session

Each presentation given by a team will be followed by a question and answer session of a duration of 20 minutes. This duration may be increased according to the actual duration of the oral presentation, the total duration of the final round being 40 minutes by team. This session will allow the jury to test, on the one hand, the knowledge and the understanding of policy issues and to judge, on the other hand, how the teams justify their interest rate decision. It will take place in the spirit of the question and answer sessions at press conferences following the meetings of the ECB's Governing Council, at which the President of the ECB explains monetary policy decisions.

Members of the teams may be asked to clarify or develop certain points evoked during the presentation, or to explain the workings of the economy and how the decision made about the interest rate is part of the mandate entrusted to the Eurosystem, which consists in ensuring price stability. Questions may also be asked about major events that may have recently affected the economy.

Team members may consult each other during the Question and answer session, without being able to call on their teacher. All members of the team should take part in the question and answer session.

At the end of the presentations and question and answer sessions, the jury will retire to deliberate and select the victorious team. The decision will be announced in front of all participants during the following award ceremony. All students who participated in the final round will receive a certificate and an award. They will also have the opportunity to do an internship in the BCL during the summer.

4. COMPOSITION OF THE JURY

The assignments and presentations will be assessed by a jury composed of staff from the BCL

5. ASSESSMENT CRITERIA

The jury will assess the assignments on the basis of:

- reasoning behind the proposed decision concerning the interest rate;
- relevance of the decision;
- familiarity with, and accurate use of, expressions and terms related to monetary policy;
- the students' creativity and own research.

The jury will assess the oral presentations on the basis of:

- reasoning behind the proposed decision concerning the interest rate;
- relevance of the decision;
- familiarity with, and accurate use of, expressions and terms related to monetary policy;
- the structure of the presentation;
- oral presentation skills;
- the level of participation of each team member;
- method used to do the presentation.

6. EUROPEAN AWARD EVENT

The winning team from each participating country will be invited to participate in the European award event at the ECB in Frankfurt am Main or via a video conference, if necessary.

The event takes place during two days, in May or June 2021, during which workshops on monetary policy will be organised, as well as an award ceremony and social activities. During the ceremony, the President of the ECB and the governors of the NCBs will welcome and congratulate the winners. The ECB will reimburse travel and accommodation costs for all team members and accompanying teachers participating in the European award event. Lunches and dinner will also be covered by the ECB.

7. PRIVACY STATEMENT

i) Data protection and purpose of processing

Any personal data the students and teachers provide will be processed in accordance with the Data Protection Regulation¹. The Outreach Division of the ECB will collect and handle the personal data as the data controller. The data processor which hosts the Generation Euro website and processes the data on the website under instruction from and on behalf of the ECB is Havas Worldwide Düsseldorf GmbH (Euro RSCG GmbH).

All the participants' data provided in the registration form on the Generation Euro website will be put into a database. The data collected will be used to manage participation in the competition, to access competition-related information, to

rank the participants, to award the prizes and to contact and provide the participants with any relevant information. Only the personal data provided by registering on the Generation Euro website or by sending an e-mail to generationeuro@ecb.europa.eu will be retained.

By entering their personal data, the participating students and teachers agree to the publication of the name of the winning team and its members on the websites of the ECB and/or NCBs and/or to its announcement at public events. It is also likely that photographs will be taken and short video recordings of the winning teams will be made on the national award days and at the final award event, and that these will be published by the ECB and/or NCBs.

¹ Regulation (EC) No 45/2001 of the European Parliament and of the Council of 18 December 2000 on the protection of individuals with regard to the processing of personal data by the Community institutions and bodies and on the free movement of such data.

ii) Security and transfer to third parties

Personal data collected through the Generation Euro website may be transferred to the NCBs of the euro area Member States to manage, where necessary, the competition at national level. Any further processing of the personal data by the NCBs is subject to the guarantees provided in the national legislation implementing the Data Protection Directive 95/46/EC². Havas Worldwide Düsseldorf GmbH (Euro RSCG GmbH), as data processor, and the NCBs have agreed to ensure the confidentiality of the personal data and provide adequate protection of privacy. The central banks to

which the personal data may be disclosed are: the European Central Bank, Nationale Bank van België/Banque Nationale de Belgique, Deutsche Bundesbank, Central Bank of Ireland, Bank of Greece, Banco de España, Eesti Pank, Banque de France, Banca d'Italia, Central Bank of Cyprus, Latvijas Banka, Lietuvos bankas, Banque centrale du Luxembourg, Bank Ċentrali ta' Malta/Central Bank of Malta, De Nederlandsche Bank, Oesterreichische Nationalbank, Banco de Portugal, Banka Slovenije, Národná banka Slovenska and Suomen Pankki - Finlands Bank.

