



Lorenzo Bini Smaghi

Chairman,
Société Générale

The Pros and the Cons of the ECB policy stance

Central Banks around the world - and the ECB more than others - are increasingly criticized for the ultra-accommodative stance of their policies. Indeed, since the early stage of the global financial crisis, the ECB has been actively using both standard and non-standard tools. It has offered banks unlimited liquidity, cut its deposit facility interest rate into negative territory and implemented large-scale asset purchases. With the benefit of hindsight, what have been so far the benefits and costs of this policy?

First, both CPI inflation data and inflation expectations have recently picked-up. This is a very positive outcome, as both were decreasing dangerously since 2012, leading to a resurgence of deflation fears. The turn-up in energy prices is obviously part of the explanation, but monetary actions have also played their role. Indeed, ECB policy has successfully contained long term interest rates and narrowed sovereign yield spreads, thus allowing a better transmission of monetary policy. Indeed, credit conditions for both households and corporates have significantly improved, including in periphery economies.

Second, the real trade-weighted exchange rate of the euro exchange rate has depreciated by more than 15% since the crisis. This has also facilitated the adjustment of the euro area economy as a whole. It is worth noting that the record-wide current account surplus of Germany (close to 9% of GDP in 2016) primarily reflects a structural excess of domestic savings over investment, rather than an under-valued exchange rate.

Having said that, it is likely that the marginal benefits of ECB ultra-accommodative policy measures will decline over time, while their marginal undesirable side-effects may grow. This is especially true for the negative interest rate policy. This measure has initially facilitated the transmission of ECB policy to asset prices and the exchange rate. However, over time, it will increasingly hurt bank profitability and thus the credit channel. The good news is that the expected higher pace of interest rate hikes in the US may eventually allow the ECB to exit from its negative rate policy.

So what should the ECB do? The widespread view, shared by the ECB itself, is that without the contribution of other policies - in particular structural reforms and fiscal expansion in countries where there is room - the effects of monetary policy are waning.

Yet, against the current political backdrop in Europe, it would be naïve and dangerous to bet that governments would have no alternative but to take the baton if the central bank decided to stop playing its part. The risk for the ECB would rather be to lose its credibility and ultimately its independence and legitimacy.

The fact that monetary policy is the only game in town is problematic. But at this critical political juncture in Europe, it is reassuring to know that there is at least one credible player in town. ●