20 years

since 1999

THE ECB AND ITS WATCHERS XX

Reflecting on 20 Years of Monetary Policy: "The ECB and Its Watchers"

Institute for Monetary and Financial Stability
Goethe University Frankfurt
House of Finance
Theodor-W.-Adorno-Platz 3
60323 Frankfurt am Main
Tel: +49 (0)69-33805
www.imfs-frankfurt.de

PHOTOS
IMFS/Hannelore Förster, UBS, Joppen

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"The ECB and Its Watchers"...

...will celebrate its 20th anniversary on March 27, 2019 as central bankers, financial market participants and academics gather to discuss current issues on monetary policy and financial stability at the conference. Since the European Central Bank (ECB) received its mandate in 1999, every year about 400 ECB watchers from Europe, North America and Asia regularly attend the conference to gain first-hand information and exchange ideas with ECB Governing Council members, representatives of international organizations, market professionals and renowned academics.

"The ECB and Its Watchers" was initiated in 1999 by Axel Weber during his time as Director of the Center for Financial Studies (CFS) in cooperation with Otmar Issing, then Member of the ECB Executive Board in charge of DG Economics and DG Research.

They envisioned the conference as a platform for ECB watchers to review the bank's decisions and strategies, discuss new research findings and provide recommendations to improve policy-making in the euro area.

Volker Wieland has organized "The ECB and Its Watchers" since 2004, first as CFS Director and then, from 2012, as Managing Director of the Institute for Monetary and Financial Stability (IMFS). Günter Beck, Research Fellow at the IMFS and CFS, was in charge of the event between 2015 and 2017. Wieland took on the responsibility again in 2018. Currently, the conference series is organized by the IMFS and supported financially by donations from the Foundation of Monetary and Financial Stability and the Circle of Friends of "The ECB and Its Watchers".

Welcome

Volker Wieland

IMFS Managing Director and Organizer of "The ECB and Its Watchers" conference series

Welcome to "The ECB and Its Watchers"! Since the introduction of euro notes and coins in 2002, nineteen EU countries have joined the euro area. This means that 340 million Europeans use the euro every day. The ECB has been conducting monetary policy for this large and unique monetary union for two decades.

Over the years, the ECB watchers have addressed many important policy questions. They have monitored the ECB's performance together with economic developments in the euro area.

Topics discussed at the conference included, among others, ECB transparency and communication, the divergence of national inflation rates, growing economic imbalances in the euro area, fears of inflation and deflation, financial instabilities, the international role of the euro, fiscal sustainability, the interaction of monetary and fiscal policy, the financial crisis and the Great Recession, the euro debt crisis, unconventional monetary policies and the ever-topical issue of the future of the euro area.

The ECB has welcomed this exchange. ECB Presidents and Executive Board Members have stood ready to clarify policy measures and intentions, respond to questions and accept or refute criticisms raised by conference participants. ECB watchers discussed, and some warned of, financial imbalances and fiscal sustainability problems prior to the global financial crisis and the euro debt crisis. At times, proposals of ECB watchers were ahead of their time such as the publication of minutes which was eventually introduced by the ECB in 2015. The conference series also provided a forum with diverse views on such key policy issues as whether and how the ECB should venture in the territory of quantitative easing and other unconventional policy measures.

We are delighted to provide this platform for mutual exchange and are looking forward to further fruitful discussions.

Views on the conference

Otmar Issing

CFS President; former Member of the ECB Executive Board initiating "The ECB and Its Watchers" conference series

This conference is unique, and this applies also to its origin. Several watchers groups had been formed before the euro was born and the ECB started conducting monetary policy for the euro area.

All groups had made critical comments especially on the ECB's two-pillar strategy. As member of the first Executive Board with responsibility for economics and research, I was convinced we should meet our critics in a conference open to the public.

Already the first conference was a great success. I had the chance to explain our strategy and the ECB's monetary policy. Over the years, I personally learned a lot from the sometimes vehement discussions – and I think this is also true for the ECB in general as well as for its watchers. "The ECB and Its Watchers" has been an innovation in the world of central banking which has gained global reputation. The organizers have done a great job and again brought together outstanding representatives from around the world.