iii) Time limit and rights of access, correction and deletion

The time limit for storing the above-mentioned data is three years, starting from the day when the personal data including a portrait, photograph or video were obtained. The students and teachers have the right to access, correct and update the data about themselves. To make inquiries about the collection and processing of personal data or to exercise the right of access or rectification, a request should be sent to generationeuro@ecb.europa.eu. Data subjects have the right to resort to the European Data Protection Supervisor: <https://secure.edps.europa.eu/EDPSWEB/>.

² Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data.

maintain price stability".

The challenge faced by the ECB can be stated as follows: the Governing Council of the ECB has to influence conditions in the money market, and thereby the level of short-term interest rates, to ensure that price stability is maintained over the medium term.

Money market: The market in which short-term funds are raised, invested and traded, using instruments which generally have an original maturity of up to one year.

Short-term interest rate: The interest rate on a loan or other obligation with a maturity of less than one year.

First, monetary policy is considerably more effective if it firmly anchors inflation expectations, i.e. people's expectations of future price increases. In this regard, central banks should specify their objectives, elaborate them and stick to a consistent and systematic method for conducting monetary policy, as well as communicate clearly and openly. These are key elements for acquiring a high level of credibility. If a central bank does not keep its word, the public will lose confidence in it and the bank's credibility will suffer as a result. Credibility is, therefore, a necessary precondition for influencing people's inflation expectations.

Second, owing to the lags in the effects of interest rate changes on the economy (i.e. the transmission process), changes in monetary policy today will only affect the price level after a number of quarters or years. This means that central banks need to ascertain what policy stance is needed in order to maintain price stability in the future, after all adjustments in the economy have worked through. In this sense, monetary policy must be forward-looking.

The central bank has to be forward-looking, yet it is impossible for monetary policy to offset unanticipated events that have an impact on the economy, or what we call economic shocks. In the case of a shock to the price level (for example, those caused by changes in international commodity prices or indirect taxes) in the short run, some short-term volatility in inflation rates is inevitable. In addition, owing to the complexity of how the monetary policy affects the economy, there is always a high degree of uncertainty surrounding

ANNEX

CENTRAL BANKING AND THE EUROSISTEM'S MONETARY POLICY

1. The mandate and task of monetary policy

The Treaty on the Functioning of the European Union assigns to the Eurosystem the goal of maintaining price stability in the euro area. In particular it states that "the primary objective of the ESCB [European System of Central Banks] shall be to



The Luxembourg winners of the 2019 competition with their professor, the President of the ECB and the Governor of the BCL at the European award event.



The winners of the national competitions at the ECB for the European award event in 2019.

the effects of economic shocks and monetary policy. For these reasons, monetary policy should have a medium-term orientation in order to avoid excessive activism and the introduction of unnecessary volatility into the real economy. Finally, just like any other central bank, the ECB faces considerable uncertainty about the reliability of the statistics it receives about the economy (the so-called economic indicators), how the euro area economy works, i.e. the structure of the euro area economy and how monetary policy feeds through to the economy, among other things. A successful monetary policy therefore has to be broadly based, taking into account all relevant information in order to understand the factors driving economic developments, and cannot rely on a small set of indicators or a single model of the economy.

The Governing Council of the ECB has adopted and announced a monetary policy strategy¹ to ensure a consistent and systematic approach to monetary policy decisions. This monetary policy strategy embodies the above-mentioned general principles in order to meet the challenges facing the central bank. It aims to provide a comprehensive framework within which decisions on the appropriate level of short-term interest rates can be taken and communicated to the public.

¹ A monetary policy strategy is a coherent and structured description of how monetary policy decisions will be made in order for a central bank to achieve its objectives.

2. The main elements of the ECB's monetary policy strategy

The first element of the ECB's monetary policy strategy is a quantitative definition of price stability. In addition, the strategy establishes a framework to ensure that the Governing Council assesses all the relevant information and analyses needed to take monetary policy decisions so that price stability over the medium term is maintained.

2.1 Primary objective

The primary objective of the Eurosystem is to maintain price stability in the euro area, thus protecting the international value of the euro, or its purchasing power. Ensuring stable prices is the most important contribution that monetary policy can make in order to achieve a favourable economic environment and a high level of employment. Both high inflation and deflation can be very costly to society economically and socially speaking. Without prejudice to its primary objective of price stability, the Eurosystem also

supports the general economic policies in the European Union. Furthermore, the Eurosystem acts in accordance with the principles of an open market economy, as stipulated by the Treaty.

