Helaba

CHIEF ECONOMIST’S COMMENT

21 February 2019

Lessons after 20 years of the euro

AUTHOR
Dr Gertrud R. Traud
Chief Economist
Head of Research
phone: +49 69/91 32-20 24
research@helaba.de

EDITOR
Markus Reinwand, CFA

PUBLISHER
Helaba
Landesbank
Hessen-Thüringen
MAIN TOWER
Neue Mainzer Str. 52-58
60311 Frankfurt am Main
Tel: +49 69/91 32-20 24
Fax: +49 69/91 32-22 44

1 January 1999 marked the birth of European Monetary Union. For a transitional phase of three years, however, the national currencies remained legal tender. It was not until 2002 that the euro replaced national currencies and euro notes and coins entered circulation. I even saved up a so-called Starter Kit.

As early as 1999, responsibility for monetary policy was transferred to the European Central Bank (ECB). In order for the ECB to be able to start its work on time, numerous preparations had to be made in advance. The decision to locate the ECB here was very important for Frankfurt. However, the ECB has only occupied its current location in Frankfurt's Ostend since 2015. Previously, the ECB resided in the Eurotower in the city centre.

When planning for the new building commenced in 2002, it was not yet foreseeable that the ECB's tasks would become much broader than originally envisaged. As a consequence of the euro sovereign debt crisis, the ECB was also entrusted with the supervision of systemically important banks in the euro area in November 2014. Although Frankfurt's cityscape only changed significantly with the construction of the new ECB building in the Ostend, this decision had a direct impact on employment at the central bank. In the meantime, the ECB employs almost 3,400 staff and Frankfurt is thus a clear beneficiary of European Monetary Union. But what does the situation look like otherwise?

Concerns that the introduction of the euro would lead to higher inflation have not materialised. Nevertheless, it should be noted that global inflation rates have been on a downward trajectory in recent decades. With regard to growth, the merits of European Monetary Union are contentious. Until the financial crisis, many countries benefited from interest rate convergence to the low German level. However, the resulting growth spurt and interest that was saved were not used to reduce debt. On the contrary, the financial crisis exposed the problems and ultimately culminated in the sovereign debt crisis in the euro area. In Germany, the trend was in precisely the opposite direction. While the country was known as the "sick man of Europe" during the first years of the euro area, the largest euro country transformed into an engine of growth post-2008.

It has become apparent, particularly with regard to sovereign debt, that some people were naive in their expectations of the euro – notably that it could prevent excessive borrowing. Unfortunately, however, the Stability Pact is constructed in such a way that, ultimately, the only decisive factor is the political will of the countries themselves. The history of the euro teaches us that sound public finances are not a priority. This has also been clearly demonstrated by Italy's recent budget dispute with the EU.

Some would like to see a common fiscal policy to solve these problems. But this would be the wrong approach. With the loss of the exchange rate as an adjustment mechanism within a monetary union, other policy areas such as fiscal, social and wage policy must remain the responsibility of the Member States. Only then will the respective country have a chance to react and maintain its competitiveness. The harder it is for national governments to make adjustments, the stronger the call for more solidarity with corresponding transfer payments will become. However, this would result in countries abandoning their own efforts and ultimately endangering the single currency as a whole. Capital market interest rates must return to a situation in which they are determined entirely by market forces, so that they can develop their controlling effect. This is the only way to ensure that there will still be an ECB in Frankfurt 20 years from now. ■