Jens Weidmann: Hans Möller medal acceptance speech

Speech by Dr Jens Weidmann, President of the Deutsche Bundesbank and Chairman of the Board of Directors of the Bank for International Settlements, at the annual meeting of the Munich Volkswirte Alumni-Club, Munich, 1 July 2016.

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Dear Mr Baader

Ladies and gentlemen

First of all, I would like to echo the words of welcome offered by our host and likewise welcome you to the Bundesbank's Regional Office in Bavaria.

The fact that you are holding your annual meeting here at the Bundesbank for the third time now after doing so in both 2012 and 2013 is a clear sign that you feel very much at home with us. But as you know, we do offer you a suitable venue and I can assure you, Mr Baader, that you didn't have to present me with this award to be able to hold your meeting here again.

Nevertheless, I am of course delighted to receive the Hans Möller medal and I would like to express my sincere gratitude for this honour.

You outlined the reasons for your choice just now, and I value them as support for my efforts to broaden my audience beyond narrow circles of relevant experts when discussing issues of European integration and monetary policy. I also feel encouraged to continue promoting a stability-oriented monetary union.

The fact that a club of economists is recognising my efforts to make economic issues accessible to a wider public is very fitting given the words of Hans-Werner Sinn in his farewell lecture – namely that economists must, first and foremost, serve the people.

Monetary policy and economic education

But I'm not just an economist – I'm also a central banker. In this capacity, I have a special interest in communicating with audiences beyond industry professionals.

This is because the successful functioning of any central bank hinges heavily on the support of the general public. Or, as Otmar Issing put it, "Ultimately, every society has the inflation rate that it wants and deserves."

It is without a doubt easier to implement a stability-oriented monetary policy when the general public holds monetary stability in high regard. What's more, the stronger the public's support for a central bank's stability-oriented stance and the greater the confidence it enjoys, the greater its level of independence becomes.

Appreciation of monetary stability is, of course, not to be confused with detailed knowledge of the mechanisms of monetary policy, although there is evidence to suggest that a person's appreciation increases in parallel with the knowledge he or she has about the way in which these two factors interact.

A number of studies indicate that economic education has – to put it diplomatically – some room for improvement. The Bundesbank has therefore expanded its economic education programmes in recent years.

By using educational materials and organising various types of events, we want to improve to the best of our ability the general public's understanding of monetary and foreign exchange policy issues. For example, our Regional Offices provide teacher training, visit school groups and organise public lectures under the motto "Forum Bundesbank". The feedback that we have received on these initiatives has been very positive.

I myself meet once a year with teachers and once with pupils. Time and time again, I see when young people visit the Bundesbank that they are very interested in our work and ask intelligent questions.

We should, of course, be aware that the impact that such measures can have is limited in terms of both breadth and depth. Such was the account recently given by the senior business editor of the Frankfurter Allgemeine Zeitung concerning her own offspring: "It is a positive thing that [the Bundesbank] goes into schools to raise awareness about monetary stability and to provide insights into the secrets of interest rate policy. It really is never too early to start tackling such topics in times such as these. However, it should be under no illusions as to the success of its efforts. My child took precisely one term away from the talk given by a Bundesbank representative to a year 12 class: marginal lending facility."

Incidentally, this technical term is even on the sixth form curriculum in Bavaria. That being said, it is also clear that the jargon that we have become accustomed to as central bankers should not detract from the essentials.

The principle of liability as a guide

But it is not just vocabulary that detracts from the essentials. Nowadays, economists' reasoning is highly mathematical and model-oriented, which often makes it difficult for non-economists to comprehend. However, institutional rules and regulations have also become so complex nowadays that often only a few experts are able to fully understand them.

Consider the federal financial equalisation system, for example. Addressing this subject, Peer Steinbrück once said, "There are only three people that really understood this concept. The first is dead. The second is in a mental asylum. The third is me – and I've forgotten everything."

Another example is the Stability and Growth Pact. With respect to the annual budget deficit ceiling, the old saying was, "3% is 3%." In the meantime, however, there are now federal states that have been flouting the deficit rule for seven years – and have been able to call upon the exceptional circumstances approved by the European Commission.

These days, even the experts are hard-pressed to judge whether fiscal rules are being observed or broken. The general public has long since bowed out of this discussion ...

