Interim Report on the path to a more stable economic and monetary union

Speech by Jörg Asmussen, a member of the Executive Board, Parliamentary Evening of the Bundesbank headquarters in Hamburg, Mecklenburg-Vorpommern and Schleswig-Holstein, Free and Hanseatic City of Hamburg 27, August 2012

Dear Madam President,

Dear Senator Tschentscher,

Ladies and Gentlemen,

"Helps even more Europe?" Headlined *The time* in its issue of 21 June. That was the exact day a week before the heads of state and head of government of the EU took a first step toward financial union. They ordered also the President of the European Council, Herman van Rompuy - and I quote the summit conclusions literally - *"in close cooperation with the President of the Commission, the President of the Euro Group and the President of the ECB, a specific timetable with deadlines for achieving real economic and monetary union work out "* .

At first glance it seems that the question of *time* has already been answered 7 days later. But it is not so simple. If "more Europe," the response to the crisis, then that automatically raises new questions: for example, how new integration steps should be constructed politically and institutionally. The debate on this has just begun. And the discussion in this country about possible referendums show that there must be a broad debate. Many thanks to the colleagues of the Bundesbank for the opportunity to discuss this important issue with you here. On three main areas I want to focus on:

- First, the current situation on the financial markets and the state of the economy in the euro zone in general, and in selected countries;
- Second, the monetary policy of the ECB;
- Third, the steps necessary to develop the monetary union, with a special focus on financial Union and the future role of the ECB in a common banking supervision.

First Economic situation

1.1. The situation in financial markets

The situation in the financial markets in the euro area has deteriorated since the middle of last year again.The risk premiums demanded by investors in government bonds reflect since been proved not only the risk of insolvency of individual states, but also an exchange rate risk, which it theoretically should not exist in the monetary union. That is, the markets pricing in a breakup of the euro area. Such doubts are systemic dramatically - and not for the European Central Bank acceptable. Only one currency, to their constituents, there is no doubt, is a stable currency.

No less disturbing is the increasing fragmentation of the European financial market. While in the early years of monetary union, financial markets of the Member States together grew more and more, have been in the wake of the crisis - metaphorically speaking - the barriers rebuilt. For example, the share of cross-border loans in the money markets between mid-2011 and plummeted from 60 percent to 40 percent. In several countries, foreign bank deposits have reached their lowest level since early 2008.Banks are increasingly using domestic security in access to ECB facilities.

This has serious consequences for the common monetary policy: a monetary policy signal, as we have set, for example, with the rate cut in July comes, inconsistent or in some cases not at all to the real economy. The fed funds rate, the "lead" is actually supposed to do, this is only limited.

1.2. The general economic situation

The outlook for the euro area point to a weak economic development in the coming months. The IMF predicts a slightly negative growth (-0.3%) for this year, and a moderate recovery of 0.7% for the next.Accompanying a moderate inflation, a weakening of the high rate of inflation this year, and an inflation rate in the coming year is less than 2%. The key for our policy inflation expectations are firmly anchored.The just mentioned tensions in financial markets - including various disaster scenarios - have a negative impact on morale and confidence in the economy.

In this total, some might not exactly rosy outlook an observer, and perhaps one or two of you who may feel the euro as a currency is in crisis. And that monetary union has strayed from the fundamental price.

The euro itself is not in a crisis: We are currently experiencing a sequence of different crises in Europe: Some countries have to deal with the national debt, is in others it primarily a crisis in the banking sector and in some is more the private sector debt, the most pressing problem . In some states, the most serious problem the year-long loss of competitiveness and, in some occur simultaneously on the aforementioned causes, such as in Ireland, where we are experiencing a banking crisis at a high personal debt. Overall, it is now a major crisis of confidence has become. This is why we try - *together* in Europe - to tackle this crisis. Adjustment programs, bailouts, deeper integration, ECB's Special Measures. The list of important strategic position, taken within the past two years is long. Certainly not always the process was effectively and quickly. But whenever decisions were needed, they were also taken.

The bottom line is there is a fear that more new bailouts are just waste of money, that the problem countries are manifestly incapable of reform or reform reluctantly. I'm always amazed at how lightly spoken about other inhabitants of the common European home. Here is the game with national stereotypes of the complexity of the situation is not just.

The facts say otherwise. Even in Greece - probably the most difficult case - there has been progress.Despite a weak economic development, the primary deficit of -10.4 per cent of GDP in 2009 to -2.2 percent in 2011 to be reduced. Painful adjustment processes, such as wages and salaries, were begun.

These findings should not, however, mask the reform process in India has come because of the elections in the spring to a halt and that what has been achieved so far, is far from sufficient. It is also clear that any delays in reforms, every aspect of the adaptation period, costs money. Money that can be saved either elsewhere, or will be provided by the partners must be available.