Axel Weber

Chairman, UBS Group; Founder of "The ECB and Its Watchers" conference series as former Director of the Center for Financial Studies

From its inception, we wanted "The ECB and Its Watchers" to be more than an academic gathering. The aim was to enhance market participants' understanding of ECB policy and, vice versa, allowing ECB policy-makers to gauge market perceptions. Communication is and always has been an important part of the transmission of monetary policy. As such, "The ECB and Its Watchers" from the start has been the go-to place for ECB decision-makers, market participants and academics.

Peter Praet

Member of the Executive Board of the European Central Bank

Monetary policy always benefits from open intellectual discourse. "The ECB and Its Watchers" is a great opportunity for a broad range of ECB experts to engage with each other, including financial market professionals, academics, policy-makers and journalists. The discussions at this particular conference are stimulating and sometimes surprising. The conference is intense and focused. I always leave with a sense of having participated in a constructive dialogue.

Jürgen Stark

Member of the Executive Board of the European Central Bank 2006-2011

It was a courageous but very wise decision to create a special public forum for discussing the ECB's monetary policy and central banking in more general terms 20 years ago. In this innovative approach, ECB officials have been brought together once a year with market participants, academics and journalists, moving ahead on a new path of central bank transparency and accountability to the public. Thus, from the very start the ECB did not shy away from entering in an open and sometimes controversial but always fruitful dialogue, engaging also with the critics of the ECB's monetary policy. The conference series offers the opportunity to ECB representatives to clarify and explain the institution's position. I have personally always enjoyed the lively interactions in these conferences and appreciated the recommendations and suggestions made. It was always a "must" for me.

1999-2000

Developing a systematic approach

The euro area came into operation on January 1, 1999 when the irrevocable exchange rate for the eleven Member States in the European Monetary Union (EMU) became effective, following a decade-long preparation. The Member States were Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal, and Spain. The ECB was established earlier on June 1, 1998 to manage monetary policy in the euro area. As stated in the Treaty on the Functioning of the European Union, the ECB's primary objective is price stability. In the beginning, the ECB's Governing Council adopted a quantitative definition of this objective agreeing on a below 2% year-on-year increase in the Harmonized Index of Consumer Prices (HICP). The Governing Council raised the main policy rate, in a series of rate hikes, to 4.75% through October 2000.

When they initiated "The ECB and Its Watchers" in 1999, Otmar Issing and Axel Weber felt the need to build a platform for discussions concerning the challenges lying ahead. For the ECB it was necessary to establish credibility and develop a systematic approach to policy-making.

The ECB has been responsive to the continuous demand for a more transparent monetary policy and better communication with the markets since the first conference. ECB Board Member Tommaso Padoa-Schioppa emphasized at the first conference that the role of the ECB is "to have a view, to have a single view, and to make it felt".

At the second conference in 2000, ECB watchers provided a series of recommendations for improving the ECB's communication strategy, such as presenting inflation forecasts, publishing the minutes of the ECB council meetings or summarizing the arguments raised at the council meetings in the ECB monthly reports. The attempt to reach unanimous decisions in an ECB council, which was believed to be too large, was suspected to cause delays in the decision-making.

2001-2002

Two-pillar strategy

The number of Member States in the euro area increased to twelve when Greece entered the third stage of the EMU on January 1, 2001. Euro coins and banknotes were introduced on January 1, 2002 after three years of using the euro as "book money" along with national currencies. The cash changeover was the biggest in history, with around 14 billion notes and 52 billion coins produced and partly distributed for 302 million individuals within the participating countries.

In the first few years, the ECB's two-pillar strategy, which referred to a separate monetary and economic analysis, sparked a debate among ECB watchers. Critics proposed looking only at the second pillar, expressing a clear preference for inflation targeting. Others supported the use of a monetary reference value.

