Jörg Asmussen: Interview in *Börsen-Zeitung*

Interview with Mr Jörg Asmussen, Member of the Executive Board of the European Central Bank, in *Börsen-Zeitung*, published on 12 September 2013.

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The summer in the euro area was rather quiet this time – compared with previous years. After the ECB's summer break, do you feel properly relaxed and fit for the next all-night crisis talks in Brussels?

I've been back at work since the second week of August. It's almost a tradition at the ECB for German Members of the Executive Board to take an early summer vacation and then hold the fort in August. So my vacation is already just a memory.

But on a serious note: how hot will it get in the much forecasted "hot autumn", with new discussions about Greece, Ireland, Portugal and Co.?

"Hot autumn" is an interesting term, but I think it's overestimated. Even if many people, for widely diverging reasons, think that the world will look different on 23 September – following the parliamentary elections – it is not true. The introduction of the eurobonds and the end of consolidation, etc. will not come about on 23 September either. Instead, in this autumn too, we will have to gradually confront the existing difficulties.

What is the most pressing topic?

Greece will certainly be at the top of the agenda again, with two urgent issues that will need to be resolved this autumn under the ongoing programme. First, it is set to run a budget deficit in 2015 and 2016 that will need to be corrected during the Troika programme review at the end of September, because Greece has introduced a medium-term fiscal strategy. Second, the ongoing programme reveals a financing gap in the second half of 2014 on the part of the donor countries, which will also need to be closed to ensure the involvement of the International Monetary Fund (IMF), because IMF involvement requires a programme that is fully funded for 12 months in advance.

Is that the gap of around EUR 4 billion up to EUR 4.5 billion?

I'm always amazed at the kind of speculation heard about such figures.

That figure was given by the Minister of Finance Wolfgang Schäuble.

The exact amount cannot be quantified at all yet, and I wouldn't like to speculate. The level will for one depend on the extent to which Greece will be able to privatise assets. The more assets that Athens privatises, the narrower the gap will be.

Greece will have to return to the capital markets in 2014, because government bonds will mature. Will it manage to do so? And if not: how will the ECB, which holds a large part of these bonds, react?

According to the Greek Minister of Finance Ioannis Stournaras, Greece will try to return to the capital markets in the second half of the year. That is the right thing to do, and it remains to be seen if it will succeed. In any case, we as the ECB assume that the bonds we purchased under the Securities Markets Programme (SMP) will be fully repaid.

One option would be for the ECB to transfer the bonds to the European Stability Mechanism (ESM), which would be more flexible, in respect of, say, maturity extensions.

That idea crops up repeatedly, but I don't think it would be at all feasible politically. We will hold the bonds until maturity under the SMP programme.

And when will a decision be made on "Greece III"? Will there also be a haircut?

If the country does not succeed in gaining full access to the markets for 2015, the question of a supplementary programme will arise in the course of 2014. But the main concern now is the implementation of the ongoing programme – not what happens after that.

Another urgent topic is Ireland. The rescue programme finishes at the end of this year. If there is to be more help, a decision would need to be taken soon.

But it's also possible that the Irish will find their own solution.

The Minister for Finance Michael Noonan has, however, announced that Ireland is seeking a precautionary credit line from the ESM to the amount of EUR 10 billion in order to safeguard its return to the capital markets. Would that suffice as a prerequisite for the ECB to purchase Irish government bonds under its Outright Monetary Transactions (OMT) programme in order to support prices if necessary. Noonan has indeed expressed his hope that the credit line would not be linked to new conditions.

I have of course read what he said. He knows that a precautionary ESM programme also involves conditionality.

But that is limited to a country's adherence to the Stability Pact and other EU regulations. There are no new conditions requiring reforms. Is that sufficient for the ECB?

OMTs can only be activated under the conditions that have been made known: a country requires an ESM programme, and that may also be a precautionary programme with the option of the ESM engaging in purchases in the primary market. Another requirement is IMF involvement. But it's particularly important, and we have said this repeatedly, that countries under a European Financial Stability Facility (EFSF) Programme must be in a position to regain full access to the capital markets. Treasury bills, for example, are not sufficient. OMTs are a monetary tool, not a substitute for a lack of capital market access.

But OMTs can also be used to help countries to regain this access – they don't need to have it already.

The ECB Governing Council will evaluate that in each case, based on considerations such as: does the country have an issuance calendar? What volumes does it issue? Can it present a complete yield curve? A decision will then be made.

In Portugal the government itself is talking of a second rescue package and is hoping for a further relaxation of the conditions. Will Portugal need more help and will it receive it?

