Jürgen Stark: Closing address at the Fifth ECB Central Banking Conference

Speech by Mr Jürgen Stark, Member of the Executive Board of the European Central Bank, at the Fifth ECB Central Banking Conference "The Euro at Ten: Lessons and Challenges", Frankfurt am Main, 14 November 2008.

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Ladies and gentlemen

I wish to thank all of you for joining this 5th ECB Central Banking Conference here in Frankfurt. It has been a privilege for us – and here I am speaking also on behalf of my colleagues on the Executive Board of the ECB – to host this event, with such distinguished panellists and participants during this busy and extremely difficult time.

In my view, the past one and a half days have been a great success. Your expertise, experience and thought-provoking ideas, as well as your contributions to the discussions have enriched the intellectual and political debate on monetary union in Europe – its achievements, its challenges and its future.

It has not been the aim of this conference to celebrate the ECB and its achievements. However, it is worth recalling that, contrary to what was expected by a number of critical observers in the run-up to Economic and Monetary Union (EMU), the euro has been a remarkable achievement. Let me also remind you in this context that the ECB is obliged to maintain price stability.

With inflation averaging only slightly above 2% in the euro area in the face of several significant adverse supply shocks, we have witnessed a decade of relatively stable prices. Likewise, longer-term inflation expectations have remained broadly anchored at levels in line with price stability during this time. Such anchoring reflects favourably on the high degree of credibility enjoyed by the ECB's monetary policy. This success is also a tangible proof of the institutional robustness, coherence and unity of the Eurosystem – of its capacity to act in a truly European spirit on the basis of shared values, high standards and common principles. This has in turn led to striking progress in economic and financial integration in the euro area.

Ten years on, even those early critics admit that the euro has performed better than expected. And meanwhile, today's critics are saying that the ECB's monetary policy over this period has not really been tested, that it's just been lucky. Not true. The past ten years have not been plain sailing. Far from it. From the outset, the ECB has been confronted with a high degree of uncertainty and a series of severe shocks: the aftermath of the Asian crisis in the late 1990s; the bursting of the dot.com bubble; 9/11; and sharp rises in oil and food prices worldwide.

Over this same period, the euro area has also had internal imbalances to contend with. An issue that was intesively discussed yesterday. These imbalances remain a challenge. While EMU highlights the need for flexible economies, the euro cannot be blamed for the emergence of those imbalances. Rather, this largely reflects a lack of adjustment in a number of Member States. This is particularly true for those euro area countries whose adjustment mechanisms and responsiveness to exogenous shocks is still rather slow. To allow euro area economies to develop their growth potential and to reap the full economic benefits of EMU, it remains indispensable that the countries concerned bring their structural reforms and fiscal consolidation measures more into line with the conditions and rules of monetary union.

Overall, the ECB has done well to overcome these difficulties. However, the current global financial distress poses challenges of a significant and unprecedented nature to the ECB and other central banks around the globe. With this crisis, EMU is now ultimately experiencing a real test.

In these demanding times, some widely-recognised core principles have helped the ECB to weather the storm. The Maastricht Treaty assigns a clear and unambiguous mandate to the ECB to maintain price stability. It also grants the ECB full independence from political influence to fulfil this mandate. Besides these institutional safety belts, monetary policy needs to be forward-looking, medium-term oriented and underpinned by a comprehensive analytical framework. Given the monetary nature of inflation over the longer term, such a framework must include a thorough analysis of monetary and credit developments to allow for well-informed and consistent decision-making. Finally, one principle – that has gained much attention during the current crisis – is to keep the determination of the monetary policy stance distinguished from the management of liquidity in money markets.

All these principles are captured in the ECB's monetary policy strategy. And globalisation does not fundamentally alter these principles – which give guidance, in particular, in critical times. To weaken or even abandon these principles would undermine our commitment and credibility. And, in the end, we would risk losing orientation.

Our strategy has provided a consistent and coherent framework not only for internal analysis and policy decision-making but also for external communication. Using the same framework for internal and external purposes has helped the ECB to ensure that its monetary policy remains consistent, credible and effective. One key element here is that the ECB, from the outset, has been transparent about its mandate, strategy, and decisions, as well as about what monetary policy can do and, even more importantly, what it cannot do. In this sense, expectations about transparency requirements should be in line with the actual strategy followed by the central bank.

Without compromising on its mandate, the ECB has demonstrated a willingness and capacity to react rapidly to exceptional circumstances. It has taken a large number of extraordinary measures to support the functioning of the money market and interbank intermediation. These measures could be perceived as innovative:

- it has provided full allotment at a fixed interest rate in all its refinancing operations;
- it has expanded the range of eligible collateral in this context; and,
- in close cooperation with other central banks, it has taken measures to improve global funding conditions in various currencies.

Allow me to add here, on a personal basis, a word of caution: we, as central bankers, have the obligation to remain prudent. First, not to set the wrong incentives for market participants. Second, central banks need to be aware of any operational and reputational risks associated with the adoption of new measures and less traditional instruments, notably for the balance sheet of the Eurosystem and, ultimately, for the credibility of the ECB's monetary policy. Not to mention the potential impact on central bank independence. The reputation of the ECB is firmly based on the credibility of its commitment to price stability. This credibility must by no means be put at stake.

