Jörg Asmussen: A European Central Bank perspective on key issues of the crisis

Speech by Mr Jörg Asmussen, Member of the Executive Board of the European Central Bank, at the European Financial Congress, Sopot, Poland, 24 May 2012.

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Dear ladies and gentlemen,

It is a great pleasure to be here with you at the European Financial Congress in Sopot. It would have been nice to visit Poland two weeks from now for the opening game of the UEFA Euro 2012! However, I did have the chance to spend 30 minutes this afternoon at Sopot's boardwalk and I very much enjoyed the Baltic Sea and the Polish coast after spending another long night in Brussels yesterday at the informal European Council.

In my view, the European Council delivered two strong messages. First, it confirmed the euro area's commitment to a long-term vision. The final destination is clear: a deepened economic union which manifests the partial political union our currency de facto already represents. The most important outcome of last night is that leaders showed their commitment to move the economic and monetary union to a new stage. Second, all EU leaders agree that growth-enhancing measures and efforts to achieve sustainable public finances need to go hand in hand.

I would like to structure my remarks around three claims. These are claims that I have come across more than once. They express understandable concerns and relate to key issues of the crisis.

1. "Policy-makers are obsessed with austerity. They ignore the need for growth in Europe."
2. "The ECB is moving on very thin ice. Its actions increase inflationary risks in the euro area."
3. "The current crisis management is all about quick fixes. There is no medium or long term strategy."

1. "Policy-makers are obsessed with austerity. They ignore the need for growth in Europe."

Austerity versus growth. This debate is wrong. Policy-makers are often accused of being obsessed with fiscal austerity and ignoring the need for growth in Europe.

Let me be clear: fiscal consolidation is not an end in itself. Rather, it is a pre-condition for achieving sustainable growth. Fiscal consolidation creates the confidence that investors and consumers need. Ultimately, it supports both economic growth and employment. The only alternative would be to fight debt with more debt. This is no solution.

Improvements on the fiscal front are becoming visible in the data. The euro area public deficit declined to 4.1% of GDP in 2011. It is expected to fall to 3.2% in 2012. The French deficit, for instance, came in at 5.2% of GDP in 2011, 0.5 percentage points below the government's target. I expect France to continue on this path and to achieve the 3% deficit target in 2013.

But while fiscal consolidation is a necessary pre-condition for sustainable growth, it is not sufficient. So the debate is not about austerity versus growth, instead it is about austerity and growth. We need both.

No one is against growth, but growth cannot be achieved by spending programmes which fuel the economy for a quarter or two but are no more than a flash in the pan. The important thing is to find ways to increase the growth potential, and this is far more challenging than introducing popular but short-sighted initiatives.

From my perspective, a growth package should have three components:

i) reforms in product and services markets

ii) reforms in labour markets

ii) funding of growth initiatives.

As regards reforms in services markets, for example, policy instruments that could help to boost growth already exist at the EU level. The Services Directive was adopted in 2006. However, it has not yet been fully implemented in all Member States. Nine out of ten new jobs in the EU are created in the services sector. Yet cross-border provision of services in the EU remains difficult. While 70% of the EU's GDP is generated in services, only 20% of services are provided cross-border. Up to 1.8% in additional growth could be unleashed for the EU with the full implementation of the Services Directive. The June European Council will adopt measures to make sure that the growth-enhancing potential of the Services Directive is fully exploited.

In labour markets, we see that Member States have started to implement important structural reforms. Spain is increasing the flexibility of employment contracts and addressing the problem of the country's "dual labour market". Here in Poland, the increase in the retirement age to 67 is a good example. It illustrates the fact that implementing structural reforms can be painful. But this pain should pay off in the future, as we have seen in Germany with the "Agenda 2010" labour market reforms implemented from 2003 to 2005. Germany is now profiting significantly from these reforms now.

A key factor in labour market reforms is mobility – particularly in the euro area, but also at the level of the EU 27. The restrictions on the free movement of workers from Eastern Europe after the EU enlargement of 2004 will be gradually phased out; they no longer apply to Poland. Enhanced procedures in the cross-border recognition of higher education diplomas, easing the issue of pension transfers and a better networking of job agencies across Europe come immediately to mind as ways to further increase the mobility of workers.

As I said, a growth package should not be confused with the idea of large-scale spending programmes. Nevertheless, growth-enhancing measures will not come for free in each case. For the funding, financial instruments of the European Investment Bank (EIB) could be used, for example project bonds to support infrastructure projects. More generally, funds from the EU budget should be redirected to areas where the money is really needed and where its impact would be greatest. Member States have to move away from "juste retour" thinking.

2. "The ECB is moving on very thin ice. Its actions increase inflationary risks in the euro area."

Let me now address the recent action taken by the ECB. In particular, I would like to focus on the two three-year longer-term refinancing operations (LTROs) that we conducted in December 2011 and February 2012.

Any assessment of the impact of the LTROs on the real economy would be premature at this stage. It is true that bank lending to the private sector is still very much subdued. But the data up to March confirm that the LTROs have reduced deleveraging pressures for banks and helped to avoid a major credit crunch in the euro area.