At the conference in 2001, Otmar Issing, who had led the development of the monetary policy strategy at the ECB, responded extensively to these concerns and questions regarding the ECB's definition of price stability. He pointed out that the ECB's quantitative definition of price stability was a symmetric objective, with zero being the lower bound.

As the economic outlook deteriorated after the burst of the dot-com bubble and the terrorist attacks on September 11, 2001 in the United States, the ECB Governing Council and the Federal Open Market Committee (FOMC) of the Federal Reserve cut interest rates by 50 basis points on September 13, 2001. Over the subsequent period, the ECB continued to lower interest rates by a total of 275 basis points.

2003-2004

Evaluating the strategy

In May 2003, the ECB published a review of its strategic framework, and monetary policy in the euro area entered a new phase. The monetary pillar was somewhat de-emphasized and meant to serve primarily for cross-checking the economic analysis. Furthermore, the quantitative definition of the price stability objective was set at "below but close to 2%" for HICP inflation. This clarification or revision marks the end of the first phase of ECB monetary policy. In June of that year, interest rates were reduced to a then historically low level of 2% and remained steady for the next two and a half years.

At "The ECB and Its Watchers" in July 2003, Otmar Issing explained the evaluation of the strategy, arguing that the ECB had "examined the full range of views, including those coming from the Watchers' meetings". He emphasized that "effective communication facilitates the transmission of monetary policy decisions to the economy" and that "our reflection on the strategy is an ongoing process". A key argument for lifting the "target" inflation to close to 2% was to create room for policy easing in the event of a recession or possible decline in inflation. This would help create more distance from the zero lower bound on nominal interest rates as shown on the basis of ECB analysis with modern quantitative macroeconomic models.

In June 2004, the ECB started publishing macroeconomic projections of its staff in addition to the euro system projections. Interest rates remained unchanged.

At the conference in July, the longer-term performance of inflation in the EMU became an issue for discussion. Academics such as Harald Uhlig criticized the ECB for failing to keep inflation below 2% for most of the time. Otmar Issing, in turn, considered euro area inflation of roughly 2% on average a great achievement of the ECB. International macroeconomic imbalances also loomed large at the conference.

2005-2006

Money and credit

At the conference in 2005, ECB watchers such as Thomas Mayer saw the ECB caught between economic weakness on one side and strong liquidity growth on the other side. Otmar Issing addressed criticism toward the monetary analysis, explaining "why we rely – and will continue to rely – on the monetary pillar of our strategy": "Giving a role to money and credit can [...] reduce the risk of monetary policy accommodating an asset price bubble which could possibly undermine price stability over rather long horizons". In December 2005, the ECB raised interest rates – a tightening that ECB President Jean-Claude Trichet attributed to the ECB's monetary analysis. Previously, money growth had been building up for some time relative to GDP and inflation.

As economic activity increased, the ECB responded with further increases in interest rates throughout the year. Meanwhile, money and credit continued to expand: housing prices in a number of countries were rising and many countries built up a debt overhang. In his conference speech in 2006, ECB Vice-President Lucas Papademos appealed to the new and prospective Member States: "Good preparation and the attainment of sustainable long-term convergence are crucial before joining monetary union".

2007-2008

Financial crisis

On January 1, 2007, Slovenia became the 13th member of the euro area. In June, the interest rate cycle came to an end, reaching a level of 4% after the ECB had raised interest rates by a total of 200 basis points since 2005. Greece, Ireland, Portugal and Spain were showing substantial current account deficits. With the global financial crisis breaking out in the subprime mortgage market in the United States, the first indications of problems in the money market also emerged in the euro area. When ECB officials and ECB watchers met at the conference in September 2007, ECB President Trichet reported that liquidity-starved banks had been rushing into the "ECB's emergency room" to receive immediate aid.

