

Jean-Claude Trichet: The ECB's response to the crisis

Speech by Mr Jean-Claude Trichet, President of the European Central Bank, at the WDR Europa-Forum, Berlin, 26 May 2011.

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Sehr geehrte Damen und Herren,

ich freue mich sehr, heute hier zu sein. Vielen herzlichen Dank für die Einladung.

Ich freue mich besonders, zu einem so wichtigen Thema – der europäischen Antwort auf die Wirtschafts- und Finanzkrise – zu sprechen.

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Wie Sie wissen, ist das primäre Mandat der EZB, für Preisstabilität im Eurogebiet zu sorgen. So ist es von den Europäischen Staats- und Regierungschefs in den Verträgen zur Europäischen Union 1992 festgeschrieben worden. Und dementsprechend strebt der EZB-Rat eine mittelfristige Inflationsrate von unter, aber nahe bei 2% an.

Die EZB ist diesem Mandat in den vergangenen zwölf Jahren gerecht geworden. Die jährliche Teuerungsrate betrug über diesen Zeitraum im Eurogebiet 1.97%. In Deutschland lag sie mit 1.5% seit 1999 sogar noch deutlich darunter. Für Deutschland ist dies das beste Ergebnis über einen vergleichbaren Zeitraum seit 50 Jahren mit der D-Mark. „Stark wie die Mark“ sollte der Euro sein – und stark wie die Mark ist er geworden.

It is important to understand the significance of this achievement. Over the past 12 years, the ECB has faced many challenges in the pursuit of our goal of price stability. They include the bursting of the internet bubble, the aftermath of 11 September 2001, sharp volatility in commodity prices and of course the worst financial crisis since World War II.

Today I would like to focus specifically on our response to the crisis – and on the programmes of reform of financial regulation and economic governance on which the euro area and the European Union as a whole are engaged.

While there is no doubt of the scale of the challenge that the crisis has posed for all advanced economies, including the US and Japan, there is also no doubt that we have taken significant measures in responding to that challenge. But much more needs to be done.

I. Financial and economic reform prompted by the crisis

Let me begin with financial regulation. The crisis calls for a comprehensive agenda of reform of virtually every aspect of the global financial system. We must control the forces that led the system to become absorbed with itself and ensure instead that it serves the real economy. And we must be assured that the financial system provides a sustainable contribution to economic growth.

At this point, we have achieved a blueprint of more stringent bank regulations, which includes more loss-absorbing capital, better risk coverage and limitations on undue leverage. Countercyclical capital buffers are intended to lower pro-cyclicality.

The oversight of financial institutions, financial markets and market infrastructure are being strengthened, and the organisational structure of financial supervision is being overhauled.

But much remains to be done. The most important aspect is implementation of these reforms. Moreover, the issue of systemically important financial institutions still requires decisions, and oversight of financial markets must be strengthened. We cannot afford the consequences of limited transparency and excessive influence of dominant players and oligopolistic market structures.

The new European System of Financial Supervision is an important step forward. The three new European Authorities – for banking, for insurance and occupational pensions, and for securities and markets – are strengthening our focus on interlinkages and spillovers within the EU's financial system. And the European Systemic Risk Board is developing the tools it needs to issue warnings and make recommendations for action on potential future sources of systemic risk.

Inattention to financial risk was the prime cause of the crisis. Inattention to macroeconomic risk – and the many ways in which such risk interacts with fragile fiscal structures – prepared the ground for the budgetary troubles that some euro area countries are facing today. This brings me to reform of economic governance.

The EU is about to introduce surveillance focused on imbalances and divergences in competitiveness across the euro area. This is long overdue. Since 2005 within the Eurogroup and – shortly thereafter – publicly, the ECB has warned that such divergences create considerable risks and must be corrected.

If fully implemented, macroeconomic surveillance will make a strong contribution to the smooth functioning of EMU. It will compel Member States to take measures to counter emerging macroeconomic imbalances at an early stage, before they become a drag on their macroeconomic prospects and potentially escalate to systemic proportions.

Governments had agreed on the Stability and Growth Pact to prevent a debt crisis. But in 2005 the Member States agreed on a reform of the Pact. At the request of Germany and France, more discretion and flexibility was added to the surveillance procedures. This turned out to be to the detriment of the Pact. It weakened the Pact considerably.

