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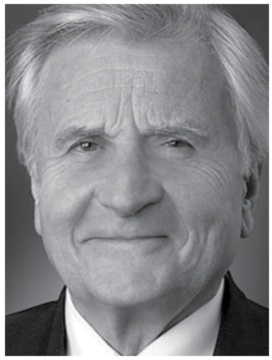
The Empire Strikes Back

The former central bankers' memorandum omits three major ECB successes, according to Mario Draghi's predecessor, Jean-Claude Trichet.



Former ECB President **Jean-Claude Trichet:** *Attacks on the European Central Bank are misguided.*

I have read the memorandum on the ECB's Monetary Policy, signed by former central bankers (*TIE,* p. 35). Such a memorandum appears as a definitive condemnation of the monetary policy pursued by the ECB. Being myself a former central banker, as Governor of Banque de France and President of the ECB, I do not share at all the negative views expressed by my former colleagues.

It is not that I am against debates. On the contrary, I have always praised monetary policy debates and discussions. I have always thought that the Governing Council of the ECB is the place where different visions, opinions, and recommendations have to be confronted. This is true for all central banks and certainly appropriate in the case of the ECB, which is issuing a currency for an entire continent and for nineteen countries.

That being said, the memorandum is not only incorrect in its criticism of the monetary policy, but it also omits three major successes of the ECB.

■ First, there is no recognition—or even mention—of the fact that the ECB, over its twenty years of existence has delivered price stability, its Treaty primary mandate, not only as well as its best performing predecessor national central banks—which was the legal and political promise at its inception—but even significantly better. Average yearly inflation of the euro area is around 1.7 percent since 1999, while the average yearly inflation of the most credible former national currencies, over the forty years before the euro, was around 2.9 percent. This is a remarkable success that was considered impossible to attain and should put to rest the fears of those, including signatories of the memorandum, who thought that the introduction of the euro would put price stability at risk.

■ Second, one cannot ignore that the ECB, like all central banks of the advanced economies, had to cope with the worst financial and economic crisis since World War II, starting in 2007 with the subprime meltdown. This called in 2007–2009 for very bold and difficult to take decisions, including the generalization at ECB auctions of full allotment of liquidity without limit, which is still in place. Starting at the end of 2009, the crisis morphed into a sovereign risk crisis and its epicentre moved to the euro area. New, extremely bold decisions had to be taken under my presidency, including the start of the purchases of Treasuries of Greece, Ireland, and Portugal in 2010, and then of Spain and Italy in 2011 (Securities Market Program, SMP). The memorandum signed by former colleagues is implicitly condemning also those decisions, which were taken during the present "decade." It seems that only the decisions taken more than "a decade ago" are acceptable for that memorandum. I am not surprised because indeed, at the time, I had, sadly, to see two of my colleagues resigning after the Governing Council took, against their vote, these difficult decisions. I believe that the Governing Council of the ECB took the right decision when it approved the SMP and I also believe that it was right when it took, under continuous difficulties, the subsequent decisions under the chairmanship of Mario

Draghi in the following years. All taken into account, the ECB Governing Council not only surmounted the worst global financial crisis since World War II, but also the worst sovereign risk crisis of the advanced economies ever. Not only the fifteen countries that were members of the euro area on the day of the bankruptcy of the Lehman Brothers (September 15th, 2018) still have the euro, but two countries joined in after the crisis when I was President (Slovakia and Estonia) and two more under Mario's presidency (Lithuania and Latvia), so the euro is the single currency of nineteen countries today. This remarkable resilience of the euro and of the euro area was obtained without prejudice either for price stability, or for the international credibility of the euro, or, still for the economy (over twenty years, since the inception of the euro, growth per capita in the euro area is of the same order of magnitude as in the U.S.).

■ Third, the popular support of the euro is higher today than ever. The last publication of the Eurobarometer shows that 76 percent of the members of the euro area are supporting the euro (on a national level: 81 percent in Germany, 79 percent in Netherlands, 73 percent in Austria, 70 percent in France). The general public does not seem to share the dark view of the memorandum signatories about the euro and its management by the ECB.

