Sabine Lautenschläger: Interview with Deutschlandfunk

Interview by Ms Sabine Lautenschläger, Member of the Executive Board of the European Central Bank and Vice-Chair of the Supervisory Board of the Single Supervisory Mechanism, with Deutschlandfunk, conducted by Mr Klemens Kindermann and published on 19 February 2017.

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Ms Lautenschläger, ten years ago, in the summer of 2007, the banking crisis that subsequently developed into a global financial crisis began in the United States. Besides being one of the six members of the ECB's Executive Board, you are also Vice-Chair of European banking supervision. How safe are European banks today?

Much has changed over the past ten years. European institutions hold far more capital, of much better quality. They also have much more liquidity – so the level of resilience in the European banking market is far higher. But that doesn't alter the fact that some banks still need to do their homework.

We are not holding this interview in the ECB's new twin-tower high-rise in Ostend, but here in the Eurotower, right in the heart of the Frankfurt banking district – really up close – because European banking supervision moved back in here after the building was renovated. Can taxpayers and investors be sure that, in future, a banking crash will be indeed prevented by you, the banking supervisor, among others?

Well, I am not going to promise you here that that one bank or another won't be withdrawing from the market over the next ten years. It is certainly not up to us to prevent that happening. If a bank no longer has a sustainable business model, it should indeed leave the market. The important thing is that the process is orderly, without much turmoil and without heavy losses for the bank's creditors. As I said, I won't promise that there will be no withdrawals here and there from the market; a small banking crisis can neither be predicted nor fully eliminated. However, it has become far less likely; an incredible number of new rules and a vast improvement in supervision have made a banking crisis more improbable. However, you can obviously not eradicate it completely.

When you refer to such a bank closure – we basically have such a case at the moment: I mean, shouldn't the Italian bank Monte dei Paschi di Siena actually have been resolved in line with the new rules of the banking union, but the Italian government now wants to rescue it in some way? How does that work?

Let me first say that I am unfortunately unable to speak about individual institutions. I have a crystal-clear obligation to secrecy that prohibits me from giving you any details that I of course have about the bank. But perhaps I can explain that in a slightly more abstract way. There are rules that clearly set out what should be done if, say, a stress test, which does not reflect reality, but rather potentially adverse scenarios, reveals a capital shortfall at an institution. And the relevant European guidelines provide for the possibility, subject to fulfilling certain conditions, of obtaining a "precautionary recap", i.e. a temporary recapitalisation, for possible future events. Clear conditions apply, however, and they must be fulfilled – by each bank.

So that should now be done at the bank in question, the one that we don't want to elaborate on now. But is it then correct, that a state, specifically the Italian state, should once again come to a bank's rescue – speaking in purely general terms.

The law (and that is a European directive – that is unrelated to Italy at present) allows for such a possibility if there is a threat to financial stability, provided that certain conditions are fulfilled. If, for example, this capital injection is not used to cover existing losses, but rather future potential losses, that arise, say, from a stress test scenario. As I said, that has nothing to do with Italy...

Will it though, will it...?

....

Yes.

But that is a European directive that applies to all.

There is now talk of establishing a bad bank that would be used to package non-performing loans. What do you think of that idea – for Europe?

I am quite open to this idea in principle, although I would of course need to have all the details. Does that mean that the banks would then sell their impaired loans to a bad bank at market price or at another price? What impact would it have on possible State aid procedures if the sale were not made at market price? So it is extremely important to know all the details about this idea of a bad bank before actually being able to decide whether it would be a viable possibility that would comply with the rules.

Ms Lautenschläger, here in Europe you are endeavouring to keep banks on a tighter rein so as to avoid any recurrence of a financial crisis such as the last one. In the United States, however, things seem to be moving in a different direction; the new US President Donald Trump has signed an executive order for a review of the Dodd-Frank Act, which provides for the tighter regulation of banks. Are you concerned that this may open the door to another financial crisis?

