Benoît Cœuré: Interview with Bloomberg

Edited excerpts from an interview by Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, with Bloomberg, conducted by Mr Paul Gordon, Ms Jana Randow and Mr Jeff Black on 15 January 2014.

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On money-market conditions:

"It's not new that we've been worried by possible upward shifts in our money-market curve, in particular caused by external shocks. U.S. tapering is one of them, but there could be others that could make the money-market curve both higher and steeper. It's all a matter of judgment and measure, not black and white. But at some point such developments could interfere with our monetary-policy stance, generally, and with our forward guidance, more specifically. So we want to make sure that monetary conditions, including money-market rates in the euro area, remain appropriate to the situation. Our recovery is lagging the recovery in the U.S. That's a fact and that warrants different monetary conditions."

"What we've seen around the end of 2013 was positive. The market was able to absorb a significant drain of liquidity due to year-end factors which we knew would be temporary. It has been managed and addressed by market participants in a very smooth way. We are now close to money-market conditions that were prevailing before the year end. It shows that the money market can be resilient to temporary factors."

"At the end of December, we had very tight liquidity and elevated Eonia and Euribor rates; that's something we wouldn't like to see as a permanent situation. But the issue was addressed by banks drawing more on our main refinancing operation, the MRO. This can serve as an illustration of the usefulness of fixed-rate, full-allotment as a way to provide a liquidity backstop to the market. I would take it also as evidence that markets shouldn't focus too much on the decreasing size of the balance sheet of the ECB, as they sometimes do. As long as we have fixed-rate, full-allotment, that is, at least until July 2015, we will be there to provide the liquidity.

That's an important backstop for the market and that worked effectively at the end of last year."

On the fixed-rate, full-allotment policy:

"There is not enough recognition in the market of the power of the fixed-rate full-allotment regime, meaning that the amount of liquidity extension by the central bank, or the size of the balance sheet of the central bank can be X or Y at a point in time, but there is still a lot of flexibility to cope with any liquidity shocks. And we've seen that working in December. We saw a substitution away from the LTRO and towards the MRO. The power of that instrument is sometimes not appreciated by the market."

"We've always had a policy to provide some term liquidity; we have the 3-month LTRO, for instance, which is still there.

However, I see a lot of difference between ensuring the stability of the money market, which is part of monetary policy, and helping banks to meet regulatory requirements when it comes to liquidity, which is not the role of monetary policy."

On possible further liquidity operations:

"It's our duty to make sure that the money market is well functioning, especially in terms of possible liquidity bottle necks and volatility of short term rates. And we have a duty to ensure that the level of money market rates remains appropriate to the situation of the economy. This is something that we monitor."

"If the question is, what happens when the 3-year LTRO is eventually paid back in January 2015, it's an open question whether the standard liquidity facility that we have – 1-week MRO, 3-Month LTRO – will be enough to roll over that liquidity, or whether we need something more. That's something that we'll decide in the course of 2014."

"It will depend on how the money market behaves. It may be the case that the standing facilities are enough to ensure an appropriate level of liquidity; if this is not the case, then we would act. There's no question."

On conditional liquidity operations:

"It has been done in other jurisdictions, but they are very different from us – so I wouldn't draw direct lessons from what has been done, say, in the U.K. for us, because the market is so different. The nature of the monetary policy transmission issues that we are facing here are very different from the U.K.

To take an obvious example, the mortgage market is not quite as important here as it is in the U.K."

"For such operations to be useful, you have to make the case that the primary obstacle that banks are facing when they lend to the real economy is lack of access to liquidity. But in the euro area there are many other issues that they face, starting with credit risk. In other words, you have to make the case that monetary policy can provide a significant contribution to something that might primarily be a case of excessive risk, or lack of capital, either in the banking system or in the corporate sector, or both."

On a further cut to the main refinancing rate:

"The MRO rate is at 25 basis points. There is room to cut it if needed, which is consistent with our forward guidance that rates will remain at their current level or lower."

