Jens Weidmann: The economic situation in Germany and the euro area, monetary policy and the longer-term challenges facing the euro area

Introductory statement by Dr Jens Weidmann, President of the Deutsche Bundesbank and Chairman of the Board of Directors of the Bank for International Settlements, at a discussion with the Association of the Foreign Press (VAP), Berlin, 23 August 2018.

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1 The German economy

Ladies and gentlemen

I am delighted to have this opportunity to exchange my views with you today. Allow me to first make a few brief remarks about the economic situation in Germany and the euro area, monetary policy and the longer-term challenges facing the euro area before I take your questions.

The German economy is flourishing: indeed, it is still enjoying a period of economic boom. Economic output is outstripping pre-crisis levels by far. Unemployment is at its lowest level since German reunification and employment remains on the up.

The upswing is likely to continue. It is broadly based across demand components: consumption, investment and exports are all increasing. It will also benefit from a more expansionary fiscal policy stance, especially next year.

However, it is unlikely that economic expansion will maintain the pace seen in 2017. In particular, exports will probably increase at a more moderate rate. At home, the rising shortage of skilled workers looks set to dampen employment growth.

This is also the result of high levels of aggregate capacity utilisation. Labour market tightness is contributing to higher wage growth and to increasing domestic price pressures. So far, the wage agreements concluded this year have been significantly higher than those concluded last year.

But the uncertainty surrounding the outlook for the economy has increased. Global economic growth remains buoyant, primarily driven by the two biggest economies in the world – the United States and China. However, political risks have increased, in particular – notably the risk of international trade conflicts intensifying.

When tackling the global economic crisis of 2008–09, the G20 countries refrained from adopting beggar-thy-neighbour policies, thereby ensuring that they did not repeat the mistakes of the 1930s. Back then, protectionist measures played a role in exacerbating the Great Depression. Today, a major trade war could be severely detrimental to the global economy.

Recently, risks for individual emerging market economies have gained greater prominence.

The developments in Turkey make it crystal-clear that the best way to stave off crises is to run sound and responsible economic and fiscal policies and to pursue an independent monetary policy geared towards price stability.

2 The euro area economy

It’s not just Germany – the euro area is also experiencing an economic upturn. This growth is broadly based across member states. Measured since 1996, the differences between national growth rates have never been as narrow as in recent times.

However, the pace of expansion in the euro area eased off in the first half of the year compared with 2017.This is likely to be attributable to multiple factors: in particular, last year's export growth was exceptionally high and therefore could probably not have been maintained; capacity utilisation is going up; and last but not least, the oil price hike is probably weighing on private consumption.

Nevertheless, the underlying forces driving economic activity remain intact: rising employment, favourable financing conditions and global economic growth. While the majority of sentiment indicators were unable to maintain the very high levels that they had previously reached, they still point towards continued economic expansion in the euro area.

3 Price developments and monetary policy

The economic upturn contrasts with the monetary policy stance remaining exceptionally expansionary. Today, the stance of monetary policy is no less expansionary than it was at the peak of the crisis. This is suggested by indicators which, among other things, also take the effects of the Eurosystem's asset purchases into account.

However, the very expansionary monetary policy stance should be seen against the backdrop of domestic price pressures remaining low. Overall euro area inflation hit 2.1% in July, but inflation is currently being driven up by higher energy prices, in particular.

Domestic price pressures are still distinctly lower. However, they are likely to intensify as aggregate capacity utilisation increases. They will thus counteract waning impetus from other components of the inflation rate, such as energy prices.

In their June projections, Eurosystem experts predict that the annual inflation rate will come in at 1.7% until 2020. If you ask me, that is broadly consistent with our medium-term price stability goal. For this reason, it's also time to begin exiting the very expansionary monetary policy and the non-standard measures, especially considering their possible side effects.

Thus, the ECB Governing Council's June monetary policy decisions anticipated the end of the net asset purchases. The Eurosystem's large asset holdings are to remain constant for an extended period of time yet, as the proceeds of maturing bonds are reinvested.

The Governing Council also enhanced its communication on key interest rates in June, saying it expects key ECB interest rates to remain at their present low levels "at least through the summer of 2019" and in any case for as long as necessary.

On the whole, constant asset holdings, the low key interest rates and enhanced communication will keep monetary policy on a very accommodative track even after the net purchases have ended.

It should be noted here that the degree of monetary policy accommodation as measured by the real short-term interest rate has risen again in recent months. This is the result of the higher actual inflation rate reducing the rate of interest in real terms, given unchanged nominal interest rates.

Ending the net asset purchases is therefore just a first step towards a necessary normalisation of monetary policy in the euro area. The next steps will of course depend on developments in economic activity and prices. However, this normalisation process will probably take place only gradually over the next few years. That's exactly why it has been so important to actually get the ball rolling without undue delay.

It’s also a question of how much room monetary policy has to manoeuvre. If, contrary to our projections, the economy weakens, fiscal policy will have to do more than in the past to stabilise the situation. With that in mind, it is important to create fiscal space now and to ensure sound public finances.

4 Challenges facing the euro area

September will mark the tenth anniversary of the Lehman Brothers collapse, a decisive moment in the financial crisis for many. In the euro area, the financial crisis later merged with a sovereign debt crisis. We are still processing the fallout of the crisis and extracting the right lessons.

Our task in the euro area is to make its financial systems more resilient. It is crucial that we strengthen the competitiveness and growth fundamentals of the various economies. The heavy burden of public debt needs to be broken down. These are challenges that each member state must face individually.

Furthermore, the regulatory framework of monetary union has to be rendered more crisis-proof. This requires a better balance between individual responsibility for actions and liability. Only then will misincentives be reduced.

That’s not to say that I’m ruling out greater risk-sharing between member states in general. But those that are explicitly calling for more risk-sharing must also be prepared to relinquish more sovereign rights to the European level.

I now look forward to your questions.