

Peter Praet: Interview in De Standaard

Interview with Mr Peter Praet, Member of the Executive Board of the European Central Bank, in De Standaard, conducted by Mr Pascal Dendooven and Ms Goele De Cort on 3 July 2017 and published on 8 July 2017.

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It looked like a reversal last week. ECB President Mario Draghi's speech in Sintra had an impact on the markets, interest rates increased and the euro strengthened, the markets took it as a signal that an end to the ECB's stimulus is in sight.

I see it more as an evolution in our communications. In essence, we said that the economy is doing better and that growth is looking good. And since the last meeting of the Governing Council the positive news has continued. The tone was rather optimistic regarding growth, and rightly so. But, and this has to do with our mandate, the underlying inflationary pressure remains subdued. This is why we also stress that we should be patient and persistent regarding our monetary policy.

Proof that your policy of quantitative easing has worked?

Some people said that this policy would create hyperinflation whereas others thought that, at best, it would have no effect. Low interest rates would supposedly not lead to more investment and growth, but they have in fact had a very favourable impact. Not only in the real estate market but also elsewhere. It was also said that people would start to save more and spend less in order to compensate for the loss of interest income and to secure their retirement. But the saving rate has remained stable. Only investment was more sluggish than we had hoped, but that is picking up now. Surveys among SMEs show that they no longer find it so difficult to obtain loans.

Nothing new, in your view, but a sharp market reaction nonetheless. Have markets not become overly focused on messages from the ECB? Is that still a healthy situation?

It's true that in the short term there was a clear reaction. People also had the impression that it was a sort of "coordinated" action by different central bankers but that wasn't the case.

Our message was very nuanced. The thing is, deflationary pressures were considerable in 2015. At that time, we faced negative shocks to the economy. There was a sense of urgency. That no longer applies.

Now indeed inflation is picking up, but that is a process that is a long way from completion. From an inflation perspective, we cannot be satisfied yet.

We need patience and persistence. We need to be patient because inflation convergence needs more time to show through convincingly in the data. And we need to be persistent, because our baseline for future inflation remains crucially contingent on very easy financing conditions which, to a large extent, depend on the current accommodative monetary policy stance.

The Bank for International Settlements (BIS) says that we should increase interest rates so as to keep some ammunition in reserve in case we encounter difficult times again. But if we increase interest rates and tighten policy too quickly, we could jeopardise the recovery and end up further away than ever from our (inflation) target.

The ECB has pumped more than €2 trillion into the market. How confident are you that all those funds can be absorbed in an orderly manner?

The ECB Governing Council will discuss the conclusions for monetary policy and what this

means for quantitative easing. I can't say anything about that yet. We do say that we still need a long period of accommodative policy before we are ready.

As the economic prospects brighten, higher expected returns on business investment will make borrowing conditions increasingly attractive. This will reinforce accommodation and make sure that inflation sustainably converges towards our objective of below, but close to, 2% over the medium term.

Growth is picking up and unemployment is going down, but wages are not really increasing. Doesn't that totally contradict traditional economic theory?

Wages are also a reflection of the past. Wage increases are partly based on current inflation rates and they are relatively low at the moment. Let us also not forget that the level of unemployment is still high. That merely underlines that the process of reflation is a long one that remains highly dependent on accommodative monetary policy.

But will the wages still evolve in the same way as before, now that all kinds of new factors are emerging such as computerisation, flexible jobs, etc? Are the ECB's instruments still reliable?

Well, how do you measure the impact of China on international competition, of e-commerce, of automation? We have many internal discussions about that, about whether something in the inflation process has broken down. The Phillips curve (which shows that wages rise when unemployment falls) is not broken, but it is flatter and the process is slower. Wage inflation is on the way, but we need to be patient about these things.

Wages are not increasing very much and most of the newly created jobs offer less attractive terms of employment.

Some labour market developments are positive but others negative. People aged over 50 are returning to the labour market; that came as a surprise to us. And we also see an increase in labour market potential owing to migration, especially from central and eastern European countries. Because of migration from those countries, Germany still has a significant labour supply despite having a high level of employment.

Some of those central and eastern European countries, such as Poland, Hungary and the Czech Republic, are now experiencing stronger wage inflation. That will spread. The more people who are employed, the bigger the increase in disposable income, the more that is spent.

On the other hand, we see that youth unemployment is particularly high in a number of countries and that getting young people into jobs is not easy. Another factor influencing wage inflation is that more people are working as self-employed. We are increasingly seeing a dual labour market. Even in the civil service. On the one hand, you have insiders with an attractive job and a high degree of protection and on the other, the new employees who do not have the same terms, work under more flexible contracts and can be let go more easily.

Of course you might say: so what's the problem? That is part of market reform, it's good for the economy. Don't forget that, in this way, quite a few people can avoid long periods of unemployment. Those new jobs create earnings and stop people from losing their skills. On the other hand, there are also risks if the labour market reforms lead to a dual labour market, not only from an ethical standpoint but also because economic growth is not "inclusive". For that reason, I see a role for the government in correcting the negative redistribution effects of reforms.

It's a fixed component in President Mario Draghi's speeches: governments also need to introduce structural reforms, monetary policy cannot do everything. Has Belgium made sufficient use of the low interest rates to introduce the necessary reforms?

I don't like commenting on government policy, and certainly not on that of my own country. But speaking in general terms, I can say that the pension reforms were good decisions in countries such as Italy and Belgium. Belgium has also undertaken a small measure of labour market reform.