While the Treaty clearly establishes the maintenance of price stability as the primary objective of the ECB, it does not give a precise definition. In order to specify this objective more precisely, the Governing Council of the ECB announced the following quantitative definition in 1998: "Price stability shall be defined as a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below 2%. Price stability is to be maintained over the medium term" In 2003 the Governing Council further clarified that, within the definition, it aims to maintain inflation rates below, but close to, 2% over the medium term.

The Governing Council decided to announce to the public a quantitative definition of price stability for a number of reasons. First, by clarifying how the Governing Council interprets the objective it has been assigned by the Treaty, the definition helps to make the monetary policy framework easier to understand (i.e. it makes monetary policy more transparent). Second, the definition of price stability provides a clear and measurable yardstick against which the public can hold the ECB accountable². In case of deviations of price developments from the definition of price stability, the ECB would be required to provide an explanation for such deviations and to explain how it intends to re-establish price stability within an acceptable period of time. Finally, the definition gives guidance to the public, allowing it to form its own expectations regarding future price developments.

The definition of price stability has a number of noteworthy features. First, the ECB has a euro area-wide mandate. Accordingly, decisions regarding the single monetary policy aim to achieve price stability in the euro area as a whole. This focus on the euro area as a whole is the natural consequence of the fact that, within a monetary union, monetary policy can only steer the average money market interest rate level in the area, i.e. it cannot set different interest rates for different regions of the euro area.

2.2 The HICP

The definition also identifies a specific price index - namely the Harmonised Index of Consumer Prices (HICP) for the euro area - as that to be used for assessing whether price stability has been achieved. The use of a broad price index ensures the transparency of the ECB's commitment to full and effective

protection against losses in the purchasing power of money.

The HICP, which is released by Eurostat, the Statistical Office of the European Union, is the key measure for price developments in the euro area. This index has been harmonised across the various countries of the euro area with the aim of measuring price developments on a comparable basis. The HICP is the index that most closely allows one to approximate the changes over time in the price of a representative basket of consumer expenditures in the euro area.

2.3 Reasons for aiming at inflation rates of below, but close to, 2%

By referring to an "increase in the HICP of below 2%"; the definition makes it clear that both inflation above 2% and deflation (i.e. declines in the price level) are inconsistent with price stability. In this respect, the explicit indication by the ECB to aim to maintain the inflation rate at a level below, but close to, 2% signals its commitment to provide an adequate margin to avoid the risks of deflation.

² The legal and political obligation of an independent institution to properly explain and justify its decisions to the public and their elected representatives, thereby making it responsible for fulfilling its objectives. The ECB is accountable to the people of Europe and, more formally, to the European Parliament.

A safety margin against deflation

Referring to an "increase in the HICP of below, but close to, 2%" provides a safety margin against a persistent fall in the average level of prices in the economy, i.e. deflation. While deflation implies similar costs for the economy as inflation, it is particularly important that deflation is avoided because, once it occurs, it may become entrenched as a result of the fact that nominal interest rates cannot fall below zero, as normally no lender would be willing to lend money to someone else if he/she expected less money to be paid back after a certain period. In a deflationary environment monetary policy may therefore not be able to sufficiently stimulate aggregate demand by using its interest rate instrument. Any attempt to bring the nominal interest rate below zero would fail, as the public would prefer to have cash rather than to lend or hold deposits at a negative rate. Although some monetary policy actions can still be carried out even when nominal interest rates are at zero, the effectiveness of these alternative policies is not fully certain. It is thus preferable for monetary policy to have a safety margin against deflation. By aiming at an increase of the HICP of below, but close to, 2%, a possible measurement bias in the HICP, that is to say overestimating

the true price increase in the economy, and the potential implications of inflation differentials in the euro area, with some countries having low inflation while others have high, are also taken into account.

2.4 The medium-term orientation of the ECB's monetary policy

A key aspect of the ECB's monetary policy is that it aims to pursue price stability "over the medium term". As outlined above, this reflects the consensus that monetary policy cannot, and therefore should not, aim to attempt to fine-tune developments in prices or inflation over short horizons of a few weeks or months. Changes in monetary policy only affect prices with a time lag, and the magnitude of the eventual impact is uncertain. This implies that monetary policy cannot offset all unanticipated disturbances to the price level. Some short-term volatility in inflation is therefore inevitable.

