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Patrick T Harker: What to Expect When You're Expecting to Normalize Monetary Policy

Speech by Mr Patrick T Harker, President and Chief Executive Officer of the Federal Reserve Bank of Philadelphia, at the Global Interdependence Center's Central Banking Series, Tokyo, 13 November 2017.

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Good morning. It truly is a pleasure to be here, and I'd like to thank our hosts for their exceptional hospitality and such exquisite surroundings. In cases like this, you feel compelled to reciprocate, by way of cultural exchange, with some emblem of your country. But I realize that some of what we hold to be quintessentially American — from blue jeans to baseball — have been so embraced, and dare I say even so improved in some cases, that they're also quintessentially Japanese. I find, therefore, that the remaining, unique tradition I can share is this: the standard Fed disclaimer that the views I express today are mine alone and do not necessarily reflect those of anyone else in the Federal Reserve System.

With that out of the way, I'll begin by noting the subject of today's panel: How to cope with unconventional policy. I suppose this stands out to me because, while unconventional policy certainly needs to be managed and requires an adjustment by both policymakers and markets, it is, overall, a coping mechanism in and of itself. Each of us turned to these tools to address our own situations during and after the financial crisis. Unconventional policy was the salve to the crisis's wounds.

The Road to Normal

Each of us on this panel, and indeed in this room, brings a different perspective on how those policies played out. But we're all more or less on the same path; we're just at different points on a journey that ultimately leads to normalization. In the U.S., we're a bit farther along than our counterparts and, as such, can be looked at as something of a test case, though the cynic might compare us instead to the canary in the proverbial coal mine. In either case, our steps so far can prove illuminating, and some of our research and discoveries may prove informative as well.

The caveat, of course, is that there are a few differences in the case of the U.S. Unlike many in this room, the U.S. did not enter into a regime of negative rates. Instead, we lowered the fed funds rate to essentially zero, then engaged in three rounds of quantitative easing when rates failed to adequately spur recovery. We aren't alone in that experience, although we are farther ahead in terms of normalization. And the last qualification: In the grand tradition of Americans retaining the imperial measurement and Fahrenheit systems, monetary policy implementation in the U.S. is just different enough than others' to make exact translation difficult.

That said, I believe our experience can still be informative.

Unconventional Policy and the Fed's Balance Sheet

As a quick reminder, I'll offer a brief history of U.S. monetary policy during and after the crash. When lowering rates to near-zero failed to jump-start the economy, we turned, as most of us here did, to unconventional policies, which were primarily driven by large-scale asset purchases, or LSAPs — a phrase policy wonks concede we have lost the battle on, so I'll simply refer to the program by its better known moniker of quantitative easing, or QE.

QE involved buying more and different assets than our usual practice of holding mostly short- term Treasuries. We purchased longer-term Treasuries and bought mortgage-backed securities. The balance sheet swelled to approximately $4.5 trillion, a significant increase from the roughly $900 billion balance before the onset of the crisis.

Since late 2014, when we ended the purchases, we've been reinvesting the proceedings as they've reached maturity, keeping the balance sheet constant, until last month.

A modest rate hike in December of 2015 signaled the first baby steps toward normalization. We've since raised them three more times, by 25 basis points each time, and I still have another 25 basis point rate increase penciled in for this year, although perhaps I should say, "lightly penciled in."

Unwinding

That, of course, is not the only mechanism by which normalization must occur. In our September FOMC meeting, we voted to start the process of unwinding the balance sheet, commencing last month. The size of the balance sheet is larger than we've ever seen, and the MBS in particular renders its makeup different than before the crisis. Current assets are made up primarily of those Treasuries and MBS, while the liability side overwhelmingly consists of paper currency and bank reserves and balances and, to a much lesser extent, the overnight reverse repurchase — or reverse repo — facility.

It's true that we haven't faced exactly this type of normalization before — no one has — but it's also true that it's unlikely to be remotely interesting as a policy event, except as a chapter in some future generation's economics textbook. It will be slow, deliberate, boring, and essentially on autopilot.

To look at what we've done — and are planning to do — and to consider what lessons that could hold for other central banks, we should go back to first principles.

"Why," for instance, is a legitimate question. It is possible to maintain an exorbitantly large balance sheet and let the growth of the economy eventually render it proportional.

