Mario Draghi: Interview with *Financial Times*

Interview with Mr Mario Draghi, President of the European Central Bank, in Financial Times, conducted by Mr Lionel Barber, Financial Times editor, and Mr Michael Steen, Frankfurt bureau chief, in Frankfurt on 11 December 2012, published on 14 December 2012.

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The following is an edited transcript of the interview.

FT Do you think when historians look back, that they will say this was the year that the euro was rescued?

MD This year will in my view be remembered as the year when the long-term vision for the euro and the euro area was re-launched. The June summit, especially, was a key event. It's also the year when euro area governments achieved substantial progress in adjusting their economies. And it's the year when the ECB has stepped in to remove tail risks.

FT Why was the June summit so important?

MD The June summit was important because, for the first time in many years, it laid out a medium-term vision for a genuine economic and monetary union, made by four pillars: fiscal union, the so-called banking union, economic union and political union, endorsed by the leaders. That was an important milestone.

FT This was the extension to the Maastricht framework that had proven to be inadequate?

MD Exactly. The leaders built on Maastricht with a stronger fiscal discipline. In the euro area a country cannot pursue its economic policies in a completely independent way, ignoring their implications for other member states. This was one of the main conclusions of that summit. Sovereignty is something that needs to be shared.

FT Was the June summit the precondition for OMT?

MD No, the decision for OMT was meant to pursue, within our mandate, our objective to deliver price stability. The removal of tail risks related to unfounded fears regarding the euro was essential to fight fragmentation of the euro area markets. And that has been important because with fragmentation – I've stressed this many times – we are not in a position to deliver price stability for the euro area as a whole.

FT When did it become clear that you had to take that step as a central bank?

MD Clear visible signs of fragmentation had been with us since the second half of last year, gradually leading to a euro area-wide credit crunch by year-end. Then the ECB conducted the two LTRO operations, which removed another type of risk, namely the possibility of a banking crisis caused by lack of liquidity. They had a very powerful effect of calming financial markets for some time. But then, by the end of April this year, we saw all types of spreads widening again, and the amount of short positions against the euro picking up. These signs made clear that fragmentation had reached points beyond which we would not be able to deliver price stability.

FT I'm going to explore this crucial approach, which you adopted on OMT and which you clearly said, one, that it would be conditional. And, two, that you were acting within the ECB mandate. But before I do that, I just want to turn the reel back to when you started and ask you about strategy, because it seems to me that you have had a strategy. You may not have been convinced that you could save the euro, or, at least, re-launch the euro, but you had a strategy. Is that right, or have you more improvised?

MD There certainly was a deep reflection going on in the months before, both in the ECB and in the Governing Council, about how to cope with this fragmentation. The objective was and still is to restore a financially integrated monetary area. The OMT was the result of this reflection. The first element of which was the acknowledgment that we were in what economists call a “bad equilibrium”, namely, a situation in which you have self-reinforcing expectations that, if left on their own, produce disruptive outcomes. It’s a vicious circle that we had to break, but we should never forget how we found ourselves in that “bad equilibrium” to begin with, and that was because during the previous ten years several governments of the euro area pursued economic policies which were either plainly wrong, or they were simply missing, in a world that was changing fast.

FT But the crucial point is that this was a different quality of intervention and approach from earlier years in the ECB. You said it will be conditional and unlimited, whereas earlier it was limited and unconditional.

MD That’s the difference between the OMT and the SMP.

FT But did you say, look, we understand, historically and politically, why it’s been limited and unconditional, but this isn’t working. We have to move beyond that. Was that you arguing that, or do you think that was within the ECB, everybody understood it?

MD There was a sense among us that the SMP had run out of steam in terms of its effectiveness.

FT All the top financiers were saying that they’ve got to have unlimited ECB capacity. Of course, but the conditionality was crucial for winning support within the Governing Council, but even more important in Berlin.

MD The decision was taken in total and full independence. Certainly, conditionality, in a set-up like ours, is essential for two reasons. One is that it’s a form of a credit enhancement in the bonds issued by the country that applies for OMT because the more it will comply with conditions, the more creditworthy will be its bonds. The second reason is that with any type of intervention, moral hazard has to be avoided and fiscal discipline, in particular, has to be ensured. That’s why conditionality is crucial, but it is only a necessary condition because in any event the Governing Council assesses independently the state of monetary fragmentation. Let’s not forget our objective is fight financial fragmentation and deliver price stability.

FT Let me just go back to the political element. I respect what you’re saying about the ECB’s paramount independence, but, at the same time, you’re not monks in cells. You don’t sort of deliberate within the monastery and come up with something.

MD Today most central banks are independent, headed by non-elected officials, and quite powerful. This set-up is acceptable only if independence is limited by the mandate. That’s the framework that legislators have given us – independence limited by our mandate. That’s why we are so keen about respecting the mandate, because that’s the true guarantee of our independence, which especially in the euro area set-up is crucial for our credibility. And credibility is essential for delivering price stability.

