Benoît Cœuré: The local impact of the European Central Bank's monetary policy

Speech by Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, at Les Champs du Possible, Châteaudun, 4 October 2018.

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It is a great pleasure to be here in Châteaudun and have the opportunity to exchange views with you. The ECB Governing Council, which sets monetary policy for the euro area, benefits from such dialogue in two very important ways.[1]

The first is that it enriches our understanding of the state and the drivers of the economy. Earlier today, I had the opportunity to meet with local high school students. I also visited a company that exports its products to Europe and the wider world. In a currency union with 19 countries, policymakers are always at risk of focusing too much on the big picture and overlooking local reality.

The second benefit is that such visits to local communities enable us to explain our actions. We are accountable to the 340 million people living in the euro area, so we have a responsibility to clarify what we do and why we think our actions are appropriate.

So that is what I would like to do in the next 15 minutes. In particular, I would like to talk about the role of the ECB's monetary policy in the current economic expansion and describe how it has helped to foster employment and growth in the euro area as a whole, and also here in Eure-et-Loir. And, perhaps even more importantly, I will also set out what monetary policy cannot do, and how sustainable growth crucially depends on growth and job policies decided at regional, national and European level.

The ECB's response to financial fragmentation

Let me start with an overview of the situation in the euro area.

As you can see on my first slide, the euro area economy has now enjoyed five years of uninterrupted growth. Gross domestic product – the blue line – is well above the levels we observed before the great financial crisis.

The labour market has also improved notably in recent years. Employment – the yellow line – has risen by 9.2 million since mid-2013. The unemployment rate fell to 8.1% in August 2018, its lowest level in ten years. The participation rate of people aged between 15 and 74 now stands at 64%, 1.5 percentage point higher than ten years ago. By comparison, in the United States the participation ratio of those aged 16 and over decreased from 66% in 2008 to 63% in 2017.

With stronger growth and rising employment, we also see a gradual build-up in price pressures. On the right-hand side you can see that, after a long period of quiescence, wages, here measured as compensation per employee, have finally started to recover. And as they are growing faster than the rate of inflation, many people are seeing their real incomes rising. This can only be good news for businesses' order books.

So, overall, it is fair to say that the euro area economy is in the best shape it has been in for many years. Yet we are well aware that there might be a discrepancy, or disconnect, between the macroeconomic data that the ECB primarily relies on – and that we use in communicating and justifying our decisions – and what people can see around them.

For example, although in the euro area as a whole the recent rise in employment more than compensated for the decline since the crisis, the unemployment rate here in Centre-Val de Loire increased from 5.5% in 2008 to 8.6% last year according to Eurostat. Before the outbreak of the crisis, the unemployment rate in this region was lower than in the median euro area region; today it is higher.

Let me reassure you that such differences across regions, or across countries, do not go unnoticed in the ECB headquarters in Frankfurt. We are keeping a close eye on regional developments and carefully investigate the possible causes of persistent differences in growth and inflation. After all, a permanent divergence of the regions or countries in a currency union would make it increasingly difficult to define and implement a common monetary policy.

There are instances where monetary policy can do very little about regional differences. I will turn to these in a minute. But there are also circumstances where central banks can and should help reduce perilous disparities, in particular when they threaten the effectiveness of our monetary policy.

Our experience since 2014 illustrates this aspect well.

Around that time, we faced a dangerous disparity in firms' access to credit. You can see this more clearly on my next slide.

What you can see here are the responses to the ECB's survey on the access to finance of enterprises, which is mainly targeted at small and medium-sized enterprises (SMEs) and conducted jointly with the European Commission. Specifically, the chart shows the responses of firms across broad European regions to the question: "Would you say that the availability of bank loans has improved, remained unchanged or deteriorated for your enterprise over the past six months?". Yellow areas indicate that firms see a deterioration in availability.

Clearly, in 2014 there were many regions in the euro area where SMEs – the backbone of our economy – reported restricted access to credit, including here in what statisticians refer to as the Paris Basin.[2]

As influencing the cost of credit is an essential part of what central banks do, the restricted access to credit experienced by enterprises meant that our monetary policy could not fully unfold its potential in these regions, a situation that, in turn, threatened investment and job creation.

Our standard monetary policy instrument – the interest rate at which banks can borrow funds overnight – was not suited for addressing such fragmentation. We therefore adopted, from mid-2014 onwards, a range of measures that would ensure that banks could more easily extend credit to the real economy.

In a nutshell, we allowed banks to borrow funds from the ECB over much longer horizons – of up to four years – and at very attractive rates, on the condition that they would increase their lending to the real economy. We did this through what we call "targeted longer-term refinancing operations". And the collateral pledged by banks when borrowing from the ECB (in practice, from the Banque de France) can include credit claims, including loans to SMEs.

We also took two other policy decisions.

The first was our decision to purchase securities on financial markets, a move known as "quantitative easing" in the parlance of economists. As at the end of September 2018, we had purchased €2,076 billion of public sector bonds, €259 billion of covered bonds, €170 billion of corporate bonds and €27 billion of asset-backed securities.

How do such purchases benefit the real economy? The underlying mechanism is, in fact, very simple and powerful: by purchasing government bonds in particular we compress the return that banks and other investors can expect from holding a riskless financial asset, thereby making it more attractive for them to extend credit or provide capital to the real economy.

