

Peter Praet: Interview in *Handelsblatt*

Interview with Mr Peter Praet, Member of the Executive Board of the European Central Bank, in *Handelsblatt*, conducted by Mr Jan Mallien and Mr Daniel Schäfer and published on 10 December 2015.

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Mr Praet, rather than the next big flood of money that was expected from the European Central Bank (ECB), there was only a very small expansion of the existing stimulus. Did you have to back down? Does the majority of the ECB's Governing Council no longer support your and Mario Draghi's policy?

Quite the opposite: we had a very strong majority! By way of explanation: the relevant working groups provide the Executive Board with an analysis of the different measures and the Board discusses a monetary policy package, which I then put forward to the Governing Council. What was agreed last week is exactly in line with what I proposed to the Council on Thursday, taking into account what was discussed in the committees.

You had already met the other members of the ECB's Governing Council for dinner on Wednesday though. Did you encounter so much resistance then that you scaled back your proposals before Thursday's meeting?

The dinner always takes place, but these issues are not discussed during the meal. It is true that at first I was not sure how the proposals would be received. But in the end, the discussion was not very controversial. Not everyone was in favour of my proposals, but it is not the case that we said "we want this", and then got less. That is just not true.

If you didn't want to achieve anything more, why did you create such high expectations beforehand?

We had already talked about reviewing our measures when the Governing Council met in Malta in October. The markets already reacted to this back then, which was understandable. The problem was that the markets' expectations grew ever bigger in the meantime and were persisting, even though the most recent economic data had been encouraging. One big problem was that, during the quiet period...

...i.e. the days directly before the Governing Council meeting, when members of the Council are not allowed to talk about monetary policy...

...during this period, the markets exaggerated the situation again. But we could not respond to it because we are obliged to remain silent.

What do you mean by "exaggerated"?

That there was speculation about a package of measures that had never been up for discussion.

But prior to the start of the quiet period you and Mario Draghi gave pretty hard-hitting speeches which made the markets feel euphoric. Why didn't you quickly try to correct expectations?

You shouldn't push expectations management too far. If expectations get out of control, we, as the central bank, will try to correct it. But that simply cannot be done during the quiet period.

What are the consequences of this communications debacle?

We don't communicate in order to please the markets, but to fulfil our mandate.

Investors seem to have taken a different view.

To begin with, the market expected a reduction in the deposit rate, an increase in the amount of monthly bond purchases and an extension of the bond-buying programme. But what was

not anticipated at all was the reinvestment of maturing bonds or the expansion of the programme to include regional bonds. The reinvestment of maturing bonds is an important decision because it ensures enough liquidity is available for as long as is necessary. The expansion to include regional bonds is also important because the markets were concerned that, in some instances in the foreseeable future, there might not be enough bonds to purchase.

But is that enough to get inflation moving back towards 2%?

Firstly, when it comes to our inflation objective, I'm really determined. I'm a hardliner on this point. And we as the ECB are ensuring that the necessary degree of monetary policy easing will be maintained in order to achieve the goal. But there are two big uncertainties: developments in the emerging countries and the effects of the interest rate turnaround in the US. As regards the emerging countries, we have arrived at the third phase of the great financial crisis. It started in the US, continued in the euro area and now it has reached the emerging economies. It'll take a long time to overcome. I would not be so concerned about this if the position of the euro area were more robust, but unfortunately it is still very fragile.

And what risks do you see in the US?

We don't comment on the monetary policy of other central banks. But the markets still don't know what the effects of the imminent turnaround in US monetary policy will be on long-term interest rates and global bond markets. It obviously brings uncertainty.

Are you ready, if need be, to do more, and what would be your preferred instruments?

We have clearly said that we are ready to do more, if this became necessary. The precise choice of instruments cannot be determined long in advance; it is based on the specific circumstances. The asset purchase programme is sufficiently flexible for its size, composition and duration to be adapted if necessary.

You have been pumping in money since March with large-scale purchases of government bonds. Nevertheless, inflation in November only stood at around 0.1%. Doesn't that prove that your policy isn't working?

No, it's working very well. In fact we were pleased to see how strongly our monetary policy has improved credit conditions. The impact on inflation however seems to be taking longer. Some would say that greater patience is called for. We have already pushed back several times our expectations of when the inflation rate will reach just under 2%. If we keep pushing them back, credibility will be put at risk.

Is this view shared by other members of the Governing Council?

Almost everyone on the ECB's Governing Council thinks that the measures are working. But that doesn't mean that everyone finds them good. There are two schools of thought among the critics on the Council. Some say they're unnecessary because the economic situation isn't that bad at all. For instance, they don't regard the development in inflation expectations as being so dramatic. Others say that, because of the special nature of a currency union, such asset purchases should only be used if we are in a deflationary situation. This point can be discussed at length. A large majority of the Council members, which includes me, think that if you deal with that only in the extreme circumstances of deflation then it's too late. It can only be corrected, the thinking goes, with great difficulty and requires much more effort.

But doesn't the ultra-loose monetary policy reduce the pressure on policymakers to undertake reforms?

I am of course concerned about the rather hesitant pace of economic policy reform. Many politicians are afraid of alarming the voters. That's why they drag out reforms. Monetary policy cannot solve the problems. But we cannot be inactive either, simply because the other side does not deliver.

You have often used market-based inflation expectations to argue for monetary easing. Are markets still a useful source of information for monetary policy?

I never take only one indicator. And we don't conduct monetary policy on the basis of market prices. That is only one part of the information we look at. Even when there's no news, the markets are still subject to a lot of volatility anyway.

A number of German politicians have recently voiced strong criticism of a secret agreement on the purchase of securities by the national central banks. Some of those banks have purchased on a large scale, others not. Why is there this difference?

There's no secret agreement. When the currency union was founded governments decided to transfer functions and tasks that are necessary for monetary policy to the Eurosystem and to leave other tasks as the responsibility of the national central banks. They invest, for instance, to cover the pensions of their employees or to build up capital and reserves. Some central banks also manage the investment portfolios of other central banks outside the euro area and invest this money so that it stays in circulation. It's vital that the Governing Council of the ECB is in full control of the size of the Eurosystem balance sheet, and that is the case.

If that's the case, why not do it publicly?

Personally, I see no problem in being more transparent on this matter. But the decision has to be taken by the Governing Council.

Could the ECB force the national central banks to do that?

As I said, the national central banks fulfil some of their tasks under their own responsibility and at their own risk, as provided for in the European treaties.

But aren't these purchases monetary financing?

No, the ECB's Governing Council limits the overall amount and has the necessary information. There is no such thing as "money printing by national central banks" outside of the Eurosystem framework. In any case, the Governing Council ensures that no Eurosystem operations infringe the prohibition of monetary financing.

Mr Praet, you were born in Germany and grew up here. Do you understand why the ECB's policy is being so severely criticised here?

The situation in Germany is different from elsewhere in Europe. There has been no credit cycle here. But in Germany it's often forgotten that we would have faced a catastrophic situation if we had not acted. The European environment is very difficult. We have institutional weaknesses in the euro area which have to be addressed and eliminated. Until this happens, the work we have as a central bank will be more difficult than is the case in other currency areas. There is no proper resolution system for banks, and nothing in the event a state runs into difficulties. It's not about us favouring one country over another. It is simply about making the best of a difficult situation. What we have done is right. It's the best we could do, and it has been working.