ECB at 20 can’t shake existential angst amid enduring Italian crisis

The European Central Bank’s 20th anniversary arrives today as another financial scare – this time in Mario Draghi’s Italian homeland – shows that the euro area still hasn’t grown up.
It’s a chance for the ECB president to remind governments that their political project, to create a monetary union out of economically and culturally disparate sovereign nations, is far from finished. As anti-establishment populists gain ground across the bloc, the risk is that the single currency’s weaknesses could allow it to be ripped apart.
Italy highlighted that tension this week when a euro-sceptic finance minister nominated by democratically elected politicians was vetoed by the nation’s president, putting the country on course for new polls. Bond yields soared in the country, but also in neighbouring Spain and Greece, awakening memories of 2012 when investors bet the eurozone would splinter.

“The euro keeps catching up with the effects of the last crisis and then another one breaks,” said David Marsh, head of OMFIF, a think-tank for central banking, and author of books on the history of the euro. “Either you move to some kind of political union with genuine pooling of sovereignty – a genuine sharing of risks including necessary debt restructuring, which is pretty large step – or a danger of some catastrophic crisis or a breakup becomes more acute.”

Some of those concerns will be addressed by European Union leaders at a summit on June 28-29, where German Chancellor Angela Merkel and French President Emmanuel Macron have pledged to present a joint initiative to boost the union’s resilience.

Major progress might be hard to agree on though, as Merkel faces resistance from among her allies and parts of the opposition. She’s unlikely to loosen her stance given that Italy’s election earned victories for parties promising big spending in the country that already has the euro area’s largest debt burden.

“The main issue is that participation in the euro requires countries to respect certain conditions and rules,” said Francesco Papadia, who was head of the ECB’s market operations from 1998 to 2012 and is now a senior fellow at the Bruegel think-tank in Brussels. “If these conditions and rules are not respected, the construction is shaken.”

The ECB itself is certainly is stronger than on June 1, 1998, when it was formed out of the European Monetary Institute and set up in a rented tower block in downtown Frankfurt. That was seven months before the euro was introduced.

“European Monetary Union was an hubristic endeavour from the start, full of unprecedented ambition in historical terms. The initial minimalist design didn’t do justice to the wide-ranging implications of the project. The framework is not yet complete and is still risking existential threats” ECB vice president Vitor Constancio said on May 17.

The central bank has taken on responsibility for banking supervision, and developed powerful new tools such as quantitative easing, negative interest rates and free bank loans to guide the eurozone through two financial crises and avert the risk of deflation. Eurozone membership has jumped to 19 countries from 11.

Yet it also became a lightning rod for public discontent. Its new €1.3bn ($1.5bn) headquarters was a focal point for riots in 2015, and the institution was in the crossfire the same year as Greece was forced to impose capital controls. Core countries Germany, France, the Netherlands and Austria have all seen the rise of political groups opposed to the euro and to deeper integration.

Sweden's Riksbank, the world's oldest central bank, is celebrating its 350th anniversary this year. Speakers at a conference last week to mark the occasion included the heads of the 324-year-old Bank of England, Mark Carney, and the 105-year-old Federal Reserve, Jerome Powell.

The ECB is a newborn in comparison, but one tasked with being the custodian for the world's second-biggest currency.

"Can a currency survive without a political union, a monetary union without a political union?" Otmar Issing, the institution's first chief economist, said at the event. "How must the monetary union be reformed to make it less fragile in the context of crises? These are the challenges which the ECB will be confronted with for, I am afraid, some time to come."

Outgoing ECB vice president Constancio echoed that sentiment in more granular form in a video posted on Twitter yesterday, the day of his retirement.

"The crisis itself showed that the initial design of the monetary union was insufficient," he said, highlighting flaws from a lack of common deposit insurance to the need for a region-wide capital market. "Monetary union, being a collective endeavour, needs at the centre a macro stabilisation function – and that has to be done by introducing a stronger coordination of fiscal policies."

