Mario Draghi: Interview in *De Telegraaf*

Interview with Mario Draghi, President of the European Central Bank, in *De Telegraaf*, published 21 June 2014.

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When Mario Draghi took over as President of the European Central Bank in November 2011, he stepped into the eye of the hurricane. The euro area was confronted with serious problems. After the financial misery in Greece, Portugal and Ireland, larger countries like Spain and Italy were also threatening to collapse. Panic was widespread, both among politicians and among investors.

As of his very first day in office as the President of the central bank, the Italian had to take crisis measures. The most serious concerns are a thing of the past, but Europe is still experiencing economic woes. Draghi remains outwardly calm despite the turbulence he has had to deal with. Did he ever have doubts about taking on the job? “No, no, I never hesitated. Things happen.”

Mario Draghi is 66 years old and has a further five and a half years ahead of him in Frankfurt. He met the reporters of De Telegraaf for an exclusive interview on the 35th floor of the ECB tower. In the near future, he will be moving to gleaming new premises, but at the moment he is still surrounded by what his predecessors Jean-Claude Trichet and Wim Duisenberg have left him. “Only the books are different – they are mine.”

He is happy to take up the Dutch debate on the euro. He doesn’t think much of politicians who promise the earth outside the single European currency. “Some people think we should move back in time, thirty or forty years back. I prefer to go forward.” And that also means to continue to build up Monetary Union because it has by no means been completed.

Minister Dijsselbloem said recently that the crisis was over. What is your view?

“The recovery has now been ongoing for around nine months. It is still weak and unevenly distributed across the euro area. And it is vulnerable. Accidents could happen in the global economy that can quickly change the situation. That might be a disruption on the financial markets, or geopolitical risks. In addition, unemployment has now been stabilising for some six months. Very slowly it has been going down. Also in crisis countries such as Portugal. But the level of unemployment is still very high. That alone poses a risk to the recovery because it leads to lower consumer demand.”

You would thus define a recovery as any growth above zero?

“No, but economic activity is gradually, though slowly, picking up. Both manufacturers’ and consumers’ confidence has been quite good in recent times. However, in the first quarter of this year we saw slower growth.”

The troubles in Iraq are causing oil prices to surge. How much of a risk is that?

“Our mandate is to ensure price stability. If inflation in the medium term is higher than the target of close to, but below, 2%, we are concerned. But we are also concerned if it is far lower. We are constantly asking ourselves why inflation is so low in the euro area. Initially, this was due to lower energy and food prices. Later, US dollar prices of these products stabilised, but the euro appreciated, causing inflation to fall still further. Higher oil prices are sure to have an impact on inflation, at least if we do not experience a further appreciation of the euro. But it is also good news for the countries that produce energy, as in the case of the Netherlands with its gas.”

At least if the winter is not too mild, since that cost the Netherlands quite a bit in terms of gas sales at the beginning of the year.

"Yes, indeed. Is it not remarkable that the significant fall in economic activity in the Netherlands in the first quarter was due primarily to this fact? Many people simply don't realise just how large the energy sector is. Incidentally, one has to acknowledge that too low inflation, while being generally negative for growth and especially so in the euro area, does support real disposable incomes. That is one of the reasons why consumption in the euro area is rising."

Compared with the United Kingdom and the United States, economic activity in Europe is still rather weak.

"Our recovery is in an earlier stage that that in the United States, the United Kingdom and Japan. That is why the ECB adopted a number of policy measures on 5 June: a lower interest rate (and for banks a negative deposit rate), the introduction of support for banks that is linked to the provision of credit, the so-called TLTROs and preparations for a programme for purchases of packaged corporate loans, asset-backed securities. In April, I already said in Amsterdam that there are three situations that could induce the ECB to take action. One was an unwarranted tightening of the monetary policy stance that is reflected in an increase in short-term interest rates. That could lead to higher medium-term interest rates, and thus also impact economic growth and price stability. The second was an ongoing deterioration of lending. That was also a matter for our attention because lending has now been weak for a very long time. The third development was a deterioration of the prospects for price stability over the medium term."

And all three occurred at one and the same time?

"No, we responded primarily to the first two. We have not seen any deflation in the sense of prices declining across the whole spectrum in the euro area, with households and firms postponing consumption and investment because they are waiting for lower prices. What we do see is that low inflation persists for a long time. If it lasts too long, adjustment in the crisis countries is made more difficult. In a situation of low inflation, wages in these countries need to really decline in absolute terms in order to improve their competitiveness."

Does the fact play a role that debt weighs more heavily when inflation is low?

"Certainly, that is yet another consequence of low inflation. The reduction of debt levels, which is of great importance in large parts of the euro area, becomes more difficult in the event of low inflation."

Private and public sector debt?