"From a purely operational point of view I don't see a binding limit to where we can go if need be, and we've been clear that the deposit facility can go negative. It is probably possible for a fraction of the money market to trade at negative rates, but probably not the whole of the market as it stands today."

On forward guidance:

"We would certainly be ready and willing to strengthen the forward guidance in the sense that we are absolutely clear that further downside risks to the current scenario would be taken into account. And we are absolutely clear, looking through short-term developments, that we are serious about our inflation objective and that it's a symmetric objective. We have been clear on that and we would be very happy to be even clearer if needed."

"If the question is: Is it useful to add numbers or triggers or thresholds to our forward guidance? My personal view is that we don't know enough about the functioning and the structural change the euro zone is going through to put numbers on our reaction function. We are in a period of structural change. We don't know much about future trends in productivity, the functioning of labor markets and the degree of price rigidities in the euro area. A number of countries are undergoing very serious structural changes, for the best. That warrants certain cautiousness when it comes to numbers and to mapping a certain state of the economy into a monetary policy stance. That is my personal view but that must be the prevailing view in the governing council, else we would have numbers."

On triggers for more action:

"If we have a strong sense that anything impacts the medium-term scenario and moves our medium-term inflation expectation further away from 2 percent, then there would have to be a monetary policy reaction. If it's a pure short-term development, then there may be targeted instruments, such as ways to provide more liquidity, to cope with specific temporary situations, that doesn't have to be standard monetary policy. It can be within the universe of non-standard measures."

"It's our duty to prepare for all possibilities. It's normal preparation for Governing Council meetings and monetary policy discussion that we go through the scenarios and see what we can do."

On financial-market fragmentation:

"Fragmentation in European markets will subside only very gradually. That's because economic convergence itself is slow.

It's taking place but it takes time for reforms to feed into the economic fabric of each country. And then it takes time for structural changes in the economy to be acknowledged by financial market participants, particularly in terms of credit supply. There's not much that we can do about that time dimension."

On interplay between government reforms and monetary policy:

"The priority is for governments to deliver on what they have committed to in terms of growth and structural reforms. We have positive news that the situation is improving in several countries and we have strong commitments to reforms, such as the announcements made last Tuesday by the French president, which I take as an important statement of intent. We also need strong actions to strengthen confidence in the banking sector and complete the whole banking union project. The role of the ECB is to support these processes. We have a clear treaty mandate to support the policies of the community. The best way to do this is to deliver on our inflation mandate. The ECB will deliver on its mandate. But that's not a sufficient condition to deliver growth in Europe. It's a necessary condition but not a sufficient condition."

"Coming to monetary policy, we have the scenario of a slowly developing growth, inflation slowly coming back to the 2 percent number over the medium term, but there are risks around this baseline scenario. We would have different answers to different risks. That's why we need a range of instruments. But it doesn't serve a purpose if the public discussion of monetary policy starts with the instruments. The instruments are the tail that wags the dog."

On the economy:

"What we've seen lately is a series of positive economic data which are broadly consistent with the ECB staff forecast.

So the economy is on track for a recovery but it's still a weak, slow, subdued recovery and there's no reason, at least from the data we have, to revise the expected path and no reason to think that the economic recovery will be stronger than what we've expected so far. But it's broadly on track."

"We do believe in the recovery. We do trust the recovery.

In terms of risks, the range of uncertainty is narrower today than it was some months ago. That doesn't change the baseline scenario. The baseline scenario is weak but tail risks are much more limited today than six months ago. So to that extent, we're more confident in the recovery. The recovery will become stronger as we go through 2014 and 2015. It's a gradual acceleration."

On risks to the economic outlook:

"There are short-term risks related to the liquidity situation and the money-market curve. There are outside risks from the international economic environment. There are also possible endogenous, or local risks. We have to make sure that the ebbs and flows of liquidity in the euro area don't generate excess volatility of the money-market curve. That's the normal job of a central bank. That's what we're monitoring. Then there are long-term risks. They relate to our price stability mandate and to our policy aim of maintaining inflation below but close to the 2 percent number. We want to be sure that price stability will be delivered in the medium term and we want to make sure that inflation expectations in Europe remain anchored. We are very attentive to any sign that inflation expectations in Europe would be de-anchored because that would be following the Japanese path that we don't want the euro zone to follow."