At that time, the ECB expressed serious concerns about the negative effect of these reforms on the functioning of EMU.

It is important that Member States have acknowledged this mistake and intend to strengthen the Pact again. The new focus on fiscal sustainability and reducing government debt levels, backed by more effective sanctions, certainly goes in the right direction.

The euro is unique among international currencies. It is the only major currency that is issued not by a single sovereign state but by a union of states. Fiscal policies remain largely the competence of national governments and reflect national political preferences. Monetary policy is inherently indivisible in a monetary union, and in the euro area it is thus conducted at the European level.

The current crisis is not a crisis of the euro. Neither is it a crisis of monetary union. Rather, it is a crisis of the economic policies in some Member States and a crisis of mutual surveillance. If we recall that EMU stands for Economic and Monetary Union, it is not the monetary pillar of EMU that is under scrutiny at present, but the economic pillar. Speaking in terms of letters, the “E” and not the “M” in EMU is giving cause for concern.

Our economic governance framework has not been sufficient to ensure sound policies are conducted in all Member States. The Treaty clearly specifies that Member States have committed to economic policies geared to contributing to the objectives of the Union, one of which is a stable single currency. They have yet to live up to this commitment fully.

The Governing Council of the ECB is concerned that the reforms to economic governance currently under discussion are a step in the right direction but do not go far enough to address the structural weaknesses of fiscal and broader macroeconomic governance in the euro area. At the very least, we require more automaticity in the sanctioning mechanisms. Euro area countries that are breaching our common rules should be called to account, with as little room for discretion and flexibility as possible. This implies less room for halting or suspending procedures and stricter deadlines.

Behind this we argue in favour of stronger sanctions to encourage compliance. This would require, on the one hand, a wider range of financial and non-financial measures, and on the

other hand, less discretion to reduce or suspend them. Such a strengthening would improve effectiveness and set the right incentives.

At the same time, more ambitious policy requirements would better match the current reality of the euro area. This means having ambitious benchmarks when establishing an excessive deficit and when setting the adjustment path towards a “safe” budgetary position. It is very important for macroeconomic surveillance to have a clear focus on the countries with the greatest vulnerabilities.

Anchoring these new rules at the national level would forcefully anchor them in national legislation. Binding commitments by Member States to implement strong national budgetary frameworks are key to ensuring national ownership. Finally, further improvements in the production of fiscal statistics are in our view warranted.

These are all areas in which the ECB is presenting arguments. In the end, these matters are decided by the Council and the Parliament, and they have therefore the key responsibility in shaping the new framework.

II. The ECB’s response to the crisis

Let me now turn to my final topic – the “M” in EMU, which is the direct responsibility of the ECB. During the crisis, along with central banks around the world, the ECB has had to operate in uncharted waters.

The ECB demonstrated its alertness from the very first day. When the problems in financial markets first became apparent on 9 August 2007, we were the first central bank to respond, acting within hours.

While the crisis required fast and unprecedented action we have never lost sight of our primary objective: to maintain price stability over the medium term for the 331 million citizens of the euro area. All – and I emphasise *all* – our monetary policy decisions during the past twelve and a half years have aimed at delivering on that commitment.

As you know, in normal times central banks mainly influence the economy and inflation through the setting of short-term interest rates.

In practice, identifying risks to price stability at an early stage is far from trivial. To accomplish this task the ECB relies on a robust monetary policy strategy that draws on several sources of information. Economic analysis allows us to synthesise information on short-term inflationary pressures from a multitude of economic indicators. Monetary analysis allows us to cross-check this information with information on medium-term inflationary pressures extracted from monetary and financial indicators. It is on this basis that we decide on the appropriate monetary policy stance and adjust interest rates accordingly.

Our positive track record has endorsed our approach. Over the past twelve and a half years we have built a strong reputation for setting interest rates as appropriate to maintain price stability.

Our decisions in the face of political pressure have demonstrated our fierce independence. We refused to decrease rates at the beginning of 2004 when Germany, France and Italy, in particular, asked us to do so. We did not hesitate to raise interest rates in December 2005. At that point, ten euro area governments out of 12 and many international observers pressured us to keep rates on hold.

