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Commentary

THE BUFFIN FOUNDATION SOCIAL AND ECONOMIC DEVELOPMENT ISSUES

A View from the European Central Bank

The European Central Bank (ECB) is the central banking authority of the euro zone that comprises the nineteen European Union (EU) member states that have adopted the euro as their common currency. The ECB was established in 1998 by the Treaty of Amsterdam; its headquarters are in Frankfurt am Main, Germany. The main task of the ECB is to conduct monetary policy by managing the supply of the euro and maintaining price stability. The ECB is one of the most important central banks in the world; it supervises over 120 central banks and commercial banks in the member states. The ECB first exercised its full powers on January 1, 1991, after the introduction of the euro as the official currency for the euro area. There are four decision-making bodies of the ECB that are mandated to undertake its objectives, namely Governing Council, Executive Board, General Council, and Supervisory Board. The primary function of the Governing Council is the formulation of monetary policy for the euro area, including monetary objectives, interest rates, and the supply of reserves in the euro system. The role of the Executive Board is to implement the monetary policy as determined by the Governing Council and manage day-to-day operations. The General Council is a transitional body that carries out responsibilities taken over from the European Monetary Institute (EMI). Currently, only nineteen of the twenty-eight EU members have adopted the euro; the General Council will continue its role until all EU members have adopted the euro. The Supervisory Board plans and executes the supervisory function of the ECB and initiates proposals for consideration by the Governing Council. With respect to its mandate to maintain price stability and safeguard the value of the euro, the Governing Council has defined price stability as inflation under but close to two percent per annum. Price stability is essential for spurring economic growth and job creation that are essential core objectives of the EU. Other responsibilities of the ECB include conducting foreign exchange operations, promoting the proper functioning and safety of payment systems and managing the euro zone's foreign currency reserves. The principal monetary policy tool of the ECB is collateralized borrowing or repo agreements; this collateral is typically high quality public and private sector debt.

From late 2009, some mainly southern euro zone member states were unable to repay national euro-denominated government debt or to finance the bail-out of troubled financial sectors, resulting in a European debt crisis. At the time, the ECB legal framework prevented the implementation of quantitative easing as had been adopted by the US Federal Reserve and the Bank of England. In May 2010 the ECB announced a Securities Market Programme that involved the purchase of sovereign bonds in secondary markets. After Mario Draghi became President of the ECB in 2011 the bank introduced a new monetary tool known as Long-Term Refinancing Operations. In July 2012 Mario Draghi proclaimed that the ECB "is ready to do whatever it takes to preserve the euro" and this statement significantly contributed to stabilizing financial markets and ending the sovereign debt crisis. The ECB balance sheet was massively expanded during the term of the Draghi presidency that expired in October 2019. Madame Christine Lagarde, former Managing Director of the International Monetary Fund, succeeded Draghi as ECB President.

In a speech on *The Future of the Euro Area Economy* delivered on November 22nd to the European Banking Congress, Madame Lagarde noted that discussions are moving forward on completing a banking union and building a capital markets union. Uncertainty abounds as the global environment has been transformed with the fracturing of the post-war global order, the rise of new powers, rapid changes in technology, and an uncertain outlook for global trade and finance. Ongoing trade tensions and geopolitical uncertainties are contributing to a slowdown in world trade growth. There are also changes of a more structural nature with a global shift from external demand to domestic demand, from investment to consumption, and from manufacturing to services. World trade is being reordered as new technologies disrupt conventional supply chains and workplace organization, and as new risks emerge due to climate change. The euro zone must adapt to these new realities and boost domestic growth. Madame Lagarde advocates moving towards a new policy mix with a key element being the euro area's fiscal policy. Even when governments need to consolidate their finances, there is nevertheless a common interest in maintaining sufficient levels of public investment in a future economy that is more productive, more digital and greener. The digital single market, the capital markets union and the single market in services are the building blocks of the European economy of the future.

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