From my perspective, removing accommodation is the right next step for a few reasons. Monetary policy in the United States has been very accommodative for close to a decade. The economy now is more or less at full strength: There's very little slack left in the labor market and growth has kept pace with our projections. Inflation is still below the Fed's target rate and is the one area that not only continues to elicit caution, it even constitutes a conundrum ... I won’t get into too much detail, but some work by my staff suggests that the Phillips curve has not been a good predictor of inflation over the past several decades. [1] I do think we have to be cautious, therefore, about how we’re measuring inflation. At the same time, I don’t advocate throwing out all conventional economic positions with the bathwater. With a labor market this tight, inflation is likely to reassert itself at some point. All of which is to say that as we near the point of full health, it makes sense to return policy to a more normal stance.

This is also about keeping our powder dry. In the event of another shock to the system, I want our tools to be at their most effective and, in my view, that means reducing our balance sheet. Additionally, as productivity has dropped, it’s taken the neutral funds rate with it, making the zero lower bound closer and resulting in less room for maneuver with the funds rate, which will continue to be our primary monetary policy tool.

In the case of rates returning to zero, then, if something were to happen — if another crisis were to occur — further asset purchases may prove less effective, or perhaps simply more difficult and costly to execute, with a large balance sheet still in place.

The famous line is that the Fed takes away the punch bowl just as the party is getting good. I don’t think we’re taking away the bowl; I think we’re making sure there’s enough punch for the future.

Slow, Predictable, and Utterly Unexciting

In making the decision to start bringing the balance sheet back into alignment, three aspects were crucial. How to do it was obviously top of mind but also how to ensure a slow, steady pace that could essentially be left to churn on its own. We also knew, from past experience, that communicating our intentions was going to be a key factor in the efforts.

The means of unwinding the balance sheet were straightforward: We could either stop reinvesting the securities as they come to maturity or sell them on the open market. We opted for the former, with gradually increasing caps on the amounts that are not reinvested. This ensures the crucial aspects of gradual, predictable, and boring that we’re aiming for.

This is not to say that we will ignore the process as it unfolds. We’ll keep a watchful eye and revisit it in meetings. If economic or other events necessitate intervention, we’ll make that call. But we fundamentally want this to slowly and mechanically happen in the background.

I’ve said before that this will be the policy equivalent of watching paint dry. But I should specify that the paint is oil based; the process is going to take some time. We have not yet established what the new normal will look like.

The balance sheet will definitely be bigger than it was before the crisis because the economy is bigger. But its eventual size will depend on how overnight and other short-term rates behave as the unwinding progresses.

Also vital to our plans is the sense of predictability. I'm not sure there's a single Fed employee, from president to examiner, who didn't take the lessons of the 2013 taper tantrum to heart. Regarding unwinding then, we made every effort to communicate early and often, and as clearly as possible — a feat for an organization renowned for its policy speak — to ensure the message was clear. The market response to the announcement was somewhere between a yawn and a shrug, so I really do have to commend the entire Fed System for the clarity and consistency of the message. It's one of the key successes I'd point to in managing normalization after such an extraordinary time.

Key Lessons

There are other lessons to be gleaned, not just from the progress on the balance sheet, but from the moment of liftoff.

One of the most important is that, in the normalization process, it's possible to manage the balance sheet and rates separately, albeit with limits.

When we ended QE in late 2014, serious questions were posed about the feasibility of raising rates, given the size of the balance sheet. Traditionally, the New York Fed's markets units that implement the policy — which we refer to simply as "the Desk" — implemented rate increases by making reserves scarce in the fed funds market. But more than $2 trillion of reserves rendered them anything but scarce. The only way the Desk could remove $2 trillion of reserves overnight would be by effectively holding the largest fire sale in economic history.

The current situation necessitated a great deal of effort to gain a deep understanding of uncharted waters. Ultimately, a combination of expertise and analysis engineered a successful liftoff in December 2015. Rates have been under control since and remain well connected to other money markets. As the FOMC decides to increase the target range for the federal funds rate, it increases both the interest banks earn on reserves and the rate an extended list of counterparties can earn via the reverse repo facility.

Here I'll return to the note I made earlier that the United States differs in a few areas. In the classic model of a corridor system, the interest on reserves provides a floor, for the obvious reason that no bank wants to lend at a lower rate than it would earn by simply keeping its balances. In the U.S., however, not all institutions qualify to earn interest on reserves. With reserve markets satiated, it is therefore the reverse repos — available to a wider range of additional institutions — that provide a firm floor on market rates and the interest on reserves provides a cap.

