Andreas Dombret: Twenty-five years of Bundesbank's representative office in Tokyo

Welcoming remarks by Dr Andreas Dombret, Member of the Executive Board of the Deutsche Bundesbank, at the opening of the enlarged office of the Deutsche Bundesbank in Tokyo, Tokyo, 6 September 2012.

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1. Introduction

Governor Shirakawa,

Vice Minister Nakao,

Ladies and Gentlemen,

This is my third visit to Tokyo since I took over as the Bundesbank's "foreign minister"– that is the Bundesbank's Board Member responsible for international relations. The long-standing partnership between the Bank of Japan and the Bundesbank singles out Japan as one of our key partners in the international sphere. For this reason, my first bilateral visit at the Bundesbank brought me to Tokyo in 2010. It was my explicit wish back then to come to Japan first. Needless to say, that I am glad to be back again.

And it is a great pleasure for my colleague Joachim Nagel and me to welcome such a distinguished gathering of central bankers, government officials, representatives of the financial community and friends. All of you have come despite a busy schedule. This reflects the reputation our representative office has gained in its 25 years of existence and the close and successful cooperation which exists between you, our Japanese hosts, and the Bundesbank. Also on behalf of my colleague Joachim Nagel, our thanks therefore go to all those who have been supporting the Bundesbank over so many years. You will appreciate me mentioning our colleagues from the Bank of Japan in particular.

Today, financial markets are awaiting the decision of the ECB Governing Council. In the following, I will focus on some important aspects from the viewpoint of the Bundesbank.

2. The European sovereign debt crisis

Let me start with an important statement: the euro is a stable and successful currency, both politically and economically. It is the showpiece project of political integration in Europe and has, since it was introduced, successfully safeguarded price stability. And still doubts are being voiced about the euro's continued existence. European Monetary Union is facing the greatest challenge in its history.

The founding fathers knew very well that in the European Monetary Union – with a single monetary policy but national fiscal policies – safeguards were needed to ensure sound fiscal policy. Otherwise, the deficit bias would be reinforced. Unsound fiscal policies in turn would make it more difficult for monetary policy to maintain price stability at low interest rates and could lead to pressure on the central bank to "communitise" government debt through its balance sheet.

The convergence of long-term interest rates to what for the countries at the euro area periphery were historically low levels had a number of implications. In some countries, private or government consumption grew faster than the economy's potential output. In addition, in some countries, a significant real-estate bubble was the consequence. The international competitiveness in a number of countries deteriorated. Necessary reforms to make labour, product and services markets more flexible were postponed. The global financial crisis revealed these unsustainable developments, which are reflected in the form of deteriorating public finances.

Greece was the first Eurozone country which lost market access when investors questioned the sustainability of its public finances. In the absence of a joint assistance mechanism, the country initially obtained bilateral loans from other euro area countries. The IMF, too, was involved in providing assistance. All support was tied to strict conditionality. This conditionality was meant to reinforce the policy measures taken to mend economic structures and government finances. Strict conditionality must be the precondition for financial assistance so as to avoid disincentives and ensure the programme's success.

A temporary crisis resolution mechanism – the European Financial Stability Facility – was set up between EMU countries in 2010. It will be replaced by a permanent mechanism – the European Stability Mechanism – probably before the end of this year. As the crisis went on, both the EFSF and ESM were expanded and their firepower was increased. More specifically, they can now include not only loans to governments; they can also comprise precautionary credit lines, interventions in the primary and secondary markets, and special-purpose loans to euro area states for the purpose of recapitalising financial institutions.

Since then, support programmes have also been set up for both Ireland and Portugal. For Greece, a second rescue package has been approved, combined with extensive debt restructuring. More recently, Spain has expressed its intention to apply for assistance to restructure its banking sector. It is the responsibility of the Spanish government to act decisively now.

Generally speaking, these temporary support measures buy time until sustainable measures become effective. But a firewall cannot extinguish a fire. The fire has to be extinguished by fiscal consolidation and fiscal reforms.

In this context, the EU member states demonstrated their ability to act collectively in crisis situations by agreeing on a number of important measures. One of these is the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. This treaty, which is due to become effective on 1 January 2013, comprises a fiscal compact. Its main component is anchoring the commitment to enact laws, requiring budgets of member states to be at least close to balance in structural terms.

Nevertheless, structural adjustments are needed not just for public finances but also to address macroeconomic imbalances. Both areas remain the preserve of national governments. The process of implementing necessary policy measures at the national level has already begun in some countries. Labour markets have been deregulated, and institutional impediments to competition have been eliminated. Some signs of success are already emerging in the export sectors of crisis-hit countries. The budgetary situation has also improved.

Markets, however, are not yet fully convinced that these efforts will be sustained. But one thing is clear: Although the first steps have been taken, further extensive consolidation measures and structural reforms are very much necessary.

The Eurosystem responded to the crisis by cutting interest rates and launching non-standard monetary policy measures. It provided, for the first time, three-year liquidity in two longer-term refinancing operations. Another non-standard measure, the Securities Market Programme, has been the subject of debate. We at the Bundesbank continue to believe that purchases of government bonds by the Eurosystem reduce pressure on governments of countries that are in the markets' spotlight to consolidate their budgets and embark on structural reforms. By no means, they should become the "new normal".

Through these measures, monetary policy is increasingly strained. It makes a world of difference whether it is the Eurosystem or a stand-alone central bank, like the Bank of Japan, that is using its balance sheet as a tool to combat a crisis. In the Eurosystem's case, balance sheet measures and the risks of losses related to them have an important implication. They involve shifting burdens from the taxpayers of one member state to those of another. Such burden-sharing, however, is the task of democratically elected fiscal policymakers and not of monetary policy.

There is no quick fix for the European sovereign debt crisis. However, the measures already taken by some countries are steps in the right direction. If this direction is maintained, if the segregation of monetary policy from fiscal policy is upheld and once a decision is taken on the monetary union's future institutional shape, the foundations for a lasting solution should be in place.

3. Closing remarks

Let me now return to Japan, our host country. 25 years have passed since the Bundesbank opened its representative office in Tokyo. Since then, it has successfully helped improve our understanding of the Japanese economy. Many of the developments which our office reported proved to be of importance for our own policies. Let me mention the lessons from the build-up, bursting and clean-up of the Japanese financial bubble and, in particular, the Bank of Japan's experience in the fields of financial stability and unconventional monetary policy. Another example is the Lehman collapse in September of 2008. Both the Bundesbank's office in Tokyo and the Bank of Japan's office in Frankfurt provided an efficient channel for a vital bilateral flow of information.

Germany stood side by side with Japan in the difficult times following the tragic events of 11 March, 2011. We are pleased to learn that the Japanese economy is on a path to recovery. Against this background I am particularly happy that the anniversary of our representative office coincides with the inauguration of our new premises. Moreover, within these enlarged premises, we will set up a trading office which will begin operating this month. My colleague Joachim Nagel will now give you more information in this regard.