But what members of the public certainly do understand are the basic principles of the market economy as taught to them by their own life experience.

Take the principle of individual responsibility, for instance. As Walter Eucken once put it, "Those who reap the benefits must also bear the costs." Conversely, however, the principle of liability also means that those who are liable for losses must also be those who, based on their decisions, are responsible for said losses.

To illustrate what this means, I always like to draw the following comparison for my audience. Imagine that your neighbour were able to go shopping using your credit card and you had no control over what he or she was spending. You would quite rightly say that such a situation is unacceptable – "I can't be liable for something that I have no control over."

However, the two propositions "Those who reap the benefits must also bear the costs" and "I can't be liable for something that I have no control over" go beyond the personal level and apply in an institutional context as well.

The principle of liability ensures that decisions are made more responsibly. This is also, and especially, true for the institutional architecture of monetary union.

When I gave my speech at the Volkswirte Alumni-Club three years ago, I quoted today's keynote speaker Harold James, who wrote in his book "Making the European Monetary Union" that, without a common fiscal regime and without a stable financial system, the monetary union had a very high centre of gravity that made for vulnerability and instability.

To stay with his allegory, the aim of an institutional reform in the monetary union must therefore be to lower its centre of gravity so that it cannot be blown off course so easily. But this will only work if the principle of liability is once again paid greater attention and a balance is struck between action and liability.

The essence of this argument was taken into account when financial regulation was overhauled and the banking union established. By tightening capital requirements and introducing a bail-in regime, the principle of liability is being more rigorously enforced in the banking sector: the greater the volume of liable capital that shareholders and creditors have available, the greater the losses that a bank is able to shoulder and the less likely a taxpayer bail-out becomes.

The principle of liability also plays an important role in the discussion surrounding a European deposit insurance scheme. It cannot be denied that a single deposit insurance scheme could have a stabilising effect.

However, as long as actions at the national level, such as drafting insolvency law or responding to very high stocks of government bonds on banks' balance sheets, can have a substantial impact on the welfare of financial institutions, savers from other member states should not be held jointly liable.

In this respect, I welcome the fact that the Economic and Financial Affairs Council will not decide on the European deposit insurance scheme until adequate de-risking measures have been taken. And it goes without saying that adequate measures also include regulatory steps leading to the end of preferential treatment of government bonds over loans to the private sector. In any case, risk-appropriate capital backing and limiting government bond investments would significantly reduce the risk of recourse being made to the deposit insurance scheme.

Conclusions from the Brexit vote

Ladies and gentlemen

I agree with the President of the European Parliament, who has called for "a more unified and cohesive European Union".

But this should not come at the price of increased joint liability unless joint control rights at the European level are agreed at the same time. And, in this case, we would have to make sure that the decisions made at the European level are also conducive to stability.

However, many of the proposals put forward before the Brexit referendum and aimed at "completing monetary union" only focus on elements of joint liability and disregard the issue of joint decision-making. They obviously anticipate and accept member states' reluctance to transfer national sovereignty to the community level.

Although such proposals might lower the centre of gravity of the monetary union, to stay with Harold James' allegory, they would also shift it to one side, which would not enable the monetary union to survive as a stability union in the long term.

Opinions on the future shape of the monetary union therefore differ greatly. However, even where common rules have been agreed – in the area of fiscal policy, for instance, – they are not taken seriously, and the Commission lets the major euro-area countries, in particular, do largely as they please. Not only does this damage the reputation of the European institutions, it also impairs the soundness of public finances in the member states.

Unsound public finances can make it more difficult for monetary policy makers to fulfil their mandate of ensuring price stability. It was precisely to protect the single currency that these fiscal rules were agreed in order to prevent monetary policy from playing second fiddle to fiscal policy and from coming under pressure to make high levels of debt sustainable through low interest rates.

Ladies and gentlemen

It is not only in the United Kingdom that the EU is seen as a canvas on which to project the drawbacks of globalisation and migration. Euroscepticism exists in other EU member states, too, and is possibly even strengthened by the fact that Europe breaks its own rules. I can therefore only reiterate what the Federal Chancellor said on Tuesday: “A successful Europe is a Europe that respects its treaties and keeps its promises.”