These two rates — interest on reserves and reverse repos — currently form the boundaries of the fed funds target. Research by my staff correctly predicted that most fed funds trades would occur at rates safely in the middle of the target range, even if actual use of reverse repos is quite low. By offering an alternative to trades in the market, the reverse repo facility improves the bargaining position of lenders and drives rates, even if lenders rarely have to resort to the facility — a “spooky action at a distance” that also helps to keep the fed funds rate connected to other money market rates. [2]

As our balance sheet declines, so does the supply of reserves. Eventually, reserves could become scarce again, which would, theoretically, make it possible to return to a classic corridor system in which interest on reserves operates as a firm floor on market rates. Exactly what level of reserves would enable that is a topic of ongoing research. That level could be substantially larger than the last time we conducted policy in a reserves-scarce environment, owing to how much has changed since 2008. I will therefore continue to monitor this issue as the balance sheet shrinks.

Conclusion

The United States is, by and large, farther down the road to normal than other countries that turned to unconventional policies and, as such, we can pass along the lessons of our experiences thus far. These are clearly not direct correlations, but there are echoes, and we all operate on the fundamental monetary policy oath of “first do no harm.”

The knowledge that rates and the balance sheet can be decoupled has been invaluable, as has the work to prepare the markets for what’s to come.

This is a new path for all of us. What we’re trying has never been done before, at least not on this scale, and while it might be, to borrow a phrase, the “final frontier” of monetary policy, I do believe we’ll pull off the ultimate feat and make a couple trillion dollars utterly uninteresting.

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[1] Michael Dotsey, Shigeru Fujita, and Tom Stark, “Do Phillips Curves Conditionally Help to Forecast Inflation?” Federal Reserve Bank of Philadelphia Working Paper 17-26, August 2017.

[2] Roc Armenter and Ben Lester, “Excess Reserves and Monetary Policy Implementation,” Review of Economic Dynamics, 23, (2017), pp. 212–235.

Fonte: Federal Reserve Bank of Philadelphia

https://www.philadelphiafed.org/-/media/publications/speeches/harker/2017/11-12-17-gic-central-banking-series.pdf?la=en

François Villeroy de Galhau: The euro – which way to go?

Keynote speech by Mr François Villeroy de Galhau, Governor of the Bank of France, at the EconPol Europe (European Network for Economic and Fiscal Policy Research) Founding Conference and first Annual Meeting "The Euro - Which Way to Go?", Brussels, 9 November 2017

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Mr President, Ladies and Gentlemen, [1]

It is a pleasure to be in Brussels today, which doesn't happen so often for a central banker... who has just arrived from Frankfurt. I welcome the fact that you at EconPol Europe have chosen the euro as the theme of your founding conference, and invited me to give this keynote speech. Since Maastricht 25 years ago, we have succeeded in building a Monetary Union. However we have not delivered on Economic Union. To avoid overburdening monetary policy, our Union must stand on two feet rather than just one: that is why it is legitimate that we, as central bankers, propose ideas on this subject, even if we are not those who legitimately make decisions. It is now urgent to make concrete progress on Economic Union, all the more so as the economic context is now favourable, as confirmed today by the European Commission. Euro area growth of 2.2% in 2017 should be the highest rate in 10 years, and as strong as in the United States. It could be for France even slightly higher than forecasted (1.6%), if we look at our Banque de France forecast for Q4 published this morning – at 0.5%. It will be sustained in the next two years thanks to strong investment and increased convergence among countries. These forecasts, including a positive but still subdued inflation, confirm the adequacy of the gradual normalisation of our monetary policy we are engaged in.

There is a risk, however, that the debate will continue to revolve around two long-standing divisions: "German rules" vs "French expenditure" and "community methods" vs "intergovernmental methods". Too many fears and suspicions have been inherited from the past, but we are living in a new era – which is also thanks to the acceleration of reforms in France – and in a time of unique historic opportunity. In Rome, on 25 March of this year, the Member States all expressed their clear will for "the completion of the Economic and Monetary Union". We are in agreement on the "why": greater stability, to counter the risk of a new crisis befalling an unprotected euro area; and greater growth, to catch up our past lag on the United States and finally treat the fatal disease of mass unemployment in Europe.

But how can we achieve this shared objective? We should trigger four accelerators: a macro accelerator, which would consist of a collective economic strategy shared by all euro area Member States; a micro accelerator, which would take the form of a Financing Union for Investment and Innovation, going beyond the CMU (Capital Markets Union); a fiscal accelerator, which would draw on a euro area budget. The fourth is not an accelerator in substance, but rather a "facilitator" for the first three: on institutions, a euro area Finance Minister and Parliament.