However, the public perception of the adjustment programs in general is dominated by the very slow progress in Greece. Take the example of Ireland: In early July, the country the first time three-month government bonds worth 500 million euros and an interest rate of 1.8 percent in the market place. For Portugal, the yield on government bonds is the end of August at levels, as it was achieved before jumping in the bailout package for the last time. [1] These are the first tentative steps on the road back to normality. In relation to the core objectives of the adjustment programs - the reduction of government deficits and to restore access to the market - that initial success can be reported.

In the short-termism of the financial markets is always forgotten that profound structural changes require a lot of patience. We know also from the German experience, either. With reunification or the conversion of the labor market These days the media are full of "10 years Hartz laws." Their positive effects we feel really only recently. The "overhaul" of the economies of the countries in crisis or breakdown of internal and external economic imbalances - that no matter of two or three years. Patience and perseverance are also required.

Results when the analysis is more inclusive, and not just the problem countries are considered, for the euro area as a whole a much more nuanced reviewed in terms of fiscal policy key figures of other major economies, is the euro area as relatively good. The fiscal deficits in the euro countries, taken together, make about 4% of gross domestic product. That is much less than in the U.S. or Japan, where budget deficits are at 9 ½%, or 10% of GDP even higher than that of Greece (9.1%). Even with the sovereign debt in the euro area is around 87% of GDP in the U.S. (around 103%). And Japan's debt surpasses almost 230% of GDP even significantly by Greece (165%). [2] By this I do not gloss over the situation in the euro zone, but it must also be seen in an international context. The problems in the euro area are concentrating on individual countries, and must be solved primarily by those countries.

Nevertheless, market uncertainty and a feeling of disorientation among the citizens. Some wonder whether the economic and monetary union has a fundamental design flaw. This is first of all to the complexity of the issue itself. Columns of newspaper publishers and online bloggers, open letters from professors, in their own interest-based analysis of market participants in Germany and around the world: there is no shortage of studies, reviews, scenarios of seemingly inevitable disasters, and suggestions on what "politics", or more simply yet, "the Central Bank" but please do, or have to leave. This brings me to the second part of my remarks - the role of the ECB.

Second Role of the ECB

Europe has a very successful monetary order. The German Bundesbank was to model. The four key pillars to achieve:

- First, price stability as the primary objective of monetary policy;
- Second, the independence of the ECB and the national central banks
- Third, the ban on state funding through the Federal Reserve
- Fourth, the prohibition on the assumption of liabilities of other Member States (the so-called 'bail-out' clause)

I am aware that some people ask, quietly or publicly, whether for these pillars are still standing. These concerns we must take seriously and respond to them. Let me do so now.

First of all, the ECB remains committed to price stability, no ifs or buts. The facts speak for themselves for the first 13 years of the monetary union, the euro area average inflation stood at 2 percent, Germany at 1.6 percent. This good result is not obvious, because the challenges for monetary policy - the bursting of the dotcom bubble, the 11th September 2001, the sharp fluctuations in oil prices and the current crisis - were and are significant.

We must recognize that some of the standard tools of monetary policy in these turbulent waters no longer apply. The uniform transmission of monetary policy of the Eurosystem is increasingly hindered - with obvious consequences for the real economy. In program countries since the end of 2010 interest rates rise for corporate loans, although the interest of the central bank facilities have remained low.

Than the standard tools were no longer sufficient, they were accompanied by specific measures. For example, the long-term refinancing operations of up to 3 years duration. For this purpose we had in the fall of 2011 decided in a critical situation, to avert a panic situation in the financial markets and a credit crunch. Both would have incalculable consequences for the real economy, and thus for growth and jobs.

In both 3-year operations granted to banks secured loans totaling around 1,000 billion euros. The net cash flow amounted to only half. The participating banks were not only large banks, but also many smaller institutions, such as community banks and savings banks. Exactly those institutions loans primarily awarded to SMEs, which form the backbone of the economy in the euro area. So it was about ensuring that banks are able, their primary function - to lend to firms and households - can meet. And thus able to pass on the central bank's monetary policy impulse.

The uniform transmission of monetary policy of the ECB is still hampered by the severe disruption in the government bond market. Particularly speculation about a single outlet crisis states - coupled with a devaluation - impair the functioning of the interbank market massively.