Only five days before the Lehman Brothers investment bank announced a loss of almost 4 billion dollars and subsequently collapsed on September 15, 2008, ECB watchers met at the 10th anniversary of the conference and the looming risks dominated the agenda. ECB watchers discussed, among other questions, whether the euro area possessed an appropriate framework for dealing with the threat of an immediate failure of a large, European, cross-border bank. A number of commentators were highly skeptical. In his speech, ECB President Trichet reflected that the financial turmoil "marked the end of a long phase of heightened risk tolerance". Marvin Goodfriend provided a U.S. perspective at the conference, arguing that the capital shortage in the banking system, which was at the core of the credit turmoil, was more protracted and more serious than might have been expected, and may last for a while. One month later, the ECB lowered the interest rate by 50 basis points to 3.75% – essentially an internationally coordinated policy easing. Until the end of the year, two more rate cuts followed. From October 15 onwards, the ECB implemented a full allotment policy, thereby providing banks with as much liquidity as they desired at the going rate. As of 2008, Cyprus and Malta had also joined the euro area.

2009-2010

Recession and debt crisis

On January 1, Slovakia introduced the euro and the number of Member States rose to sixteen. After a total of seven rate cuts, the ECB's main policy rate reached a historical low of 1% in May. Meanwhile, the ECB adopted further non-standard measures, such as the lengthening of the maximum maturity of refinancing operations and the start of the first outright purchase program, the CBPP. At "The ECB and Its Watchers" in September, President Trichet argued that "the need for enhanced credit support remains". Participants also discussed the ECB's performance subject to threats of a deflationary spiral or rebounding inflation, reviewed its exit strategy from unconventional policies, and debated whether the ECB had appropriate instruments for addressing potential trade-offs between monetary and financial stability. Furthermore, the panels dealt with fiscal issues, for example, whether euro area governments should help each other to ensure fiscal sustainability and whether inter-governmental bailouts threatened the long-run stability of the EMU.

While the euro area seemed to recover from the Great Recession, the revision of the Greek public deficit and alarming results of bank stress tests contributed to the markets' loss in confidence.

This resulted in the European sovereign debt crisis. In May of 2010, the ECB surprised many of its watchers by starting direct purchases of euro area government bonds, introducing the securities market programme (SMP). In June, European governments put together a rescue package and adjustment programs for Greece, and the International Monetary Fund (IMF) was called on for support. Contrary to earlier policy responses to the financial crisis, these measures proved to be highly controversial. In November, European ministers reached an agreement over a bailout worth about 85 billion euros for Ireland.

In his conference address in July, President Trichet called for national fiscal reforms, stronger institutions and more stringent implementation of euro area fiscal rules. ECB Board Member Jürgen Stark presented the ECB's enhanced monetary analysis and reviewed lessons learnt in the financial crisis regarding the appropriate role of money and credit in monetary policy. He concluded that growth excesses in money and credit such as those observed before the financial crisis, should be headed off by monetary policy rather than be left alone. Anil Kashyap from the University of Chicago reviewed the new institutions and regulations developed in Europe and the United States and questioned whether these structures were sufficiently well-designed to deal with the threat of moral hazard and systemic risk in a satisfactory manner.

2011

Non-standard measures

At the start of 2011, which welcomed Estonia to the monetary union, euro area growth seemed on a positive track while overall inflation was rising above 2%. The ECB responded by raising policy rates in two steps in April and July to 1.5%. As the Greek debt was restructured, Portugal and Cyprus needed financial assistance and adjustment programs, and financial tensions intensified. In the stress test of the European Banking Authority (EBA), eight out of 90 banks in the euro area failed. A sovereign debt plus banking crisis ensued.

At the 2011 conference in June, President Trichet advocated a strong reinforcement of economic governance in the euro area and aligning each member's economic policy with EMU requirements.

ECB Board Member Jürgen Stark asked national policy-makers and authorities "to take full responsibility [...] by restoring fiscal sustainability and by putting the financial sector on a healthy footing".

In August, ECB President Trichet announced that the ECB would reactivate the SMP. In October, the ECB introduced two one-year long-term refinancing operations (LTROs) and a second covered bond purchase program as new non-standard measures. Under the new President, Mario Draghi, the ECB cut interest rates again in November and December by a total of 50 basis points to the level of 1% and introduced two three-year LTROs.