The country was set back by the political uncertainty in the summer. This uncertainty has now been overcome and the country can and should take up from where it stood in the spring of this year, when it was able to successfully issue a long-term bond. Market confidence could be won back through a full implementation of the programme. That is why it is essential to keep to the existing programme and all its objectives.

The debate on a second package is heard in Cyprus too. Not least because the collapse of the economy was worse than forecast. When can we expect "Cyprus II"?

This question never ceases to amaze me. The Cyprus programme has not even been operating for six months and it has a duration of three years. I fail to understand why the question of a supplementary programme is already being raised. Cyprus must now implement the programme. There has been one review so far and that was successfully completed. The issue now is to continue the programme – nothing more.

Not much has been heard about Slovenia recently. Will that country seek a rescue package if the ECB's asset quality review exposes all the trouble in the banking sector?

Slovenia is now conducting a separate stress test for the country's ten major banks. The results will be available in late November or early December. We will then know what the capital shortfalls are and whether they can be covered. Moreover, the state of the banking sector is a serious problem for the country, but not the only one. Slovenia has inefficient state enterprises, attempts to introduce pension reform have failed twice and it is running a larger budget deficit than EU regulations allow.

Many people are also concerned about the heavyweights France and Italy. Some observers fear that both countries are completely incapable of introducing reforms. How frustrated are you and your ECB colleagues that the large countries are not making better use of the time that the ECB, too, is "buying" for them to introduce reforms.

Let me say one thing first: we all have a strong interest in an economically strong France. The entire construction of the euro area can only function with a strong France. The latest pension reforms are a step in the right direction but do not go far enough. I also see problems regarding the intended funding through higher taxes and contributions, rather than through specific spending cuts. Besides, the plans also contradict the EU Commission's country-specific recommendations. The bottom line is that France will need to do more to enhance its competitiveness. The government will need to speed up the pace of reforms.

And Italy?

Much was achieved through fiscal policy efforts under the former prime minister Mario Monti. It is now important to ensure that these successful achievements are not eroded. The latest retreat in respect of property tax also conflicts with the EU's country-specific recommendations. Italy has one major problem: its extremely slow potential growth, which by all estimates hovers around 0%. That is what needs to be addressed, everything revolves around that.

But how likely do you think it is that something will change. Surely the examples point to the conclusion that reforms might be successfully pushed through were it not for the lack of a sustainable political willingness to reform.

I am basically more optimistic. Reforms will be made under the pressure that something has to be done. If there is no compulsion – through pressure on interest rates, say, or a high level of unemployment – nothing will happen. That not only applies to the current problem countries but also to Germany.

But many critics actually accuse the ECB of eliminating this market pressure by adopting OMTs.

I don't think that reproach is justified. OMTs are not aimed at harmonising interest rates on government bonds in the euro area. What we wanted was to eliminate the unwarranted redenomination risk from the interest rates. The pressure to reform is still high, but it comes mainly from the high level of unemployment, especially high youth unemployment.

Besides the reforms in the individual countries, reforms are proceeding in the euro area itself. Banking union is a key issue. Before the ECB takes on banking supervision, it wants to conduct a rigorous asset quality review. In carrying out this review, is it a condition for the ECB that countries commit themselves in advance to covering a capital shortfall if necessary?

This asset quality review will provide clarity about the banks' balance sheets. Of course we don't want to take on any "bad eggs"; the reputational risk is ours alone. However, from our perspective, a lack of clarity about the balance sheets is one of the main obstacles preventing banks from extending more credit. Clarity would also improve the functioning of the interbank market. In that sense, the review is not a threat but an opportunity. If it is to be a success, we must know what will be done should a capital shortfall emerge. If there is no answer to that, people will suspect that the review was too favourable. That doesn't help anybody.

So you are confident, all in all. But some observers find that the crisis is unresolvable, pointing to what they see as unbridgeable conflicts of interest.

Yes, I have a fundamentally different view. Look at what has happened since 2012, much of that would have been hard to imagine in advance. To name a few examples: the fiscal compact, the German-style debt brake in 25 EU countries, the steps towards banking union with the single supervisory mechanism and the ESM. I am aware that the ESM is controversial in Germany, but as a crisis management tool that did not exist before, it nonetheless fills an institutional gap. I am optimistic that Europe will come out of the crisis stronger and more robust.

But that won't be true of the euro area's growth potential, will it? Many economists now think that will be much lower.

