Mario Draghi: Interview in *Handelsblatt*

Interview with Mr Mario Draghi, President of the European Central Bank, in *Handelsblatt*, published on 2 January 2015.

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Mr President, the Pope is of the opinion that, these days, Europe is looking old and sick. Do you share his opinion?

Draghi: Europe needs to regain its self-confidence after the crisis. This cannot happen by miracle. It hinges upon European Governments and European Institutions. It requires the introduction of reforms and a stable financial framework. This way, European citizens will regain confidence in their future and their opportunities. Confidence is the prerequisite for a society in which people buy and invest. Europe can do that and I am firmly committed to that goal. The Pope says that, also for the sake of the rest of the world, Europe should regain youth and health, and it is in our power to make it happen.

What is causing this lack of confidence that you refer to?

Draghi: It is a legacy of the various crises that happened in 2008 and 2009 which clearly revealed the weaknesses in the old framework.

And what did you find?

Draghi: We found that the debt levels of banks and nation-states were too high. Important rules of a market economy – for example, the rule that risk and responsibility go hand in hand – had been forgotten. All this contributed to shatter the confidence of many people in Europe. This is why Europe is in need of structural reform. I have been saying this for a very, very long time. I can only repeat it.

You keep saying it but you are not being heard. The ratio of debt to GDP has continued to rise everywhere in the West. In Europe, the government debt to GDP ratio has risen by almost 50% since the start of the financial crisis in autumn 2008. At the moment, only five of the 18 euro area countries do not exceed the debt limits laid down in the Stability and Growth Pact.

Draghi: This is partly due to the fact that, in some parts of Europe, there has been absolutely no growth over the past few years. However, more recently, most countries have started to grow again, though weakly, and to put their fiscal positions in order and to undertake structural reforms. And, as a result, debt levels are falling for the first time. But, this takes time. Moreover, progress on the important structural reforms – more flexible labour markets, less bureaucracy, lower taxes – is clearly too slow.

Can you be more specific, Mr President? Which countries in the euro area need to do more?

Draghi: All of them.

Including Germany?

I said all of them, some more than others. I welcome the German government's announcement of additional public investment in infrastructure. Every country has its own agenda. Those governments that have already implemented reforms are now reaping the benefits. This applies first and foremost to Germany with its Agenda 2010. Germany is now much more robust and stable than the rest of the euro area countries. Such examples are encouraging. Once upon a time, southern Germany was farmland. Now, it is the hub of new technologies.

What about the highly indebted countries in southern Europe?

Draghi: Spain has begun its liberalisation with great courage and is now one of the fastest-growing countries. In France and Italy, the willingness to implement reforms is growing. Some have been approved e.g. the labour market reform in Italy, others have been presented and are being discussed, which has taken time. The real challenge is to put it into practice. I understand the impatience. Reforms have waited too long. It is now time to implement them. That's my message.

And what about Greece specifically?

Draghi: It's now for the Greek electorate to decide about the future composition of the parliament and the government.

Jean-Claude Juncker, President of the EU Commission, nonetheless wants to give France, Italy and Belgium more time to reduce their much too high debt. All three are in breach of the agreed fiscal rule of spending no more than 3% of national income on new debt. Should another exception be made?

Draghi: It is up to the EU Commission to judge this. In March, it will give its judgement on the behaviour of the countries in question. For the ECB, it is important that the European Stability and Growth Pact is adhered to, because compliance with the rules that we gave ourselves is a primary source of confidence.

In reality, your expansionary monetary policy, which is pumping trillions of euro into the markets, is just buying the governments more time – and it seems that no one is really using this time. Do you feel alone in your fight to save Monetary Union?

Draghi: We have a mandate. It is to keep inflation close to but below 2%. That is our legal obligation. And we must deliver, within our mandate given by the European Treaty. But it is quite clear that our monetary policy would be much more effective if the governments implemented structural reforms.

The ECB acts and waits ...

Draghi: It acts and delivers. The others must also do their duty.

The question is why you see price stability at 2% inflation at all. 0% would be much better, wouldn't it?

Draghi: The 2% target was decided by the Governing Council in 2003. It would certainly not help confidence if targets were changed when it becomes difficult to meet them! Otherwise, when we had 3% inflation, we could have set 3% as the target. We must be reliable. Inflation has been low for some time now. This is partly due to falling oil prices and corrections of high prices in some countries, but also to weak demand. Core inflation has been around 0.7% for a year.

