

# Speech by Eurogroup President Mario Centeno at the London Business School, 16 April 2019

A source of stability: the role of the euro in an uncertain world

Thank you, Francisco, for the introduction – and thank you very much for the kind invitation to speak about the euro and its future.

It is an honour and a pleasure to address you and come to the London Business School.

Let me start with a disclaimer: I am not going to talk to you about Brexit today.

I understand it has been quite a drama on this side of the channel. So perhaps the time we spend together will allow you some respite.

The truth is, out there, the world keeps spinning.

Don't get me wrong, this uncertainty is taking a toll on us all. And we are very sad to see Britain go.

But there are other important problems and challenges that we face and need to address. I will talk a bit about those.

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As we meet here today, there is a wave of pessimism regarding the future. Some fear that the global economy is headed to another recession.

The crisis we have gone through nearly a decade ago was a once-in-a-lifetime event. It is a shame that we failed to prevent it, and, after, that we

let it go so far.

We saw financial bubbles grow beyond repair, as regulation was weakened and supervisors failed to connect the dots. Many lessons were learnt, but not all.

Markets went from dormant to overzealous, which made the euro debt crisis worse than it should have been.

Many are still wary. No one wants to be caught on the wrong foot. You are labelled naive for pointing out that the economy moves in cycles, or that there are temporary factors.

This last weekend I went to the IMF Spring Meetings in Washington. The expectation was that the mood was going to be grim, also because the IMF forecasts had been gloomy. Ahead of the meetings many questioned yet again whether the euro would be prepared for another crisis, having spent way too long dealing with the previous one.

My takeaway from Washington is more positive.

The balance of risks in the global economy may be turning again. The threat of a disorderly Brexit has been pushed back.

On trade, the US and China could be coming close to an agreement, easing tensions.

China's policy driven expansion is compensating for some of the vulnerabilities of emerging market economies.

Surely, we will see a global slowdown this year. And the euro area will be no exception.

But once again we will disappoint the scaremongers. While some, including in this country, continue to expect the collapse of the euro every other year, the single currency has made its survival from the crisis to a point of no return. Let me explain why and put this slowdown in perspective.

If the slowdown is due to a tremendous accumulation of political uncertainties, not fundamentals, only political resolve will fix it.

And in the euro area we have seen some strong political commitment.

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It is true that the euro area's growth decelerated somewhat last year. This trend is expected to continue in 2019.

This should not come as a surprise. The euro area growth is 'normalising', which is inevitable after what was an exceptionally good year in 2017, when growth reached 2.4%.

Such rates of growth could not last for long, as it is well above growth potential of about 1.5%.

Regardless of this 'normalisation', the eurozone will grow for the fifth year in a row – the longest growth streak since inception.

The euro area continues to create jobs - 10 million new jobs since the crisis - and better-paid ones too, as wages are now growing across the board.

Unemployment has continued to fall for 15 consecutive quarters, and it stood at 7.8 % in February this year – the lowest rate recorded in the euro area since October 2008.

The services sector remained strong. Consumer confidence remains above long term average. We have corrected trade and budget deficits. No country posted an excessive deficit last year. The euro area has a comfortable budget position to react to any economic shock.

This was the result of sound policies after the crisis, namely a combination of fiscal consolidation and structural reforms.

At the same time, citizens' confidence in the euro – which is celebrating only its 20th anniversary this year – has also been constantly growing,

and is currently at its highest level ever: 74 % believe that the euro is a good thing for Europe. We must surely be doing something right.

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I've mentioned a number of external risks. But there are some internal risks, too. 2019 will be a year of political changes in Europe. Most key leadership positions in European institutions will change. These have been good years for Europe, we must keep the trend.

This comes at a time when we see a wave of new political movements all across the western world, on the fringes of the party system. These have fragmented the political landscape and are shaking the political centre. This is weighing heavily on economic policies and public sentiment.

All these risks are mainly political, rather than economic or financial.

In a way, this is a good thing. Addressing political risks depends directly on us. In Italy it is high time for budget execution and delivery. In Germany it is time to use the leeway to foster the recovery, in particular of the manufacturing sector. We still have time to bury a trade war and to give clarity to economic agents on the Brexit process.

So, we must use our time wisely.

The euro area has done exactly so since it faced an existential crisis a decade ago. It is not time for complacency.

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Europe is sometimes hard to understand for British citizens. Sometimes it is also hard to understand for the rest of the Europeans, too.

We need diversity for economic systems to work properly, and we have that in Europe. But the UK is an important part of that diversity. Losing it needs some preparedness. Are we doing our part?

The euro area has indeed come a long way. After a rosy start, but where

the business cycle was rather unusual (remember growth in Germany was sluggish in the first seven years of this Century?), the financial crisis found the euro area unprepared and pushed it to the brink of collapse.