These accelerators would contribute to the functions of economic policy, as described by Musgrave: [2] allocation, stabilisation and distribution. The allocation function aims at making sure

that resources are used in an efficient way. This would obviously be the role of the micro accelerator, but also of the fiscal one – through the financing of European common goods. The stabilisation function consists in the smoothing of the cycle and cushioning of the impact of crises, and this could be ensured mainly by the macro accelerator, but also by the micro one, thanks to enhanced private risk sharing, and possibly by the fiscal one. Finally, the distribution function is to foster an equitable sharing of income. This role could possibly fall to the fiscal accelerator but its implementation would require increased trust and greater economic convergence between euro area Member States in order to avoid a “transfer union” which would be a one-way budget: in that case, I would understand German fears.

So these four accelerators are needed, but this does not mean they all have to be implemented at the same time. The latter two accelerators, fiscal and institutional, would indeed require Treaty changes, unless they were to be very limited. However, this must not stop us from taking steps straight away on the first two accelerators, macro and micro, on which I will insist today. I would like to share with you some personal reflections – useful for the proposals that the European Commission will make in December and for our debate today. To be more specific, I will focus on one part of each of these two accelerators, where progress can be made quickly: I will first dwell on the creation of a Stabilisation Lending Instrument (SLI) as part of the macro accelerator, and I will then elaborate on the completion of the Banking Union as part of the micro accelerator.

I. A macro accelerator, including a Stabilisation Lending Instrument (SLI) and perhaps a European Monetary Fund

The macro accelerator is premised on one simple fact: economic growth and employment would be stronger in the euro area if we combined more reforms in countries where they are needed, like France or Italy, and more stimulus in countries with leeway for it, like Germany or the Netherlands. To achieve this collective economic strategy, euro area Member States have to seal a deal, which could be prepared and adopted as early as 2018.

In addition to this commitment, I also suggest creating a Stabilisation Lending Instrument at the euro area level, and I would like to detail some key aspects regarding its objectives and operational efficiency. I will then talk more broadly about a possible European Monetary Fund.

Let me start with the objectives. The SLI would provide loans to euro area Member States faced with an asymmetric economic shock, in order to support their countercyclical policies. Finland for instance was faced with a triple asymmetric shock in the late 2000s, due to the collapse of Nokia, the decline of the paper industry and the aftermath of the Russian crisis – real GDP contracted by 9% in 2009. Such a shock could also stem for instance from temporary political uncertainty – as long as it is not fuelled by inadequate economic policies

– from natural disasters or from an irrational loss of confidence in the financial markets resulting in excessive pressure on the sovereign spread. The SLI would be a complement to and not a substitute for national stabilisers. It would help Member States not to abandon their long term investments, especially by preventing an unwarranted widening of their financing conditions.

Beyond this Stabilisation Lending Instrument, the creation of a “rainy day fund” with fiscal resources could be considered at a later stage once confidence and economic convergence between Member States have increased.

On the operational efficiency of the SLI, access to the instrument should be simple, subject to carefully chosen macro-financial criteria. Minimum conditions would be first that Member States actually abide by common rules – the Stability and Growth Pact and the Macroeconomic Imbalances Procedure – and second that they actually conduct policies consistent with the euro area collective economic strategy. However, contrary to the ESM instruments that have been used so far, access to the SLI should not be conditional on the implementation of an adjustment program. Its design would be such that it does not involve a stigma for Member States.

The issue of governance brings me to a broader reflection on the idea of a European Monetary Fund (EMF). An EMF would only make sense if its scope of action and its governance went beyond those of the current ESM. Otherwise, why would we give it a different name? The scope of action of a potential EMF should not be limited to crisis management. We should entrust it with the role of crisis prevention in a broad sense, including contingent lending through the SLI. This would require decision-making processes that would not be tied up by veto-based governance.

As President of the Eurogroup and Member of the European Commission, the Finance Minister of the euro area would logically chair the Board of Governors of an EMF and play a stronger role in situations that require Board level judgement. In due course, it would be beneficial to bring an EMF into the fold of the Community method, which means anchoring this institution in the framework of Union law [the Commission has suggested proceeding on the basis of art. 352 of the TFEU]. Within this framework – and only within it – it would make sense to entrust an EMF with a broader surveillance mission, including the task of monitoring compliance with the common rules, a role that is today assigned to the European Commission.