No major central bank has an objective of 0%. The reason is simple. If one aims at 0%, half the time inflation will be positive and half the time it will be negative. And when inflation is negative and interest rates have fallen to zero, one cannot lower interest rates to bring inflation back to zero.

Do you fear deflation, i.e. declining prices and wages?

Draghi: The risk cannot be ruled out completely, but it is limited. The important thing is what inflation rate people expect over the medium term. Since June, we have seen that these expectations have declined. If inflation remains low for a long time, people might expect prices to fall even further and postpone their spending. We are not there yet. But we need to tackle this risk.

… and the result is grotesque. The central bank fights for more inflation. That's strange for Germans, whose country has suffered two periods of hyperinflation and fears a new currency reform. Do you understand the unease of the people of this country?

Draghi: History shows that falling prices can be as damaging to the prosperity and stability of our countries as high inflation. That is why our mandate is symmetric. And that is why we are now ensuring that the risk of deflation you just asked me about does not materialise. You, as a journalist, also have a duty to explain. Public opinion in Germany is very important for us.

Your intentions are good, the effects of your policies are simply not acceptable for many citizens. People are worried about their savings and pensions. They did not invest money, like Goldman Sachs, in shares, options and highly controversial bonds, but focused with your majority – rather conservatively – on savings books, German government bonds and life insurance policies. Because of the ECB's low interest rate policy, they are currently experiencing a clear drop in wealth. Savings accounts and insurance policy pay-outs are melting.

Draghi: Interest rates have been very, very low for a long time – and they will presumably stay like that for a while longer. People see that the returns on their savings and the profits from their life insurance policies are shrinking. We understand the concerns of savers. But now let me ask a question: is that the only factor? My answer is no. After the crisis, Germany became a safe haven. A lot of money therefore flowed into the country, with the result of falling interest rates on medium and long term bonds – the interest rates of which are not set by the ECB. This has hurt some savers but also benefitted borrowers, for example those who bought houses.

Wait a minute – it was your institution which lowered the key interest rate step by step, to 0.05% at the moment. Savings are no longer worth very much in this environment.

Draghi: In an environment of widespread economic weaknesses and falling inflation, our monetary policy has to be accommodative. Is that cause or effect? We have to look at the whole euro area. If we raised interest rates, the crisis would be worse. Stability would suffer – and that would hurt investors and savers even more. We are keeping interest rates low to stimulate the real economy and to achieve price stability.

In order to save the euro, you announced decisive measures in the middle of 2012 – "whatever it takes". Does that mean that you are consciously putting German savings at risk to save the euro?

Draghi: No. Quite the opposite. The risk for the German tax payer has gone down. Recall that internal loans between some central banks in the ECB system, the famous Target 2 loans, were previously much higher. They have already gone down by half.

The answer is not really reassuring. Low interest rates are still low interest rates.

Draghi: In the United States, interest rates were also low and people complained about it. When the recovery took hold, long term interest rates started to rise again. Likewise in the euro area, interest rates will rise and normality will return.

Many German savers feel expropriated nonetheless. What is your advice? What should they do?

Draghi: Insurers and banks, whose business it is to assess risk and reward, should give the answer.

What does that mean? Investors should spread their risks around the world?

Draghi: I can't give any advice here. I'm a central banker, not an investment adviser.

The United States is in a better situation, with the economy growing stronger. The Fed can afford to relax, unlike the ECB in the euro area. Why is Europe in such a worse position?

Draghi: One reason is the lack of effective structural reforms. The ECB has created better possibilities for banks; they can, in principle, lend more. But there are countries where a young entrepreneur must wait nine months before getting a permit to open his business. And even then, he must pay a license fee – and that's before he's made the first sale. So what incentive does this entrepreneur have to borrow money from a bank? That's a true story. And there are hundreds like it.

You're complaining about state obstacles?

Draghi: I am complaining about too much bureaucracy and too high taxes. Here in Europe, we have some of the highest taxation in the whole world. That's a big competitive disadvantage.

… not for Apple, Google and Starbucks, which pay only 1–2% in taxes in Europe.

Draghi: Aside from that: in the euro area citizens pay between 45% and 55% of their income to the state. And that compares with 35% in the United States and 33% in Japan. The triad of weakness in the reform process, bureaucracy and the tax burden hinder Europe's recovery. If we don't solve this, our growth will remain weak.