A number of questions have been raised about these operations. The most important concern is that the LTROs increase inflationary pressures.

A large injection of central bank liquidity could, in principle, give rise to inflationary risks. Inflationary risks would increase if a massive rise in firms' demand for credit was met by an equally massive increase in banks' capacity and willingness to supply credit. These conditions are clearly not met at the moment.

As with all other measures the ECB has taken, the LTROs are fully in line with our guiding principle: the maintenance of price stability. We constantly monitor the developments of credit and money in the euro area. If inflationary risks were to emerge, we would take the necessary action to prevent these risks from materialising and withdraw any excess liquidity.

When we measure monetary liquidity, we do not look at the balance sheet of the Eurosystem. We look at the balance sheet of the euro area banking sector. Only the latter shows the interaction with the real economy. And it tells us that the growth of money and credit remains very subdued, despite a recent stabilisation.

There is no reason to question our commitment to price stability. According to the most recent ECB Survey of Professional Forecasters (for the second quarter of 2012), euro area inflation is expected to rise to 2.3% in 2012. But it will fall thereafter and remain close to or slightly below 2% for the foreseeable future (up to 2016).

As regards the collateral framework that has been adopted by some national central banks to give banks access to the liquidity of the three-year LTROs, let me just say the following: appropriate haircuts, often very high, are applied to all credit claims provided as collateral. Any discretion on the part of national central banks is limited. The ECB constantly monitors all related risks.

3. "The current crisis management is all about quick fixes. There is no medium or long term strategy."

This leads me to the third and last part of what I would like to say. In the current crisis management, the ECB has a prominent role, more prominently than I would actually like. But the bulk of the responsibility for resolving this crisis lies with national governments. I have mentioned the need for fiscal consolidation and structural reforms. But more is being done.

To many observers the crisis management looks very much like "muddling through". This is only half true. In addition to the day-to-day crisis fighting, a number of far-reaching decisions have been taken at the European level, some under the Polish Presidency last year. These decisions are more than just quick fixes. They should help to improve the functioning of the Monetary Union in the future.

Strong firewalls have been created. In July 2012, the European Financial Stability Facility will be replaced by a permanent safety net, the European Stability Mechanism (ESM). The ESM will have a robust capital structure and flexible crisis intervention tools at hand to mitigate contagion risks in the euro area. Overall, the euro area is mobilising a firewall of about EUR 800 billion, or more than USD 1 trillion.

The EU's fiscal regime, the Stability and Growth Pact, has been strengthened. 25 EU Member States have signed the fiscal compact, which commits countries to enshrining important fiscal rules in binding national legislation. The fiscal compact is an important step towards a fiscal union in the euro area. Its timely ratification is now key.

A real innovation is the Macroeconomic Imbalances Procedure. It will help to detect and correct economic imbalances, for instance in house price developments. This should avoid situations like in Ireland, where a bursting housing bubble, together with bank guarantees provided by the state, led to an abrupt fiscal deterioration.

More legislative acts are under way to further increase the surveillance of national economic policies. Once the "two-pack" has been adopted, it will be possible for draft national budgets to be examined in Brussels. And revisions will be demanded if the budgets are not in line with the euro area's fiscal rules.

If implemented successfully, these measures will help countries to internalise an important point: any member of a currency union has to treat its economic policies as a matter of common concern. The euro area is already much closer to a political union than many of us realise.

There is one broad area, however, where a good strategy is still missing. This is the area of financial markets. Let me mention just one concern which needs to be addressed: the negative feedback loops between banks and national governments. The recapitalisation of a troubled bank by its government may lead to a deterioration of the government's fiscal position. The deteriorating fiscal position in turn further weakens banks' balance sheets, through their holdings of sovereign bonds.

This feedback loop has to be stopped. We have to move closer to a financial markets' union. A European bank resolution authority and a European deposit insurance scheme are two elements that could be used to address the nexus between sovereigns and banks.

I see further issues that need to be addressed in the area of financial markets, for example the potential conflict of interest for national supervisors whose task should be to ensure financial stability and a smooth functioning of European financial markets, but who are – at the end of the day – accountable to a national parliament and the tax payers of one single country. This, from my point of view, is an argument in favour of the single European rulebook without loop-holes and a supervisory authority at the European level for systemically relevant financial institutions with a cross-border business model.

Concluding remarks

Let me conclude. The crisis in Europe is still ongoing, but we have come a long way in addressing the most important issues.

It is important for the euro area to continue on its reform path. This is difficult but indispensable.

I am aware that here in Poland, people view the euro area's crisis management with some scepticism. They fear a division of the EU into two blocs: the euro area and the rest.

The creation of a dividing line is certainly not our goal. The Single Market binds all 27 EU Member States closely together. This level playing field has to be preserved. But the crisis has shown that the economies inside the euro area are even more intertwined than those outside. Therefore, reforms have to be more ambitious and rules stricter. This does not mean that those outside the euro area are excluded. As you are well aware, Poland, for instance, has signed the Euro Plus Pact and the fiscal compact.

And the euro area is not a closed club: it is open to every EU Member State that fulfils the convergence criteria on a sustainable basis.

Thank you.