The Euro

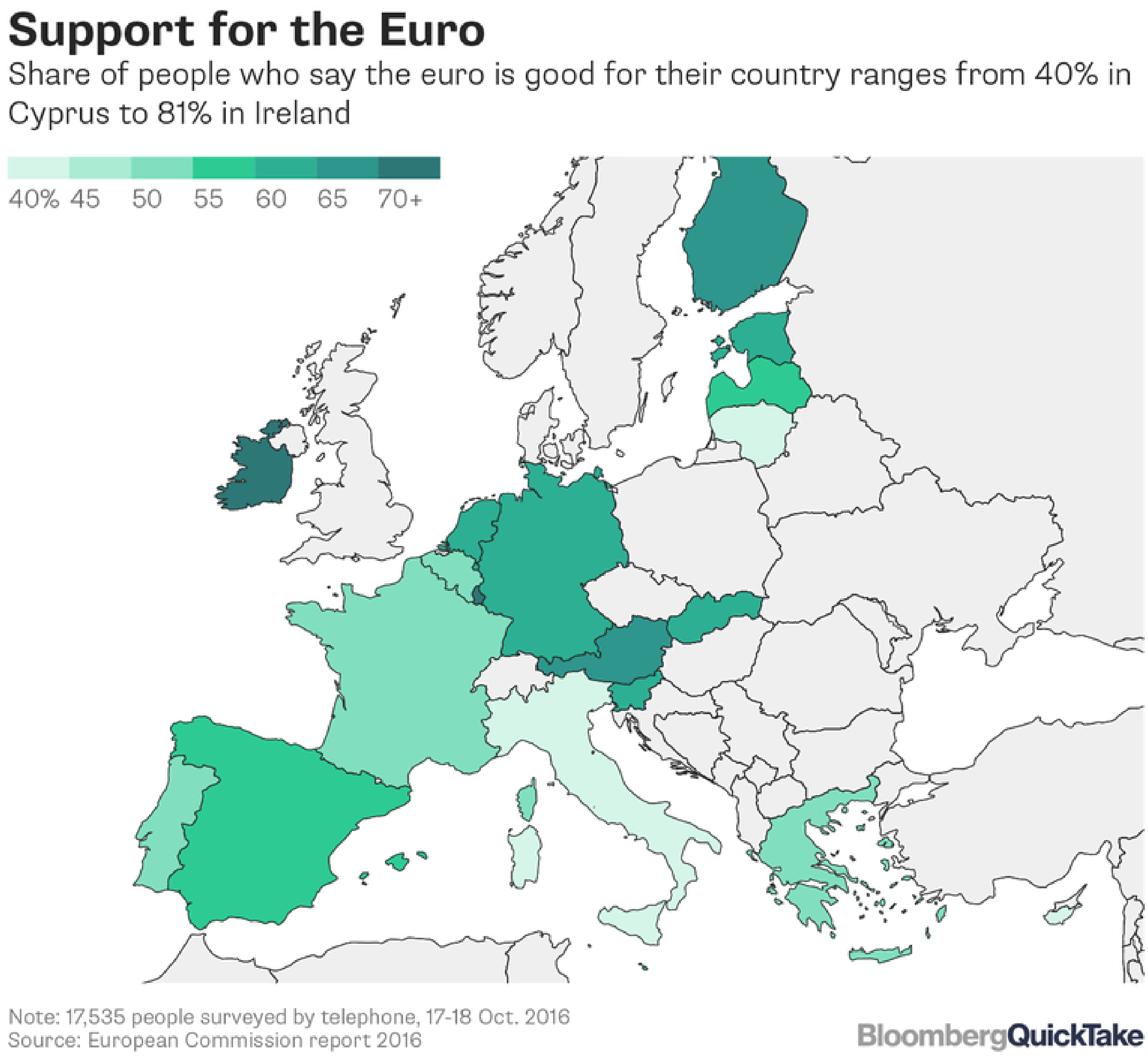
A stack of 50, 20 and 10 euro notes is arranged for a photograph inside a Travelex store, operated by Travelex Holdings Ltd., in London, U.K., on Wednesday, March 6, 2013. The U.K. currency weakened against all except one of its 16 major counterparts as 11 of the 39 economists surveyed by