An economy is continuously subject to largely unforeseeable shocks that also affect price developments. At the same time, monetary policy can only affect price developments with significant time lags, which are variable and, like most economic relationships, highly uncertain. Against this background, it would be impossible for any central bank to keep inflation at a specific point target at all times or to bring it back to a desired level within a very short period of time. Consequently, monetary policy needs to act in a forward-looking manner and can only maintain price stability over longer periods of time. This is the reasoning that lies at the heart of the ECB's medium-term orientation.

The "medium term" notion deliberately retains some flexibility with regard to an exact time frame. This reflects the fact that it is not advisable to specify ex ante a precise horizon for the conduct of monetary policy, since the time frame in which it feeds through to the economy is variable and uncertain. An excessively aggressive policy response to restore price stability within a very short time span may, under these circumstances, risk incurring a significant cost in terms of output and employment volatility which, over a longer horizon, could also affect price developments. In these cases, it is widely recognised that a gradual response of monetary policy is appropriate both to avoid unnecessarily high volatility in real activity and to maintain price stability over a longer horizon. Thus, the medium-term orientation also gives the ECB the flexibility required to respond in an appropriate manner to the different economic shocks that might occur. At the same time, it should be clear that, from an ex post perspective, the ECB can be held accountable only for trends in inflation.

2.5 The two pillars of the ECB's monetary policy strategy

The ECB's approach to organising, evaluating and cross-checking the information relevant for assessing the risks to price stability is based on two analytical perspectives, referred to as the two "pillars".

In the ECB's strategy, monetary policy decisions are based on a comprehensive analysis of the risks to price stability. This analysis is organised on the basis of two complementary perspectives on the determination of price developments. The first perspective is aimed at assessing the short to medium-term determinants of price developments, with a focus on real activity and financial conditions in the economy. It takes account of the fact that price developments over those horizons are influenced largely by the interplay of supply and demand in the goods, services and factor markets. The ECB refers to this as the "economic analysis". The second perspective, referred to as the "monetary analysis", focuses on a longer-term horizon, exploiting the long-run link between money and prices. The monetary analysis serves mainly as a means of cross-checking, from a medium to long-term perspective, the short to medium-term indications for monetary policy coming from the economic analysis.

The two-pillar approach is designed to ensure that all relevant information is used in the assessment of the risks to price stability and that appropriate attention is paid to different perspectives and the cross-checking of information in order to come to an overall judgement of the risks to price stability. It represents, and conveys to the public, the notion of diversified analysis and ensures robust decision-making based on different analytical perspectives.

2.5.1 Economic analysis

The economic analysis focuses mainly on the assessment of current economic and financial developments and the implied short to medium-term risks to price stability. The economic and financial variables that are the subject of this analysis include, for example, developments in overall output; aggregate demand and its components; fiscal policy; capital and labour market conditions; a broad range of price and cost indicators; developments in the exchange rate, the global economy and the balance of payments; financial markets; and the balance sheet positions of euro area sectors. All these factors are helpful in assessing the dynamics of real activity and the likely development of prices from the perspective of the interplay between supply and demand in the goods, services and factor markets at shorter horizons.

Real economic and financial indicators

In the framework of its economic analysis, the ECB focuses mainly on the assessment of current economic and financial developments and the implied short to medium-term risks to price stability.

Regarding the analysis of real economy indicators, the ECB regularly reviews developments in overall output, demand and labour market conditions, a broad range of price and cost indicators, and fiscal policy, as well as the balance of payments for the euro area.

For instance, in terms of price and cost developments, alongside the HICP and its components, price developments in the industrial sector, as measured by producer prices, are analysed because changes in production costs may feed through to consumer prices. Labour costs, which are an important element of overall production costs, may have a significant impact on price formation. Labour cost statistics also provide information on the competitiveness of the euro area economy.

Second, indicators of output and demand (national accounts, short-term statistics on activity in industry and services, orders, and qualitative survey data) provide information on the cyclical position of the economy, which in turn is relevant for the analysis of prospects for price developments. Furthermore, labour market data (on employment, unemployment, vacancies and labour market participation) are important for monitoring economic developments and assessing structural changes in the functioning of the euro area economy. Moreover, the government sector represents a substantial part of economic activity; information on both financial and nonfinancial public sector accounts is essential.

Third, balance of payments statistics, along with external trade statistics, provide information on developments in exports and imports which may affect inflationary pressures via their impact on demand conditions. These data also allow external trade prices - currently proxied by export and import unit value indices - to be monitored. These indices help to assess, in particular, the potential impact on import prices of movements in the exchange rate and changes in commodity prices (such as oil). In short, these indicators help to assess movements in aggregate demand, aggregate supply and the degree of capacity utilisation.

