Benoît Cœuré: Interview in *Il Sole 24 Ore*

Interview with Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, in *Il Sole 24 Ore*, conducted by Mr Alessandro Merli on 25 April and published on 27 April 2016.

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Last Friday in Amsterdam the Economic and Financial Affairs Council (Ecofin) discussed a Dutch presidency proposal to change the rules on sovereign debt holdings in banks' portfolios. That was opposed by a majority of countries. What happens now?

There were clearly different views among ministers and they agreed that the issue needs to be investigated further. It's a long technical process. Several participants, including the ECB, made the point that we should seek to achieve global consistency. We should have as level a playing field as possible in banking regulation. To be honest, I was never totally convinced by the argument that there cannot be a European discussion on sovereign risk: the bank/sovereign nexus exists everywhere, but in the euro area it's unique in its intensity and there is an acceptance that it has been a major contributor to the euro area crisis. But any European answer has to be set against a global background. We need to wait and see how the discussion develops in the Basel Committee. That was very much the tone in Amsterdam.

The Germans, and a few others, make the point that there cannot be a European deposit insurance scheme (EDIS), which the ECB says is an essential part of the banking union, without a solution to banks' sovereign exposure. So, if EDIS is put on hold, does that mean there will be a long delay before a common deposit insurance is introduced?

The exclusive link between the two is a political construction. There are at least three dimensions to the issue of sovereign risk. One has to do with the risk in banks: that is clearly tied to EDIS. Progress in risk sharing has to be combined with progress in risk reduction. It makes sense in economic terms and it makes sense in political terms. But if we want to examine all the consequences of putting risk weights on sovereign bonds or setting a limit on exposure, they are not just about risk in banks. They also have an impact on how governments fund themselves. In Europe, unlike the US, most government bonds are purchased by banks. So any change in sovereign exposure for banks would also have consequences for government funding. This second dimension ties in with the discussion on fiscal union. There is also a third question: the need for financial markets to function with risk-free assets. So, if we start considering government bonds as risky, that is good in terms of discipline for banks, but it can also create systemic fragility and have an impact on the functioning of capital markets. That is no excuse not to discuss the issue. But we need to understand all the consequences and in all likelihood it will lead to a process that will be phased in over a very long period so that the consequences can be managed and anticipated more closely by governments, banks, and market participants.

The ECB published a legal opinion last week saying that the deposit insurance scheme should not be conditional on issues whose solution in uncertain, as would seem to be the case with this discussion on sovereign risk. What happens if Germany asks for EDIS to be put on hold until the sovereign risk issue is solved?

The two discussions will continue in parallel. What the ECB has argued in its legal opinion[1] is that in the event of a conditional phasing-in of EDIS, any milestone on risk-reduction would

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[1] https://www.ecb.europa.eu/ecb/legal/pdf/en_con_2016_26_f__sign.pdf

have to be precisely defined ex-ante. Banks and depositors need to know what the timeframe and conditions will be. I expect the two discussions to take time, as there are many unresolved questions. The Dutch Presidency has already made clear that it will be passing this dossier to Slovakia next semester.

In Amsterdam, there was also a discussion on Greece, with an agreement that the government should adopt contingency measures to be triggered if it fails to reach the targets set out by the programme, but no immediate progress on debt relief. Are we in for another long, hot summer of Greek drama?

On Greece, I am cautiously optimistic. There has been good progress in recent weeks, and in the few days before Amsterdam's Eurogroup meeting. The Greek government has been committed in moving towards a solution that delivers on the programme agreed last August. The review is about implementation. The Greek government has moved closer to the institutions: there is near agreement on the measures to be taken, including in the difficult areas such as pension reform and personal income tax. That is promising. We are not 100% there yet, but we are close. It's time to discuss the next step: the fiscal path until and beyond 2018, debt sustainability and whether debt measures will be needed. The mission chiefs are back in Athens. The priority this week is to agree on contingency measures, which I see as an insurance in the event that the IMF fiscal scenario, which is more conservative than the European one, materialises. It's not surprising that there are different views, as there is so much uncertainty. At this point it's a discussion about risk management and how to hedge against risk. These are measures, if the scenario of the Commission, the ECB and the ESM is the right one, that Greece will never have to implement. On debt, the uncertainty is even greater, as we are talking about what happens after 2018 and in the longer term. The debt sustainability analysis will hinge on assumptions about long-term growth, primary surpluses, and interest rates. On this basis, I expect debt measures to be needed to address risks to debt sustainability.

When will this go back to the Eurogroup?

As soon as possible, as there is a value in not waiting too long. The Greek economy has the potential to rebound when depositors bring their money back to the banks and banks can again lend to the economy, and when foreign investors come back. But of course all of this assumes that the Greek government delivers the agreed reforms.

The Greek banks are still receiving massive support from emergency liquidity assistance (ELA)…

They are now in a solid capital position, having been recapitalised. The main issues are access to liquidity, which depends on overall confidence in the Greek economy, and a high level of non-performing loans (NPLs), which should be addressed in a decisive manner.

On monetary policy, you claim that your measures have been a success. But eventually that will be measured on your results on inflation. Inflation is at zero and inflation expectations are at a low. The markets don't seem to trust the ECB

This is not a question of trust in the ECB. We are in a unique situation in terms of inflation. We have a combination of strong disinflationary forces, which are the legacy of the crisis (namely: high public and private debt, non-performing exposures of banks, high unemployment and, in general, vast unutilised capacity in the economy), and a series of negative external shocks, especially lower commodity prices, all of which explain why inflation is very low and increasing only gradually. But all other indicators show that our monetary policy is working: credit is improving significantly, both in the volume and cost of loans, and economic activity is recovering. Not strongly enough, but it is steadily increasing.

