Term

Macroeconomic Stability

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Definition

The term "Macroeconomic Stability" describes a national economy that has minimized vulnerability to external shocks, which in turn increases its prospects for sustained growth.

Context

Macroeconomic stability acts as a buffer against currency and interest fluctuations in the global market. It is a necessary, but insufficient requirement for growth.[1] Exposure to currency fluctuations, large debt burdens, and unmanaged inflation can cause economic crises and collapse in GDP.

Both the IMF[2] and the EU place an emphasis on macroeconomic stability. According to the Maastricht criteria[3], stability is measured by five variables.

- **Low and stable inflation** indicates healthy demand in the marketplace; however, high or unstable inflation threaten growth.[4] High inflation alters the value of long term contracts. Volatile inflation creates uncertainty in the market place, increasing risk premiums. Since many tax rates are adjusted by average inflation, volatile inflation can severely alter government revenues and individual liabilities. The Maastricht criteria capped inflation at 3%.
- **Low long-term interest rates** reflect stable future inflation expectations. While current inflation rates may be acceptably low, high long-term rates imply higher inflation to come. Keeping these rates low implies that the economy is stable and is likely to remain so. The Maastricht criteria restricted long-term rates to the range of 9%.
- **Low national debt relative to GDP** indicates that the government will have the flexibility to use its tax revenue to address domestic needs instead of paying foreign creditors. Additionally, a low national debt permits lenient fiscal policy in times of crisis. The Maastricht criteria capped debt at 60% of GDP.
- **Low deficits** prevent growth in the national debt. When government expenditure exceeds revenue the deficit is financed by selling bonds. Furthermore, when the government offers debt in the market, it drives up interest rates and consequently debt service increases. The Maastricht criteria capped the deficit at 3% of GDP.
- **Currency stability** allows importers and exporters to develop long-term growth strategies and in reduces investors' needs to manage exchange-rate risk. For national accounting, currency stability

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[1] The World Economic Forum's Global Competitiveness Report 2006-2007, p.4. "There is overwhelming evidence that in the absence of … macroeconomic stability, growth will be anaemic … or, at best, volatile."

[2] Macroeconomic stability is a core requirement of the IMF's reform packages. (Anne Krueger, 1st Deputy Director of the IMF, in her speech at the IMF)

[3] The Treaty on European Union is a comprehensive document addressing all aspects of the political and economic union of the European Economic Community. The macroeconomic criteria required of all member nations have come to be known as the Maastricht Criteria, after the Dutch city that hosted the convention.

[4] Walter J. Wessels, **Economics**. North Carolina: Barron's, 1993.

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reduces the threat posed by debt issue in foreign coin. The Maastricht criteria permitted fluctuation of at most 2.5%.

End.

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