2012

"Whatever it takes"

The year of 2012 marked the peak of the sovereign debt crisis. At the end of January, 25 EU members agreed on the fiscal pact with new rules that made it harder to break budget deficits. After weeks of negotiations between Greece, private lenders and the so-called troika – European Commission, ECB and IMF – the eurozone backed a second Greek bailout of 130 billion euros. Government bond yields for Greece, Portugal and Ireland, and even larger countries such as Spain and Italy, increased massively. To some extent, these yields reflected the fear that a country might exit the euro area. In May, problems in the Spanish banking sector worsened, as the fourth largest bank, Bankia, asked for a bailout in June. Spain later announced that it was going to make a formal request for a bank rescue package.

On June 15, in his first address at "The ECB and Its Watchers", President Draghi conveyed the message that "the ECB has the crucial role of providing liquidity to sound bank counterparties in return for adequate collateral [...] and this is what we will continue to do. The Eurosystem will continue to supply liquidity to solvent banks where needed". ECB watchers debated whether ECB liquidity provision was insufficient, appropriate or excessive. Only five and a half weeks later, President Draghi reinforced this message in a speech in London, asserting that "within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough".

2013-2014

Forward guidance

The Governing Council cut key ECB interest rates twice in the course of 2013. In July, the ECB introduced explicit forward guidance about the future path of key interest rates, stating that it expected "the key ECB interest rates to remain at present or lower levels for an extended period of time". From November on, policy rates were kept at their historically low level of 0.25% for the main refinancing rate, 0.00% for the rate on the deposit facility, and 0.75% for the rate on the marginal lending facility for the remainder of the year. No ECB watchers conference was scheduled in 2013.

At the 2014 conference in March, Volker Wieland for the first time welcomed the participants at Goethe University's Campus Westend. ECB Board Member Peter Praet discussed the ECB's approach to central bank communication. He pointed out that views within the ECB had changed substantially and "forward guidance has emerged as a useful complement to existing tools". In his assessment, the introduction of outright monetary transactions was an example of how communication added to the effectiveness of monetary policy tools. Praet stated: "The OMT communication – unusual as it was in substance, for the ECB and probably for the entire community of central banks – was in fact strictly coherent with our general communication approach. It was a well-articulated frame of reference for our actions".

Looking at the Federal Reserve, John B. Taylor from Stanford University pointed out that forward guidance had been unpredictable. Analyzing possible exit strategies, Taylor called for a more rule-based system with the central banks explaining the deviations. Most of all, "an exit should include a statement about the policy strategy in the future", Taylor said.

In June and September, the ECB cut the deposit facility rate twice to -0.2%, thereby entering negative interest rate territory. Moreover, it announced the first series of targeted longer-term refinancing operations (TLTROs) where the amount banks can borrow is linked to their loans to non-financial corporations and households. Furthermore, the Governing Council announced a third covered bond purchase programme (CBPP3) and an asset-backed securities purchase programme (ABSPP).

2015

Quantitative easing

The 16th edition of "The ECB and Its Watchers" on March 11, organized by Günter Beck, set a new record with more than 450 participants. As ECB President Draghi said in his speech, euro area developments were "pointing in the right direction". In his view, "the asset purchase programme may be shielding other euro area countries from contagion" after the renewed Greek crisis. Two days earlier, the ECB had started its quantitative easing program, which implied monthly purchases of up to 60 billion euros of eurozone government debt, along with private sector assets and the debt of eurozone institutions. Jordi Galí from the Centre de Recerca en Economía International (CREI) considered the non-standard measures positive but likely insufficient to jumpstart growth of the euro area economy. Volker Wieland had a more positive outlook: He pointed out that the euro area had been growing again since mid-2013 and that interest rate cuts, TLTROs and forward guidance had given an additional boost to the recovery. With the ECB taking on the responsibility of banking supervision in November 2014, ECB watchers also discussed the challenges resulting from the ECB's double role.