Delivering on the Treaty primary mandate, facing up with two dramatic financial and economic crises, preserving the euro area and winning the overwhelming support of our euro fellow citizens: if these successes are not to be put to the credit of the ECB and of its monetary policy decisions, to whom should they be credited?

Now let me turn to more specific points mentioned in the memorandum.

1. CRITICISM ON THE PRESENT INTERPRETATION OF THE DEFINITION OF PRICE STABILITY BY THE ECB

I attach a great importance to the ECB definition of price stability. When made independent in January 1994, Banque de France decided that the definition of price stability was less than 2 percent, in a medium-term perspective. The idea was not to introduce the concept of ranges like in inflation targeting. Less than 2 percent did not mean 0 percent to 2 percent or 1 percent to 2 percent. It was already very clearly, if implicitly, said that inflation should be less than but close to 2 percent. The fact that a good anchor for price stability was "close to 2 percent" was confirmed by the simultaneous publication of the arithmetic reference for M3 growth: around 5 percent, meaning real growth between 2.5 percent and 3 percent, and inflation at 2 percent.

At its inception in 1998, the ECB Governing Council adopted a quantitative definition of price stability. Price stability was defined as a yearly increase in the Harmonised Index of Consumer Prices (HICP) of the euro of below 2 percent. At the very beginning of the euro in 1999, the inflation expectations for the euro were around 1.8 percent, in line with the inflation expectations of the most credible former national currencies. There was no ambiguity in the fact that this anchoring of the medium-term inflation expectations of the euro below 2 percent and quite close to 2 percent was satisfactory.

The decision taken by the ECB Governing Council in 2003 eliminated the wrong interpretation of some economists that the Bank was an implicit pure "inflation targeter," with a relatively short horizon and a large range of 0 percent–2 percent. This wrong interpretation suggested that the Governing Council would accept lightly to be close to 0 percent, taking the risk of a materialization of deflation. This interpretation was wrong; it was never the position of the Governing Council—as is confirmed by many declarations, including by the then-ECB chief economist and myself. As a matter of fact, the inflation expectations were, from 1999 to 2003, oscillating between 1.7 percent and 1.9 percent. That is why the ECB called its decision of 2003 a "clarification" and not a dramatic change.

I do not know whether the ECB will change its definition of price stability in the future. It is up to the Governing Council under the chair of Christine Lagarde. But at the present moment, I understand that the Governing Council is right to consider, as it has been the case since the inception of the euro, that in the medium term, a good anchoring for inflation expectations is less than 2 percent but close to 2 percent, as is the case since 2003, with the implicit understanding that medium-term oscillations of expectations between 1.7 percent and 1.9 percent are normal. Contrary to what is written in the memorandum, it is not in 2014 that the ECB concluded that a low inflation could create a deflationary risk. This conclusion had been reached already in 2003 and it was the justification for the "clarification." The paradoxical conclusion of the recommendation of the memorandum would be to go back to a kind of range ("inflation targeting" like) between 0 percent and 2 percent.

I would add that an important phenomenon was observed in the crisis and since the crisis, namely that the U.S. Fed and the Bank of Japan decided, respectively in 2013 and 2014, to join the ECB and Bank of England in mentioning 2 percent in their definition of price stability. Today, the four central banks that are issuing the four convertible currencies in the basket of the Special Drawing Rights (SDR), like many other central banks of advanced economies, have all a medium-term definition of price stability with the mention of the 2 percent figure. (This is not the only example of a new remarkable "conceptual convergence" between central banks, triggered by the recent crisis: in particular a generalized role for central banks in banking surveillance, in designing macroprudential policies, and in preventing systemic risks are additional examples).