II. Amicro accelerator, including the completion of the banking union

Let me now turn to the micro accelerator for the Economic Union: a Financing Union for Investment and Innovation. The aim is to better steer the euro area’s EUR 350 billion annual savings surplus towards productive investment, notably by shoring up equity which is the key to an innovation economy. Thanks to unified governance, this Financing Union would help circumvent bureaucratic barriers and foster synergies between the existing building blocks: the Juncker Investment Plan, the Capital Markets Union and the Banking Union. Yet, for this

Financing Union to be effective, progress is still needed in four key areas: first, providing incentives for cross-border investments – mainly in equity – through accounting, taxes and insolvency laws; second, developing pan-European long-term saving products – with a key role for the insurance sector – and investment vehicles like European venture capital funds; third, completing the Banking Union; fourth, controlling financial activities and risks that are of vital importance for the euro area, such as supersystemic CCPs. And so, we could reach significant gains for digitalisation, SME's scaling up or energy transition. Today, I will focus on the third area: completing the Banking Union.

The Banking Union is a major step forward for the euro area and is now operational, based on the single rulebook and already two pillars: the Single Supervisory Mechanism (SSM) since end- 2014; and the Single Resolution Mechanism (SRM), since the beginning of 2016. Those two pillars will have to be complemented by a third pillar about Deposit Insurance, where we could find practical and reasonable compromises. But in addition, I will elaborate on two challenges that are less often mentioned: consistency, and consolidations.

The first challenge is to achieve better consistency between regulation, supervision and resolution, at three levels:

- First, in the concrete mechanisms: finalising and simplifying the resolution pillar should be a priority. The case of the Italian banks has illustrated just how complex it is to combine the resolution regime laid down in the Bank Recovery and Resolution Directive (BRRD) with the State aid framework for orderly liquidation. In addition, confidence in the Single Resolution Fund (SRF) and its capacity to intervene has to be bolstered. The setting-up of a common backstop, as mentioned in the European Commission's communication of 11 October, is a promising avenue, which could take the form of a credit line granted by the ESM. Furthermore, the issue of theliquidityof the newly resolved entities – mainly the "good banks" – is not sufficiently clearly addressed: liquidity support by public sources beyond what can legitimately be expected from the Eurosystem should be clarified.

- Second, consistency in thelegal framework and requirements: faced with the accumulation of new and "separate" requirements, we need to adopt a holistic and consistent approach in order to avoid a prudential overload. In particular, the TLAC requirement resulting from the new international framework requires a consistent adaptation of the European minimum requirement for own funds and eligible liabilities (MREL). In the same vein, the consequences of an internationally-agreed Basel III package – if and when it comes – should be carefully taken into account, as it would lead to increased risk-weighted assets, which will in turn impact the MREL. All this, combined with pillar II capital requirements, could lead to over-calibration: each individual decision may be warranted; but their somewhat disorderly accumulation is not. And obviously, we must not jeopardise the level playing field between euro area banks and their international competitors.

- Third, in the interaction between authorities, which should be improved: the case of Banco Popular, although it was a success, has also demonstrated the importance of swift and close cooperation between supervisory and resolution authorities, both at European and national levels. In this respect, there is still a need to better coordinate the roles of the different European authorities – SSM and ECB, SRM, Commission, and EBA – in order to have a clearer “pilot in the plane” in crisis management. At a later stage, we could even consider establishing a single banking authority for our single Banking Union, acting to bolster the robustness of the European banking sector.

The second challenge is to support cross-border bank consolidations in the euro area. The head of the SSM too, Danièle Nouy, insisted on this point a couple of days ago. We still lag far behind the American market in this respect: the market share in the United States of the top five banks is more than 40% whereas the market share in the euro area of the top five banks is less than 20%. Sound and safe cross-border consolidations would make banks better able to diversify their risks across the euro area, and channel savings more effectively towards investments across borders; this would foster the Financing Union I talked about.

From a supervisory point of view, it involves supporting an approach on a consolidated basis by granting more waivers on liquidity and capital so as to allow more flexible capital allocation and limit ring-fencing. Swift execution of cross-border transactions is also essential: the implementation of a fast-track process by the SSM would address this issue. From a resolution point of view, internal MREL requirements could be a tool to facilitate the resolution of institutions, but they would become meaningless if calculated on a national basis. Indeed, having internal MREL in all countries could be an obstacle to the single market and European banking cross- border mergers. Finally, we should address business and legal impediments to cross-border mergers: information asymmetry, non-performing loans (NPL) or anti-takeover legal structures in different countries. As a first concrete step, I suggest that the EBA publish a comprehensive stock-taking of all the regulatory and supervisory obstacles to cross-border activities and mergers. The aim is crystal clear: within a Monetary and Banking Union, a cross-border merger must not be more difficult and cumbersome than a “domestic” merger. The logic of the banking union is that it should be considered for banking purposes as a unique jurisdiction.

