

'The "Wise Men of Frankfurt": friends or foes?' from Le Soir (27 December 2001)

Caption: This article, from Belgian daily newspaper Le Soir, describes the arguments put forward by supporters and opponents of the monetary policy pursued by the European Central Bank with a view to achieving its objective: maintaining price stability.

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The monetary policy of the European Central Bank is far from winning unanimous support

The 'Wise Men of Frankfurt': friends or foes?

According to some, the European Central Bank (ECB) has not adequately supported economic growth in Europe. For others, it was right not to mirror the excesses of its American counterpart. However, the way in which it communicates attracts criticism from all sides.

Philippe Servaty

The European Central Bank (ECB) was established in the image of the Bundesbank. It inherited both the tangible: its seat in Frankfurt; its task (to ensure price stability); its federal structure, and the intangible: prejudices shaping its monetarist attitude, taken to be 'hard-line'. It inherited everything except the essential: its reputation. A central bank has even greater need of a good reputation than did young ladies in times gone by. Its very existence allows it to drive away unwanted visitors, in this case speculators, which limits the risk of erroneous interventions.

This lack of a reputation constitutes the ECB's initial shortfall. Since 1999, it has strived to build up its reputation in the light of markets dominated by an Anglo-American mindset which is crippled by prejudice against it. This task was made all the more difficult since, at the outset, the new monetary institution was thrust into a tumultuous economic climate. On 1 January 1999, the fallout from the Russian financial crisis renewed fears of deep global recession. One year later, the only concern was overheating (bear in mind the solemn pronouncement that 'full employment' was soon to be achieved).

In such a foggy economic climate, the ECB did not wish to try to be too smart. It set itself only one goal: to maintain price stability in the euro zone. In truth, it did not have much choice. While the American Federal Reserve (the 'Fed') pursues two concomitant objectives — price stability and sustainable economic growth — the 'Wise Men of Frankfurt' must first of all ensure that the first goal is achieved before they worry about the second.

[...]

An initial appraisal of its first three years in operation must judge the ECB on its inflation goal. Its objective has been achieved: the euro zone witnessed price overheating — a somewhat excessive expression to refer to an increase of little more than 3 % — only because of the explosion in the price of oil, an element beyond ECB control.

According to the critics of the team headed by Wim Duisenberg (President of the ECB), this absence of an inflationary threat should spur on the ECB to support growth by reducing interest rates at the first sign of economic downturn. In fact, the ECB has never been 'quick off the mark'. This year, it waited until May to break the monetary stranglehold, whereas the Fed had done so in January, at the first sign of economic cool down. Today, the European reference rate is 3.25 %; on the other side of the Atlantic, it has been cut to 1.75 %. It is true that the slump in economic activity has been steeper in the United States than in the euro zone.

This is where the supporters of the ECB have their say. They maintain that the Fed policy, which mirrors the economic climate and stock market trends, has without doubt contributed to the fact that the American economy has been on a roller coaster ride over these last two years: bull markets, the turndown of which encouraged the current recession, were not stamped out by the Fed, and it is now slashing rates in order to put the American economy back on track. From 1999 to the present day, the Fed's rates have fallen from 6.5 % to 1.75 %, a drop of 4.75 %, while the difference between the highest (4.75 %) and the lowest (2.5 %) European reference rates over the same period is less than half (2.25 %). This demonstrates the success of the ECB's less aggressive approach.

The OECD, the rich countries' club, deems this 'soft' approach not to have been harmful: *The policy of the*

ECB has given every opportunity to growth; monetary conditions in the broad sense have remained relatively accommodating.

Supporters and critics of the ECB agree, however, on one point: Wim Duisenberg and his colleagues are not good at explaining their decisions. That is astounding for an institution which, unlike the Fed, more often than not accompanies its communiqués with a fairly lengthy press conference. However, the European central bankers must face facts: they are not good at speaking off the cuff.

This communication gap aside, the criticism levelled at the ECB appears to be steeped in bad faith. This is all the more true because, over the last few months, Europe has been the area in the world where the economy has best stood up to the crisis. Not bad for a region relentlessly accused of economic stagnation.

And if, over these last three years, American growth has on average remained (significantly) higher, this must be attributed more to the lack of integration amongst the European markets — for which policy is responsible — than to a supposedly cautious ECB policy. But then, a central banker will always get the blame. He can usually bear it.

Le Soir, Thursday, 27 December 2001

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