It is still too soon to make a final assessment because we don't know exactly what the US government wishes to review or which areas of the Dodd-Frank Act, which numbers hundreds of pages, are being targeted for amendment. Overall – yes, it is true that we are keeping European institutions on a tighter rein, as you put it – I think the financial regulation has turned out well. We will need to review some aspects over the next ten years to see if there have been any unintended consequences. But on the whole, I think it is imperative that we do not take a leap backwards, especially not on an international scale, but rather ensure that we continue to provide the banking sector, which is indeed global, with a set of international rules.

Yes, but when the main player – the United States, which is home to the world's major banks – deviates and deregulates, what does that mean for us here in Europe?

We're not at that stage yet. As I said, it's too early to judge what exactly will be addressed in the United States. The Dodd-Frank Act contains many national rules, which, if they were to be revoked, would have no impact on Europe as such.

Will there be competition for a more relaxed regulation?

Not from our side. I don't believe in more relaxed regulation. Nor do I believe in excessively tight regulation; there must be a happy medium that enables the institutions to provide the real economy with the financing and services that it needs so much. We have seen, precisely in 2007 and 2008, what happens when regulation is too weak, when we trust in the self-discipline of the markets.

Are you already in talks with the United States?

I have been speaking with my US colleagues for many, many years and, of course, over the past month too. And I will also speak with them over the next few years. But again, it is still too early to form a judgement. So far there is just a general tendency and a statement that they want to address something. It is important to know what exactly that is.

Ms Lautenschläger, inflation has returned. After a long period with no inflation, the latest estimate puts it at 1.8% for the euro area. The ECB has always said it aimed for an inflation rate of close to 2% – that is what we have now. When will you raise interest rates?

Returning your question, can we say that inflation has come back, having had such an inflation rate for one month? We have...

It was 1.7% in December.

No, the rate for the euro area in December...

It was, nevertheless, 1.7% in Germany and 1.1% in the euro area.

Exactly. In the euro area – and the ECB conducts monetary policy for the euro area – inflation was 1.1% in December and it is estimated at 1.8% in January. Frankly, I am delighted about that: we are close to our objective of below, but close to, 2%. However, it's important that this is not a temporary, short-lived spike. I can tell you that we don't yet have an exact figure for January. For December, the increase in inflation was driven mainly by energy prices, specifically by what is known as the base effect. We had come to the end of a year in which prices were low – that has an impact, as do – believe it or not – package holidays, which the Germans booked in December. Unfortunately, that does not happen every month, even though we are the world champions when it comes to travelling. And therefore...

Ok, but let's stay with...

Please let me finish: ...therefore it is really important to see a trend, that it is certain that inflation really has come back.

But let's stay with energy prices for the moment. It is surely not conceivable that oil prices will fall again over the coming period. So we already have inflation – a trend – but interest rates are still at 0%. How can that be explained? When are you going to respond?

I am one of the most optimistic ones, who want to return to a normalisation of the very expansive monetary policy as soon as possible. But, for me, it is crucial that we don't just have a short, temporary upward outlier, which would then – months later –give us inflation rates that were too low, and we might then have to respond with stronger and even more accommodative monetary policy measures. That would be, how should I put it, more than counterproductive. So just let us wait for another few months and then we can be sure...

But Ms Lautenschläger, can't one be too late in in stopping the taking of a medicine? Because it was intended as medicine.

Oh yes, of course. And it's a strong medicine, with risks and side effects that should not be underestimated. But it would be even more difficult if we were to withdraw it and would then realise two months later that it was too soon, that growth is collapsing, unemployment rising again, that Germans can no longer set aside savings because they are not in employment, but out of employment, and because business owners are not obtaining orders owing to the lack of growth. The whole ability to save would be diminished and higher interest rates would be of no use to you – absolutely no use at all. And therefore it is important...

But if you do see the Germans as...

