Benoît Cœuré: Interview in *Börsen-Zeitung*

Interview with Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, in *Börsen-Zeitung*, conducted by Mr Mark Schrörs, and published on 15 August 2015.

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Mr Cœuré, the last two bailout programmes have failed to get Greece back on its feet. What makes you think that this time everything will be different and this third programme will turn Greece into a "thriving economy", to use the expression recently employed by Mario Draghi, President of the European Central Bank (ECB)?

First of all, you have to remember where we started in 2010. Back then, the Greek economy was enormously imbalanced and inefficient. It was – and remains – clear that the process of getting Greece back on its feet will be long and hard. However, we should also not forget that at the end of last year Greece was gradually recovering. Positive growth was being forecast for 2015, and the banks had been able to obtain capital from the markets in 2014.

But then Alexis Tsipras' leftist government came to power.

This year has seen a lot of trust destroyed, and reforms have been reversed. That has been a real setback. But Greece can build on what it has achieved under the first two programmes, and the new memorandum of understanding has everything it needs to give the Greek economy considerable support. I would like to stress two things in this regard. First, we have the right mix as regards fiscal measures. Ambitious medium-term budgetary objectives have been set, without the economy being strangled in the short term. Second, there is a strong focus on structural reforms. Looking back, one could say that if there had been more focus on structural measures – such as the reform and opening-up of markets, improved tax collection and the fight against interest groups – from the start, that would have reduced the burden that adjustment placed on the most vulnerable in society and speeded up Greece's recovery.

So, the first two programmes were poorly constructed?

No, I would not say that. The information we had back then was completely different. Now that Greece has accepted these reforms, it is important that they are implemented in full. This is not a short-term solution aimed at obtaining money to cover the next few weeks. It should be seen as what it is: a three-year programme aimed at getting the country back on track and reaping the full benefits of the euro area recovery.

But isn't that precisely the problem? The Greek people clearly voted "no" in the referendum, and Tsipras openly says that he does not believe in the programme.

What counts is the agreement that has been reached and the Greek parliament's adoption of the relevant laws. And I am grateful for the good spirit and cooperation of the new Greek Finance Minister.

Up to €25 billion is planned for the recapitalisation of the Greek banks. Will that be enough? And would the ECB be in favour of all that money being handed over right at the outset as one large initial payment?

We believe that the recapitalisation of the Greek banks should take place as soon as possible. The banks' ability to grant credit is an important precondition for growth. However, first we need detailed information about the situation. For that reason, banking supervisors at the ECB have started a new asset quality review and stress test for Greece's four major banks. Those credit institutions were adequately capitalised, but they are now operating in an extremely difficult economic environment, and non-performing loans are likely to increase in the next few years. It is quite clear, therefore, that the banks will require more capital. How much remains to be seen. The banking supervisors will need a few weeks to conclude their assessment. For that reason, the recapitalisation should not take place immediately. But it should happen before the end of the year, taking into account the existing resolution and competition frameworks. It is also important, though, that we do not just put more money into these banks. We need to ensure that this achieves the desired objective.

What do you mean by that?

We need to place the Greek banking system on a sound footing. That also entails considerable changes to the system's governance structure, and the banks need to clean up their balance sheets. The problem of those non-performing loans needs to be solved in an efficient manner, which will involve, among other things, an efficient insolvency framework and, where necessary, the sale of such loans to investors other than banks. Only then will we be able to ensure that the money we put into the banks is not lost.

Once this third programme has been agreed, can the capital controls be lifted?

That is not for the ECB to decide. It is a matter for the Greek government. As long as there is uncertainty regarding the future of Greece's banks, the government in Athens should tread very carefully. I do not see scope for substantially relaxing Greece's capital controls until it is clear how and when the banks will be recapitalised.

Will the Governing Council of the ECB immediately reapply the waiver – i.e. the exemption under which the bonds of a country with a poor credit rating are accepted as collateral if the country is in a programme – once Greece's third programme is agreed? That would be an enormous help to Greece.

The Governing Council has not yet discussed that.

But it is not automatic?

In order for a country to benefit from the waiver, a programme needs to be in place, and that programme needs to be functioning well. Once we have reached that point, we will discuss it in the Governing Council.

But does the Governing Council not need to wait for the initial assessment by the creditors, which is scheduled for October? That is also relevant as regards the question of when Greece could benefit from the ECB's bond purchase – i.e. quantitative easing (QE) – programme.

We could potentially act earlier. Greece's new programme contains a large number of "prior actions". The question for the Governing Council will be whether these preliminary measures are sufficient to meet our criteria.

This is the first time that the potential for a country to leave the euro area has been publicly discussed. Is the euro area now just a fixed exchange rate system?

