# Introductory statement at the IIMA Symposium, Tokyo

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Secular stagnation is a global concern. At the current juncture, all advanced economies - but also China - are facing very low or negative inflation rates. This is the case not only in the euro area, but also in the United Kingdom (UK) and the United States (US), where central banks have more forcefully intervened and nominal growth is more robust.

There are two different theories to explain why economic growth has slowed down globally. On the one hand, Larry Summers argues that secular stagnation is the result of a lack of demand and, thus, calls for fiscal stimulus. On the other, Robert Gordon and others argue that the main problem is the dismal behaviour of productivity that is on a downward trend without any turnaround near in the medium term. According to the latter view, the problem is on the supply side of the economy.

This distinction in diagnosis is well reflected in diverging policy reactions to the crisis. While the US and UK have relied heavily on fiscal and monetary stimulus (to close the output gap), in Europe, much more importance has been given to structural reforms (aimed at increasing productivity and potential output). It would seem that Brussels reads Gordon while London and Washington are more in tune with Summers.

In the US and the UK, fiscal policy has been more accommodative and Central Banks have engaged in risk shifting policies by purchasing large amounts of private and public assets. Instead, the European policy mix placed more emphasis on achieving structural reforms and fiscal adjustment. Euro area countries, especially those under official support, are undergoing significant reforms aimed at improving labour and product market efficiency. On the fiscal side, euro area countries have control mechanisms to avoid an excessive accumulation of government debt. With most of the heavy lifting on the fiscal side now behind us, the aggregate euro area fiscal stance is expected to be neutral this year.

Different policy prescriptions are also rooted in the challenges associated with population ageing. The related shortage of labour supply in future is more acute in Europe, partly because of a lower birth rate and partly because the US economy has been more open to immigration.

In any case, headwinds to future growth are numerous. Various factors are likely to translate into less economic dynamism:

- Demographic dynamics (ageing) are likely to lead to increased savings, pressing interest rates downward.
- Globalization is decelerating. Over the last 30 years, trade grew much faster than world GDP (5.3% vs. 3.2%). While this process of trade integration provided an important growth impulse, it is a one-off factor that will not be repeated in the future.
- A similar one-off argument relates to female integration into the labour market, a process mostly exhausted in the advanced world.
- Private and public debt and financial bubbles cannot, without limits, push growth (as they did in the recent past).
- Contingent liabilities stemming from social security promises will, in future, be a huge problem.

All this points to future trend growth moving lower than in the past. In any case, Total Factor Productivity (TFP) remains the main driver of potential GDP growth. The academic literature suggests that distortions in the efficient sectoral allocation of production inputs may generate very different aggregate TFP levels across countries. For this reason, in Europe, much emphasis has been rightly given to structural reforms.

Structural reforms are the key to promote long-term growth and an efficient functioning of the currency union. The implementation of difficult reforms and the necessary fiscal consolidation have contributed to the unsatisfactory short-term growth performance of some European economies in recent years. These reforms will bring, however, great future benefits and they will make the currency union more stable by reducing disparities among its members. Moreover, the need for additional fiscal adjustment from now on will be much smaller. One should also bear in mind that, in particular in programme countries, low growth is to a large extent the consequence of excessive past growth, which led to (and was sustained by) the accumulation of imbalances.

Some European economies have been reform champions during the last years. Widely recognized structural reform indicators, such as those prepared by the World Bank, the OECD or the Lisbon Council, illustrate the extent of the effort made by European economies, especially those under program. As documented by these institutions, the reforms have translated into lower nominal labour costs and more efficient product market regulations. Countries like Ireland and Spain already see the benefits of their reforms in terms of higher economic growth. According to the OECD, also Greece could have high growth in coming decades if its reform efforts were to be continued.

The Union is implementing additional policies to promote growth. First, the neutral fiscal stance, the easing of monetary policy and the related weakening of the euro exchange rate support aggregate demand.

Second, the recent investment plan unveiled by the European Commission President, Jean-Claude Juncker, will strengthen public and private investment in Europe, and thus strengthen demand.

Third, with the aim of restarting the credit channel and limiting the interdependence between sovereign and bank risks, the European Union is implementing a banking union and designing a capital markets union (to reduce current reliance on bank financing).

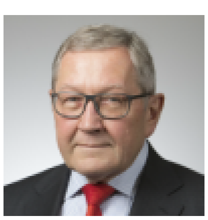
Europe conceived the banking union, so the financial sector would be capable of supporting a recovery in the euro area. In doing so, the immediate problem was to stabilise banks and remove the link between sovereign and banking sector risks. Regarding the medium term, a framework was needed that would reduce the likelihood of future financial crises. Europe responded to this challenge on multiple levels.

The European Union (EU) has completely overhauled the regulatory and supervisory environment in which banks operate. Basel III is implemented in the EU, the Bank Recovery and Resolution Directive (BRRD) has reformed resolution and shifts the burden of bailout from taxpayer to creditors; and, the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM) ensure sound supervision and resolution of systemic institutions at the European level. Lastly, the European Stability Mechanism now has an instrument to recapitalise banks directly, limiting the burden for the member state. These changes will help the EU to become more resilient to future financial crises than in 2008, when the crisis hit.

The Balance Sheet Assessment carried out by the ECB and European Banking Authority (EBA) last autumn has provided euro area banks with a clean slate and has fostered transparency in the sector. The exercise assessed the asset quality of euro area banks according to harmonised standards to ensure a level playing field and to provide maximum transparency to the SSM when it took office. Bank provisioning was also sense-checked to further reduce vulnerabilities. This will return confidence in the sector and help banks focus on new projects. After raising several hundred billion euro of fresh capital , bank lending in the euro area should no longer be constrained by solvency concerns.

I am confident that, in the medium to long-term, the combination of structural and fiscal reforms and the creation of the banking union will deliver sizeable benefits. The multi-layered euro area policy approach, which relies on using fiscal and monetary policies to help the economy accommodate to structural changes, is creating a sound basis for sustained medium-term growth. 2 The 30 largest banks in the SSM alone have raised some € 200 billion between 2008 and 2013. Furthermore, 54 SSM banks have raised € 57,1 billion in 2014 alone. (See “Aggregate report on the comprehensive assessment”, ECB (2014)) 4 Because of these policies, together with a new framework that enhances policy coordination and the creation of new institutions such as the ESM and European Systemic Risk Board (ESRB), the monetary union will function better after the crisis than it did before.

## Author



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