The IMF, for example, was emphasising the risks that tightening – after a prolonged period of policy accommodation – could pose for the recovery. We tightened policy despite these warnings, and we were vindicated – by the IMF’s own admission.

We also did not hesitate to raise interest rates in July 2008. Then, our analysis indicated that past oil price increases threatened to create second-round effects on wages and prices.

After the intensification of the crisis in mid-September 2008, as inflationary pressures receded, in full consistency with our mandate, we decided to reduce our policy interest rate rapidly between October 2008 and May 2009, from 4.25% to 1%.

We reduced the interest rate to a level and at a pace that has not been experienced in the countries of the euro area at any time in recent history.

With the benefit of hindsight, the interest rate decisions we took during the crisis have proved successful. Over the past four years we have maintained a very solid anchoring of inflation expectations. Our determination to preserve price stability in the medium term has allowed us to avoid the materialisation of the risk of inflation as well as of the risk of deflation.

In most recent months, with the overall recovery more firmly established, we have witnessed the emergence of upside risks to the medium-term outlook for price stability. Once more, strong increases in oil and other commodity prices have had a strong impact on headline inflation. Once more, we have to avoid commodity price increases becoming entrenched in longer-term inflation expectations, which could have second-round effects on wages and prices.

It is against this background that the Governing Council decided to raise interest rates in April. And I would like to emphasise that this decision was unanimous. The Governing Council is united by a common purpose.

We are carefully monitoring the situation and we stand ready to do whatever is necessary to fulfil our mandate – just as we have done over the past twelve and a half years.

This logic applies not only to our policy interest rate but also to the other measures we have adopted in response to the crisis. When the crisis hit, dysfunctional financial markets threatened our ability to steer the outlook for price stability with our standard interest rate instrument. In response, we adopted a number of non-standard measures to ensure that our interest rate decisions were transmitted to the broader economy, despite the problems in the financial sector and financial markets. In particular, the aim has been to enable banks – at any level of the monetary policy interest rate – to continue lending to household and firms.

Let me emphasise that our non-standard measures do not in any way impinge on our capacity to tighten our monetary policy stance in response to inflationary pressures.

There is a clear separation principle between our non-standard measures and our interest rate policy. Interest rate policy depends on the outlook for price stability. The use of non-standard measures depends on the functioning of the monetary policy transmission and must be commensurate with the level of malfunctioning or disruption of money and financial markets and segments of markets.

This separation principle is strictly applied. To give you a recent example, the Governing Council decided in March and April both that it was now time to increase interest rates and, at the same time, that it was appropriate to maintain in the second quarter the full allotment at fixed price refinancing on a 3 month duration.

III. Conclusion

Damit komme ich zum Schluss. Die Krise hat den Euroraum vor große Herausforderungen gestellt. Aber wir haben diese Herausforderungen angenommen. Der Euro hat sich als Stabilitätsanker in stürmischer See erwiesen. Davon haben alle – ich betone, alle – Länder des Euroraums profitiert.

Bei alledem sollten wir nicht übersehen, dass der Euroraum als Ganzes in den vergangenen zwölf Jahren erhebliche Fortschritte gemacht hat. Die wirtschaftliche Dynamik im Euroraum hat derjenigen in den Vereinigten Staaten in nichts nachgestanden. In beiden Regionen ist das Pro-Kopf-Einkommen im Jahresdurchschnitt um etwa 1% gestiegen. Dabei hat der Euroraum deutlich mehr Beschäftigung geschaffen als die Vereinigten Staaten. Im Euroraum

als Ganzes ist die Beschäftigung in den vergangenen zwölf Jahren um mehr als 14 Millionen gestiegen. In den Vereinigten Staaten betrug der Anstieg 8 Millionen. Und all das haben wir erreicht vor dem Hintergrund von Inflationserwartungen im Eurogebiet, die auf einem niedrigen Niveau verankert sind. Dies ist eine mehr als beachtliche Bilanz.

Ich kann Ihnen versichern, dass die Europäische Zentralbank auch in Zukunft ihren Teil zum reibungslosen Funktionieren der Wirtschafts- und Währungsunion beitragen wird: wir werden ohne Wenn und Aber die Preisstabilität sichern.

Ich danke Ihnen für Ihre Aufmerksamkeit.