In December, the ECB decreased the deposit rate by 10 basis points to -0.3% and prolonged the asset purchase program. Meanwhile, Latvia and Lithuania had joined the euro area, raising the number of Member States to nineteen.

2016

Monetary policy expands

In March, the ECB lowered the deposit rate to -0.4% and purchases increased to 80 billion euros. A corporate sector purchase programme (CSPP) was added. In December, the Governing Council decided to extend the net asset purchase programme (APP) until the end of 2017.

Against this background, unconventional monetary policy measures were in the center of the discussion at the 17th edition of the conference on April 7. The ECB's measures could be increased, Peter Praet told the audience. "If further adverse shocks were to materialize, our measures could be recalibrated once more commensurate with the strength of the headwind, also taking into account possible side effects". Without the stimulus, inflation in the euro area would have been around half a percentage point lower in the first months of 2016, he said. Benoît Cœuré, ECB Executive Board Member, emphasized the ECB's independence: "Our mandate is not conditional on what others are doing". Growth-friendly measures would make the ECB's expansionary monetary policy more effective, he added.

2017

Lower for longer

The statement that the monetary policy stance of the ECB was still appropriate was the key message President Draghi delivered at the 18th edition of the conference series, which took place at the lecture hall building of Goethe University on April 6. He argued that ECB "monetary policy is working and that it has been a key factor behind the resilience of the euro area economy over recent years".

Throughout the year, the ECB was reducing monthly purchases thereby slowing down the increase in its balance sheet. In October, the Governing Council decided to extend the asset purchase program until September 2018. The monthly pace of purchases was reduced to 30 billion euros starting from January 2018.

2018

ECB balance sheet doubles

At the conference in March 2018, President Draghi said the ECB would avoid surprising investors with sudden changes to its stimulus plans, stressing that inflation was still too low: “We still need to see further evidence that inflation dynamics are moving in the right direction. So monetary policy will remain patient, persistent and prudent”. Peter Praet, the ECB’s chief economist, also underlined that it was too soon to declare “mission accomplished” on inflation.

Daniel Gros from the Centre for European Policy Studies (CEPS) characterized quantitative easing as a “monetary placebo plus fiscal aspirin”, a treatment which ought to be stopped right away. According to Elga Bartsch from Morgan Stanley, quantitative easing had been very effective: “The bond-buying program allowed the ECB to take back control of financial conditions in the euro area”. In June 2018, the ECB announced that it anticipated to stop buying additional bonds by the end of the year.

Yet, it would keep reinvesting proceeds of the program and anticipated policy rates to remain at their present levels at least throughout the summer of 2019. Indeed, the program was ended in December 2018. Meanwhile, the Eurosystem’s balance sheet has reached a total of more than 4,700 billion euros. This represents roughly 42% of the euro area’s GDP for 2017. It is approximately 2.2 times the size of its balance sheet at the end of 2014. This increase is mostly attributable to additional purchases of government bonds. The ECB intends to continue reinvesting, in full, the principal payments from maturing securities for an extended period of time.

2019

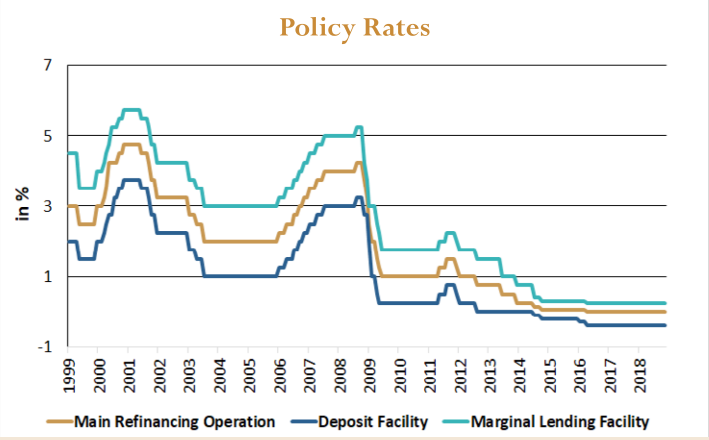
Turning point?

