Jean-Claude Trichet: The times of unprecedented challenges

Address by Mr Jean-Claude Trichet, President of the European Central Bank, at the conference "20 years after the collapse of the socialist economy: transformation, economic growth and convergence in Poland and other central and eastern European countries", organised by the National Bank of Poland, Warsaw, 5 June 2009.

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Dear President Kaczyński,
dear President Klaus,
dear President Skrzypek,
dear Joaquín,
dear Governors,
Ladies and gentlemen,

We are celebrating today the 20th anniversary of Poland's first free elections after the Second World War. This is a historic moment not only for Poland but also for Europe as a whole. Without the courageous actions by the Polish people at the time, this country might not be part of the European Union today, and Europe might even be still divided in East and West. By holding its first democratic elections two decades ago, Poland – together with the other Central and Eastern European countries – had set the most important pre-accession requirement to join the European Union in May 2004. It was a historic re-unification of Europe after decades of division. Today, the EU is a family of 27 members, 16 of which share the euro as a common currency.

On the road to the EU: convergence and integration

During the past two decades, Poland has gone through a long and challenging process of transformation. The fruits of this process are clearly visible today. Over the past 20 years Polish GDP per capita more than tripled. In recent years Poland has also made progress on the structural side, for instance, by improving labour market flexibility and by limiting the very costly early retirement schemes that were in place. At the same time, the adoption of an inflation targeting framework at the National Bank of Poland back in 1998 has been an important step towards bringing inflation down and closer to a level that is consistent with price stability.

The catching-up process has been accompanied by a strong economic and financial integration with the EU. Jacques Delors – the former Commission President – once defined the European integration as a triad: competition, which stimulates us, cooperation, which strengthens us, and solidarity which unites us. Let me briefly spell out his words in today's context.

First, competition. The historic enlargement of the European Union in 2004 has extended the border of our common internal market eastwards, thus unleashing the beneficial forces of competition in these countries whilst providing for a solid regulatory framework. Polish businesses are part of a single market of half a billion people.

Second, cooperation. The joint efforts to tackle the financial crises are perhaps the most prominent recent example. But cooperation has gone a long way in Europe. In the EU we have developed common institutions and common policies. And we have found ways to overcome differences and find common solutions.

Third, solidarity. Solidarity is an essential part of Europe's common roots and values. Solidarity among the peoples of Europe was the explicit aim of the founding fathers. Why was this? Because they believed that a de facto solidarity, a linkage of their interests, would prevent a new war. Let me quote a passage from the Schuman declaration of 9 May 1950:

"Europe will not be made all at once, or according to a single plan. It will be built through concrete achievements which first create a de facto solidarity."

It is in this spirit that EU solidarity has bolstered EU integration. In the case of Poland, concrete signposts of EU solidarity can be spotted all along Poland's long road towards EU integration. EU solidarity started well before accession, with Poland joining the PHARE programme already in 1989 and receiving pre-accession support. This solidarity continued after accession, in the form of an important flow of EU funds, especially in the context of EU cohesion and agricultural policy. To give but one example, net transfers from the EU budget to Poland amounted to EUR 5.1 billion in 2007.

Solidarity did also not come to a halt during the crisis. Poland – like virtually all countries in the global economy – has been affected by the financial crisis. Not because its financial institutions were particularly exposed to the US sub-prime market, but because it has become an integral part of the global economy. Nevertheless, it is noteworthy that Poland has so far fared relatively better than some of its neighbouring countries.

In coping with the crisis within the EU, solidarity was fundamental. Let me just mention some concrete achievements in terms of solidarity within the European Union: first, increased financing available under the Medium Term Financial Assistance (MTFA) facility, which rose from EUR 12 billion in 2002 to EUR 25 billion in 2008 and then again to EUR 50 billion in May this year; second, increased ceilings for EIB lending of at least EUR 8.5 billion during 2009 and 2010; and third, accelerated payments of structural funds of EUR 6.3 billion in 2009. In addition, only a few days ago, the Commission put forward plans to accelerate payments under the European Social Fund for an amount of EUR 19 billion in 2009-2010 alone, an important part of which [(35%)] is destined for Central and Eastern European countries. Together with the liquidity provisions extended by the ECB to a number of countries, the total amount of funds earmarked by the EU to its members and neighbours to tackle the crisis exceeds EUR 70 billion. It is indeed quite natural for the EU to exercise its solidarity in these days. It is solidarity that makes us a community and a union, not just a market.

But solidarity is not a panacea. It is no substitute for sound macroeconomic policies and structural reforms. In fact, the crisis has highlighted once again the importance of a solid structural economic foundation for sustainable growth. In this respect, it is striking to see how different the impact of the global financial crisis has been across individual countries, both in terms of financial market responses and with respect to real economic activity. The fact that the impact of the global financial crisis has been considerably less pronounced in Poland as compared to its regional peers, might have various reasons. The most important one, in my view, is that Poland has built-up less of macroeconomic imbalances and that it has implemented a set of policies and reforms that have overall been appropriate in recent years.