It is crucial for the stability of the euro area that there is no doubt that participation in the euro is irreversible. Now there is such doubt. The discussion about Grexit has undoubtedly caused instability in this respect. It is like a fine hairline crack that can lead to a major fracture. Consequently, it has to be repaired now. This is particularly important for us as a central bank. We do not decide who belongs in the euro area. That is a political decision. But the ECB's working assumption is that a country's participation in the euro is irreversible. This is also how we have dealt with Greece and why the provision of liquidity to Greece could be sustained.

And this repair should take place by means of more integration?

Yes, absolutely. The right response now is to strengthen the euro area. This requires a series of measures, with two aims. First, a greater sense of responsibility is needed at the national level. Greece is undoubtedly an extreme example, but it is also a useful warning of what happens to confidence when a country departs significantly from the consensus and the agreed rules. This kind of thing must never happen again. Second, we need more risk sharing, meaning solidarity for countries which have experienced shocks.

And more solidarity means transfer payments between euro area countries?

No, euro area solidarity does not mean permanent transfers. It is about supporting a country which is in difficulty, but only temporarily, and it is conditional on efforts being made to return to balance. The euro area is based on the principle that it is not a transfer union. One can dream of a completely different model – a federal state with transfers which are legitimised by a common political institution – but that is not the system we have today, and I do not see any political will to change that.

The debate about Greece has revealed fundamentally different economic ideas and political cultures in the euro area countries. Will these centrifugal forces break up the euro area some day?

We have to be careful here, as that can quickly become a self-fulfilling prophecy. The more you talk about it, the more people think nationalistically again and stop trusting Europe – and when people do not trust Europe, Europe becomes part of the problem instead of being part of the solution. Europe has always thrived on the diversity of its models, ideas and cultures. We need to prevent economic divergence from becoming so large that it threatens the survival of the euro area. But diversity as such is not a bad thing; it also promotes best practices and competition.

Let's talk about monetary policy. Some economists are already speculating that the renewed drop in oil prices could ensure that the inflation rate, which was 0.2% in July, falls below 0% again. Longer-term inflation expectations have also fallen again slightly. Are you starting to get worried again?

We do not wake up every morning and look at the economic indicators in order to decide whether to raise or lower interest rates or whether to stop or expand QE. We have a medium-term perspective. We have oriented our monetary policy stance – with low and even negative interest rates and forward guidance, together with bond purchases – towards a long time horizon. Hence, we have said that those purchases can run until at least September 2016, or later if necessary. There was a good reason for this long-term focus, namely that the economic recovery is still weak and is only gradually strengthening.

So, at the moment you do not see any need to act?

Our monetary policy decisions are gradually finding their way into the provision of credit and the real economy, even if only slowly. We therefore want to keep a steady hand. We would only see ourselves forced to act if there was a fundamental change in the economic situation or the monetary stance was materially altered because of developments in the markets – for example, in the event of a sharp increase in long-term bond yields. So far, I am not worried by what I am seeing.

So, renewed worries about deflation are exaggerated?

There is nothing in the data that supports such an assessment.

In the United States, the first interest rate rise is on the horizon. Would this make the ECB's job easier, for example because the euro would lose value against the US dollar, or more difficult because rising US bond yields have often pushed up their European counterparts in the past?

If the Federal Reserve comes to the conclusion that it can raise interest rates, that means that the US economy is strong. That would be good news for the global economy, and therefore also good news for the euro area. It will be crucial that global financial markets are resilient enough to deal with this change in monetary policy.

And, are they resilient enough? Or should we be worried that the first US interest rate rise since June 2006 will cause chaos in the markets?

We have been living with very low interest rates for a very long time. The challenge is to ensure that market participants recognise that the future regime will be more like it normally was in the past – with higher interest rates. There is a risk that some have forgotten what that looks like. That also applies to us in Europe. It is extremely important that our unconventional monetary policy does not damage financial markets.

But that is exactly what many market participants are accusing central bankers of – especially the ECB. They are accusing them of overriding market mechanisms and ousting private investors.

It is clear to me that these unconventional measures have to be of a temporary nature. If they became a permanent phenomenon, that would have much more significant implications for market structures and the profitability of financial intermediaries. Then I would be worried. But I am convinced that this regime will be temporary, and that is because our purchase programme is already bearing fruit.

At the moment, market participants are focusing almost exclusively on what central bankers have to say. Is that not dangerous, and does that not lead to more volatility?

Central banks have always influenced the markets – that is how monetary policy works. At the moment, however, there is exceptional nervousness worldwide. The prospective change in monetary policy in the United States and the United Kingdom is contributing to this, as are worries about China and emerging economies and major geopolitical risks. At the same time, market participants are making important changes to their business models and adapting to new regulation. This uncertainty and volatility cannot mean that we stop doing our job. We must nevertheless be extremely careful. In an environment of great uncertainty, we as the ECB should look beyond short-term volatility and stay calm.