The point is that it should also be possible to do so. In Belgium the debate on the reform of corporate tax, for example, has been going on for quite some time. There is still a heavy reform agenda. Much still needs to be done and not everyone agrees on how to go about it.

The risk is that the appetite for reform will wane as the economy improves. People have a tendency to lean back and take a break.

Is that what's happening in Belgium now?

Not only in Belgium. There is a sort of honeymoon atmosphere. Times have been hard and people would like to take a break from reforming and enjoy the improvements for a while. There's a kind of reform fatigue. But not everyone is enjoying the recovery because unemployment is still too high and there are differences in contracts between insiders and outsiders, etc.

But it has to happen, because monetary policy can't fix everything. France is a good example. The financial situation there was not much different to that in Germany. There was no banking crisis in France. But growth has been weaker in France than in Germany, because German industry was able to adapt, to focus on new markets – first China, then the United States. They have more SMEs that are export oriented, whereas French industry is much more dependent on a number of national champions. This shows that there are limits to what monetary policy can do.

Critics are saying that the ECB's low interest rate policy is reducing the incentive to reform.

Governments should have made more use of the low interest rates. But the fact that there has been too little reform isn't because low interest rates are making it easier for them to muddle through. Rather, it's because they aren't managing to sell the reforms. I talk to politicians regularly and they all know what needs to be done. But they are also afraid that they won't get elected again afterwards.

I hope that the general public, through seeing better and better results, will start to grasp the importance of reforms.

Will the [rise of the far left] PTB party in Wallonia have a major impact?

Yes, I've seen it. But take Macron: he's been able to build a movement because there was a window of opportunity to go for reforms. But that has nothing to do with the interest rate. In France the public voted for Macron because they want changes, but we have yet to see which ones will actually get through.

In Belgium the Government also started out with reform ambitions.

Yes, indeed. Lots of governments have good intentions. The OECD has commented positively on that recently.

Above all, reform means getting people on board. I sometimes take a taxi and I often talk to the taxi driver. Many of them have paid huge sums for a licence, which they intend to sell later to guarantee themselves a pension. It's only logical that the taxi drivers will fight for their jobs. If you suddenly changed the rules to try to break the taxi market open, it would really cost a lot of money. Let's assume that in the Paris region alone there are more than 30,000 taxis. The costs

for a licence can be as high as €200,000. If you want to buy out those rights, you're already talking about billions. Those are amounts that are suddenly macroeconomically relevant.

This is what you also see with labour market reforms. The incumbents, the insiders, are protected when there are reforms, while the newcomers who want a job have to be more flexible.

Belgium has been held up as a champion of reform. Were you surprised?

A bit. At the same time it is good to acknowledge that there have been reforms. Nevertheless we know that there are still huge challenges. Belgium is still some way behind Germany, where there's money left over and they don't know what to do with it.

Which reforms are needed most urgently now?

There are several. Reforms to pensions, the labour market and justice for example are recognised as being crucial in Italy. Education and training are also crucial in my view. Flanders has a good education system, but training for jobs on the shop floor could be better.

Should we be worried about automation and robotisation?

Productivity growth has been the source of wealth since time immemorial. But there are other ways of countering negative redistribution effects than blocking progress. That's what we have the government's redistribution policies for.

There are also things that robots can't do. Human interaction will remain important in many service jobs. These are currently often quite badly paid jobs, such as waiting tables or caring for the elderly in retirement homes. There is a reason why these professions are known as "bottleneck jobs".

Whether their wages will rise if demand increases further? I don't know. In any case in the future it will be not just about having the right skills on the labour market, but also about the necessary EQ and empathy, the soft skills. A robot can't offer that.

In the recent bank rescue in Italy, Italian taxpayers have been left to pick up the bill, despite all the bail-in principles. Was Europe looking the other way?

It's not a case of good or bad, we are still in a transition phase. The most important thing is for the banking sector to adapt. I can understand the decision to use tax money to solve problems from the past. But the sector has to adapt and restructure.

There are still a lot of bad loans in the sector, we have yet to see whether the adjustments will have been sufficient.

Banking union is essential. The resolution component is too slow. There can be flexibility for solving historical problems, but the sector needs to adapt.

Do you agree with the late Luc Coene that there's one big bank too many in Belgium, without mentioning Belfius specifically?

I don't know. Luc was a very good friend of mine. He had a very clear solution to any problem. I think there's also room for diversity in the banking market. In Belgium what you see is that many of those in the market are targeting home loans, resulting in intense competition there. Diversity means that big banks have to look abroad more for profit. You don't necessarily need fewer banks, it's just that they shouldn't all target the same thing.

Something else: fifty years ago you were the tender age of eighteen, during the Summer of Love. It's said that you were a real hippie in those days. How much is left of the ideals

from back then?

(Laughs) That is so long ago. 1967! Actually I was in Woodstock again recently, as I had a conference not far away. So I gave my wife a call: "Guess where I am now?"

What can I say? Belgium was also new to me at the time, when I went to Brussels to study at the age of seventeen. That was difficult, because I didn't know anyone at all. The second year was a relief.

It was mostly fun. A time of liberal thought, of freedom and tolerance for different ideas. Before that it was very different.

It was a time when the consumer society was making headway, nobody was very worried that they wouldn't be able to find a job. People were interested in each other and took time to greet each other, like bikers still do now. You see that a lot less these days.