Our second decision was to impose negative interest rates, namely an annualised interest rate of -0.4% on banks' overnight deposits at the ECB. Here, we face considerable scepticism from the general public as people feel they are being deprived of their "right" to earn positive interest on savings.

But one often forgets two things. First, negative rates barely apply to firms, and even less so to households. They are, by and large, levied on banks. And, second, charging banks to leave their funds overnight at the ECB has created a "hot potato" effect: it discourages banks from hoarding cash and gives them an incentive to extend credit to firms and households instead.

You can see the success of our measures on the right-hand side. Today, credit is no longer an impediment to growth. Virtually all euro area regions now report improvements in the availability of bank loans, also here in Paris Basin. In other words, our measures have visibly reduced fragmentation in the euro area. You can see this also on my next slide.

While in 2014 firms in Italy and Spain faced much higher borrowing rates than in Germany or France, today this gap has vanished, by and large. Firms are no longer penalised by their location within our currency union. And those that already benefited from low interest rates a few years ago today enjoy the lowest borrowing conditions on record.

Never has it been cheaper for you – for firms – to borrow from banks than it is today. In France, for example, the composite cost of borrowing for firms during the first half of this year was just 1.5%. Of course, that is not to say that all of you will always obtain credit from your bank. Assessing credit risk remains a key function of banks, and the relationship is a commercial one. But all other things being equal, credit has become easier and cheaper.

And firms have responded to the marked easing in borrowing conditions. You can see this on the right-hand side. Thanks to the impact of our policy measures on borrowing rates, annual loan growth to firms has accelerated measurably in recent years. As a result, corporate investment is currently growing at an annual rate of well above 3% in the euro area. In France, loans have increased to such an extent that the Haut Conseil de stabilité financière decided that, from 1 July 2019, banks will have to put aside more capital against possible future risks.

Making our economies work better

So, the ECB's monetary policy has played a crucial role in promoting investment, consumption and, ultimately, price stability by reducing the borrowing rates faced by the real economy. It is therefore fair to say that many of the jobs created over the past few years can be partly attributed to the success of ECB policies.

However, while a stability-oriented monetary policy is a necessary condition for sustainable growth, it is not enough on its own. Many of the remaining regional disparities reflect factors other than monetary policy.

For example, my next slide shows that despite favourable financing conditions, in recent years growth and job creation here in Centre-Val de Loire have been lagging behind developments in many other euro area regions. You can see this on my next slide. To some extent, the gap has even been widening.

Such disparities often result from differences in labour market practices, product market regulations or, more generally, the ease of doing business. And, indeed, euro area countries still differ widely in many aspects of their economic and financial structures. Such differences are of course not a bad thing per se; they reflect national preferences, cultures and histories that should be preserved and cultivated. Europe does not impose a one-size-fits-all development model.

But there is a clear relationship between the quality of institutions and economic prosperity. You can see this on my next slide. As shown by the left-hand chart, the better the overall quality of their economic institutions, the richer countries tend to be.

France is a case in point, as you can see on the right-hand side. In the ECB survey on access to finance which I referred to earlier, firms were also asked which factors they consider as the greatest impediments to their business. Clearly, many SMEs consider regulation as the most pressing problem in France, and noticeably more share that view here in the Paris Basin than in many other euro area regions.

For this reason, reforming economies, reducing red tape and improving the business environment can help to promote stronger and more sustainable growth in all regions of the euro area.

Again, this is not about all countries adopting a single model. It is about each Member State adopting a model that delivers the right outcomes while allowing them to find and exploit their comparative advantages in the Single Market and in Economic and Monetary Union.[3]

The European Union actively supports governments in their efforts to allow productive firms to thrive, also here in France. For example, the region of Centre-Val de Loire can draw on EU funds worth about €600 million via the European Structural and Investment Funds for the period 2014-20.

These funds aim, among other things, to boost job creation in SMEs, facilitate climate change adaptation, including the transition towards a low-carbon economy, and to support training initiatives for the younger generation. With the help of this programme, more than 1,500 unemployed young people, who here in the Centre region have lower qualifications than the national average, could already return to education, gain a qualification or are now in employment.

The European Investment Bank is active in this region too. Since 2011, it has provided financing of about €1.5 billion for projects in Centre-Val de Loire, including the modernisation of high schools and the construction, operation and maintenance of a new section of the high-speed railway between Tours and Bordeaux.

Conclusion

All of this means, and with this I would like to conclude, that if we all work together as a team within our respective mandates – local, regional and central governments as well as European institutions – we can create and nurture the conditions needed for small firms to compete in the global market and thereby provide jobs, safety and prosperity for their local communities.

For its part, the ECB will continue to support the stability of the euro area as a whole. Our actions over the past few years have decisively contributed to reducing financial fragmentation across euro area borders and I am convinced that they have played a crucial role in supporting growth, employment and stable prices.

Thank you.

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[1] I would like to thank Maarten Dossche for his contributions to this speech. I remain solely responsible for the opinions contained herein.

[2] Until 2016, based on former French administrative regions, the Paris Basin was a statistical concept including Champagne-Ardenne, l'Île-de-France, Picardy, Lower and Upper Normandy, Centre and Burgundy.

[3] See Cœuré, B. (2017), "Convergence matters for monetary policy", speech at the Competitiveness Research

Network (CompNet) conference on “Innovation, firm size, productivity and imbalances in the age of de-globalization” in Brussels, 30 June.