Concern about a hard landing for the Chinese economy has recently been growing. How concerned about this are you?

The depreciation of the renminbi can be seen as a symptom of a slowdown in the Chinese economy, at least in the export sector. That is a reminder of the major global uncertainty that we face. Here in the euro area, we should see this as a warning about the importance of strong domestic demand. Strong exports are a sign of competitiveness, and as such they are a good thing, but it would be unreasonable to base the long-term growth model for the euro area on exports alone. That would make us totally dependent on global growth, particularly growth in emerging market economies. Euro area countries must strengthen domestic demand, and above all private investment, in order to make themselves more resilient.

What is your assessment of the Chinese central bank's decision to change the way in which the renminbi is pegged to the US dollar, which has led to a strong devaluation and stoked fears of an increased currency war?

Fundamentally, it means a step towards an exchange rate system which is more strongly determined by the markets. That is generally a good thing; it strengthens the resilience of the global economy and is in line with the G20's recommendations. Within this framework, I trust the Chinese authorities not to use the exchange rate as a policy instrument. That would go against the recommendations of the G20.

Would the ECB welcome the renminbi being part of the currency basket for the IMF's Special Drawing Rights?

Fundamentally, I am convinced that it will happen anyway in time because China's global significance continues to grow. But there is no reason to jump the gun at this point. There are IMF criteria for inclusion and they have to be met. This should not be a political decision.

To come back to the ECB: there is a global discussion about central banks' mandates, for example whether financial stability should become an explicit target, and about inflation targets, i.e. whether 2% is still appropriate. Do you see a need for the ECB to rethink its operational framework?

Here in the euro area, we are slowly fighting our way out of the crisis. Now is definitely not the right time to be having these discussions. We have fared well with our narrow mandate.

We are mindful of financial stability considerations, but our primary mandate remains price stability. As regards the figure of 2%, there is not much point in thinking about this when inflation is at 0.2%. We should concentrate first of all on bringing inflation back towards 2%.

But that is precisely the point. Some people in Germany believe that price stability is not 2% inflation, but rather 0% inflation.

Price stability does not mean 0% inflation. When inflation is measured at 0%, the actual rate of inflation is less than 0%, as there is a tendency to overestimate the rate of inflation by underestimating the underlying adjustments in the quality of goods and services. And just think: if we reduce our inflation objective when inflation stands at 0.2%, how are we to prevent it from being raised the next time it stands at 3.5%? Our inflation objective has served us well, and the medium-term orientation gives us sufficient flexibility.

There are also repeated discussions as to whether the ECB should act as a guarantor in the financing of euro area governments – similar to what the Federal Reserve does in the United States. What do you think of that?

If "guarantor" means that the ECB fosters trust in the irreversibility of the euro and ensures stability, that is already part of our mandate. If it means that we become a lender of last resort for governments, the answer is a clear "no". The monetary financing of governments is prohibited by the Treaty on the Functioning of the European Union, and that gives us important protection. Some people in Europe would like to amend that part of the Treaty, but that would be very dangerous.

Back in May, you attracted a lot of attention when you indicated at a non-public event involving hedge fund managers that the ECB would frontload some QE purchases before the summer, with the speech not being published until 12 hours later. President Draghi announced that the rules governing such appearances would be changed. What lessons need to be learned from that?

As the ECB has stated publicly, the discussion that was triggered was primarily a result of several misunderstandings relating to the substance and the news content of the speech, as well as an internal procedural error regarding the timing of its publication. But I have also drawn my own personal lessons from the incident.

What are they?

For me, the key lesson from this episode is what the reaction said about people's expectations of us at the ECB. The discussions about it have clearly shown that central banks must be above any suspicion that they are too close to market participants. That is true of central banks generally, and even more so when they are also responsible for banking supervision, as in the case of the ECB. As for me personally, I will no longer speak at events organised by banks. I did that in the past, there are no problems with that from a legal perspective and indeed, it is useful to learn from market participants. But we must be careful that people do not get the wrong impression.

Central bankers at the Federal Reserve publish their diaries of events. Could the ECB follow suit? There is also the question of how transparent a central bank can actually be.

Societies are increasingly demanding more transparency from public institutions such as the ECB. In time, I believe there will be more to come in that regard. We have responded to that by publishing, for example, summaries of our monetary policy discussions. I was fully in favour of indicating how individual members of the Governing Council had voted, and I remain convinced that it will happen someday. I would have absolutely nothing against publishing details of our diaries of meetings with external parties, as some public institutions already do. However, while being transparent and accountable, we must also be careful that we do not lose access to market participants. Part of my job involves understanding their views and explaining our actions to them.