Euroscepticism in the United Kingdom was so strong that, despite numerous warnings about the economic consequences, the majority voted in favour of leaving the European Union. For the first time in the history of European integration, a country wishes to leave the EU.

This decision is very regrettable and, in my eyes, a mistake. But it should be respected and we will have to deal with it. It would appear that it is becoming harder and harder to convince people of the benefits of the European Union and to encourage them to believe in Europe.

The decision marks a turning point both for the United Kingdom and for the EU as a whole and we have no way of knowing exactly what the consequences will be.

Although the result of the referendum appeared to take the financial markets by surprise – at least judging by the sharp drop of 11% in the value of the pound sterling on Friday – all things considered, the reaction has not been disastrous so far.

The search for safe investments has led investors towards government bonds, which has pushed long-term interest rates back down and caused the yield curve to flatten again. The stock markets also recorded price losses and the pound sterling remains under pressure. But overall, financial markets responded calmly and there were no signs of panic.

This was probably because, among other things, the vast majority of banks and supervisory bodies had treated the Brexit scenario with the seriousness it deserved and had been prepared for that outcome. Another reason for the lack of severe disruption is that banks are now far more resilient than they were in the autumn of 2008. Nowadays, thanks to tighter regulation, they hold more capital and are therefore more robust.

Even so, it should be borne in mind that the fall in long-term interest rates and the further flattening of the yield curve will probably put more pressure on banks’ earnings, which are already squeezed. That alone is reason enough to doubt that we are already seeing the new equilibrium prices in the financial markets. This means that a prolonged period of uncertainty is a distinct possibility.

The ECB, along with other major central banks, has therefore announced that it will supply additional liquidity if required. So far, this has not been necessary.

It is not clear at present how serious the economic impact will actually be.

In the run-up to the Brexit referendum, the International Monetary Fund (IMF) had voiced concerns that established trade links would be disrupted, causing serious regional and global damage. The IMF also predicts that, until the terms of the UK’s withdrawal have been negotiated, the uncertainty will have negative implications for investment and will give rise to additional financial market volatility.

Although the sharp depreciation of the pound sterling is likely to dampen the impact on the aggregate UK economy for a time, it is important to keep the spell of uncertainty as short as possible.

It is in the interests of both parties for the EU and the United Kingdom to quickly enter into level-headed negotiations on their future relationship. Neither party will have anything to gain from erecting trade barriers.

Negotiations should not revolve around treating the UK better than other countries such as Switzerland or Norway, nor, however, should the objective be to make a political example of the UK.

Ladies and gentlemen

The UK economy will bear the brunt of the Brexit fallout, although the pace of euro-area activity might decelerate a little as well. And there is no way of telling what the political implications will be.

Brexit will probably also place a strain on Germany’s economy, particularly since the UK is Germany’s third most important export destination.

The Frankfurt financial centre alone might see new opportunities opening up, though that would also call for political backing. We should welcome any businesses that shift their activity from London to Frankfurt.

I see no need for any further loosening of euro-area monetary policy in response to the Brexit vote. Monetary policy is already in highly expansionary mode, and it is doubtful whether easing it further still would deliver any stimulus whatsoever. Monetary policy can be as easy as it likes, but that cannot prevent political uncertainty from dragging on the economy.

The crisis that has now engulfed the European Union is a political one that needs to be resolved in the political sphere.

Conclusion

Ladies and gentlemen

The Brexit referendum on 23 June marked a turning point in the history of European integration.

The vote should be regarded as a warning shot in the debate on institutional reform in the euro area.

It was, in my opinion, a grave error to increase mutual liability without simultaneously communitising fiscal control rights.

However, if willingness to transfer sovereignty to Brussels is also limited in the euro-area countries, the monetary union can only be stabilised in the long term by reinforcing individual national responsibility in order to strike a balance between action and liability.

Incidentally, I mentioned this three years ago in my last speech here at the Munich Volkswirte Alumni-Club.

On that note, I would now like to conclude my remarks and hand over to Professor James, whose speech I very much look forward to hearing.

But before I do that, I would like to warmly congratulate today’s award winners, and to pass on my own thanks. I am delighted to receive the Hans Möller medal and see it as a token of support and encouragement.

Monetary policy and European integration are really not simple topics. Helping the general public to understand them is an important task. They are topics that do not just concern the experts, but all members of the general public.

Thank you very much.