Likewise, in its monetary policy decisions, the ECB has not shied away from taking some highly unusual but appropriate steps. Within the space of less than one month, on 8 October and 6 November, the ECB lowered its key rates by 100 basis points in total. These moves were remarkable and unique in the ECB's ten-year history – in terms of magnitude, timing and rapidity. Importantly, the latest policy decisions remained fully in line with the ECB's mandate and the principles I mentioned just now.

Those who say that we were or still are "behind the curve" should consider all the decisions the ECB has taken since the financial crisis has intensified and broadened. In this respect, let us not forget that a central bank has only one instrument at hand, namely monetary policy. It cannot be held accountable for meeting more than one objective. Any such attempt would overburden monetary policy. For this reason, the Treaty provides for a clear and efficient allocation of policy responsibilities, with price stability being exclusively and primarily assigned to an independent ECB as its primary objective.

Not surprisingly, our debates yesterday and today have triggered the question of how to safeguard EMU and build on its achievements at a time when the world's financial landscape is changing dramatically. In fact, the current financial turmoil – the origins and implications of which we discussed in detail – is likely to dampen demand in the euro area and the rest of the world for quite some time. It may well turn out to be a litmus test for the functioning of EMU, both in economic and institutional terms.

Having carefully listened to the presentations, I remain confident that monetary union will withstand the test of time. As illustrated during the conference, the euro has already brought real benefits to the 320 million people in the euro area. It has been the main driver behind the remarkable increase in economic and financial integration as well as the transformation of the financial system over the past decade. It has made the euro area economically more stable for both investors and consumers.

In particular, financial integration has promoted cross-border portfolio flows in the euro area and thus enabled consumers and investors to share and diversify risks. As illustrated yesterday, EMU has increased banking integration.

Another interesting finding is that key policy initiatives at the European level, notably within the context of the Financial Services Action Plan, have made a significant contribution to fostering banking and regulatory integration.

However, in my view, there is room for improvement, especially as regards cooperation and coordination between national supervisors and regulators in Europe. As the Vice-President emphasised in his opening address yesterday, there is a growing understanding of the need to strengthen the pan-European character of financial stability arrangements for crisis prevention and resolution.

However, during the ongoing financial turmoil, the euro area and the EU as a whole have proved their capacity to act decisively and promptly under difficult circumstances. National measures have been coordinated in a pragmatic manner with a view to enhancing their effectiveness through mutual reinforcement.

As regards the role of central banks in banking supervision, recent tensions in financial markets have confirmed that close cooperation and active exchanges of information between central banks and supervisory authorities are indispensable. In particular, the financial turmoil has revealed areas in which cooperation could be strengthened. In fact, central banks contribute to financial stability.

But improved coordination and institutional innovations, while necessary, are not sufficient to make the euro area economy more resilient to adverse shocks. To enhance the adjustment capacity of the euro area economy, the current situation should serve as a catalyst for the resolute implementation of the necessary reforms. This would enable the Member States of the EU to fully exploit the benefits of economic and financial integration, with positive effects on growth potential and job creation in the euro area.

Having said all this, we should not forget how Europe would look today without the euro. An issue that was only marginally addressed during the conference. It goes without saying that the euro area countries would be significantly worse off. Multiple crises would arise simultaneously. Currency crises would go hand in hand with banking crises and real economy disruptions at country level. These currency crises might also spill over to other countries in the region. Not to forget political tensions between countries. By eliminating contagion via the exchange rate channel, the euro has mitigated the risk of contagion stemming from national economic or financial crises. In this sense, the euro has been a very important stabilising element in difficult times.

It is therefore not surprising that many central and eastern European countries would like to join the euro area on a fast-track procedure to be better shielded from global financial tensions and crises. This is understandable, given that many of them have already made progress towards adopting the euro. But we have also heard clear words of caution. Let me take the opportunity to emphasise that the euro area is not a closed shop. Following three enlargement rounds since the start of monetary union in January 1999, and with Slovakia joining the euro area as its 16th member on 1 January 2009, there is no reason to believe that the door might one day be closed.

But there is no shortcut. In fact, the difficulties that some countries face today are related to their failures to adjust, failures that go back a long way. As a result, domestic and external imbalances have emerged, with adverse effects on the sustainability of the catching-up processes in those countries. The fast introduction of the euro would not resolve the underlying problems – but could weaken EMU.

Structural adjustments as well as nominal and real convergence are therefore needed prior to the adoption of the euro. This means that the countries concerned must achieve a sustainable level of nominal convergence at high standards in terms of meeting the convergence criteria.

The adoption of the euro without adjustment is not possible. To regard entry into EMU as an easy way to solve or circumvent the current challenges surrounding the catching-up processes would be wrong. And a premature entry might aggravate current problems and put the credibility of EMU at risk. Policymakers have to be aware that the adoption of the euro represents a regime shift and thus, as Governor *Constancio* pointed out yesterday, need to learn the rules of the game in advance.

The ECB has demonstrated its ability to act even under extraordinary circumstances – without compromising its price stability mandate. This has strengthened the ECB's credibility.

If the ECB is to continue to deliver price stability over the medium term, then the financial system has to be stable and function smoothly. It is first and foremost through that financial system that monetary policy impulses are transmitted to future price developments. It is indispensable to restore confidence and bring the global financial system back on a solid footing. It is crucial to understand the implications of globalised financial markets for the design of institutional arrangements for the prevention and resolution of financial crises.

Let me conclude: We are going through a period when solid institutions are needed around the globe. And solid institutions are expected to be disciplined. As such, central banks provide an anchor of confidence and stability in difficult times. This must not be put at risk by weakening or even "lifting" this anchor.