bankenverband

Blog

TRUST AND RELIABILITY - ECB STARTS OFF IN THETRADITION OFTHEBUNDESBANK

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von

The launch of European monetary union at the beginning of 1999 and the start of the work of the European Central Bank (ECB) were highly successful, particularly in terms of price stability. The annual rate of inflation for the eurozone as a whole was 2.2% on average during the first ten years of monetary union: a stability-oriented rate that many critics would not have thought possible, especially over such a long period, before the introduction of the single currency.

This success was due, among other things, to the institutional preparations for monetary union: the ECB was basically modelled on the Bundesbank. Price stability was declared its primary objective and enshrined in the EU Treaties along with the political independence of the ECB and the participating national central banks. But a transfer of reputation from the Bundesbank to the ECB was also possible because the Bundesbank managed to contribute heavily to the work of the ECB as its “stability policy conscience” right from the outset. The successful start was, moreover, eased by the global disinflationary environment of the late 1990s and the noughties.

PRAGMATIC “STEADY HAND” MONETARY POLICY

A key to the Bundesbank’s successful stability policy in the decades before the launch of monetary union was, incidentally, its communication policy. Market players were given rough, long-term reference points, e.g. through a stability-oriented expansion of the money supply affecting demand. A rate of expansion for the money supply was thus set annually as an interim target for price stability.

Yet while the guardians of the German currency failed to reach this interim target in almost half of all cases, they still managed during this period to further strengthen the high level of trust in their stability policy. This was mainly because they closely analysed target deviations and carefully explained the relevant special factors. But an important point was also that they always made clear that they do not submit their monetary policy to any kind of automatism, but thoroughly examine the complex overall environment. This comprehensive, long-term approach enabled the Bundesbank to use its oft-quoted “steady hand” policy to also “look through” short-term fluctuations in key economic indicators. This, in particular, allowed greater steadiness and reliability in monetary policy.

Kurzgefasst

The ECB should therefore drop its over-fixation on the 1.9% inflation rate figure and communicate a timetable for exiting the monetary policy crisis mode as soon as possible. In our view, both an end to the net bond purchases and a swift exit from the negative-interest-rate policy are called for in the Coming year.

Schlagworte

Wirtschaft
EU
Geldpolitik
Niedrigzinsen
Inflation
Notenbanken
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STRUCTURAL PROBLEMS BECOME EVIDENT

The ECB faced particularly serious challenges during the financial crisis (2008-2010) and the subsequent European sovereign debt crisis. Especially during the sovereign debt crisis, the flaws in the architecture of monetary union, but also the preceding misguided developments in national economic policies, were painfully exposed.

The inadequate level of economic and economic policyconvergence between the individual eurozone countries was revealed particularly clearly. Despite monetary union and a single monetary policy, no common direction was pursued when it came to setting the national economic policy course in the eurozone countries. Above all, the target of common international competitiveness, which is a highly important one in a monetary union and maybe reflected in, for example, the trend in unit wage costs, displayed sharp national divergences.

Given the absence of any scene for devaluation in the eurozone, this would have called for appropriate measures by national governments to address the divergence in international competitiveness. But in actual fact the hardening imbalances in the development of unit wage costs and national inflation rates were more or less passively accepted.

This development can, incidentally, be explained quite clearly by “classical” patterns of behaviour in economic policy. Whilst some eurozone countries integrate their economy very proactively into international trade and respond to deteriorating competitiveness particularly by implementing structural reforms in their business sector and theireconomic operating environment, others were accustomed over decades to declining international competiveness being fixed solely by devaluation. These differing national patterns of behaviour are unfortunately still in place even after the launch of monetary union and ultimately hamper economic convergence.

FINANCIAL AND SOVEREIGN DEBT CRISES: ECB POLICY SUCCESSFUL...

The ECB responded to the financial and sovereign debt crises very skilfully through its monetary policy. For example, to stabilise the economy, the ECB also undertook comprehensive “unorthodox” measures. Among other things, it introduced a negative interest rate on deposits and launched a massive bond-buying programme. Both measures were also designed to bring down interest rates on long-term loans further.

This policy was - partly, at least - justifiedat the time.After all, the economic situation of some eurozone countries was extremely precarious for a long time as a result of the

European sovereign debt crisis. Yet, from the very start, two points of criticism were obvious:

- Firstly, the ECB was and is merely managing to buy time with its extremely expansive monetary policy. The underlying structural problems need to be tackled and eliminated by national economic policymakers.

- Secondly, it was clear that the risks and side effects of this monetary policy would increase in step with the duration and intensity of the measures adopted. These risks include, among other things, sharp fluctuations in risk pricing, the threat of asset price bubbles in some market segments, an extremely heavy strain on all fully funded forms of provision for retirement and an interest rate risk that continues to pile up - not only on banks' balance sheets but also in public finances.

... BUT FISCAL POLICY PRESSURE ON ECB IS GROWING

The ECB s monetary policy threatens to slip into a dilemma due to the only very hesitant economic reforms in the eurozone countries: the fiscal policy constraints are increasing and the room for manoeuvre in monetary policy following an interest rate hike that will sooner or later become necessary again is dwindling. What is more, to justifyits ample supply of liquidity, the ECB has over the past three years adopted a tendency to embrace a quite mechanistic monetary policy, which is ultimately the exact opposite of a "steady hand" monetary policy geared to the long term.

A contributing factor is that the long-term inflation target, which was deliberately worded relatively vaguely at the launch of monetary union, has been reinterpreted in monetary policy practice virtually as a pinpoint target of 1.9% that should, if possible, be reached within a two-year forecast period. Disruptions of this shortened and highly mechanistic equation have led and are still leading to a continued expansion of the ultra-loose monetary policy measures.

MONETARY POLICY FRAMEWORK FUNDAMENTALLY IMPROVED

Over the past twelve to eighteen months, the setting for the ECB's monetary policy has, however, noticeably improved. This is due, above all, to a cyclical economic recovery and a sustained economic upturn in most industrialised countries. The eurozone, too, is now experiencing a robust economic upturn, which has gained in breadth and stability. Macroeconomic performance in the eurozone will expandmuch more strongly this year than potential output for the third year in succession.

Unemployment in the eurozone as a whole is dropping, though it is still relatively high. The inflation rate has moved well clear of the zero line. For 2017, an annual average rate of 1.5% is expected. Serious deflation risks have long since been overcome.

Bank lending to businesses and private households is also starting to pick up again. Yet measured against the ample supply of liquidity and historically low key interest rates, this recovery is still weak. It proves that the economic upturn in the eurozone was not - or at least not primarily - driven by monetary policy. On the contrary, in some eurozone countries there are signs that the prospect of interest rates remaining low for some time to come has actually encouraged businesses to adopt a wait-and-see attitude towards investment, particularly as this monetary policy outlook stands, in principle,more for economic pessimism.

Despite this fundamental change in the eurozone monetary environment, the ECB’s monetary policy remains deep in crisis mode. The interest rate on the ECB’s deposit facility remains negative (-0.4%) and, because of the bond-buying programme, the ECB’s balance sheet is steadily growing. The extension of the bond-buying programme until at least September 2018 that was decided by the ECB Governing Council at the end of October 2017 means an additional monetary policy stimulus of €270 billion.

Please find the complete article here.

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