On bank lending:

"The AQR will make a very important contribution to support the effectiveness of monetary policy if it is transparent enough and if it is strict enough. That does not imply that there is a sequence whereby we first go to the end of the AQR, meaning November 2014, and then we see. A lot of the benefit of the AQR can be front-loaded. We have seen already banks beginning to adjust."

"There will be a gradual improvement anyway in bank lending due to the improvement in the economic situation. Also, risk being reduced in stressed economies and ongoing structural reform should have an impact on credit spreads. The improvements that we've seen over the last months on capital markets for government funding, for the funding of banks in stressed countries, these will feed gradually into lending rates. That's a normal mechanism. I don't expect the landscape to change overnight."

On exiting expansionary monetary policy:

"The tapering decision and more generally the improving economic situation in the U.S. and the confirmation that monetary policy in the U.S. is on a normalization path, are generally expected to drive up global long-term yields. So far the European market has shown a good deal of resilience and capacity to disconnect from U.S. developments, which is welcome because it's consistent with the state of the euro-area economy.

But it's something that needs to be monitored very closely."

"Everything we're doing now is temporary; it has to end at some point. It's not meant to stay here eternally. But the time isn't ripe. The euro area economy is improving but it's still weak. The recovery is fragile and there are still downside risks so it will need the very accommodative policy for an extended period of time, as we've said. The time is not ripe yet for normalization but it will have to come and when it comes, that will be good news."

On the definition of medium term:

"There is an academic definition of 'medium term' which is the Milton Friedman definition. That's 18 months. But it has always been recognized by the ECB, from inception, that the path through which inflation reverts back to the 2 percent number depends on the nature of the shock and it depends on the type of nominal rigidities that you have in the economy. In the current situation, where you have this enormous structural adjustment going on and enormous deleveraging pressures that are obviously weighing a lot on prices, contributing to the subdued price pressures, it is only normal that we see inflation coming back more slowly to the medium term objective. That's compounded by the fact that a number of European countries are going through a relative price adjustment which is a necessary adjustment, since it's part of regaining competitiveness. This is temporary, and should not be confused with deflation. Mechanically, this relative price adjustment weighs down on the average euro-zone inflation number. For all these reasons, inflationary pressures will be very subdued for an extended period of time. The definition of medium term is probably more extended now than it could have been in other circumstances because of the situation the euro area economy is in. And we have to acknowledge it."

On publication of minutes:

"It's an important discussion and there's a clear commitment to take this discussion forward. So please be patient on that. It's a very important discussion for us because it has to do with our monetary-policy framework, the communication of monetary policy. I have no doubt personally that publishing an account of the discussion would serve monetary policy and make it more effective by helping markets and the public to understand monetary policy better, understand better what are the options and the risks, and with that anticipate better what we can do and not do. It would make the transmission of monetary policy smoother in the sense that the information available to governing council members or changes in the thinking of governing council members would feed in a smoother way into market prices. I really think there would be a benefit."

"It is a complex discussion though. First, there are different models around us. The minutes published by the Fed are not the same as the ones published by the Bank of England or the Bank of Japan. We have to pick what's most appropriate for us.

Then there is an element of discussion which is difficult. I'm not saying that it's contentious, but there will be a substantial discussion about the publication of the individual votes. There's a choice to be made and there are pros and cons.

I personally stand on the side of those who think the individual votes should be published – but that's just my personal view.

Governors are independent and protected by the treaty. It's very clear in the treaty that governors come to the governing council in an individual capacity, acting in the interest of Europe.

That's part of the accountability of the ECB as an institution and the governors as individuals to see that governors act in the European interest and not in the interest of their country."

On board members' duties:

"The allocation of responsibilities in the ECB board is a board decision and for it to take place we need a full board. We need the successor of Mr Asmussen confirmed and then we will have this discussion. I'm fine with what I'm doing now. It's an important task and there is a lot to be done."