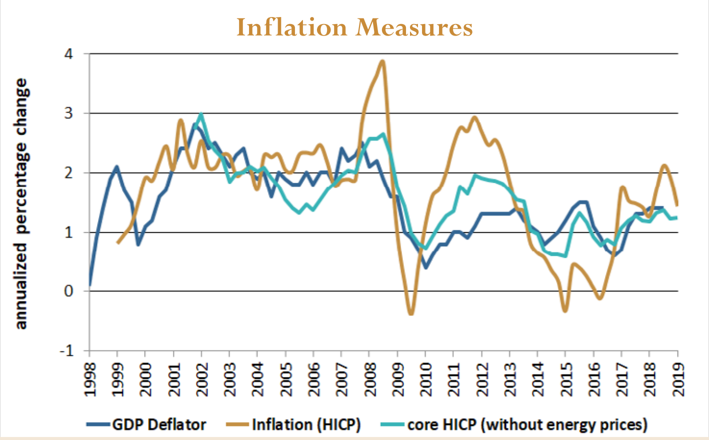
At the beginning of the year, the Governing Council reaffirmed that policy rates would remain at their present levels “for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term”.

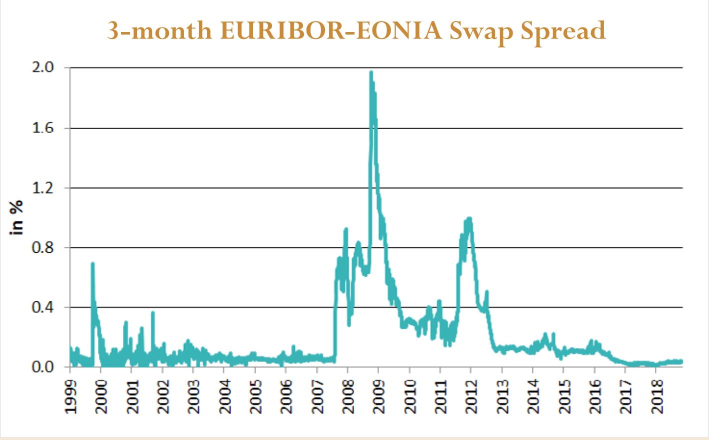
In March, the Governing Council decided to offer more cheap loans to banks and keep interest rates at record-lows for longer. The TLTROs will start in September 2019 and end in March 2021.

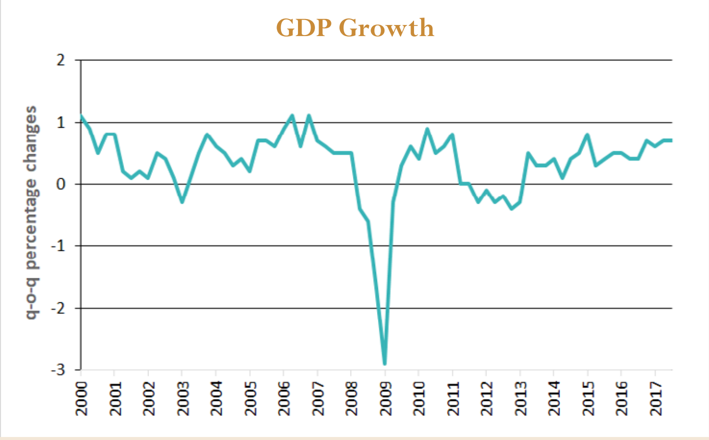
At the 20th edition of the conference on March 27, ECB watchers will discuss the next steps in policy normalization, challenges to central bank independence as well as international spillovers of monetary policy and financial stability concerns.