...to do it

Yes.

...at the right time. As soon as possible.

If you view Germans as savers, well, on that very matter, can you then understand that many Germans are worried that the money they have saved up for their old age is melting away?

Yes, I'm a saver.

Let's take an example. Zero interest rate, zero inflation, i.e. if someone has €10,000 then he or she, when inflation is at 1.7% – and most economists believe that next year it will be around that – then that person only has €9,830 [after one year] and €8,400 after ten years. The money melts away and the ECB does nothing about it.

I promise you, if we have 1.8% per month for ten years, then...

You'll do something then...?

No, earlier, definitely. No – what's really very important is that every saver has a reason to save, whether he or she is a business person, self-employed or an employee. If you don't have a job, if you don't have any orders for your business because growth isn't right, because investments aren't right, then you can't save either. And if you have inflation at 1.8% for a month, then of course you won't be €200 down on your €10,000 as it can't be calculated for the whole year but only for a month. So, it's clearly a serious issue – especially for savers – and also for me, as I'm a saver too. Yes, and that's why it's important to exit from the expansionary monetary policy as quickly as possible, and because the intended effects of the monetary policy measures decrease over time, while the risks, the side effects, increase. Therefore, what matters is to exit as quickly as possible, but not to be exposed either to the risk of exiting too early, having seen a perhaps temporary outlier for a month.

In that context we of course have had a long period of low interest rates.

Yes.

And my question would be: what message are you sending young people with this low interest-rate policy? In fact, they need to start now setting aside money for their old age, to draw up life insurance policies, real estate savings agreements, but they hardly get any interest from them. What are you saying to these young people who have to make provisions?

My daughter is 25 and I tell her very clearly: "You have to set something aside for about 40 years, we want to ensure with our monetary policy measures that you can save for 40 years and not just for next year with higher interest rates. We want to ensure that you have work and there's growth. Invest your money wisely, think about it carefully, diversify if you can". By the way, in the third quarter of last year Germans gained quite a few billion euros in assets, so it's not as if none of us have assets.

Not all to the same extent.

Not all to the same extent, I agree with you.

Shareholders, house owners – they have benefited.

Yes, precisely. And young people get married, have children and want to build a house and at the moment they have a chance to build at unprecedented rates of interest. In other words, if you are a business person or have a young family and want to live in your own property then these are golden times for you.

How do you actually explain to children these days the purpose of savings if they are used to, have grown up in, in a situation where, at the end of the year, no interest is paid?

You tell the children very clearly that you don't only save for a month, but for many, many years, and that investment conditions over four decades, if you want to save for your old age, change and that you have to consider not only what you can save over that long period but also your ability to save, i.e. your earning potential. It is really important that you, as a parent, explain to your child that it is not about saving for a month – that's then a question of pocket money and whether I'd sometimes like to go to the cinema, etc. – but that to provide for one's old age you actually have to save for decades. Then the interest rates balance themselves out.

If we assume that all this is not just for a month, but that we also have inflation that rises for several months and continues to rise next year, then we would have the possibility to slow down a bit in respect of something else.

Yes.

You have at the moment an asset purchase programme on which you are spending billions and billions in order to buy assets, and it has just been extended. At the end of the year we will have reached a purchase volume of over €2 trillion – it's a number that's hard to imagine. Can't you take your foot off the accelerator a bit?

I'm one of those who are pushing for a very early exit once the conditions for it have been met. And of course this concerns mainly the public sector purchase programme, and that is an exceptional monetary policy measure. In other words, it's not part of conventional monetary policy. And you have been talking about next year and the year after or a date in ten years' time...Well, I hope and I am optimistic that we'll see that before five or ten years have elapsed. The programme itself comes to an end next year, provided that it is not renewed, in the event that our optimistic expectations are not met after all and inflation is lower. So, from that point of view, it is actually a sort of deadline. Yes.

