

2012-10-08

PRESS RELEASE

What is the role played by the Eurosystem during the financial crisis?

(Article for the September 2012 Economic Review)

For more than five years now, the world has been beset by a financial and economic crisis. In the euro area in particular, tensions have been running high since the sovereign bond markets of a number of countries have come under increasing pressure. The article shows how the Eurosystem has acted as an intermediary for individual banks and, on account of the segmentation of the financial markets along national borders, even for entire national banking sectors. This policy offers the players involved the time to arrange the orderly implementation of the necessary structural measures which offer a way out of the crisis.

During the financial and economic crisis, the Eurosystem took a range of measures. The monetary policy stance was considerably relaxed, while also non-standard measures were taken, under the heading of "enhanced credit support", aimed at providing the banks with sufficient liquidity and thus underpinning the smooth flow of finance to the euro area economy. Financial stability is in fact a necessary precondition for the maintenance of price stability. However, such an accommodative policy is not without its risks: not only financial risks for the central bank, which temporarily takes over the role of the private sector, but also the potential negative macro-economic side effects of a persistently accommodative monetary policy.

Owing to the increasing mutual contagion between governments and resident banking sectors, a number of national banking sectors faced severe difficulty in preserving access to market funding on sustainable terms. In the vulnerable countries, recourse to the Eurosystem as an alternative source of funding therefore expanded considerably, while banks in countries with sound fundamentals increasingly placed their surplus liquidity with the central bank. As a result, the Eurosystem's balance sheet expanded and the TARGET2 positions of the national central banks reached unprecedented levels.

However, the Eurosystem's increasing activity as a financial intermediary does not offer a lasting solution to the challenges currently facing the euro area. In this way, the Eurosystem can buy time though for the economic players concerned to implement the structural adjustments necessary to regain sustainable access to market funding. Not until all the players involved – financial institutions, governments and, in some countries, the non-financial private sector - have implemented those structural adjustments, and the confidence of the financial market participants has been restored, will the official sector – and particularly the Eurosystem – be able to phase out its role as a financial intermediary. There is also a role here for a strengthening of EMU, e.g. by the development of strong financial safety nets, strict adherence to the rules on economic governance, and the development of a fully-fledged financial and fiscal union.