We don't traditionally publish our estimate of that. However, we must work on the assumption that the potential growth rate has slowed down – owing to the lower use of labour and, especially, the fall off in investment. The long-term development is still unclear. If the crisis is used to push through the necessary reforms, potential growth may accelerate. But we also need to consider the rapid ageing of the population, which will depress potential growth.

Let's now look at the current situation. The ECB is more sceptical than many economists – many would even say "pessimistic" – when it comes to the economic outlook. What is that assessment based on?

I wouldn't say that we are pessimistic. We are currently seeing the confirmation of what we have been expecting since December: the euro area is recovering very slowly in the course of the year, and that improvement will continue next year. However, there is no reason for our growth forecasts to go shooting up, and that is why we remain cautious.

And that is why the ECB is continuing to try to use its forward guidance to shield the euro area economy from rising market interest rates in the event that the ultra-loose monetary policy in the United States comes to an end?

Our forward guidance comprises two elements: it aims to further clarify our views regarding the economic situation and the manner in which we intend to react to it. It is important to note that the United States and the euro area are at completely different stages of the economic cycle. Here in the euro area economy, an imminent change in the direction of monetary policy would certainly come far too early.

But how realistic is decoupling from the United States? The markets, at any rate, don't seem to have all that much faith in that prospect, if you look at the rising money market rates.

I think it's a little early to be judging that. Overall, we believe that we've been successful in reducing the volatility of rates. We've been moderately successful as regards the actual level of interest rates. Rates have risen on account of positive economic data. It remains to be seen how the situation will develop in the likely presence of further cautiously positive data.

And if things do not go according to plan, will the ECB reduce its key interest rates again or conduct new LTROs?

We will continue to monitor the situation. We haven't said any more than that. Sometimes you have to keep calm, rather than coming up with something new every month.

Why is the ECB not publishing inflation projections beyond 2014? If those projections were below the 2% mark, that could be a strong signal that an increase in key interest rates was not to be expected in the foreseeable future.

We have just published our updated inflation projections for 2013 and 2014. Both are less than our target of "below, but close to, 2%". We will publish projections for 2015 in December.

But that's not for another three months, and the Federal Reserve's policy could cause considerable volatility in that time.

Thus far, all private sector forecasts see inflation in the euro area being significantly less than 2% in 2015, as do the forecasts of other public institutions, so there's no big secret.

Is it conceivable that the ECB will, in the future, link its forward guidance to a specific inflation target?

We haven't done that so far.

There are a few things that you used not to do, but now do.

That's true, so that remains to be seen.

But you still don't see any deflationary risks for the euro area? Some economists say that it's not enough to just look at stable inflation expectations. They fear a balance sheet recession and debt deflation, as in Japan.

No, we don't see such risks, and I don't think we're underestimating them, either. It is quite clear that the inflation target is symmetrical. But at the moment, we see neither inflationary nor deflationary risks.

In the future, the ECB intends to publish accounts of its meetings. You have clearly argued in favour of indicating who voted for what and why. Now it seems that these will be more like summary accounts indicating the primary arguments.

My opinion has not changed. I do indeed believe that demands are higher today in terms of transparency. The ECB was once right at the forefront in this regard, when it introduced its monthly press conferences. Now, though, we are lagging way behind when you see what other central banks are doing. That's why I believe that publishing accounts that summarise the general course of the discussion would be helpful. I personally would also be in favour of indicating how people voted. That would require all members of the Governing Council to explain how their own arguments and their own voting behaviour were in line with the ECB's European mandate.

What about the argument that individual central bankers would then be put under pressure?

I think the concerns that the pressure would become too great have been exaggerated. Someone who takes on a job like that must be capable of withstanding pressure. Nobody will be put in prison for voting for an interest rate rise in the euro area. People shouldn't be that sensitive in this regard. I was in favour of OMTs because they were – and still are – the right response for Europe, despite the fact that many in Germany are opposed to them.

The OMT programme has made a significant contribution to the easing of the euro crisis. Many observers fear that the forthcoming ruling by Germany's Federal Constitutional Court will impose strict limits on OMTs, and that this could trigger turbulence. How big is that risk?

I don't know how the judges in Karlsruhe will rule either, and I have great respect for the court – from one independent institution to another. I think, though, that the views of market participants in New York, Frankfurt and Hong Kong are quite clear: the OMTs are fine the way they are, without any limitations being imposed.

Is it really realistic to assume that the mere announcement of OMTs will be sufficient in the longer term? Jens Weidmann, President of the Deutsche Bundesbank, has said that one lesson from the crisis is the fact that announcements will be tested.

The principle of deterrence also applied in the cold war. But what matters is that we are completely ready to act. When the necessary conditions have been met, we will take a monetary policy decision.