Therefore, the ECB has announced the beginning of August, a new bond purchase program, which will ensure better transmission. Compared to the old bond purchase program SMP will include the following improvements:

- The ECB will only act in parallel with the EFSF and the ESM later. For this purpose, a State must submit an alternative claim and extensive economic support fulfillment. Hinaussollte In my opinion, the EFSF and the ESM at the request of the country concerned to intervene in the primary market before the ECB intervenes. Such a request is only the necessary condition for action by the ECB. The Governing Council will continue shall act independently of whether, when and how the ECB's bond purchases on the secondary market. With this method, to ensure that the affected country also implements all necessary and agreed reform measures. The error with Italy in the summer of last year, as the ECB has bought Italian government bonds and the time was unfortunately not used for necessary adaptation measures may not be repeated.
- In addition, the new program will be set up so that the problem of the perception of a preferred creditor status of the ECB will be addressed. Because this perception complicates the countries concerned to return to the capital market, because their status as private investors feel insecure and turn away from the country concerned.
- Finally, the ECB will buy under the new program, only bonds with short maturities. The control of short-term Geldmärkt is the classic job of monetary policy. In addition, the distortions in the short end of the yield curve in times of crisis are particularly strong.

The technical and operational details of the program are currently being developed. The Governing Council will deal extensively with all these aspects of the program at its meeting in a few days. The whole discussion is led by the proviso that any concerns of a non-conforming state funding withdrawn. We will act only within our mandate.

Because let me emphasize this: the central bank can and can not pay for the mistakes of the fiscal and financial market policies. Governments through a resolute reforms restore its credibility. The former president of the Bundesbank, Karl Otto Pohl summed up the task briefly and concisely: *"It is not natural, that we can live on an island of stability. That has to be earned through a consistent policy of stability. "*

Third The evolution of the monetary union

Ladies and gentlemen,

The crisis has shown that a true "culture of stability" in the framework of the monetary union has not yet sufficiently anchored. The original architecture was incomplete. A working stability policy is not just from the monetary policy, but also needs the fiscal policy, economic policy, and above all a clear democratic mandate.

Europe is now at a crossroads. Either we complete the integration of the euro area, by also fiscal policy, economic policy and democratic control, sharing sovereignty in Europe. Or we choose the other way, a decentralized Europe. This then also the dismantling of the monetary union, and probably also of significant parts of the internal market.

Both ways are possible and ultimately lead to a stable equilibrium, as we call economists. The balance of disintegration, however at a lower level of prosperity. For this reason I believe we should not turn back the clock. Rather, we should complete the Economic and Monetary Union.

The decisions of the European Council of the end of June they represent an caesura, as the leaders of the EU have the President of the European Council, Commission, euro group and the ECB issued a mandate to make proposals for the completion of economic and monetary union. The four presidents will submit to the European Council in October, an interim report. This will propose measures in the short term - can be implemented - and especially without the EU Treaty change. In December, the European Council expects a final report. This will include proposals, such as the euro area might look like in ten years, and what changes in the European treaties would be required to do so.

Before I get to talk to potential content blocks, two constraints:

- First, the deepening of economic and monetary union is primarily a matter of the 17 euro countries.These 17 states have chosen the single currency to a deeper integration, which now needs to be consolidated. At the same time it must not be forgotten that 8 of the 10 non-euro countries have committed to joining the EU to adopt the single currency in the foreseeable future and to meet the convergence criteria as well. Therefore, they must be in the upcoming process of change EMU also closely involved.
- Second, quality counts and not the speed of change. The euro countries should take the time that is needed to create a sophisticated product. But it is important that we create a vision as early as possible, an endpoint such as the euro zone will look like in 10 years. This builds trust between the citizens and the financial markets. Positive expectations for tomorrow in turn affect calming effect on the present.

Now to the content itself: The June report of the four presidents has already outlined four building blocks for the upcoming reforms. They provide a good basis for discussion represent the four elements are:

1. A financial Union
2. A fiscal union
3. A genuine economic union
4. A political union

These four blocks go together and are interdependent.

First Financial Union

First Union on financial market. Due to the acute situation in some Member States there is priority action here. The strong financial entanglement between the banking sector and public finances in some Member States has resulted in a weak economic environment to a downward spiral. As soon as the budget situation worsens a state does that on government bonds in banks' balance sheets. The banks have problems refinance themselves adequately. Device a large, systemically important bank to falter, the government has to step in again. And thus the downward spiral continues.

This spiral must be broken as soon as possible. The longer we wait the more expensive it will end. For this, the architecture of financial supervision in the euro area be re-examined. At the end of this process, the new architecture should have the following features:

- First, a European Banking Supervisors, which has adequate policies and penetration skills to provide a uniform implementation of European regulation safely. These banking supervision must also be able to close non-viable institutions.
- Second, a fund financed by the financial services industry, which stands in an emergency to handle systemic banks available without that national budgets and taxpayers will be charged. This exercise must be a single European rulebook for handling systemically important banks.
- Thirdly, the deposit guarantee will be organized at European level. Could serve as an example here, the U.S. Federal Deposit Insurance Corporation (FDIC). The lack of a deposit insurance system has exacerbated the crisis in some euro area countries also. Doubts about the safety of the deposits could attract strong capital flows by itself. The euro has facilitated the transfer of deposits within the euro area even as then no exchange rate risk arises.

