Yves Mersch: Back to stable

Speech by Mr Yves Mersch, Member of the Executive Board of the European Central Bank, at the Zahlungsverkehrssymposium, Deutsche Bundesbank, Frankfurt am Main, 29 May 2019.

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The primary objective of the ECB is to ensure price stability. This is also the best contribution we can make to achieving sustainable growth.[1]

Since the launch of the euro, the ECB has delivered on this commitment and rendered price stability a reality, maintaining an average inflation rate of below, but close to, 2%. And that is why the majority of euro area citizens trust the euro.[2]

Their trust is contingent on the independence of the central bank. Independence is granted to central banks to prevent politicians from seeking electoral gain through measures which boost economic activity in the short term but damage the long-term health of the economy and the country. It is also recognised that legal tender needs to be issued by a public authority. In the case of the EU, it falls to the ECB to issue the euro and decide on the denomination of banknotes.

We could not accept a situation in which, for anti-European or populist motives, certain euro denominations were not allowed to be used in some parts of the EU.

This established consensus is being challenged by private initiatives triggered by technical innovation. We are seeing ever more solutions in search of a problem.

Bitcoin and other crypto-assets claim to need neither trust nor the backing of a sovereign. They reject the paradigm of state-supported currencies governed by central banks, along with the role of financial institutions as trusted intermediaries. These self-proclaimed currencies, more accurately described as crypto-assets, have proved to be unfit for purpose, demonstrating that well-executed central bank policies are still the only sound basis for stability.

Trustless is pointless

The original bitcoin vision replaces trust in a dedicated intermediary with cryptographic proof. In other words, any two parties can transact directly with each other as peers without requiring a trusted third party. Their transactions rely on distributed ledger technology (DLT), sometimes floridly referred to as the “trust engine” of crypto-assets.

By leveraging cryptography and mechanisms to reach consensus among peers in a distributed system, DLT ensures the integrity and security of records which, in a centralised system, would be entrusted to a responsible third party. Users of crypto-assets can therefore depend on the underlying blockchains to avoid double spending and validate ownership.

However, trust isn’t entirely dispensable. In fact, users place their trust in the opaqueness of the arrangements through which influence is dispersed across the blockchain. Public blockchains still rely on key players to perform certain tasks, but these players are often unidentified and unaccountable. A protocol has to be created, maintained and operated, while the transactions it supports need to be validated. Developers and miners perform actions that affect the outcome of public blockchains. Furthermore, the practical usability of crypto-assets relies to a great extent on identifiable intermediaries to act as “gateways” between the crypto-asset ecosystem on the one hand and the financial markets and the economy on the other.

I have said before that we need to differentiate between “assets” such as bitcoin and the technology behind them, such as blockchain. Indeed, some of the technology is worth exploring and could also be of interest to central banks. That said, our role is not to drive technological adoption by the industry and the general public, but to ensure that changing preferences can be satisfied in a secure way.

While DLT is a necessary element of crypto-assets, it is not in itself their defining feature.[3]

The single distinguishing feature of crypto-assets such as bitcoin is the absence of an underlying claim, which makes it difficult for them to maintain price stability. Crucially, crypto-assets aren't backed by any sovereign authority and, unlike financial instruments, they don't give their holders ownership or contractual rights. Central banks provide confidence in money – as a store of value, unit of account and means of payment – by safeguarding the stability of the currency. By contrast with traditional currencies, bitcoin has been highly volatile over the past two years. Bitcoin's average volatility in that period was close to 80 %, while many other crypto-assets showed even higher levels of volatility. This makes it impossible to use crypto-assets for anything but outright speculation.

Some crypto-assets have recently emerged that strive to minimise fluctuations in value against a currency of reference, but even they are no alternative to the euro. These so-called "stablecoins" broadly fall into two categories: those that are backed with an underlying asset and those that rely on an algorithm to continuously match the supply and demand of circulating units. Unsurprisingly, the stablecoins that show the least volatility are those that back every issued unit with an equal amount of fiat currency. Why use a proxy, then, if you can have the real thing – unless the issuers of that proxy seek to interfere with the control of trusted assets circulating in the economy

The poor performance of crypto-assets is not an excuse for complacency, but rather a reminder of the importance of the central bank's objective to maintain price stability. Fulfilling this objective is conditional on the independence of the central bank, as ensured by a narrow but clearly defined mandate. Central banks must not be overburdened with multiple goals without having the appropriate instruments to achieve them. This brings me to the role of the ECB in the oversight of market infrastructures.