In contrast, some other countries had accumulated large domestic and external imbalances, and these made them vulnerable to changes in international investor sentiment. Larger current account deficits imply a greater reliance on external finance and thus a larger sensitivity to a disruption in cross-border capital flows. Sound macroeconomic policies are therefore not only prerequisites for a successful participation in the economic and monetary union, but they are also necessary for the catching-up process to operate smoothly. It is after the elimination of major macroeconomic imbalances and when sufficient convergence has been achieved, that countries can expect to reap the full benefits of euro area membership.

The ECB's response to the financial crises

The experience of the past year and a half bears testimony that the euro has continued to be an anchor of stability in times of stress. Let me explain to you why this is so. The financial turmoil crystallises two principal tenets behind our monetary policy strategy: swift and flexible action guided by a steady and unwavering compass. From the onset of the crisis in August

2007 we were determined to do what was needed to alleviate the tensions in money markets. We did not hesitate to charter unknown territory and to move forcefully to counter the adverse consequences of the financial crisis. At the same time, we always kept our medium-term perspective fade in mind, and inflation expectations remained fully anchored. The Governing Council made always clear that we would not compromise – in any respect – the longer-term achievement of the price stability objective or encourage or tolerate imprudent behaviour by market participants.

The specific and targeted changes to our operational framework – some of which can be called “non-standard” – have played a critical role: they have been instrumental in organising the defence against the systemic liquidity risk that occurred in September last year and in preserving the availability of credit for households and companies at accessible rates, thereby creating the conditions for the best possible transmission of our subsequent easing of monetary conditions. We cut our key interest rate in a series of seven unprecedented steps by a cumulative 325 basis points within about half a year. The Eurosystem is currently providing unlimited refinancing at 1.0% in its main refinancing operations. From a historical perspective, these measures are unprecedented in terms of their breadth and depth.

At the same time, these measures have been taken in full consistency with our monetary policy framework and our primary objective of maintaining price stability. The crisis has not changed this objective. In contrast, the fundamental principle on which our actions were based on is that any course of policy – conventional or unconventional – should be firmly grounded on and directed to the achievement of the Eurosystem’s primary objective of preserving price stability over the medium term. This objective will always provide the context and limits within which our course of action is framed and enacted.

The evidence on our bold yet solidly anchored response to the crises is encouraging. While long-term inflation expectations continue to remain broadly anchored at levels consistent with price stability, our measures show some signs of revival in the functioning of money markets in Europe. Banks are at the heart of the financial system in the euro area. This is the main reason why our policy response so far has been tailored to the specific nature of Europe’s financial structure. It is also the reason why the Governing Council decided in its meeting in May to proceed with its enhanced credit support approach. Our enhanced liquidity provision supports banks in continuing their lending operations to firms and households. In full continuity and consistency with the operations we have undertaken since October 2008, we have delivered an array of policy decisions that provide further support to improve market liquidity in important segments of the private debt security market.

Yesterday, we decided on the implementation of the programme for purchases of euro-denominated covered bonds issued in the euro area. The decision to buy covered bonds was motivated from the fact that these bonds are a segment of the private securities markets that has been particularly affected by the financial turmoil.

We trust that all these measures will continue to contribute to restoring and fostering confidence among banks, companies and households. Confidence today relies equally upon our immediate agility of action and upon the soundness and credibility of our exit strategy. Once the macroeconomic environment improves, the Governing Council will ensure that the measures taken can be quickly unwound and the liquidity provided absorbed. Hence, any threat to price stability over the medium and longer term will be effectively countered in a timely fashion. I observe, in particular, that the concentration of our non-standard measures on the supply of liquidity, with full allotment, to banks, provides for an in-built exit strategy. That is, when tensions in financial markets ease, banks will automatically seek less credit from the ECB. This will be a decisive element in ensuring a non-inflationary recovery in the euro area.

Conclusions

Let me conclude. This is a time of unprecedented uncertainty and challenges. We all have to live up to our responsibility. We have to respond forcefully to the challenge, but we should never forget the principles for sound macro-economic policy making that are at the heart of the European Union.

The people of Poland know what it means to go through times of unprecedented uncertainty and challenges. Their courage and their determination, which we celebrate today, is a reminder of how to cope with challenging situations. We are looking forward to overcoming this crisis. The ECB’s commitment to maintaining price stability over the medium term, as laid down in the Treaty, will contribute to paving the way for future sustainable growth, job creation and economic prosperity in all Member States.

Thank you for your attention.