FT Surely it’s also important for you, though, that politically you’re seen to be within your mandate.

MD Certainly and that’s why the ECB should be transparent and accountable.

FT Returning to the question of conditionally, there are important critics, particularly in Germany, who say that it removes the incentive of governments to act. How do you counter that?

MD Quite the contrary. Conditionality makes sure that governments will make the necessary reforms and maintain fiscal discipline.

FT Let me rephrase the question. How can you restore enduring confidence if there is a high level of conditionality? I’m talking about a kind of resolution of the crisis, and if the conditionality is too tight, too severe, governments don’t act and, therefore, nothing happens.

MD The assessment of conditionality is primarily in the hands of the European Commission, the ESM, and the IMF. But also do not forget that the ultimate assessment of whether to act or not is entirely in the hands of the Governing Council.

FT You announced the programme; there was immediately a favourable reaction in the markets, remarkable. Many people assumed then that the governments would apply, but they haven't. What conclusions did you see?

MD The purpose of the OMT is to remove the tail risks. It's up to the governments to decide upon a programme. We never took a stance which was proactive in the sense of encouraging governments or discouraging governments to apply. Let's not forget that the ESM is tax-payers' money, the decision over which should be taken by governments and by national parliaments. And the same is true for the potential applicants' reforms and budget consolidation. The role of the ECB, in that stage, should be on the back stage, not front line. It's up to the governments to decide.

FT Again, let's just step back a minute. It's been a tumultuous, extraordinary year. You have been a leading player in this drama. There are others, obviously. Chancellor Merkel, Mario Monti. What were the moments that stick out in your mind? Let's just look where you said the risks are really high and we need to act, if you think about that in the blur of events.

MD The speech in London on 26 July was such a moment. If you look at the verbatim, it doesn't say anything that's outside our mandate. But indeed it's an especially strong speech that makes a firm statement on the preservation of the euro.

FT It was a very, very firm statement. How did you come up with that wording? "Whatever it takes... And, believe me, it will be enough," – with a dramatic pause before.

MD Again, there was a sense that we had to overcome the limitations of the SMP, and make sure that the signal to the market would be proportionate to the gravity of the situation. That's actually what is behind that statement.

FT Did you rehearse the pause?

MD No, I'm not really that theatrical. But the situation at this moment was clearly showing that tail risks were increasing. So my intervention was made important by the very critical situation that was evolving.

FT You intended to have a reaction in the market. Was that your intention?

MD What I thought was that the markets should know what our stance was. This was the objective of this speech. It was meant to be absolutely clear about our determination. I also made the point that it was not only our determination but it was also our leaders' determination to carry out the June summit conclusions. I said that markets underestimated the leaders' determination and the amount of political capital they have invested in the euro. This is what I said first and then added that it's our intention to be firm and to do whatever it takes but within our mandate.

FT And, just to be really clear, you did not clear that speech, those remarks with anybody outside in the capitals?

MD No, absolutely not.

FT So that was a seminal moment. What was the moment in 2012 where you felt perhaps a sense of some relief? Without over-confidence, but that maybe the mood had shifted.

MD Was there such a moment?

FT I was hoping you'd say that.

MD That's what I feel like.

FT I just want to come back to this question of public opinion, which is very important. When did you decide and why did you decide to go to the Bundestag?

MD In an interview with Süddeutsche Zeitung the journalists asked whether I would speak in the Bundestag if I were to be invited, to explain better in Germany what we do and our intentions are. I responded that if I was invited, I would be ready to go. A few days after the interview I received the invitation from President Lammert. There was a genuine interest from the Bundestag to know in greater detail about our policy decision, at the time controversial in Germany, but applauded in the rest of the world.

FT There's a serious point about German public opinion. Do you think it's become more euro-sceptical this year, with all the difficult economic circumstances?

MD The difficult economic circumstances are everywhere in the euro area and this might have caused a different sense of perception of the euro. These are very serious moments. When I'm asked whether I can persuade the German public opinion, I say that I don't know. But I know that we have the duty to explain, and we are really working very, very hard on that front. Hopefully the results will follow. And this holds true for the all euro area public opinion.

FT You can see it in Britain where it's moving towards questioning membership of the European Union. Can we perhaps turn now to the question of what comes next – economic growth and the adjustment process? So, while it is true that current account deficits are shrinking and governments are doing, in many ways, courageous things, they're passing reforms, there's still the question of economic growth. What is your prognosis for the next 12 months?

MD Last week we published our new staff projections, showing the beginning of a slow recovery in the second part of next year. We have a serious situation in front of us. At the same time, there are some encouraging signs. The spreads are tighter than they were four months ago. Liquidity conditions are better, banks and corporates are funding themselves. Bond issuance has restarted. And for the public sector, the distressed countries have basically completed all their sovereign funding plans. Furthermore we think that our very accommodative monetary policy stance will find its way into the economy in the coming months. That's why we're saying that we may see a recovery in the second part of the year. Also, at some point, one will see the benefits of fiscal consolidation and structural reforms. So far we've only seen the contractionary effect of the fiscal consolidation. We haven't seen yet the positive effects of structural reforms because, obviously, they take effect with a certain lag. And third, we will be seeing a more buoyant world growth, which will help sustain exports of the euro area.

