Benoît Cœuré: Low interest rates are not inevitable

Opinion piece by Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, in Les Echos, 9 November 2016.

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After nearly a decade of crisis, the euro area is once again experiencing growth. In volume terms, GDP now exceeds its 2008 level and the unemployment rate has posted a steady decline. Monetary policy has been instrumental in supporting this welcome recovery. But the improvement is too feeble to be a cause for true rejoicing. And some observers are concerned about the consequences of low interest rates on financial stability and profitability in the financial sector.

Is monetary policy facing an efficiency problem? Or is it actually dangerous?

The answer is clearly no. Let’s remember where we’re coming from. The euro area experienced a sovereign debt crisis coupled with a banking crisis, which shattered confidence and precipitated a double-dip recession in our continent at a time when other major economies were already recording positive growth. Today, high debt levels are still holding back the recovery and non-performing loans weigh heavily on the balance sheets of many of our banks.

Headwinds have also emerged – this time from the external side – as a result of weakening global economic activity. Since 2014, net exports have made practically no contribution to euro area growth. That means that we have only our own strengths to rely on to sustain growth.

Finally, and most importantly, our economies are suffering the effects of an erosion of long-term growth prospects and a relative increase in the global supply of savings. Long-term growth in the euro area has halved since the crisis, to less than 1% a year. These factors – the origins of which are in part technological and demographic – have played a part in reducing the “natural” level of interest rates that is consistent with balanced growth and price stability over a longer-term perspective. This is crucial: to support a given growth trajectory, monetary policy must be more accommodative than before.

Without our exceptional measures, growth would be weaker, the unemployment rate higher and inflation would be zero or even negative. The ECB will continue to support the recovery of the euro area in an uncertain international climate. A highly accommodative monetary policy remains appropriate, and will continue to be appropriate until inflation is firmly back on track and heading towards 2%.

The side effects of our measures are at present limited and give us no reason to question their relevance. Yes, low interest rates are holding back banks’ profitability, but our monetary policy is stimulating the volume and strengthening the quality of bank lending so well that its overall impact on banks is, for the time being, positive.

If growth is to rise significantly and interest rates return progressively to levels more favourable to savings, economic policies must make a more active contribution.

What does that mean in practice? Budgetary margins for manoeuvre can be used, where they exist. But in most countries of the euro area they are limited or non-existent. In France, for example, where public debt is verging on 100% of GDP, another delay in reducing deficits would mean taking an unconsidered risk with business and household confidence. In all of our countries, however, the mix of revenues and expenditure could be made friendlier to investment. And a comparison of current growth rates in the euro area shows a clear advantage for countries that have implemented the most ambitious structural reforms, most notably in their labour markets.

Weak growth, high unemployment and low rates are not inevitable. They reflect the legacy of the crisis but are also a consequence of economic policies that are lacking in ambition. The ECB will continue to protect the euro area from financial shocks, but the monetary climate will not always be so favourable. And the global economy could present new risks. It’s time to draw – and act on – the appropriate conclusions.