Your diagnosis is undoubtedly correct, but does it really allow for an effective therapy? If crisis countries were to lower taxes, wouldn't their deficits initially become even bigger?

Draghi: My advice is therefore: don't give up on fiscal consolidation! But fiscal policy must nevertheless be designed in a more growth-friendly way. Spending on investment must be increased – and this means on research, education and the digital agenda. Other expenditure, and also taxes, should be reduced.

In comparison with the United States, the political vacuum in Europe stands out. A uniform leadership is missing, the euro area is politically fragile and fragmented, and the only pan-European institution with force appears to be the ECB.

Draghi: The way Europe is governed must improve. The Union must become better than the one we know today. Once it was very helpful to have established common fiscal rules …

… which were not followed?

Draghi: Yes, unfortunately that was the case in 2003 and 2004. The agreed rules should be observed. They are important for mutual trust, which in turn is the basis for sharing sovereignty. The next stage is a stronger political union. We still have a long way to go.

Angela Merkel and the other political leaders may well have European convictions, but in everyday life they have remained national decision-makers. The nation states have rather revived in the wake of the financial and economic crisis.

Draghi: The nation states do not need to be abolished, but their policies need to be better coordinated. Why can we not make structural reforms together, in parallel across several countries? Why do the countries not establish common objectives and monitor debt developments together?

Perhaps there is simply a lack of European leadership.

Draghi: The various countries and markets are closely intertwined. If a country is not competitive, if it cannot stand on its own feet, if the labour market has become stagnant, then it will become a burden for other countries. That is why there is no alternative to a pan-European perspective. Europe is more European than some politicians think.

Many believe that you are the only real player in Europe. A single word uttered by you can move the markets. Is that not too much power in the hands of one individual?

Draghi: That is a gross overstatement and does not correspond to reality. My interpretation of our mandate is very narrow: we need to deliver price stability.

Your interpretation is not and cannot be that narrow in reality. The objective of price stability cannot be achieved in isolation from all of the other measures, such as economic growth, innovation levels, unemployment and government expenditure.

Draghi: The ECB has always been very careful about what it says. We remain within our mandate.

Jens Weidmann, the President of the Bundesbank, does not agree with that though.

Draghi: We do not disagree about our mandate.

Weidmann apparently does not consider it either legal to buy government bonds on a grand scale, as currently planned by the ECB.

Draghi: We have had several interesting conversations, but as far as I know, he does not say that. The purchase of government bonds is one of the tools in our toolbox, which we can use to fulfil our mandate. But we cannot breach Article 123 of the Treaty, which forbids monetary financing.

Your plans come very close to that.

Draghi: No that is wrong. When the ECB decided to buy government bonds a few years ago, this was to repair the transmission mechanism of monetary policy and therefore was within the mandate. These are the only government bonds the ECB has ever bought so far.

How close is your institution to buying the next large batch of government securities?

Draghi: The ECB's Governing Council has instructed the staff and Eurosystem committees to prepare concrete measures.

How much money are we talking about?

Draghi: That's difficult to say. The risks of not fulfilling our mandate of price stability are in any case higher than they were six months ago. Our mandate is symmetric. We have to avoid too high inflation and we have to avoid too low inflation as well. Headline HICP inflation has been on average 0.3% since July 2014, in other words for 6 months already.

Nevertheless, you wish to expand the ECB's balance sheet from €2 trillion to €3 trillion. Is that correct?

Draghi: We are making technical preparations to alter the size, pace and composition of our measures in early 2015, should it become necessary to further address risks of a too prolonged period of low inflation. The Governing Council agrees unanimously on that.

The euro is becoming weaker and weaker. Did you encourage this currency depreciation to bring down the price of European exports?

Draghi: The exchange rate is not an ECB policy target, even if the exchange rate is important for price stability and growth. The recovery is weaker and unemployment is higher than expected a few months ago. That has contributed to a weak exchange rate. It's a natural outcome of diverging monetary policy paths in the US and the euro area. Markets expect a less accommodative monetary policy in the United States. This contributes to a stronger dollar.

Even if Germany has no interest, and can have no interest, in them at the current time, does Europe not ultimately need eurobonds, i.e. common bonds guaranteed by all states.

Draghi: That requires trust in your partner. Asking this now is the wrong question at the wrong time. Such a climate of trust first needs to arise.

