

Mario Draghi: Interview with *The Wall Street Journal*

Interview with Mr Mario Draghi, President of the European Central Bank, in *The Wall Street Journal*, conducted by Messrs Robert Thomson, Matt Karnitschnig and Brian Blackstone on 22 February 2012, and published on 24 February 2012.

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WSJ: What inning are we in with Greece until we know if we're at the resolution to end all resolutions?

Mario Draghi: I don't know baseball. But if we didn't have that package finalized, there would be no game. So this could be the beginning of a new world for Greece where the pending financing problems have been addressed. Now the policies will have to be enacted. The Greek Government has undertaken very serious commitments in the fiscal policy and in the structural policies areas. But there are implementation risks and probably oncoming elections. The Eurogroup gave reasonable probabilities to the success of the program if the measures, especially the structural measures, were undertaken.

Also one could see that there is a different awareness in the Greek public opinion to the extent that what's happening is painful but necessary. The number of people, who favour default, inflation or even exit from the euro doesn't seem to be prevalent in Greece.

WSJ: Do you think the acute phase of the crisis has passed? It struck us this week that once the deal was decided, we didn't see the kind of elation we've seen after past programs.

Draghi: It's hard to say if the crisis is over. Let us look at the positive changes of the last few months. There is greater stability in financial markets. Many governments have taken decisions on both fiscal consolidation and structural reforms. We have a fiscal compact where the European governments are starting to release national sovereignty for the common intent of being together. The banking system seems less fragile than it was a year ago. Some bond markets have reopened.

But the recovery is proceeding very slowly and remains subject of downside risks. I was surprised too that there was no elation after the approval of the package and this probably means that markets want to see the implementation of the policy measures.

WSJ: When you look at the risk profile of the package and the deal, is the greatest risk arising from the streets of Greece, or is the greatest risk arising from a lack of growth in Greece?

Draghi: In the end it seems the greatest risk is lack of implementation. Some measures are directly targeted to enhance competitiveness and job creation. Others foresee a radical fiscal consolidation. The two are very complementary to ensure a return to growth after the unavoidable contraction in economic activity.

WSJ: But some people say Greece is really suffering depression-like conditions, GDP off 15% or 16% peak to trough. What is your view of these austerity policies in the larger strategy right now, forcing austerity at all costs in order to bring the budget deficits down?

Draghi: This is actually a general question about Europe. Is there an alternative to fiscal consolidation? In our institutional set up the levels of debt-to-GDP ratios were excessive. There was no alternative to fiscal consolidation, and we should not deny that this is contractionary in the short term. In the future there will be the so-called confidence channel, which will reactivate growth; but it's not something that happens immediately, and that's why structural reforms are so important, because the short-term contraction will be succeeded by long-term sustainable growth only if these reforms are in place.

WSJ: Austerity means different things, what's good and what's bad austerity?

Draghi: In the European context tax rates are high and government expenditure is focused on current expenditure. A "good" consolidation is one where taxes are lower and the lower government expenditure is on infrastructures and other investments.

WSJ: Bad austerity?

Draghi: The bad consolidation is actually the easier one to get, because one could produce good numbers by raising taxes and cutting capital expenditure, which is much easier to do than cutting current expenditure. That's the easy way in a sense, but it's not a good way. It depresses potential growth.

WSJ: Which do you think are the most important structural reforms?

Draghi: In Europe first is the product and services markets reform. And the second is the labour market reform which takes different shapes in different countries. In some of them one has to make labour markets more flexible and also fairer than they are today. In these countries there is a dual labour market: highly flexible for the young part of the population where labour contracts are three-month, six-month contracts that may be renewed for years. The same labour market is highly inflexible for the protected part of the population where salaries follow seniority rather than productivity. In a sense labour markets at the present time are unfair in such a setting because they put all the weight of flexibility on the young part of the population.

WSJ: Do you think Europe will become less of the social model that has defined it?

Draghi: The European social model has already gone when we see the youth unemployment rates prevailing in some countries. These reforms are necessary to increase employment, especially youth employment, and therefore expenditure and consumption.

WSJ: Job for life...

Draghi: You know there was a time when (economist) Rudi Dornbusch used to say that the Europeans are so rich they can afford to pay everybody for not working. That's gone.

WSJ: With Greece there was a lot of focus on achieving numeric targets. Now if you take countries like Portugal or Spain, if they get these big structural economic reforms right, should they have to be so focused on meeting specific deficit targets?

Draghi: There is no feasible trade-off between the two. Fiscal consolidation is unavoidable in the present set up, and it buys time needed for the structural reforms. Backtracking on fiscal targets would elicit an immediate reaction by the market. Sovereign spreads and the cost of credit would go up. We've experienced all this.

WSJ: Do you think Portugal will need another bailout?

Draghi: No. We consider the program on track.

WSJ: Where do you see the interbank market now? Is it healing? Is it still dysfunctional?