"Yes, both private and public debt."

Low interest rates are detrimental for savers, and for people's pensions. How would you answer such concern?

"It is a very understandable concern. Many life insurance policies and pension plans promised far higher value at the time they were agreed."

How long will interest rates continue to remain low?

"We have prolonged banks' access to unlimited liquidity up to the end of 2016. That is a signal. Our programme in support of bank lending to businesses will continue for four years. That shows that interest rates will remain low over a longer period. But thereafter they will increase when the recovery will firm up."

If the United States were already to raise interest rates in spring 2015, would Europe have to wait until spring 2017?

"We will have to wait and see what happens, but the extension to the end of 2016 is a signal. Incidentally, the United States has reduced the growth figure for the first quarter."

In view of the impairment of pension entitlements, people are spending less because they have to set more aside.

"We do not see this. There is no lack of spending in the countries that are affected most by the low interest rates. I understand the concerns about the low interest rates, but on the other hand, they are what leads to more investment and higher growth. And we need to take into account precisely which interest rate we are talking about. These pension products invest in government bonds with long maturities. Many of the reasons why interest rates on government bonds are low have nothing to do with the ECB. They are low because countries such as the Netherlands and Germany have become safe havens. Prior to the crisis, life insurers invested in bonds issued by all countries, both 'core' countries and 'non-core' countries. The interest earned on their investment was thus higher because weaker countries had also been included. The crisis created financial fragmentation in that insurers all used government bonds issued by their own countries to fulfil obligations. That caused insurers in the north to be confronted with low yields. Returns in the south were particularly good. Once there is renewed confidence in the euro area, the northern countries will no longer be the only safe havens. Money will then again flow freely and the recovery of confidence will lead to higher yields in the northern countries. Besides that, we have to conduct monetary policy for the whole euro area. We cannot consider only one single point of interest."

Do you have any understanding for the fact that people in the north feel that they are having to pay for the mistakes made by the south?

"I am well aware of this conflict. Some months ago, I held a lecture on Monetary Union in the United States. I said then that there were major imbalances between various euro area countries, large debtor and large creditor countries. I said that it was never a goal of Monetary Union to create permanent creditors and permanent debtors. That would have to change in order to have a balanced Union. An American in the audience responded to this by saying 'what you are saying does not hold water because here in the United States, the State of Oklahoma has always been a debtor, while New York has always been a creditor, and that is no cause for us to worry. So why should you be worried about it?' I think that this touches on the heart of the matter. The debts of US citizens are all treated equally, irrespective of where they come from."

Because the United States is a political union.

"Indeed. The Dutch have a problem with paying for the Greeks, but not with paying for other Dutch. But let's look at that 'paying'. It is not at all clear what some countries have really paid for other countries. In Greece, there was a write-off on debts held by the financial sector, but there was no further default. It has cost the euro area countries far more to save their own banks."

Will Greece ever be able to repay its debt?

"If Greece continues with its structural reforms, restores order to its public finances and improves its competitiveness, growth there will increase. If that happens, Greece will be able to do so. Greece has less debt to service over the next five years than Belgium. Much of Greek debt has a very low interest rate and very long maturities."

The ECB has taken many measures, but has not undertaken any quantitative easing, i.e. has not purchased bonds. What needs to happen before you would start doing so?

"That would be the answer to the third situation that I mentioned in Amsterdam, a deterioration of inflation expectations over the medium term. At the moment, however, we are focusing on the measures announced on 5 June."

Is it legally possible to buy up government bonds? There is still a court case pending on this issue.

"This is indeed possible within our mandate, namely if the purchases are aimed at ensuring price stability. We are not permitted to provide Member States with monetary financing."

You were very happy about the unanimity of the decision taken on 5 June. Would a unanimous decision also be possible on quantitative easing?

"Any guess would be premature. Quantitative easing can include not only government bonds, but also private sector loans. We will discuss that when the time comes."

Your statement "whatever it takes", to save the euro at any cost, made at the time of the announcement of a new government bond purchasing programme, marks a turning point in the euro crisis. Do you feel that you no longer need to follow through on it?

(Smiles) "In contrast to both the initial purchases of government bonds and possible quantitative easing, the programme of Outright Monetary Transactions (OMTs) is aimed at a very specific risk, namely the so-called tail risk of the euro area falling apart."

Did you ever fear that that might happen?

"In July 2012, there were more than enough reasons for concern. In my short statement in London, I said that one of the mistakes many people make is to underestimate how much political capital has already been invested in the euro. I was very much aware of that fact. Just before I made that statement, the political leaders had fully committed themselves to the euro at the European Summit, within the scope of which the Banking Union was created."

Are the OMTs some kind of nuclear bomb, a threat that will never be carried out?