Developments in financial market indicators and asset prices are also closely monitored. Movements in asset prices may

affect price developments via income and wealth effects. For example, as equity prices rise, share-owning households become wealthier and may choose to increase their consumption. This will add to consumer demand and may fuel domestic inflationary pressures. Conversely, when equity prices fall, households may well reduce consumption. An additional way in which asset prices can have an impact on aggregate demand is via the value of collateral that allows borrowers to obtain more loans and/or to reduce the risk premia demanded by lenders/banks. Lending decisions are often influenced to a large extent by the amount of collateral. If the value of collateral falls, then loans will become more expensive and may even be difficult to obtain at all, with the result that spending, and therefore demand, will fall.

Asset prices and financial yields can also be analysed to derive information about the expectations of the financial markets, including expected future price developments. For example, when buying and selling bonds, financial market participants implicitly reveal their expectations about future developments in real interest rates and inflation. Using a variety of techniques, the ECB can analyse financial prices to extract the markets' implicit expectations about future developments. Asset markets, and therefore asset prices, are by their very nature forward-looking. Changes in asset prices therefore largely reflect "news" - information about developments that the financial markets had not been expecting. In this sense, the monitoring of asset prices might help to identify shocks that are currently hitting the economy, in particular shocks to expectations about future economic developments. By analysing financial markets, statistical information on financial asset prices from various sources can also be assessed. In addition, the ECB collects certain statistical information itself.

Developments in the exchange rate are also closely assessed for their implications for price stability. Exchange rate movements have a direct effect on price developments through their impact on import prices. Although the euro area is a relatively closed economy compared with its individual member countries, import prices do affect domestic producer and consumer price developments. Changes in the exchange rate may also alter the price competitiveness of domestically produced goods on international markets, thereby influencing demand conditions and, potentially, the outlook for prices.

In this analysis, due attention is paid to the need to identify the origin and the nature of shocks hitting the

economy, their effects on cost and pricing behaviour and the short to medium-term prospects for their propagation in the economy. For example, the appropriate monetary policy response to the inflationary consequences of a temporary rise in the international price of oil might be different from the appropriate response to higher inflation resulting from the labour cost implications of wage increases not matched by productivity growth. The former is likely to result in a transient and short-lived increase in inflation which may quickly reverse. As such, if this shock does not lead to higher inflation expectations, it may pose little threat to price stability over the medium term. In the case of excessive wage increases, there is the danger that a self-sustaining spiral of higher costs, higher prices and higher wage demands may be created. To prevent such a spiral from occurring, a strong monetary policy action to reaffirm the central bank's commitment to the maintenance of price stability, thereby helping to stabilise inflation expectations, may be the best response.

To take appropriate decisions, the Governing Council needs to have a comprehensive understanding of the prevailing economic situation and must be aware of the specific nature and magnitude of any economic disturbances threatening price stability.

In the context of the economic analysis, the macroeconomic projections play an important role. The projections, which are produced by the staff, help to structure and summarise a large amount of economic data and ensure consistency across different sources of economic evidence. In this respect, they are a key element in sharpening the assessment of economic prospects and the short to medium-term fluctuations of inflation around its trend.

Euro area macroeconomic projections

The word "projection" is used in order to emphasise that the published projections are the results of a scenario based on a set of underlying technical assumptions, one of which is that short-term market interest rates move in line with market expectations. Projections are produced on this basis in many central banks in order to best inform monetary policy decision-makers about what could happen if policy rates were to follow what market participants expect. In view of this, it should be clear that projections are not necessarily the best predictor of future outcomes. In fact, if the projections were to show that there is a threat to price stability looking ahead, it would represent a scenario that is unlikely to materialise in practice, since monetary policy will always act to address any

SCHEDULE

THE COMPETITION WILL TAKE PLACE IN 2020-21 AS FOLLOWS:*

- Round 1 (online quiz): until 22 November 2020
- Round 2 (assignment): until 20 January 2021
- Final round at the BCL: March 2021, exact date to be confirmed
- European award event at the ECB: May or June 2021, exact date to be confirmed.

CONTACTS AT THE BCL

BCL staff members will be pleased to help you with any questions you may have in the course of the competition. Please write to: generationeuro@bcl.lu
Website: www.generationeuro.eu

facebook.com/GenerationEuroLU

*These dates are subject to change.



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