

Yves Mersch: “ECB in between state rescue and monetary policy”

Keynote speech by Mr Yves Mersch, Member of the Executive Board of the European Central Bank, at the “Welt” Währungskonferenz, Berlin, 14 May 2014.

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Ladies and Gentlemen,

Mutual trust is a precondition for effective cooperation between European institutions and between the national and European level – trust that each institution acts lawfully and within its area of responsibility. The separation of powers as well as checks and balances are fundamental achievements of modern democracies. But they do not mean that one authority acts vis-à-vis another in a spirit of mistrust and disrespect.

Even though the title of today’s discussion (“ECB in between state rescue and monetary policy”) may suggest otherwise, the ECB cannot, must not and will not “save” states. Our actions are based on our monetary policy mandate, as defined in Article 127 of the Treaty on the Functioning of the European Union (TFEU): the ECB is responsible for price stability in the euro area.

Like almost all central banks in the industrialised world, the ECB enjoys a high degree of independence. This independence is not a carte blanche for us central bankers. It provides protection, so that we can fulfil our mission free of political influence.

At the same time, this privilege of political independence has a price: absolute respect for the limits of our mandate.

The most effective way to be accountable to citizens as an independent institution is to assess if and to what extent we fulfil our price stability mission. And our results so far are beyond reproach.

We have various instruments at our disposal to help us do justice to our mandate. The purchase of government bonds in the primary market is explicitly not among them because the monetary financing of governments is prohibited under the EU Treaty.

Our mandate nevertheless includes the possibility of buying, under the appropriate conditions, government bonds on the secondary market (so-called “Outright Monetary Transactions” or OMTs), should this be necessary from a monetary policy perspective. This option is explicitly stated in Article 18.1 of the ESCB/ECB Statute.

To illustrate this clear monetary policy orientation of OMTs, let me briefly recall the situation on the European capital markets in summer 2012.

Fears that the monetary union could break up had led to severe tensions on those markets.

The government bond market was particularly hard hit. Risk premia for both long-term and short-term government bonds of some Member States reached unusually high levels. In July 2012, the yield on Spanish government bonds with a two-year maturity was 6.6% at times; for Italian ones it was 5.1%.

Some of these spreads reflected the economic fundamentals of the respective Member States. However, the rapid rise in spreads in the first half of 2012 was also an expression of the fear, an unfounded one, that the euro area could break up. Model calculations – with all their uncertainties and weaknesses both inside and outside the ECB – show that spreads for two-year Spanish and Italian government bonds that cannot be explained by fundamentals were up to 2 percentage points in July 2012.

The prices of government bonds affect the pricing of other securities, such as bank or corporate bonds – key variables in the functioning of monetary policy. Disruptions on the

government bond market therefore also have an impact on the effectiveness of our monetary policy.

In summer 2012, our monetary policy signals were reaching some euro area countries in only a limited way. Sometimes they did not even reach the real economy. Our key interest rate had lost its guiding role.

It was in these circumstances that we announced the OMTs as an option on 6 September 2012. We wanted to be certain that we can live up to our monetary policy mandate for the entire euro area even in times of crisis.

At that time, we clearly stipulated three conditions for OMTs: first, we will take them into consideration only to ensure that our monetary policy signals reach the real economy – in the whole of the euro area, as our mandate requires. Second, OMTs will only be considered provided they are not undermined by short-term national interests, that is, if the Member State concerned strictly complies with an adjustment programme of the European Financial Stability Facility (EFSF) or the European Stability Mechanism (ESM) and implements the corresponding macroeconomic, structural and budgetary reforms. Third, the Member State must have access to the bond market or be about to have access to it in order not to unduly interfere with the market price mechanism (Article 2 of our Statute).

Just as long as these three conditions are met, the ECB may consider purchasing government bonds of the eligible Member States on the secondary market, if this should be necessary from a monetary policy perspective. These three conditions – disrupted transmission of monetary policy, conditionality and market access – are thus necessary but in no way sufficient conditions for OMTs. The Governing Council will decide about the possibility of OMTs in each case independently and only bearing in mind monetary policy needs.

This monetary policy orientation is also reflected in the design of OMTs. Should they be conducted, they are limited to maturities of one to three years because other Eurosystem monetary policy instruments are traditionally geared towards this short-term period.

OMTs also differ significantly from government bond purchases made by the EFSF or the ESM, which provide financial support to stressed countries. The EFSF and the ESM render – under strict conditions – financial assistance in order to preserve financial stability and they can improve the financing conditions of the affected countries. With OMTs, however, it is not a matter of aligning the financing conditions of the Member States of the euro area. OMTs do not aim to ensure uniform interest rates in the euro area. In a functioning market, risks are properly priced. OMTs should change nothing in that respect. Therefore, fundamentally justified interest rate differences or default risk premia are not the focus. OMTs should only cut unjustified interest rate peaks.

The ECB must not, cannot and will not replace the actions of democratically legitimised governments. On the contrary. OMTs are designed so that the market mechanism remains protected and the Member States are required to undertake necessary reforms.

Despite this clear monetary policy orientation, there is public discussion about the legality of OMTs. Out of respect for the judicial system, I shall not make any comments on pending proceedings. And according to my sense of justice, it would also be to the judges' credit to do the same.

That's why I take up the words of Peter Huber, the Constitutional Court judge. The ECB will wait for the decision of the European Court of Justice in "all humility and calm". And like him, I am very optimistic that the interaction between the ECB and the Court of Justice will lead to "a good result". Until then, we are not limited in our actions.

In February, the Federal Constitutional Court submitted questions of a legal nature about the OMTs to the Court of Justice for a preliminary ruling. However, the Constitutional Court reserves the right to decide on the compatibility of OMTs with Germany's constitution. With

its submission, the Federal Constitutional Court is acting in a spirit of shared responsibility within a partnership of European courts. It respects the division of tasks between European and national legislation and can take the views of the European Court as the basis for its judgement. Conversely, the European Court of Justice will observe the limits of its jurisdiction and not intervene in the remit of the Federal Constitutional Court.

Legal and political cooperation between the public administrations of the Member States and the institutions of the European Union functions when we respect each other and trust that we will act in the interests of our respective mandates and in accordance with the applicable law. This trust forms the basis of cooperation between Member States and between Member States and the European Union and its institutions. It is based on the democratic values we share and which are explicitly laid down in the Copenhagen criteria for new Member States.

We should preserve this trusting relationship – which supports Europe as a diverse, complementary whole, founded on the European treaties.