"The markets reacted in a way that made it unnecessary to use the programme. The spreads between the interest rates [on bonds] of southern euro area countries and Germany narrowed sharply. That was something that could not have been achieved by any other monetary policy measure."

Were you surprised by this effect?

"By the magnitude of the effect? Yes, certainly. We were all surprised."

Or were you relieved that you had merely had to promise action without following through with it?

"In order to be credible, we also had to be sure that we could actually use the instrument. We were not bluffing, most certainly not."

The other side to the coin is that you bought so much time for politicians that they no longer needed to implement reforms so rapidly. Do you also see this other side?

"Yes and no. We have a mandate to safeguard price stability. We are not responsible for how politicians make use of the time they have. I do not want to mix the responsibilities of the central bank with those of governments. But look at the extent of the reforms undertaken by governments since 2012. You will then need to admit that considerable progress has been made. Take Spain, for example, which has restructured its banking sector and reformed the labour market. Portugal is another example and Ireland yet another. And even in Greece progress has been remarkable."

You have said repeatedly that the euro is an irreversible project. It is understandable that you say that, but is this not something for politicians to decide?

"Our mandate is to ensure price stability. There was more than enough evidence that a collapse of the euro would endanger price stability, and therefore our action was squarely within our mandate."

You saved the euro. In doing so, did you not take a political decision?

"No, certainly not. The issue is by no means political. My statement in July 2012 was aimed at price stability. There was unjustified uncertainty about the future of the euro, not political uncertainty but a financial one. Unjustified speculative expectations about a break-up of the euro had been self-fulfilling in a vicious spiral for several months. They had produced a very high level of interest rates. These rates were harming the real economy and the banking sector. The consequence might have been a new credit crisis and the impairment of our monetary policy, and therefore of our ability to maintain price stability. There has far too often been criticism that it was a political decision, but that is simply not true."

Much has been undertaken to close the gaps in Economic and Monetary Union, stricter budget rules and a banking union. Is everything now in place?

"The banking union is a major step forward in the direction of a more complete monetary union. The crisis has shown that the economic policies of one country have a clear impact on other countries. Economic policy cannot be a purely national matter. Where fiscal policy is concerned, a certain degree of Union-wide discipline is already given. But the marked imbalances between euro area countries are due to a lack of structural reforms in some countries. The next step to be taken is to subject structural reforms, too, to Union-wide discipline."

Current economic policy coordination in the euro area is merely a first step?

"Yes, indeed, it is merely a first step."

What will the second step look like?

"That is a matter for the political domain to decide. In the case of the budget agreements, sovereignty has been shared among Member States. That should also be done with respect to the labour market, competitiveness, bureaucracy, agreements on the internal market. Sovereignty needs to be shared at a level other than the national sphere. That is where I stop. Because now there are several options for politicians to choose from. You could grant greater powers to the European Commission, or to the Member States within the European Council, or you could create new European institutions. That is not for me to decide."

The contention of some politicians that EMU is complete is thus not correct?

"No, far more is necessary for a perfect monetary union."

Is a budgetary authority necessary at the euro area level, a fund for the compensation of weak countries?

"That is a highly political issue. Compliance with existing rules would be enough. But it is clear that my predecessor in office, Trichet, made a strong case for a budgetary authority."

Returning to your example of the State of Oklahoma, would that not be a form of financial solidarity that is needed in the euro area?

"There is at least one difference. The United States is a single country, the euro area is not. Given the more complex structure, we must seek a design that best ensures that economic policy is regarded as being of common interest."

Do you understand the concerns about such a transfer of powers? The outcome of the European elections can also be viewed against that background. Do you have a solution to this issue?

"Are we really so sure that it would have been better if we all still had our own currency? Would we have been better off over the past ten, fifteen years? In the 1970s, 1980s and 1990s, we experienced a whole number of currency devaluations with often high inflation as a result. We currently have a formidable degree of price stability, a low rate of inflation. That offers enormous opportunities for growth and job creation. It is not the fault of the euro that economic policy went wrong in some countries. But let us please conduct that debate. It is important as such. Some people feel that we should turn time back thirty or forty years, but I prefer to move forward."

Do you understand that people see the euro as the cause of the crisis, and of unemployment?

"The crisis and the unemployment are the result of a very severe financial crisis and partly also of wrong economic policies. The euro may have masked it but it has not caused it. We must end the crisis in Monetary Union and enable it to create prosperity and jobs again."

That sounds terrific, but the many EU Summits on growth and job creation have all led to nothing. What needs to be done?

"That is a complicated issue. We cannot accept the present because we currently have low growth and insufficient job creation. On the other hand, we should not dream of a past that cannot be brought back and that cannot by any means be clearly taken to be better. We must work for the future in order to achieve not only stability, but also growth and employment."