The ECB is providing ample money to the economy. Much of this probably flows into the markets for shares, real estate and art. Bubbles emerge. Does this point to the next crisis?

Draghi: We understand such concerns. But the ECB is highly alert in this regard. Though we cannot with certainty exclude this possibility in the future, we don't see speculative bubbles at this time. Bank credit has not increased very sharply. Before the crisis, bank credit had expanded far too much and too quickly which contributed to creating financial bubbles in several parts of the world. People were speculating with borrowed funds. That is not happening now.

Nikolaus von Bomhard, CEO of the largest reinsurance group Munich Re, thinks there is too much liquidity in the market. He finds that the situation is far more serious than many people believe, and states "the collateral damage caused by what the central banks in Europe are now doing is considerable".

Draghi: Our monetary policy stance is determined by our medium term assessment of price stability. It is very accommodative and rightly so. However there may be some local exaggerations in some regions and markets, for example in a few regions the prices for real estate rose sharply. Their causes are local and should be addressed using the appropriate local instruments. The answer to this should come from the new macroprudential instruments and not from monetary policy.

Stock prices have increased considerably. In their search for yield, investors have obviously discovered equity as a way out. The price of Allianz shares has doubled over the past three years, without there having been any change in the management, the strategy or the products.

Draghi: Such developments are possible at the local level, also on the property market. But I would not see our policy as the cause. Many companies have been able to increase both their turnover and their profit in real terms.

All in all, you cannot be satisfied with what has been attained. When a patient looks up a doctor and finds, time and again, that all he does is increase the dose without that having the desired effect, that will surely have an impact on the patient's confidence in the doctor, won't it?

Draghi: It is not true that our monetary policy is not having an effect. The ECB has ensured stable prices throughout its history. You should also look at the financial markets – before and after the announcement of our programmes! You will see something major: trust has returned. At the same time, we have created a banking union from scratch, including harmonised banking supervision by the ECB. That has also strengthened confidence. But these improvements have not yet been passed on in full to the real economy.

We are about to enter into a new year. What economic developments do you expect for 2015?

Draghi: The moderate recovery is continuing. It is fragile and uneven. Recently, 14 of 18 countries have recorded positive growth, only two are in recession. Europe is gradually becoming stronger. I am confident that we'll see all countries in the euro area grow this year.

And after that?

Draghi: I am prudently optimistic. We believe that the combination of an expansionary monetary policy with government reforms will bring back much of the confidence lost.

Is it still legitimate to speak of Europe in a "crisis"? Or would you say that the crisis is already part of history?

Draghi: The issue is rather an extended period of weakness than a crisis.

Is a "black zero", i.e. no government budget deficit, an important objective at present? Is Germany setting the right priorities in this respect?

Draghi: I do not want to comment on that. Investment is low everywhere, also in Germany. Public sector investment is lower than the historical average. The International Monetary Fund believes that there is an investment-to-GDP gap of 0.7%. The ECB believes the figure to be lower.

Thus, no warning about a policy that also builds upon a consolidation of public finances?

Draghi: Consolidation is the basis for sustained growth. Excessive debt led Europe into a dead-end.

You are under immense pressure. Europe is looking to you, the heads of state or government, as well as the general public and industry. Do you like such challenges, or do you tend rather to suffer under them?

Draghi: It is important for anybody who has responsibility to be aware of the obligations entailed. That accompanies me through the day. That is what gives me strength.

That sounds very Prussian for an Italian.

Draghi: I believe that fulfilling one's obligations is not a national peculiarity of the Germans.

Is it one of the obligations of the President of the ECB to develop an exit strategy in case matters turn out to be different to what we have discussed here, for instance if the euro area were to break into two halves? It would, at any rate, be difficult for monetary policy to lastingly bridge an economic divide if governments fail to find one another.

Draghi: A breakup of the euro area? That will not happen. That is also why there is no Plan B.

The political domain always needs a Plan B if things develop less well than envisaged is the view of, for example, Henry Kissinger, US Secretary of State for many years. In an interview he gave to Handelsblatt, he advised those with responsibly in Europe to think of alternatives.

Draghi: Kissinger is a politician, I am not.

And that is to remain so?

Draghi: (laughs) I don't want to be a politician.

Not even as State President of Italy, your home country? President Napolitano, the current incumbent, intends to retire shortly.

Draghi: My period of office as President of the ECB runs until 2019.

Mr Draghi, thank you for the interview.