I would like to conclude by quoting one of the founding fathers of Europe. On 10 December 1951, Robert Schuman, declared before the Assembly of the Council of Europe: “If we do not make up our minds in time, Ladies and Gentlemen, we shall run the risk of letting slip the last chance of salvation for Europe and for our countries". In a post-war context, he was well aware of the urgent need for action in Europe. In the current context, we should draw from this feeling of unique opportunity. There are of course non-economic projects: to name a few, climate change or youth education and training – in this respect an Erasmus Pro programme should be a priority for the unskilled and unemployed youth. But in the economic area which is my focus today, it is now or never: this is the right time to step up the pace in Europe. Thank you for your attention.

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[1] I would like to thank Marine Dujardin, Jordan Granata, Simon Laplace, Olya Ranguelova, Bérengère Rudelle, Caroline Varlet and Edouard Vidon for their help in preparing this speech.

[2] Musgrave, R. and Musgrave P., Public Finance in Theory and Practice, McGraw Hill, 1989.

Fonte: Bank For International Settlements (BIS)

https://www.bis.org/review/r171113c.pdf

Vítor Constâncio: Economic recovery and the new phase of monetary policy

Keynote speech by Mr Vítor Constâncio, Vice-President of the European Central Bank, at the Opening Conference of the 20th Euro Finance Week, Frankfurt am Main, 13 November 2017

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Ladies and Gentlemen,

I am grateful for the opportunity to address you today at this event that opens the 20th Euro Finance Week, addressing economic and monetary policy developments in the euro area.

At its last meeting on 26 October, the ECB Governing Council decided to substantially reduce its asset purchases. However, an ample degree of monetary stimulus remains necessary in order for underlying inflation pressures to continue to build-up and support headline inflation over the medium-term. The recalibration of our asset purchases reflects growing hope in the gradual convergence of inflation towards our inflation objective, on account of the increasingly robust and broad-based economic expansion, an uptick in measures of underlying inflation and the continued effective pass-through of our policy measures to the financing conditions and the real economy.

In my remarks today, I will reflect on the broad-based improvement in the general economic and financial situation that has allowed such significant recalibration. I will argue that this improvement illustrates, among other things, the appropriateness of the monetary policy that we have undertaken in the past years. In this perspective, I will focus on the euro area as a whole as well as more disaggregate developments in some countries.

Finally, you certainly cannot expect a central banker to end without a note of caution. In the last part of my speech I will therefore focus on the challenges we are still facing.

Let me start with a description of the current economic developments. The euro area economy is experiencing a broad-based, robust and resilient recovery, and this recovery is underpinned by the monetary policy measures introduced by the ECB since June 2014. However, despite these favourable growth dynamics, inflation developments have been subdued. At the same time, financial stability risks seem contained.

Sustained recovery

The euro area has been expanding for the past four years and the recovery has gained momentum. The GDP in the euro area has finally reached a level above that in 2007, 10 years after the crisis.

Robust economic activity is further being translated into a substantial amount of job creation. Despite the unemployment rate still being too high, almost 7 million more people are now employed in the euro area than in mid-2013, which implies that the employment losses recorded during the crisis have been offset. This stands in contrast to the largely jobless recovery of 2010 and is another indication of the sustained recovery in the euro area.

The improving labour market combined with increasing household wealth, strong consumer confidence and favourable financing conditions are supporting robust private consumption. Investment prospects also look promising, which reflects both the need to make up for forgone investment in previous years as well as the highly accommodative financing conditions which have been passed through to lower borrowing costs for euro area firms. Business investment is now slightly above the 2007 level.

Forward-looking indicators transmit a similarly positive message: business confidence is at a decade high, and survey data point to continued growth in the period ahead.

Broad-based, convergent recovery

Over recent quarters, the economic recovery has also become more broad-based across euro area countries and the different sectors of the economy.

In fact, all euro area countries, for the first time since 2007, are now enjoying positive real GDP growth in annual terms. The convergence of cyclical growth is reflected in the fact that member countries growth rates were never so close to each other since the inception of monetary union.

Moreover, unemployment rates have receded almost everywhere across the euro area. Despite the fact that unemployment is still too high in some countries, notably as regards young people, it is worth mentioning that it came down the most in several of those countries where it had previously been especially high.