You said you are ready to act with all available instruments, if needed. Should you be doing more? And which instruments, as you have ruled out helicopter money and interest rates seem near their lowest levels?

Let me first reiterate that helicopter money is not something we are discussing or even considering. We announced a very strong package in March and have not implemented all the measures yet. All conventional and non-conventional instruments are available, but we are not having that discussion now.

You have relied on negative interest rates, which by your own admission are "complex" and have a long-term impact on the financial sector. They are also harshly criticised in Germany…

We need to look beyond banks. Our action is not about supporting any particular industry. And even for banks there is evidence that the net interest margin has been rising, not falling. The effect of a low and flat yield curve is offset by expanded volumes and lower risk, which reduces loan loss provisions. This will continue with the recovery. In the long term, if interest rates continued to be this low, that would not be good news for the euro area. But that has nothing to do with monetary policy. It would mean that growth and potential growth had not picked up, which would affect the real return in the economy, the return of investment projects. We don't want to be in that situation. That is why the Eurozone needs to support investment as much as possible. Monetary policy can only contribute to this. We have seen some public initiatives, like the Juncker plan, that go in the right direction.

The IMF is more outspoken than the ECB in asking countries with fiscal space, i.e. Germany, to invest more.

We agree on that. And we have said that fiscal policy and structural reforms should support growth, to alleviate the burden on monetary policy and enhance its effectiveness. Fiscal space can be used for investing in socially valuable projects or, for example, cutting taxes on labour. But we are not in the business of giving detailed advice to governments. That is the job of the European Commission. On Germany, we note that they are spending money to address the flow of refugees. Countries that do not have fiscal space, on the other hand, should not try to invent one. And it's not a good idea to stretch the flexibility, which is there, of the Stability and Growth Pact too much, otherwise it will lose credibility. On structural reforms, all countries can act, and all countries can improve the composition of the budget by cutting taxes and unproductive expenditure.

The legacy of the crisis includes the heavy burden of NPLs on banks, including in Italy, where some measures have been taken recently.

I do not work on the supervisory side of the ECB, but NPLs matter for monetary policy if they hamper its transmission and are one of the factors that weigh on euro area growth, and not just in Italy. In the Italian case, the launch of the Atlante fund is an initiative to recreate confidence and goes in the right direction. It shows the willingness of all the parties involved to address the issue in a swift and timely manner. But beyond that, NPLs need to be addressed at the root, not only in the balance sheets of banks, but by improving the health of the borrowers. We need, for instance, to tackle the fact that SMEs don't have enough equity, or that collateral is too difficult to repossess. Insolvency laws need to be improved, and that is not specific to Italy. The sooner governments act on insolvency procedures and collateral frameworks, the better. In general, the crisis has taught us that recovery in the euro area has been delayed, in comparison with the US, because we were slow in addressing the problems of the banks and there was too much supervisory forbearance. That is why the Single Supervisory Mechanism (SSM) was created and that is why I think supervisors should err on the side of caution.

Central bankers do not like to talk about currency wars and the ECB always says that the exchange rate is not a target. However, with the dollar and emerging markets' currencies weakening, is the euro "losing the war" and therefore making it more difficult for the ECB to reach its target?

The euro has stabilised over the last month after a clear depreciation. It is not an obstacle to our monetary policy. Only if there was a sharp appreciation of the euro would that be a concern.

Did tensions over the exchange rate resurface at the G20 in Washington? And was there a Plaza-style accord in Shanghai?

All stakeholders, not only the G-7 but also the emerging markets in the G-20, agree that exchange rates should not be used for competitive purposes. That was agreed and stated in Shanghai and again in Washington. This is not a secret pact, but a strong joint commitment. The G-20 framework is there to help resist the temptation to use the exchange rate, when aggregate demand is globally weak, at the expense of others. My take-away from Shanghai and Washington is that all participants understood that it's in nobody's interest to start a disruptive process that would trigger uncertainty and volatility in the markets

The ECB is increasingly under fire in Germany, from large parts of the political and financial establishment and from the media. How damaging to your credibility is the constant opposition from the largest economy in the euro area?

It is wrong to discuss our policies along national, or even nationalistic, lines. And there are respected voices in Germany that support the ECB. Some of our critics only see the impact of our policies on themselves and miss the bigger picture. Low interest rates, for instance, are a cost for savers, but they benefit the budget, and savers are also taxpayers. They support growth and exports, and savers are also workers. That is why the ECB is independent, to take distance from short-term politics and vested interests. In Germany there is a strong recognition that central bank independence is an asset, and I don't see that view changing. Anyway, these critiques do not hamper our ability to function. Monetary policy is discussed and voted in the Governing Council, not elsewhere. But we realise that we do not operate in a political vacuum. Indeed, the stronger our political counterparts, the better. It was Tommaso Padoa-Schioppa who spoke very early on of the "institutional loneliness" of the ECB, and his was indeed a lonely voice at the time. But he was right. There has to be a political discussion on how economic policy can help create growth. That's the positive way ahead. Your finance minister, Pier Carlo Padoan, has made some good suggestions on EMU governance and what should be a stronger political centre for the euro area, with which I agree. That's the way forward.