Mugur Isărescu: Introductory speech - CEPS Ideas Lab: Europe's Choice conference

Introductory speech by Mr Mugur Isărescu, Governor of the National Bank of Romania, at the Centre for European Policy Studies (CEPS) Ideas Lab - Europe's Choice conference, Brussels, 21 February 2019.

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Chairman Almunia,

First Vice President Timmermans,

Ladies and gentlemen,

It is a great privilege for me to attend the annual meetings of Centre for European Policy Studies, at a momentous time for the Union. Surely, the elections for the European Parliament are on my mind as well, but not exclusively. As the topic of this year's meeting amply suggests, we, as EU citizens, need to make the right choices so that the future of the Union continues the project that has always fostered peace and economic reconstruction after the Second World War. It is the same project that has helped Central Eastern European countries "return to Europe" after the fall of the Berlin Wall.

Centre for European Policy Studies is a great scene for discussing the huge challenges our Union is facing at the moment. It brings together high officials from EU institutions and national governments, academics and representatives of the civil society and business circles. I speak not only on behalf of the central bank of Romania, but also as a representative of a country that holds the rotating presidency of the EU Council. I trust that we will be able to fulfill our mandate and advance projects of substance for the Union.

Let me focus in the minutes I have at my disposal on several economic issues.

Our debate is so more important for it takes place at a time of some economic slowdown all over Europe and of an erosion of multilateralism, of spreading trade conflicts. The prospect of a hard Brexit is very annoying for all of us and I still very much hope that such a denouement would be avoided. Likewise, it is high time to strike a deal on the Multiannual Financial Framework so that the great challenges the Union is facing (protection of borders, cyber fare, climate change, conflicts in near and more remote neighborhoods, etc.) find proper conciliation with the need to preserve the cohesion of the Union and avoid further fragmentation.

I also trust that EU leaders will find the right balance to address key institutional and policy related weaknesses of the Euro area. I mention this, for Romania, like other Non-member States, is bound by EU accession treaties to join the single currency area eventually. And hopefully, this will happen in the not too distant future. In this regard I wish to mention that two major documents on Romania's path to the Euro area (an analytical report and a Plan of action) have been recently completed and have been subjected to the scrutiny and approval of the political parties and the Parliament. I was one of the vice-chairs of the National Commission which guided the completion of the two documents.

I should say that we are not oblivious to what it takes for accession to be a success. No matter how much one wishes to put accession on a fast lane, success hinges on having achieved a critical mass of real and structural convergence with the Euro area. The lessons of the Euro area crisis remind us starkly this reality. The more robust the Euro area turns, as a result of institutional and policy reforms, the better for us.

When it comes to reforms of the Euro area, I would highlight the respect for rules and their enforcement, on one hand, and the introduction of risk-sharing schemes on the other. Among the latter I range a collective deposit insurance scheme (EDIS) which, together with a much stronger Resolution Fund (SRF) would complete the Banking Union, and the introduction of instruments that can help member states deal with asymmetric shocks. A euro area budget does make sense in this respect.

Let me make a few remarks on the macroeconomic scene in Europe.

The economic recovery of recent years has been heavily dependent on non-standard operations of the main central banks and very low interest rates.

There are still large public and private debts, which are especially burdensome in the Euro area – and which complicate the mission of policy normalization, of unwinding special operations of the ECB. Fortunately, some countries in our region (including Romania) enjoy a much better situation in this respect.

The very low inflation is prompting some to argue that policy normalization may have to wait still, but perverse effects need not be underplayed. But it is likely that policy normalization – understood as a return to positive real policy rates, will be quite a time consuming process, particularly in Europe.

Major risks persist, or even grow, in the global economy; they are due to interconnectedness and synchronicity of business cycles, the search for yield that has stimulated big bubbles again, a propensity to resort to protectionism measures (which adds to fragmentation tendencies), the accumulation of systemic risks in non-banking markets.

When it comes to monetary policy let me mention a few challenges.

The models central banks use have baffled in quite a few instances; we still do not have clear answers as to why inflation is persistently so low in most of the Union, in spite of economic recovery.

Financial stability concerns are increasingly on our radars.

There are other puzzles, like the flattening of the Philips Curve and I would range here the fall of financial intermediation in some Non-member Sates –in Romania and Hungary in particular. This seems to be a clear case of credit-less recovery, but that may also be the outcome of financial integration – for international companies prefer to source credit on external markets (where these may be cheaper).

The global financial cycle poses a major challenge. This is also due to the operations of major central banks, to their unconventional policies; policy reversals can cause major pains, especially where there is much external indebtedness, public and/or private.

As Hélène Rey says, the trilemma (free capital flows, exchange rate stability and autonomous monetary policy) may have turned into a dilemma; and that the power of monetary policy rests with the ability to control capital flows – which is a huge tall order. The resort increasingly to macro-prudential tools shows that, de facto, some kind of capital controls revival is under way, for the sake of both monetary policy effectiveness and financial stability reasons.

I would argue that exchange rate flexibility has been quite helpful for undertaking macroeconomic adjustment, in Romania, too. Under-development creates additional challenges for monetary policy since catching up is accompanied by higher inflation (the Balassa Samuelson effect). This may not be a problem right now in view of the overall context, but it will likely turn out to bother us in the not too distant future.

Migration of human capital (which is a very intense in some of our countries, including Romania) also puts a lot of pressure on wages and fuels inflation.

Let me turn now to a few regulatory issues. It is widely accepted among professionals, among us, central bankers, that the European banking sector has cleaned up much of its balance-sheets, that it is better capitalized. Likewise, the reforms of the regulation and supervision of the financial industry has taken us in the right direction, and much has been accomplished to make our banks safer. But still much needs to be done to feel the right degree of comfort.

Some final words I would direct towards the threat of protectionism. An enormous risk for the global economy is the temptation to shed the commitment to multilateralism and embark on protectionism. Beggar thy neighbor policies are quite perilous, as history amply shows. It is true that trade needs to be both free and fair, that commitments made within the framework of the World Trade Organization and other fora need to be observed. Unless we defend open markets, we invite big commercial conflicts and a proliferation of lose-lose situations.

Allow me to conclude my short address by pointing out that as a Romanian official I am confident that important steps have been already taken to ensure a more close cooperation in order to solve the afore mentioned issues.

As you know, Romania holds at the moment the Presidency of the Council of European Union and good work has already been done by our team in Bucharest and Brussels. They held 15 working parties in the Council, negotiated in 18 trilogues with the European Parliament, attended over 30 technical meetings, among bilateral meetings, informal consultations with the Parliament and the Commission. They have concluded the work and agreed on two files (Risk Reduction measures – the Banking package and Pan-European Pension Product). There has been a political agreement with the Parliament on two other files (Cross Border Distribution of Funds and European Market Infrastructure Regulation (EMIR) Refit). And I understand they have reached a general approach on the European system of financial supervision (ESFS) file, at the Council level.

I am sure we will keep up the good work and efforts on every side will have a positive outcome. The future might be uncertain, but we can surely try to better prepare for it.