2. CRITICISM OF THE POSSIBLE INTRODUCTION OF SYMMETRY IN THE PURSUIT OF PRICE STABILITY

It is no reason for alarm that symmetry could be introduced in the definition of price stability, because this is already the case. To the extent that the objective is to anchor inflation expectations in the medium-term around less than but close to 2 percent, there are necessarily periods where inflation is higher than 1.7 percent–1.9 percent and periods when it is lower. These periods have necessarily to balance themselves over the medium and long run: in my press conference of April 2011, I mentioned that the average yearly inflation over more than ten years, since the start of the euro, was 1.97 percent, which I presented as a success of the euro.

But symmetry does not imply either a kind of mechanical rule that periods when inflation has been lower than the target must be compensated by equivalent periods when inflation is higher than the target.

3. CRITICISM OF QUANTITATIVE EASING, VERY LOW AND NEGATIVE INTEREST RATES, EXTENSIVE LOANS, AND FORWARD GUIDANCE

I agree that the measures that have been decided by central banks in and after the crisis are exceptional and non-conventional. Whilst necessary and appropriate all taken into account, they can have not only positive but also adverse consequences.

But this is not the point. The two pertinent questions are the following: first, are central banks responsible for the abnormal situation of the real economy? Second, what would be the counterfactual, had they not taken such unconventional and extremely bold decisions?

The response to the first question is well documented and is negative: there are much more lasting and deeper economic factors than central bank action pushing real interest rates and inflation very low. The response to the second question calls for scrupulous scrutiny of the positives and negatives associated with each decision.

Unconventional measures are not easy to take. I have the vivid memory of the decisions to embark on allotment of liquidity without limit in 2007 and 2008, on the decision to purchase covered bonds (CBPP I and II in 2009 and 2011) and on SMP (2010 and 2011).

I know that all decisions taken in the following years were equally carefully scrutinized—comparing positives and negatives—and taken by the Governing Council to fulfil the mandate of the ECB in very difficult circumstances.

As regards quantitative easing, it is not exact that there is a "broad consensus" that the law of diminishing returns operates such that there is no longer a positive impact on domestic demand. As regards interest rates, there are no empirical estimates that the ECB is at the point where the adverse consequences of negative values are dominating. And I trust that the TLTRO decisions are appropriate in the circumstances.

Many studies—both within and outside the ECB— have been done to measure the impact of all non-conventional measures taken over the last five years. Most suggest that yearly inflation and real growth have been significantly higher than in the counterfactual scenario over the past years, thanks to measures taken. For example, some are concluding that the impact of these measures would be around +0.8 percent in 2016 and +0.5 percent in 2017, the same figures for both inflation and real growth.

In Europe as well as in most advanced economies, the central banks are up to their responsibilities but cannot be always "the only game in town." The present situation cannot last for ever. In my view, governments, parliaments, the private sector, and the social partners are not playing ball. In the euro area for instance, we are observing that:

- Despite the monetary policy accommodation, the euro area is posting an excessive current account surplus, which signals that the other macropolicies are abnormally restrictive;
- Despite the highly accommodating monetary policy during many years, and notwithstanding significant improvements over the last six years, mass unemployment still exists at the level of the euro area as a whole;
- Even in economies that are enjoying full employment and post large current account surpluses, inflation is very low—much lower than in the years before the euro.

This last observation is particularly important for the cohesion of the euro area and for the ECB: the economies that are lacking cost competitiveness and still have mass unemployment cannot afford to let their unit labor cost and inflation exceed those of the highly competitive countries, lest they would lose additional cost competitiveness and be undermined by additional unemployment. De facto, inflation in the highly competitive countries is the ceiling for inflation in all other countries.

Fiscal action in countries with room for manoeuvring, while respecting the Stability and Growth Pact, structural reforms to elevate the growth potential in all countries and, last but not least, more dynamic domestic demand, in particular in terms of wages and salaries in full employment economies, are of the essence to alleviate the burden of the ECB and to promote the wellbeing of our fellow Europeans.

Attacks on the monetary policy of the ECB are misguided. I would rather suggest the energy spent to that aim being redirected to demand European institutions, governments, parliaments, and social partners to step in and not let the ECB act alone. ◆