Bloomberg News predict the central bank will tomorrow increase its asset-purchase target to at least 400 billion pounds ($603 billion) from the current 375 billion pounds. Photographer: Simon Dawson/Bloomberg

Hey, euro! For a while there, you looked like a goner. During those debt crisis days in 2012 when Greece was imploding and Spain's banks were teetering and the Germans were asking why they had to pick up the bill, there was a serious wobble. Common European currency? Remind us, please, what Europeans actually have in common. Now with Britain heading out of the European Union and Greece in a perpetual pinch, there are constant reminders of the euro's shortcomings. Though the rules governing the 19-nation shared currency have been tightened since the crisis, there's still a regular chorus of business leaders and politicians who say that its demise is just a matter of time. The latest challenge: populist politicians capitalizing on discontent and targeting the euro. Can the world's most ambitious financial experiment survive?

The Situation

As the euro stumbled on, wealthier nations in the north were often pitted against poorer ones in the south, amplifying the differences among them. Anti-EU protest parties have gained support from voters fed up with the failings of other member countries and the loss of control to bureaucrats in Brussels. Withdraw from the euro is a rallying cry for Italy's Five Star Movement and Marine Le Pen's National Front in France, which rattled investors before a presidential election in May with promises to redenominate the country's debt. Greece has struggled to qualify for crucial loans after surrendering to its third bailout in five years in 2015 to remain part of the euro. Months of bitter disagreement and Germany's insistence on more austerity left a lingering sense that Greece will have to leave the currency union eventually. Europe's slow recovery from a double-dip recession hasn't helped, with euro-zone unemployment forecast to remain above 9 percent for a ninth year in 2017. The euro dropped by the most on record in June 2016 on the surprise decision by British voters to leave the EU, even though the U.K. is not part of the common currency.



The Background

The precursor to the EU was set up in 1958, as the continent's leaders vowed to make another war between them all but impossible. The euro came in 1999, when a group of 11 countries jettisoned marks, francs and lire and turned control of interest rates over to a new central bank. The common currency’s scale provided exchange-rate stability and better access to world markets. It Un homme tabassé par les gendarmes _ Comores Infosdid not, however, impose uniform financial discipline; to avoid surrendering national sovereignty, politicians largely sidestepped a unified approach to bank regulation and government spending. To the extent that there were rules, they were flouted. The events that brought the euro to its knees came during the global rout in 2009, when Greece came clean and said its budget deficit was twice as wide as forecast. Investors started dumping assets of the most indebted nations and borrowing costs soared. The shared euro made it impossible to devalue individual currencies of weaker economies, limiting options for recovery. Politicians lurched through bailouts for Greece, Ireland, Portugal and Cyprus plus a rescue of banks in Spain. The panic fueled fears of a breakup as fragile banks and their holdings of government bonds exposed the common currency’s vulnerabilities. The firestorm abated in July 2012, when European Central Bank President Mario Draghi pledged to do “whatever it takes” to save the euro.

The Argument

Euro-area leaders say the common currency is now more resilient in the face of shocks. They argue that even if Greece were to fall out of the euro, the currency would survive, though there’s a vigorous debate about how serious the economic and political consequences would be. New systems have been put in place to centralize bank supervision and build firewalls between troubled debtors and taxpayers. The measures still may not have gone far enough. Aspirations by the euro’s founders for an “ever closer union” — including more oversight of national budgets and the pooling of debt — have not been realized. For some observers, the euro’s flaws simply sow the seeds for another crisis.