In the end, what kept us united was the same that brought us together in the first place: a strong political will to find common solutions. Europe has always been brave to take the necessary steps towards more integration. As it means peace and shared prosperity.

In the crisis it was no different.

We significantly improved economic policy coordination among the Member States and extended it beyond fiscal surveillance.

We established the European Stability Mechanism – our powerful common firewall. We launched the Banking Union, including a single supervisor, the European Central Bank took bold decisions to address tail risks. In parallel, Member States took action to reduce national imbalances. We took our time, but we took action.

The results are there to be evaluated.

Our banking sector is now much more robust than it was on the eve of the financial crisis. Steps were taken to repair, consolidate and recapitalise it. Our banks have more and better capital and higher liquidity buffers, which are now under greater scrutiny from regulators. The stock of non-performing loans has been steadily decreasing, improving prospects on profitability.

We realise there is still quite some work to be done to bring the euro area up to a level of integration compared to say, the dollar. And that is now our agenda.

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Step-by-step we are getting there. I, along with my fellow finance ministers of the euro area countries, have been tasked by EU leaders with

carrying out several projects related to further deepening of the Economic and Monetary Union.

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Four months ago, we have reached an agreement on how the rescue fund - European Stability Mechanism (ESM) - can be used in a broader and more effective way.

This includes using the ESM's firepower as a backstop for the Single Resolution Fund, which is part of the banking union, and was created to prevent failing banks from being bailed out by governments. This enhances the credibility of our banking resolution framework.

An agreement has also been reached on how to make the ESM's precautionary credit lines more accessible to countries with sound fundamentals, to protect them against exogenous shocks.

In addition, we have found a way to expand the role of the ESM, supporting our capabilities of crisis management and prevention.

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All this will help. But arguably there are two important pieces missing in the euro. One is a common European Deposit Insurance Scheme or 'EDIS'. This is an essential piece of a coherent EMU. It will provide the system with a confidence boost, preventing bank-runs.

But this is a politically sensitive issue. And that is why we need to see small steps one at a time. That the discussion is now at a political level is a signal of confidence.

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One of the most significant steps forward in recent years – in my view – was the decision to put in place a euro area budget to support convergence and competitiveness.

Europe's finance ministers are currently working to define the main features of this instrument, which will complement monetary policy.

You are probably wondering about the size of this budget. It will not start as a bazooka, but over time we will be able to adjust it to our needs as it proves its merits. Both as Finance Minister in Portugal and as President of the Eurogroup in Brussels, I don't like big machines. We should take small steps. As economists put it, we should act on the margin. So let's look at the most effective margin to act upon and do whatever it takes on the specific margin.

What matters the most is that we are adding a new instrument to the euro area's policy toolkit – an instrument that is undoubtedly a credible testimony to our willingness and determination to continue strengthening the currency union. And also that it will attract new members to the club. In that sense, it is a premium for euro area membership.

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While we continue on the path of reform, the euro is already the world's second most important currency. For the sake of the stability of the international financial system, this role must continue to grow.

The euro is used in 36% of international payments. But when you look at its effective role in the international scene, including its weight on international loans, foreign exchange turnover or its use as a reserve currency, the dollar rules and the euro punches below its weight: proportion of foreign exchange trading is 44% in dollars but only 16% in euros.

Recent developments have raised questions about the dominance of the dollar.

The dollar being a global currency the US has an *exorbitant privilege* of borrowing from foreign creditors in its own currency, shielding itself from balance of payments crisis. But this imposes a responsibility of stabilising the system through the provision of liquidity, in particular in times of

crisis. Washington is openly using the dollar as a tool to complement economic sanctions. Central bank independence is under strain.

Europe is waking up to this reality. We can only rely on ourselves, not on others. The best way to boost our global relevance is to do exactly what we are doing: deepening both the banking and the capital markets unions, and building an euro area budget. These will reassure investors and other agents in financial markets. That is why I am so optimistic.

There are so still many potential economic gains from a fully functioning EMU, and benefits to reap. And still the euro thrives.

We are clearly working within our production possibilities frontier. That is why I remain optimistic about the future.

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The difference between the EU and each Member State taken individually, is that together, we can make a difference in the world today. We have the choice to make that difference.

To follow this example, the Portuguese escudo, or the British pound for that matter, cannot aspire to dominate or even dispute the dominance of the international financial system, as they could centuries ago. Individually we are small, although some still think they are big.

In the future, the world is not going to become less interconnected, less digitalised or even less globalised, despite the latest populist and protectionist tendencies.

Amidst what looks like increasing global political turbulence, we, in the euro area, will continue to keep a cool head and choose the path of solidarity and multilateralism to address current and future challenges.

If we want to continue to have a say, shaping the world financial order with our values and with a rules –based system, the euro is our best and only shot.

Thank you again for having me. Looking forward to our debate on European issues, and that includes Brexit!