If everything stays as it is, can we expect that a first step will be taken in the spring?

I can't name any dates. But to recap, if the inflation rate as we saw it in January were to continue, then I wouldn't want to wait until next year.

Let's turn to the US economy. The economy is doing very well there, the Federal Reserve will probably increase the interest rate gradually. Don't you have to react to that in some way?

The Federal Reserve has a mandate to ensure price stability in the US. We have a mandate to ensure price stability in the euro area. The US economy is indeed doing better than Europe's. It's been growing much stronger for much longer. The Federal Reserve also has to take into consideration the unemployment and employment figures, which are an explicit part of its mandate. Conditions there have been much more positive for a much longer period and that means we are working with different preconditions.

Is the US government right to claim that Germany is exploiting the US and other countries through an undervalued euro?

No. That's not right. Each of us – both the ECB and the Federal Reserve – have a price stability mandate. And if the inflation rate here is much too low for a long period and inflation expectations – if you look at them – are very low, i.e. below, well below 2% that we aim for, then we have to react, as that is our mandate. It's got nothing to do with someone or other exploiting someone else.

Ms Lautenschläger, coming up in Europe we have some important elections in the Netherlands, France and here in Germany too. The Eurosceptic movements, such as the Five Star Movement in Italy and the Front National in France, are arguing that the economy would be more competitive with a flexible exchange rate. Is that true? And is there a risk that countries will leave the euro? Do you think that might happen?

Whether countries leave the euro is for me speculation. The prosperity the euro has brought is often underestimated. The benefits of the euro in terms of cohesion, trust in the euro area as a whole, the costs that have disappeared because businesses no longer have the foreign exchange risk between euro area Member States, all these things lead to a clear answer, in my opinion, to the question of whether I would be in a better position inside or outside the euro area. We are in a better position inside and I hope that the people of Italy, France and Germany appreciate the benefits of the euro and the single currency area.

The populist parties in Europe get much of their support also from the distrust towards institutions in Europe, including the ECB. Are you afraid that you will also be affected by this? Or are you already taking it into account?

Well, what I'm aware of, what I've heard, is that support for the euro and Europe, for example, among the people of Germany has never been so high. I have also noticed of course that support for the ECB is not so high. I think we have to explain much more what we stand for, what we do, what we don't do what, what we can't influence, and also we have to explain much more and in a better way, including why the ECB plays a very important role for Europe and the euro. And this interview today is a chance to do that.

Yes. But there are also other times when a very academic and technical language is used…

Yes, that's true.

... when perhaps not everyone can follow the arguments being made by the European Central Bank. What can you do about that?

We have to simplify our language. But I agree with you, it is very difficult, here and there, to explain the economic terms, the technical terms, in a way that everyone can understand, including those who have not have studied economics. But it is our duty and it is important. I believe that if you ask, "Can a German still save today and how do I explain that to my children?", then it's my job to explain.

On the subject of Brexit. What would be its impact on the euro area?

In the second half of last year, we saw no effects on economic growth. Whether it remains like that in the coming years is very difficult to foresee. It also depends somewhat on the outcome of the negotiations, the exit negotiations between the UK and the European bodies and institutions.

Deutsche Börse and the London Stock Exchange are meant to be merging, at least that's what they want to do. Might this planned merger also need to be reviewed by the European Central Bank?

It was already necessary before the Brexit decision, because, among other things, it involves shifts of various shareholdings in various banks. I can't go into detail, for reasons of confidentiality, but a merger of this kind is always looked at by different supervisors from different perspectives and a decision one way or another must be taken.

Basically then...

It's quite separate from Brexit.

In principle, doesn't the ECB have, shall we say, no general objections to such a merger?

We haven't yet finished our checks. So I can't say what the end result will be. And I'm not at liberty either to say anything because it involves individual institutions. I trust you understand.

Ms Lautenschläger, thank you very much for the interview.

I thank you very much.