We've had extremely low interest rates worldwide for a long period of time, combined with unprecedented non-standard measures. The Bank for International Settlements (BIS) is warning that, this time, the exit will be even more difficult than in the past. Is it actually possible to exit this situation without turbulence?

Otmar Issing said that an exit was a question not of technical possibilities, but of political will. This exit will certainly be more complex on account of the non-standard instruments. But yes, I am of the opinion that an exit without turmoil is possible. It just needs to be communicated clearly.

William White, former chief economist at the BIS, warns that the current ultra-loose monetary policy has long been creating new threats to financial stability.

There are good reasons why interest rates are currently at the level they are. However, it is also clear that if you keep rates low for a long period of time, that will have many side effects, such as misallocation of capital and reduced pressure for structural reforms. We must not lose sight of those side effects.

And, if necessary, push back against erroneous developments in the markets by means of interest rate rises – "leaning against the wind", as it's called in economic jargon?

I think the number of arguments in favour of "leaning against the wind" has indeed increased in recent years. But at the same time, our mandate at the ECB is clear. Our primary objective is price stability, and only if that is achieved does the Treaty on the Functioning of the European Union provide for us contributing to financial stability. Those objectives have a clear hierarchy.

What are the major lessons that the ECB – and central banks in general – should learn from the crises of recent years?

As I have said, I think the main thing has been the increase in the significance of financial stability. There has been a tendency during the crisis to shift responsibility for banking supervision to central banks, making them responsible for macro-prudential supervision. As regards the euro area, one important thing has certainly been the realisation that our monetary union was incomplete. You can draw two conclusions from that: you can decide to scrap it altogether, which would, in my view, be a mistake; or you can decide to complete it. The banking union is the first step in that direction, but not the last.

Many experts think that another necessary lesson is the importance of stronger international coordination of monetary policy, as action at national level is increasingly having spillover effects. They also point to the recent turbulence in emerging economies as a result of the debate surrounding the Federal Reserve.

Perhaps I should first say a few words about the turbulence in emerging economies. The weakening observed in many countries is certainly related to the reversal of capital flows. However, it is also the case that this weakening is particularly affecting emerging economies that have large current account deficits and have failed to carry out reforms. You can protect yourself from such developments by doing your homework.

And with capital controls? Even the IMF is no longer strictly opposed to those.

I am very cautious in that regard. There are certainly extreme situations where that instrument can be used. But in normal situations, there is no doubt that free movement of capital supports growth.

But let's go back to international cooperation. Would that be appropriate, and would it be feasible from a political perspective?

I don’t think the answer here is black and white. On the one hand, every central bank has a national mandate. And I don’t think that will change in the foreseeable future. On the other hand, there is already some coordination – at the BIS, at the G7 and at the G20.

The latest G20 summit has just ended. Little came of it. Are you disappointed?

The summit was clearly overshadowed by events in Syria. I think the fact that the issue of tax avoidance and tax structuring is now being raised at G20 level is a positive development. There was some limited progress in terms of financial regulation. However, I was indeed disappointed by the decisions made in the area of fiscal policy, as the United States and Japan in particular – especially the latter – have no credible medium-term consolidation plans. These are required as a matter of great urgency.

You have talked about the reform of the global financial system. Almost exactly five years after Lehman Brothers, where are we exactly?

I do think that the global financial system has become more robust. However, it’s quite clear that we are not yet where we should be. Progress is urgently needed on the “too big to fail” issue, which primarily concerns the complexity of these institutions. The second issue is shadow banking. It is true that we have tightened up the regulation of banks. However, that leads to shifts into other areas. Consequently, the risk may not ultimately be any smaller; it may just lie somewhere else. That must now be followed up.

Is it not now the case that regulation itself is too complex?

That is a legitimate question. However, if you establish simple rules, that comes at the expense of fairness in individual cases. That is true of the leverage ratio, for example. That certainly has disadvantages and may be unfair in individual cases. But it’s a rough initial guide that we can work with. I’m also convinced that there will be a Basel IV – and that will be simpler than Basel III.

Will it also put an end to the situation whereby no capital needs to be held for the government bonds of EU countries? The Deutsche Bundesbank in particular is pushing for the abolition of this zero weighting and limits on the amount of government bonds that financial institutions are allowed to hold.

The ECB does not yet have a position on that. My view is that consideration should be given to amending the zero weighting in the medium term. I would not do that today, though. I would do it after the crisis. And I would only do it if it was coordinated at global level. Action on that needs to be taken at international level.