Contribution from the accommodative monetary policy of the past years

We recalibrated our policies following the positive economic outcomes, but these outcomes would not have materialised, at least not to the same extent, without the ECB’s expansionary monetary policy.

When calibrating its monetary policy instruments, the Governing Council forms a view on the degree of accommodation that is necessary to achieve its price stability objective. Concretely, our monetary policy measures have supported economic growth and the reduction in unemployment in a variety of ways. First and foremost, they have supported domestic demand and have facilitated the deleveraging process in the aftermath of the crisis. The recovery in investment also benefitted from very favourable financing conditions and improvements in corporate profitability.

A precise quantification of the contribution of monetary policy to the current economic recovery is difficult, but current estimates suggest that the measures undertaken have been highly successful. Recent ECB staff estimates indicate that our monetary policy measures are contributing to an increase in the euro area GDP of around 1.7 percentage points, cumulatively over the period 2016–2019. This contribution is well above monetary policy's contribution to the two previous euro area recoveries in 2003Q2-2006Q4 and 2009Q3-2011Q3.

The effectiveness of monetary policy is also reflected in the way our decision to reduce our monthly purchase of securities by half was smoothly received by the financial markets. In spite of the restrictive nature of the decision, bond yields hardly moved and some even came down, while the exchange rate slightly depreciated. This was the result of our cautious preparation and communication, as well as from the ongoing positive growth momentum.

Looking ahead, the growth rate, unemployment, the labour market, the survey data, all provide positive indications that we are moving towards a shrinking output gap as well as an improving labour market. These will eventually produce higher nominal wage growth and thus higher inflation. But we know that this process still relies significantly on our monetary policy support. It is not yet self-sustained and therefore we must be patient and persistent.

Deflation risks diminished, inflation risks remain subdued

Every policy entails risks. Several concerns have thus been expressed about possible collateral consequences of our policy. Such concerns have however not materialised in real facts and we can now underline the appropriateness of our monetary policy stance.

Firstly, our monetary policy measures were not an "experiment" on the economy, but were in line with the policies previously adopted by other major central banks. Interest rate paths and balance sheets of the ECB and the FED are broadly comparable, despite the longer and slower economic recovery of the euro area after the crisis.

Secondly, much-feared inflationary pressures have not materialised, nor can they be foreseen in the immediate future. Measures of underlying inflation have ticked up only moderately in recent months, and have yet to show convincing signs of a sustained upward trend. Underlying inflation in the euro area is expected to rise only gradually over the medium-term, supported by our monetary policy measures, the continuing economic expansion, the corresponding gradual absorption of economic slack and rising wages. Domestic cost pressures, notably from labour markets, are still subdued. The strong worldwide reflationary phase that seemed likely at the beginning of the year has not materialised. Overall, price pressures are still muted and the path of inflation remains conditional on continued support from monetary policy.

Finally, there were concerns that the ECB monetary policy could pose risks to financial stability and provoke excessive asset price increases. Clearly, this did not materialise as there are no generalised asset overvaluations in the euro area. In various countries, some restricted regional pockets of real estate price buoyancy are being dealt with targeted macroprudential measures.

It is against this overall positive background that the ECB Governing Council has decided on a re- calibration of its instruments, with a view to safeguarding the monetary policy impulse that is still necessary to secure a sustained adjustment in the path of inflation, in a way that is consistent with our monetary policy aim.

All countries have benefited from the recovery

An important feature of the recovery is that all member countries have benefited from the recovery and have seen an improvement in their economic fundamentals.

The enormous credit flows from banks in core countries to their peers in the periphery, fuelled economic overheating with housing price bubbles in some cases and generalised high external deficits in the run-up to the crisis. The financial crisis then led to significant fiscal deficits when governments had to assist domestic banks. Notably, since the inception of the financial crisis, those countries have undergone a significant adjustment path, in some cases supported by EU/IMF financial assistance programmes. When we compare today with the situation in 2008, we see an impressive adjustment along several of the main economic variables. Fiscal deficits have been significantly reduced and in those countries the primary fiscal balance is now positive. At the same time, their current account balances have adjusted by more than 12 percentage points from an average of –10 percent of GDP to a surplus of nearly 2 percent at the end of last year. This adjustment has been facilitated by a significant recovery from the losses in competitiveness experienced before the crisis. Unit labour costs of these countries have, on average, been reduced by nearly 10 percent over these years. In turn, this adjustment has been enabled by significant reforms of countries' labour and product markets by allowing more resources to be used in the tradable sectors and increasing the adaptability of their economies at large. Overall, both ECB and IMF estimates show that the current account adjustments are, to a large extent, of a structural nature and not just cyclical. They are therefore likely to be sustained as the economic recovery of the euro area continues.