Draghi: What we saw is that after the first (Longer Term Refinancing Operation) the senior unsecured bond market reopened. In the last two months we had something like EUR 40 billion of new issuance, which is as about as much as it was in the previous six months or more. We also saw EUR 30 billion in new covered bond issuance. But for the interbank markets to function we need a return of full confidence in the counterparty. We can address only the liquidity side of the problem. But then growth prospects have to pick up. After a very weak fourth quarter, economic activity in the euro area is progressively stabilizing at low levels.

WSJ: It still seems as though credit has dried up in Spain, Italy and elsewhere.

Draghi: Our last bank lending survey was done in between the time the first LTRO was decided and when it was executed, so it gives only a partial picture of what is happening. That picture was not positive. Credit was tightening all over the euro area in different degrees of intensity, more dramatically in the southern regions. We have to ask ourselves why this is so. The LTRO allotment (in December) was EUR 490 billion. The return of shorter-term liquidity from the banking system before the LTRO was about EUR 280 billion, so that the net injection was only EUR 210 billion. And the bank bonds coming due in the first quarter were also about EUR 210 billion. Therefore, it is likely that banks simply repurchased their own bonds coming due. We have avoided an even worse credit crunch.

WSJ: Would you be open to doing more, or longer, LTROs if needed?

Draghi: You know how we answer these questions. We never pre-commit.

WSJ: The ECB protected its Greek bond holdings from losses by swapping the bonds for new ones. Critics say the ECB should suffer the fate that private sector bondholders have suffered. What's your response to that?

Draghi: The Securities Market Program bought these bonds because the monetary policy transmission channels were broken. The purchase of these bonds was done for public interest reasons. Also people tend to forget that this money the ECB has spent is not private money. It is public money, it is taxpayers' money and the ECB is committed to protect the taxpayers' money.

WSJ: Will that lessen the impact of future purchases, or are you willing to wind down the SMP?

Draghi: The SMP holdings are small if compared to the size of the European bond markets, and the interventions have become smaller and smaller in recent times.

WSJ: Can you rule out future debt restructurings? Some analysts would say that a country like Portugal would benefit from this.

Draghi: We have confidence that the program countries are taking appropriate actions and that the targets of their programs are achievable and realistic.

WSJ: There's been a lot of discussion on whether the Chinese will get involved, whether China will buy bonds. What do you see on Chinese institutional involvement in European financial markets?

Draghi: So far I don't see any official public involvement in European financial markets. There have been lots of talks and conversations. I hear about them but I haven't seen any official investment in European financial markets.

WSJ: Over the past year two top German officials at the ECB resigned. The current Bundesbank president opposed the bond swap and has spoken about risks associated with the three-year LTROs. Is there a risk Germany becomes isolated within the ECB?

Draghi: The vote for the three-year LTROs was unanimous. Given the peculiar nature of the ECB, one of my objectives is that we have as much consensus as possible. We have to do the right things, and we have to do them together.

WSJ: Looking at the debt crisis from the outside, people see all these crisis meetings and even though Europe has a lot of wealth it doesn't seem to be able to channel the money and has gone to the IMF three times. What do you say to people outside Europe? Europe seems to be a major risk and doesn't appear to be resolving its problems on its own.

Draghi: I wouldn't take such a negative view. Many things have happened in Europe in the last year and a half. You have different countries that have different initial conditions – high

debt, low growth countries and countries with low debt and high growth – and they pose the fundamental question of how do we go on without being a fiscal union. We can't have a system where you spend as you want, and then you ask to issue (debt) together. You can't have a system where you spend and I pay for that. Before we move to a fiscal union we have to have in place a system where countries can show that they can stand on their own. And this is the prerequisite for countries to trust each other. This so-called fiscal compact treaty is actually a major political achievement because it's the first step towards a fiscal union. It's a treaty whereby countries release national sovereignty in order to accept common fiscal rules that are especially binding, and accept monitoring and accept to have these rules in their primary legislation so they are not easy to change. So that's the beginning.

WSJ: You've been in the position now for four months. Is there anything that has surprised you? Do you regret taking the job yet?

Draghi: Would I tell you that if it was true? No, I don't regret taking this job. I've been a member of the Governing Council for six years, so certainly the new part of this job is the inner machinery of the ECB. But the monetary policy decisions and the related decisions were part of my knowledge even before, because we shared decisions that were taken in the past.

WSJ: Your first months saw a lot of activity. Is there much more the ECB can do when it comes to financial stability and economic growth? Has it done about as much as it can?

Draghi: What I am going to say doesn't imply anything as far as future monetary policy decisions are concerned. Within its primary mandate the ECB will do its utmost to ensure price stability in the medium term and within the remit of the Treaty to foster financial stability.

WSJ: What's the first statistic you look at in the morning?

Draghi: Stock markets.

WSJ: Do you look at the euro exchange rate?

Draghi: Not in the early morning.