Yves Mersch: Challenges for completing Europe's economic and monetary union

Speech by Mr Yves Mersch, Member of the Executive Board of the European Central Bank, at the MNI Connect event, Singapore, 13 October 2015.

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Over the past few months, Europe has faced two exceptional challenges. First, there was the new adjustment programme for Greece. And second, there has been the large influx of refugees, a challenge that is very far from the competences of the European Central Bank (ECB). Though very different in nature, these two events offer a common lesson for future challenges that we will collectively face: that Europe is strong only when it acts on the basis of solidarity and cooperation.

I would like to talk about two further topics of importance today: first, the ECB's assessment of recent economic developments and their implications for our monetary policy stance; and second, the necessity for completing Europe's economic and monetary union. Over the summer, industrial production and other indicators of economic activity in the euro area have shown signs of resilience. Yet at the same time, the macroeconomic environment has become more challenging. The ECB's latest macroeconomic projections indicate a weaker economic recovery and a slower increase in inflation rates than was expected earlier in the year. Inflation will remain close to zero in the very near term, before rising again towards the end of the year. It will take somewhat longer than previously anticipated for inflation to return to a rate that we consider sufficiently close to 2% and stabilise at that rate.

Three main causes underpin these developments: first, decelerating growth in emerging market economies; second, a stronger euro; and third, the fall in oil prices and commodity prices more generally. The consequences are renewed downside risks to the outlook for growth and inflation.

It is too early to judge whether these factors will cause lasting changes to the trajectory that the ECB expected inflation to follow. In particular, more time is needed to determine whether the loss of growth momentum in emerging markets is temporary or permanent in nature and to assess what is driving the fall in commodity prices and to what extent falling oil prices will have second round effects. As always, we will be closely monitoring all relevant incoming information and its potential impact on price stability.

The monetary policy measures that we have in place – including the TLTROs or 'targeted longer-term refinancing operations' – continue to have a favourable impact on the cost and availability of credit for firms and households. Thus far, despite the recent surge in financial volatility, the measures have prevented a measurable tightening in financial conditions for the real economy. The sustained decline in the cost of borrowing is strengthening domestic demand, supporting durable goods consumption and stimulating investment, particularly by small and medium-sized businesses. This is making the economy of the euro area more resistant to external shocks.

In the event that the downwards risks I have mentioned weaken the inflation outlook over the medium term more fundamentally than we currently project, we would not hesitate to act. Should more monetary policy impulse become necessary. The ECB is determined to use all available instruments to achieve its mandate over the medium term.

As for potential risks to financial stability, we do not see them materialising at present but we will naturally be monitoring them closely. Over the past two years, national authorities across Europe have been active in developing and implementing macroprudential policy measures but their effectiveness still has to be tested. Before addressing my second topic, let me mention Greece again. The comprehensive agreement that has been reached involved a long and complication discussion. But if, as we all hope, the new programme is completely implemented, it will put Greece in a strong position to grow again and to reap the full benefits of participating in our common currency. The negotiations over the summer once again confirmed that Europe's institutional framework is not yet commensurate with the requirements of sharing a single currency. A more complete union is necessary.

From the ECB's perspective, two elements are of particular importance. First, despite the best efforts of everyone involved, the crisis has revealed the need for a political centre to economic and monetary union. That centre must be able to take the relevant fiscal, economic and financial decisions for the euro area as a whole in a swift and transparent manner with full democratic legitimacy and a clear set of responsibilities determined by the legislators. This requires a move from rules-based coordination to sharing of sovereignty within common institutions. One proposal that now needs to be developed further in terms of scope, function, and democratic accountability is a euro area treasury.

But – and this is the second important element from the ECB's perspective – we should also go further with our current policies. It is clear that Europe's economic and monetary union will need to strengthen its tools to manage and prevent the build-up of fiscal, financial and other macroeconomic risks. Recent reforms include strengthening the framework of economic governance and establishing the European Stability Mechanism, the Single Supervisory Mechanism and the Single Resolution Mechanism. These are important first steps in improving our toolkit for crisis prevention and crisis management, but further progress is needed.

In the nearer term, we should move towards completing Europe's banking union through a common backstop for the Single Resolution Fund as well as a roadmap towards a European deposit insurance scheme. Both are essential for creating a truly single banking system to mirror our single currency. Both are also crucial for underpinning the credibility of the banking union and achieving its initial promise of breaking the bank-sovereign nexus, making the financial system more resilient and protecting taxpayers' interests. In addition, we must look beyond the banking sector and make progress in developing a capital markets union to enhance further the scope for cross-border private risk-sharing.

It is also essential to prevent imbalances from developing into future crises. We need a new convergence process based on the capacity of our economies to withstand shocks and recover from them quickly. This implies not only establishing a more robust financial system; it also requires stronger governance of structural reforms and tighter control of national fiscal policies. To ensure that Member States can adjust to economic shocks, whatever their size, once we achieve greater convergence we will also need to add a layer of fiscal stabilisation at the European level.

Taken together, these steps towards completing Europe's economic and monetary union would help the euro area not only to survive, but also to thrive and prosper.