Less is more

The ECB has a Treaty-based task to promote the smooth operation of payment systems, as part of which it takes a close interest in the regulatory framework for market infrastructures which clear and settle securities and derivatives in euro, in particular central counterparties (CCPs). This reflects the systemic impact CCPs can have in situations of extreme stress, by disrupting repo markets or channelling liquidity strains to banks – which are also monetary policy counterparties – thus affecting the circulation of liquidity in payment systems. Ultimately, CCPs may need to rely on central banks as lenders of last resort. Central banks therefore have an important role to play in the regulation of central clearing – a notion which is largely recognised but often misunderstood.

In this context, let me say a few words about recent developments in the area of CCP regulation, and in particular the outcome of the legislative process regarding the revision of the supervisory framework for CCPs, the European Market Infrastructure Regulation (EMIR II), and the recommendation to amend Article 22 of the Statute of the ESCB and the ECB. The ECB recommended to EU legislators that its Statute be amended to clarify that the ECB had legal competence over CCPs, which would have allowed it to perform its statutory monetary policy role under EMIR II. We made the case that the ECB needed explicit general competence to monitor and address risks relating to our mandate, including broad discretion to take necessary measures in exceptional situations where the stability of the euro is at stake.

We also cautioned repeatedly against the positions taken by some Member States – particularly those who traditionally uphold the independence of monetary policy – and ultimately reflected in the draft amended text of Article 22 discussed by EU legislators. Under this approach, the ECB would have had no competence over EU CCPs, contrary to its mandate as central bank of issue for the euro, which calls for powers over all euro clearing regardless of its location. The ECB would have been given an exhaustive list of specific and circumscribed powers – replicating the present and future provisions of EMIR II – in respect of some systemic third-country CCPs, as designated by the European Securities and Markets Authority (ESMA). This would have been uncharacteristic and overly granular for the ESCB Statute, which is primary law and gives the ECB broad discretion in the exercise of its monetary mandate, and it would have violated the ECB's functional independence. This was compounded by a requirement that ECB measures be "in alignment with" legislative acts and measures taken under those acts. Given these grave legal concerns, the Governing Council concluded that the final text seriously distorted its recommendation and interfered with fundamental principles of the Treaty, including the independent exercise by the ECB of its monetary policy.

The recommendation to amend the Statute was therefore withdrawn, which is a matter of regret. The Governing Council did, however, make it clear that the ECB remains supportive of the objectives of EMIR II and is fully committed to contributing to its implementation where legally possible and in line with its mandate. The ECB looks forward to fruitful cooperation with ESMA and other authorities in taking this forward.[4]

In times of upheaval in global payment markets, it is all the more important for Europe to close ranks. In the United States we have already seen two mergers of two significant payment service providers this year. Both mega-mergers had a market value of $55 billion and more could follow. In such dynamic markets, in which economies of scale play a pivotal role, we should not get lost in national details but should self-confidently enhance the conditions of the European single market and the competitiveness of its participants, without, however, putting up protectionist barriers.

Conclusions

Allow me to conclude.

As central banks, we must remain true to our core mandate. Through change or crisis, we must retain the capacity to adapt to evolving needs and do what needs to be done. But that should not come at the expense of independence or accountability.

Ultimately, we will be judged on how we deliver price stability. Trust is the central bank's most valuable asset.[5]

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1 European Central Bank (2011), *The monetary policy of the ECB*.

2 Eurobarometer, European Commission.

3 Mersch, Y. (2018), "Virtual currencies ante portas", speech at the 39th meeting of the Governor's Club Bodrum, Turkey, 14 May.

4 Mersch, Y. (2018), "Euro Clearing – the open race", keynote speech at the Frankfurt Finance Summit, Frankfurt, 29 May.

5 Bursian, D. and Faia, E. (2018), "Trust in the monetary authority", *Journal of Monetary Economics*, Vol. 98, pp. 66–79.