FT Are you bullish of America if they get through the fiscal cliff?

MD I'm confident they will find an agreement.

FT And even beyond that with shale gas revolution, re-shoring, property market recovered. They've fixed their banks.

MD I think they are well poised for a positive outcome. It's interesting though that until two months ago when people were asked about the major source of uncertainty and risk in the world, the answer was the euro crisis. And now it's the fiscal cliff.

FT Just going back to the forecast you were talking about. Those are actually a pretty dramatic downward revision. And this better mood in financial markets is pretty fragile, as Mario Monti's resignation shows. It just sounds like you're painting the picture of the glass being half full when that might be a bit on the optimistic side.

MD Indeed it's a significant revision downward. At the same time, the medium term outlook for price stability hasn't changed in any dramatic way. And you see these positive signs in the soft data coming out.

FT There are many critics of fiscal consolidation as you know. I know you've talked about this before. But is it problematic as the ECB to be pushing the case for it so hard, particularly in countries like Spain and Greece where this is causing real human misery, given, as you said before, you're unelected and you have to stick closely to your mandate. If there is no risk over the medium term for price stability, maybe there is a case to say there's too much austerity right now.

MD We're fully aware that the economic situation in several countries, not only Spain and Greece, is very serious, and we are not underestimating the difficulty of the situation at all. Let's not forget that the reason why fiscal consolidation became central for the policy advice of the ECB is because one can't have systems built on debt and deficits that the financial crisis has shown to be unsustainable. And there has been progress. To give up now, as some suggest, would be tantamount to waste the great sacrifices made by the citizens of Europe.

FT Yes, and what about the Martin Wolf critique that adjustment is a two-way process and that while the austerity should be pursued rigorously in the peripheral countries, the creditor countries must also adjust. They must also do their bit, which, in effect, means a somewhat more expansionary policy to counteract…

MD First of all one must stress that inflation is not a policy tool. One doesn't toy with inflation. Especially in an area made up by several sovereign states. The second point is that – in our institutional set-up – if you had to choose one policy objective that would be to increase competitiveness. The countries that have been successful in adjusting and in reforming have mitigated the short-term contractionary effects of fiscal policies. Countries that can actually manage this policy combination have a chance to reduce the difficulties that come from fiscal consolidation.

FT Are you thinking about Italy?

MD No, I'm thinking about Ireland.

FT A couple of other questions, one is the banking union because, in addition to all the questions that we've just discussed, these huge challenges for the eurozone and for the ECB, now you're going to have to take on the extra responsibility of supervision of at the least the large banks in the eurozone. Is the institution ready for this? Are you ready for this?

MD We will be ready. After the Council Regulation will enter into force, it'd take about a year to set up organisation of the SSM. There have been many discussions on how fast we should move and how broad should be the scope. One has to remember that we are a passive actor. We are in the hands of our legislators. It's clear that we want to move in a timely fashion, but it's more important to move well. And we intend to take the time that's needed for that.

FT Would one of the things about doing it right be that you need there to be some sort of European-wide bank resolution scheme in place before you take over the supervision, otherwise you're in a situation where you're nominally in charge of supervising all these banks. If one of them needs to be wound up, for whatever reason, you're completely at the mercy of the local supervisor and the local arrangements. You don't actually have the powers to do anything.

MD A European Resolution Authority is an important complement to the SSM, and it will likely be in place by the time the SSM takes up its responsibilities. But even in its absence, the single supervisor's assessment of the possible non-viability of a bank would be such a strong statement that it would likely trigger the national government's policy response.

FT A personal question, it's a human question, here you all this incredible pressure on you. If you had to think of a few people in the world, you're definitely in the top five who've got most pressure from all the places, trying to hold this together. How do you cope with that, number one? And, number two is there anything that surprised you after being in this place for one year?

MD The way to cope with these pressures is to never forget that they are part of the set of responsibilities that one carries with this job, responsibilities to deliver price stability; to take policy decisions that affect the welfare of millions of people.

I really can't answer your second question because to say that something has surprised you, you have to be able to look back and say, oh, that thing actually surprised me. And this is not the way I function. I look forward, being naturally inclined to focus on the future. At least I think. But you should ask my colleagues too.

FT Anything to add?

MD I'd like to give you this quote of Professor Zygmunt Bauman, a Polish sociologist who has become best known for his analyses of postmodernity and consumerism. It has to do with the fact that you don't lose sovereignty when you share it, but you actually regain it. Countries with high debt and deficits should understand they have lost sovereignty a long time ago over their economic policies in a globalised world. Working together in a stability-oriented union actually means to regain sovereignty at a higher level.

FT They've lost it to the markets?

MD Yes. And sharing common rules for them actually means to regain sovereignty in a shared way rather than pretending to have sovereignty they've lost a long time ago. That's the point.