The general improvement in economic fundamentals also applies to member states that were less severely affected by the crisis. Given the location of my speech today, let me look particularly at Germany. Having been the "sick man of Europe" in the early 2000s, the German economy has become today's engine of the euro area economy. Moreover, growth has recently become increasingly domestically driven. This has clearly also facilitated the recovery in the other euro area economies, via higher German import demand.

Concerning inflation, fears that our accommodative monetary policy could boost excessive inflation in Germany have clearly not materialised. Headline inflation has picked up this year from the very low level of 0.4 percent last year. Most of this increase resulted from the significant pick- up in oil prices. Underlying price pressures in Germany by contrast, have remained subdued, as indicated by the rather stable core inflation rate.

The increase in house prices may be more of concern, particularly in some of the biggest cities, but there is so far no evidence of broad-based excessive house price valuations in Germany as a whole.

Strong economic growth demonstrates that Germany is the member state that, after Ireland, shows the highest increase in income per person since the beginning of the euro. At the same time, the present unemployment rate is the lowest in the last 37 years and is well below the European average.

Challenges ahead

Let me summarise. We are witnessing a sustained economic recovery in the euro area as a whole and in all its member states. In particular, countries under financial assistance programmes have been implementing significant policy measures to improve their resilience and competitiveness. Many of these reforms will support potential growth but they tend to exert their full impact with a considerable lag. In any case, such measures have increased the resilience of member states' economies and of the euro area as a whole.

At the same time, these positive developments should not lead to complacency. Inflation, which is the core of our mandate, is still below our target after four years of growth supposedly above potential. We are not yet fulfilling our mandate and that is why monetary policy will have to continue to be very accommodative, assuring favourable financial conditions to foster growth and spur wages and prices.

On the other hand, vulnerabilities and challenges remain in many euro area economies. Unemployment rates have indeed come down, but in particular the number of young and long- term unemployed is still unacceptably high. Moreover, despite an adjustment of flow variables, such as the absence of excessive credit growth, lower budgetary deficits and improved current account balances, the legacy of the crisis is still visibly expressed in high stock imbalances, namely the high indebtedness of the private and public sector across many euro area countries. These high debt levels make the countries vulnerable to adverse shocks. Furthermore, the crisis has also interrupted the progress of real convergence in the more vulnerable economies towards higher living standards. Negative divergences in personal income levels in relation to the euro area average have again increased. Higher and more sustainable growth potential requires decisive policy actions.

At the national level, many structural and institutional reforms are still needed to safeguard and improve the future functioning of countries' economies and thereby the euro area as a whole. We should also review the way in which national policies are currently co-ordinated in the EU. Both the Five Presidents Report on "Completing Europe's Economic and Monetary Union" (2015) and the recent EU Commission paper on the "Deepening of the Economic and Monetary Union" (2017) provide guidance on the way to proceed. It is nevertheless a sign of the times that the EU Commission felt compelled to reduce the ambition of its proposal regarding the European deposit guarantee scheme1, a significant component of the banking union. This just indicates that there are understandable but relevant uncertainties about the future. Any agreement about the evolvement of European integration is a difficult endeavour as it implies the involvement of all member states as well as their respective public opinion. Some of the possible issues at stake are indeed sensitive and could generate instability if not carefully assessed. This provides another reason to take into account the concerns of all member states.

It is however also true that the present favourable economic environment, should be used to make progress in reinforcing the economic and monetary union resilience. This corresponds to the common interest of countries made closely interdependent by the single currency. Reforms at national and EU level will be crucial to improve resilience to shocks, increase growth potential and ultimately restore a path of real economic convergence among member countries.

Thank you for your attention.

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[1] See EU Commission (11 October 2017) "COMMUNICATION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN CENTRAL BANK, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS ON COMPLETING THE BANKING UNION". As the press release issued by the Commission explains: " ...In particular, today's Communication is suggesting for discussion the introduction of EDIS more gradually compared with the original proposal of November 2015. There would be only two phases: a more limited reinsurance phase and then coinsurance. However moving to this second phase would be conditional on progress achieved in reducing risks."

Fonte: Bank For International Settlements (BIS)

https://www.bis.org/review/r171114b.pdf