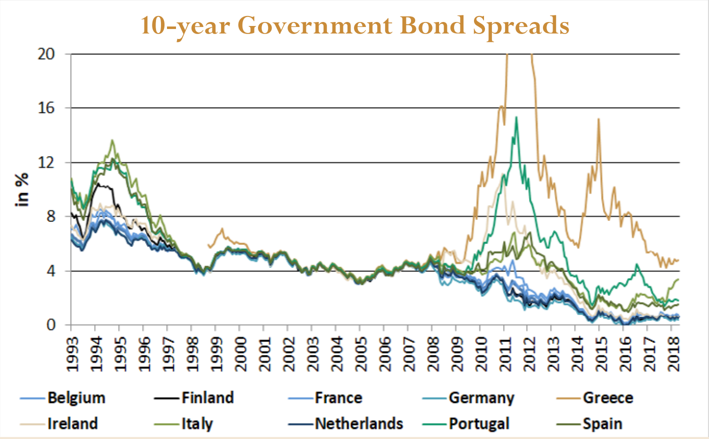
The Euro Area at a Glance

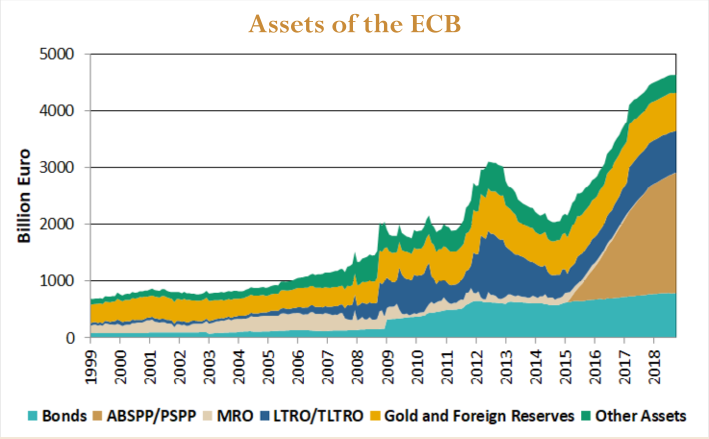


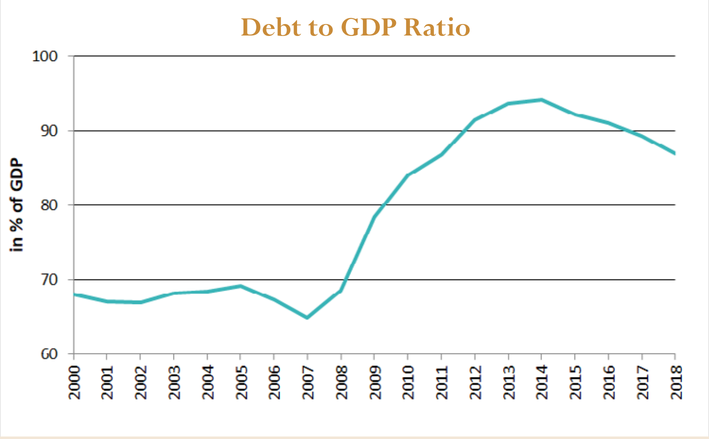


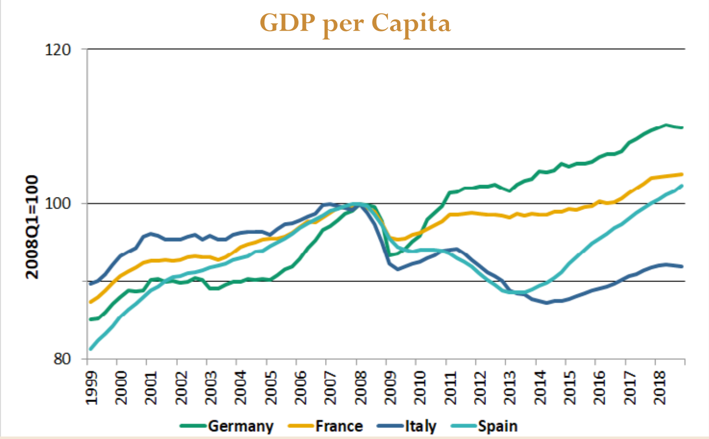












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