

Benoît Cœuré: Interview in *Le Monde*

Interview with Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, in *Le Monde*, conducted by Ms Marie Charrel on 17 April 2014.

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Is the level of government debt in the euro area sustainable?

The euro area countries have already greatly reduced their deficits. Now that growth is returning, continued efforts in this regard will allow debt-to-GDP ratios to be reduced.

The measures required of countries subject to a financial assistance programme under the Troika have had a recessionary impact stronger than that forecast by the International Monetary Fund (IMF), particularly in Greece. Have we gone too far with austerity?

The financial assistance provided by the European Union and the IMF gave these countries time to change the course of economic and financial trends that were no longer sustainable. Remember that had no financial assistance been provided, the adjustment would have been much more abrupt. The need for restraint is now lessening in the euro area, but not because debt is back in fashion! It is down to the fact that most countries have already taken the toughest measures and are now starting to reap the benefits.

Is the current level of the euro too high?

There is a particular fascination with the exchange rate in France that is not shared by other euro area countries. No doubt this has something to do with the fact that France is one of the only countries in the euro area whose external accounts are in the red. However, the euro area as a whole is running a current account surplus: the solution for France, therefore, is to improve its competitiveness, which is indeed what the government plans to do. This is not to say that the ECB is not concerned about the exchange rate; it is rather that the ECB does not have an exchange rate objective. The exchange rate is one of the factors that we take into account in deciding on our monetary policy stance. The important thing for us is to know whether the level of the euro exchange rate and its outlook are likely to hinder the return of inflation rates to below, but close to, 2%, which is our definition of price stability and which lies at the heart of our mandate.

There is no doubt that the appreciation of the euro since the summer of 2012 has contributed to the current low level of inflation. All other things being equal, the stronger the euro, the more an accommodative monetary policy is justified.

The low inflation observed in the euro area is affecting all advanced economies. What is behind this?

There is no simple answer to this question. Several factors are at play. Let's start with the difficult situation observed on the labour markets in most industrialised countries. The unemployment rate remains very high in the euro area. If this figure is lower for the United States, it is because many Americans have withdrawn from the labour market.

To this must be added the deleveraging by households and businesses, which is weighing on consumption and investment, and other factors, such as the slowing of China's economy, which is having a dampening effect on energy commodity and food prices, as well as the decline in energy prices, which is linked in part to the exploitation of shale gas in the United States. We need to know whether these developments are sustainable. All the major central banks, and not just the ECB, are asking themselves this question.

What could the ECB do to influence the level of the euro?

We have several instruments at our disposal in the event that it becomes necessary to loosen our monetary policy stance. We still have some margin to reduce key interest rates, including by pushing the deposit rate into negative territory (which remunerates the banks for funds held in the ECB's overnight deposit facility). Finally, at its last meeting, the Governing Council declared itself unanimously ready to look into non-standard measures, including the possibility of quantitative easing (QE) if circumstances dictated.

Would such quantitative easing affect purchases of government or private debt?

If implemented, this instrument is expected to have an impact on a range of assets that is broad enough to inject sufficient liquidity into the economy. The ECB's choice as to whether it should then repurchase public or private assets would depend on three factors. First, it is a question of effectiveness, in order to ensure the smooth transmission of the measures taken to the real economy, and in particular loans to businesses. Second, it is an issue of feasibility. The financial markets in Europe are very different to those in the United States: a QE for the euro area would thus be very unlike the US version of QE. Lastly, purchases of assets should be carried out in line with the Treaty, which prohibits the ECB from directly financing governments. Discussions are underway on all of these aspects.

I should add that any monetary measure will only be effective if banks in the euro area are able to start loaning to businesses again, and notably to small and medium-sized enterprises. The assessment of banks' balance sheets that the ECB is undertaking this year is key in this regard: if it is perceived as being sufficiently strict and objective, it will foster renewed confidence in the banking sector.

Would it be advantageous for the euro area to develop market financing of the economy, like in the United States?

Yes, even if the idea is not to copy the United States. European growth is based almost exclusively on financing of households and firms by banks. For a long time that worked well, European banks did their job. But the 2007 global crisis and then the euro area crisis revealed that depending so exclusively on one sole method of financing constitutes a weakness.

Developing market financing via ABS, i.e. asset-backed securities (secured corporate debt) or, for example, bond issuance by medium-sized enterprises would make the financial system more balanced and more resistant to shocks. This is essential as, by definition, we do not know where the next crisis will hit.

With this in mind, the ECB and the Bank of England are suggesting to revise the European rules on ABS. How?

The European regulators are discussing this because the euro area needs these instruments. It's a medium-term project whose purpose must not in any circumstances be to recreate the securities market as it existed before the crisis. The "new ABS" must be different from the previous ones. If they are more transparent and simpler then they will be less risky – the rules could take this lower degree of risk into account, in particular for the capital requirements applying to banks and insurance companies. It's not a question of going back over the need to raise the moral standards of finance, which has been advocated since 2008, but to promote instruments that finance the economy.

Might the normalisation of US monetary policy push European interest rates up?

It should be remembered, first, that if the US Federal Reserve System has decided to gradually taper its asset purchases in the markets, it is because it considers that the US

economy is improving and that the recovery is sound. That's good news for the global economy.

Recovery in the euro area is behind compared with the United States. We are therefore working to ensure that this differentiated recovery does not harm monetary conditions in the euro area. The ECB's adoption of "forward guidance" on its monetary policy has enabled European short-term interest rates to be disconnected efficiently from US short-term interest rates. We will ensure that this continues.

Spanish, Greek and Italian sovereign rates have declined strongly in recent weeks although these Member States still have high public debt. Are the markets too optimistic?

No, on condition that the reforms continue. International investors have confidence in the reform dynamic in euro area Member States, including in Greece. The level of the rates is only justified if the reforms are carried out as planned. This is true in small Member States just as in the big ones.

France has just announced 50 billion euro worth of savings and is slow to implement reforms. Is France lagging behind?

France has not been under the same pressures or financial stress as the peripheral countries of the euro area. France has enjoyed investor goodwill and has been fortunate to be able to decide for itself on the rhythm of its reforms. But that does not mean that the reforms are any less necessary.

The ECB has begun assessing banks' balance sheets before the start of Banking Union. Could the discovery of weaknesses in large institutions trigger another crisis?

At this stage it is too early to say what we will find. But one thing is certain: for confidence in the banking system to be restored, each time a bank has insufficient capital reserves, the gap will need to be filled quickly. And this following a well-defined procedure: first, having recourse to the bank's internal resources, then markets and finally – and only in the event that this is not enough – to public authorities at national or European level in compliance with State aid rules. Governments in the euro area have for that matter undertaken to follow this procedure if the situation requires it.

With the banking union, the ECB will be responsible for banking supervision in addition to monetary policy. Is that not too many powers in the hands of one sole institution?

It is true that the ECB will have more powers. But, as in any democratic system, it will have strong counterparts. In banking supervision just as in monetary policy, the ECB will be accountable for its decisions in accordance with the procedures which have been agreed with the European Parliament.

How will the ECB stand up to any political pressure in this regard?

The ECB has already demonstrated its ability to withstand pressure. Indeed, it is not only a question of being independent of governments but also of financial lobbies.