All three elements are interdependent, with the first step, the efficiency of the European banking supervision must be ensured. Banking supervision can only act effectively and useful if they also have complete information as to the deposit insurance has and they can also only show teeth when they can order such as the settlement of an institution.

The Commission on 11 September to present their proposals to move the transfer of supervisory tasks to the European Central Bank (based on Article 127 (6) of the Treaty on the Functioning of the European Union).

The ECB, together with the national central banks willing to take on responsibility in this regard, but only under certain conditions:

- First, the primary mandate of price stability will remain untouched. Therefore, the monetary policy of the bank supervision outward and inward organizational and personnel are also strictly separated.Some feel that a central bank should always stay out of institutional supervision. But the fact is that today 14 of the 17 national central banks of the euro area have supervisory responsibilities. This rich knowledge must be part of the European supervision. Because it is clear that many supervisory tasks can only be performed tomorrow on site.
- Second, the ECB will ensure that their independence in monetary policy can hamper in any way. At the same time it is clear that functions of banking supervision must be under a parliamentary and judicial control, for banking supervision is sovereign act by which can intervene in fundamental rights of the persons concerned. We stand to greater parliamentary scrutiny of European Banking Supervision at the ECB with an open mind.
- Third, the law must provide the ECB with all the instruments that are necessary to perform the tasks of a bank supervision effectively. This means in particular access to all necessary information, intervention and, as mentioned, the right not to close viable banks. Without this minimum configuration, the ECB is not responsible, the risk to the reputation of the institution would be too great.

Until the implementation of the Commission's proposals must include these aspects that are especially close to heart, yet another important design issues to be addressed, such as the exact split between the ECB and other European regulators.

The leaders of the euro area to see the creation of a single banking supervision for the euro area as a prerequisite for direct recapitalization of the banks by the European Stability Mechanism (ESM). This linkage between the funds and control is essential. Responsibilities for solidity and solidarity are inseparable and should be exercised at European level.

The coming months will be of great importance in this respect, and it will be a key concern for the ECB to provide an incentive compatible regulatory structure.

Second Fiscal union

This brings me to the second block, the fiscal union. The aim of the fiscal union is to prevent domestic policy failures in individual Member States stress the other Member States or the monetary union as a whole. With the reform of the Stability and Growth Pact and the so-called fiscal pact an elaborate set of rules with different limits for national fiscal policy was developed. There is also an application of the excessive deficit or debt. However, it is still unclear how to deal with the euro area Member States that do not comply with the requirements of the regulations. Figuratively speaking: The house rules in the European house is. But what to do if in an apartment still violate the house rules and the halfway house is under water? So far, we are then faced with a more or less closed doors.

In an emergency that threatens the fabric of the whole House, the international community must intervene.There are several considerations. In a first step could be to issue public debt securities are subordinated beyond the agreed limits of a European licensing. In particularly serious cases, "Brussels" may, subject to strict criteria impose an output stop.

These interventions involve a strong engagement in national sovereignty. Therefore need to be democratically legitimized. Furthermore, all interventions are designed so that the principle of national ownership is not undermined.

Third Economic Union

The third component - the true economic union - is aimed towards further integration of the European market. For monetary union for better integration is particularly urgent. Because since 1999, the competitiveness of the euro countries have developed very differently. In consequence incurred serious imbalances in trade and capital flows.

To prevent such undesirable development, there is now the so-called "process by macroeconomic imbalances". I also feel better coordination of national tax systems is particularly important. To do business in other Member States must be fiscally simpler. The Commission's proposals for a common consolidated tax base for the corporate round are a step in the right direction. Furthermore, Member States could benefit if it employees would still be easier to find a job in another EU country. But the mobility of workers has other important aspects that need to be rules to get here to improvements. For example, must also pension and retirement claims are becoming more mobile. When a change of job in another European country should also be a transfer of claims to another social security system should be possible.

4th Political Union

So I have arrived at the fourth block: the political union. The debate about the political union is as old as the monetary union, or even older. But what exactly does the term "political union"? For me it is a fundamental principle that where the European level to create new skills, to take place also in an appropriate decision-making and a full democratic control. We need therefore institutions, the legal and technical competence have to perform these functions of decision-making and control.

Many wonder how democracy can be strengthened at the European level. The only answer is the full involvement of the European Parliament in the legislative, personnel order and control? What role remains for national parliaments? Is the involvement of the European Parliament in the euro-zone format imaginable? These are complex issues that need to be discussed in the coming months and years. The important, deep integration steps that are before us, without the serious discussion by all of us, the citizens of Europe. Here, too, and right now in Hamburg. Sure am glad.

Thank you for your attention.