EZA 686/20Jun05: ECB Briefing Note

EZA discounts Press talk of early ECB rate cut and of alleged ECB concern about inflation and growth differentials within Eurozone

No indication of early rate cut

1. As recently as 16 June, in an article he wrote for French daily Le Monde, Trichet repeated clearly the categorical denial he had previously made, in answer to a question at the 2 June press conference, that the ECB was contemplating a rate cut in present circumstances. Trichet dismissed the arguments of those who advised the ECB to raise its price stability definition from 2% to 3%, in order to make room for lower interest rates an of those who advised that since inflation expectations had been successfully anchored the ECB could now afford to lower interest rates and said that surveys showed that the ECB was doing what was necessary to ensure stability and credibility - no less and no more. That was why the Governing council considered its interest rates to be appropriate. They had no bias: he was not preparing the markets for a rate cut, nor was he preparing them for a rise.

Growth and inflation differentials not cause for alarm

2. At a high-level invitation-only, ECB research workshop on the effects of EMU on Eurozone countries attended by EZA on 16-17 June - the closing panel included all three progenitors of the theory of Optimal Currency Areas: Robert Mundell, Peter Kenen and Ronald McKinnon - ECB President Trichet, Vice-President Papademos and Chief Economist Issing all argued that the heterogeneity of Eurozone countries' macro-economic performance was not exceptional and thus was not a cause for alarm: during the 6 years since the creation of the euro, growth and inflation differentials had been no greater than in the preceding 25 years; on some measures, the dispersion of growth rates had recently reached a historically low level; and both growth and inflation differentials within the Eurozone were broadly of the same order of magnitude as those between the regions, and between the metropolitan areas, of the United States.

3. What the Executive Board members' speeches did home in on, though, was the significant divergences between members of the euro area in measures of competitiveness, and this was attributed to rigidities in labour markets and to the low degree of integration and competition in certain product markets, particularly for services. It was these factors, and their resultant cumulative effects on growth that "raised concerns": as a result of them, the adjustment mechanisms were functioning slowly and the self-equilibrating forces were not as strong as they might be.

4. In our view the ECB's intended message from this analysis is that it was not monetary union that was the cause of the current economic malaise in a number of the Eurozone countries but the lack of political realization or political will to implement the national structural reforms that were clearly required from the outset for EMU participation, made even more imperative by the continuing process of globalisation. It is in this context that Issing's observation that " In my view, several countries did not fully understand what signing the Maastricht Treaty and joining EMU would imply in many areas - from fiscal policy to product and labour markets, and price- and wage-setting" should be interpreted.

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