

Peter Praet: Interview with Les Echos

Interview with Mr Peter Praet, Member of the Executive Board of the European Central Bank, in *Les Echos*, conducted by JP Lacour, I Couet, C Chatignoux, G Maujean, and published on 15 July 2014.

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What would be your diagnosis of the health of the euro area?

Growth is taking off again, but it's a modest, fragile recovery and the risks are still very present. The latest figures are in line with our official scenario overall. I had hoped that the recovery would be picking up pace, but for the moment, it's not happening. Business is driven more by domestic demand than by exports, which are less robust than before the crisis.

Do you think that the economies have stopped diverging?

It is noticeable that confidence indicators have recovered sharply in the countries most affected by the crisis. This is the case in Spain, particularly, where growth forecasts are going to be revised upwards. In other countries, it is harder to make a diagnosis, particularly in France, where the pace of the recovery is deceptive. France has, however, benefited from very favourable financing conditions throughout the crisis, unlike Italy, for example.

SMEs are complaining that they can't get the financing that they need...

It's true that financing conditions have mainly been good for large businesses, which have access to the financial markets (through bond issues). SMEs find it harder to obtain financing during a recession. This is the case in France, as it is elsewhere. The central bank has reacted by cutting rates several times, bringing them to very low levels. The figures show, however, that whereas the lending trend is, on average, negative in the euro area as a whole, it is positive in France.

What are the brakes on growth?

Monetary policy cannot do it all. France has been affected by the slowing growth of its neighbours. But basically, it's investment that is causing a particularly serious problem. Another factor is the relative weakness of its export capacity. In the German press, we read news every day about the success of SMEs in the export markets. In France, the industrial landscape centres around a small number of very large export companies. I think the country has too much of a tendency to wait for the recovery of its commercial partners. Although recent signals have been encouraging, urgent action is required. We are still in a period of balance sheet adjustment, which drags on growth and creates a climate of uncertainty. We need to restore confidence to bring about a recovery in investment, particularly through clear announcements. The finance minister was talking recently about "good finance". I would add that good finance can't do anything if the fundamentals are not good.

What mechanisms do we need to act on?

I think that certain reforms should be made a priority in some countries to boost the potential for growth. In Italy, for example, emphasis is placed on the judicial framework to ensure that relationships between creditors and debtors are safeguarded, and on the reform of the Italian Senate, which must improve its decision-making. Equally, measures could be taken in the labour market – as happened two and a half years ago in Spain, where the results can now

be seen. The important thing is to honour our commitments. Promised reform is all too often delayed or, sometimes not even implemented at all.

So do you think that the stability pact doesn't actually offer increased flexibility?

The stability pact offers enough flexibility to take the short-term cost of structural reform into consideration. However, we should not go off course to such an extent that we lose credibility.

Unlike growth, the inflation figures are not in line with your scenarios. How do you explain this?

We have had to significantly revise our inflation forecasts for 2014, trimming them from 1.1% to 0.7% since December 2013. Low inflation is no longer caused purely by adjustments in certain euro area countries, and by lower energy and food prices. Normally, a fall in prices would be able to support purchasing power and, therefore, domestic demand. But demand has remained weak, including in the biggest euro area economies.

How does all this affect the ECB?

With rates of inflation that are too low month after month, our comfort zone for reaching the target of price inflation close to 2% over the medium term has shrunk. Faced with this risk, we were obliged to act as we did in June.

Are the actors in the euro area already expecting inflation to be a long way from your medium-term target?

Medium-term expectations remain well anchored. And if you were to ask me about the probability of a deflationary scenario becoming a reality, my response would be that there is very little risk of this happening in the euro area. Nonetheless, the risks of a prolonged period of low inflation have been identified by the ECB. This has led us to adapt our communication, which is based on the intention to keep rates low for a prolonged period.

Given the low level of inflation, investors are anticipating a QE package between now and the end of the year. Are they mistaken?

Our new long-term liquidity lending (TLTRO) programme, which will be launched in September, will in particular enable banks to address their major bond refinancing needs. As a result, the banks will not only be encouraged to lend more and at more favourable conditions, but they will raise less funding on the markets. This liquidity will be returned to investors, which they can use to buy other assets.

So we shouldn't be expecting a genuine QE package?

Last month we launched a package of measures that will be activated in September and December before being renewed on a quarterly basis. Barring any new circumstances, we need to take time to measure the effects.

When you talk about large-scale asset purchases, which assets do you mean, exactly?

To be really effective, bearing in mind the limited size of the private capital market in Europe, this type of programme is likely to include mainly government bonds.

The new longer-term loans to banks are conditional on them granting credit. Don't you think they will use them to purchase sovereign bonds as in the past?

They could do it to invest their liquidity on a temporary basis before finding a permanent home for it. The banks are aware that it is not wise to be over-exposed to sovereign debt. The link between banks and governments, which is what prompted the sovereign debt crisis, is now monitored very closely.

The euro has not really fallen despite the fall in the key interest rates. Is this a concern for you?

We have noticed that following the new measures, a persistent rising trend has been halted. We are confident that when the new measures are implemented, they will underpin an accommodative monetary policy. The euro area needs such a policy – unlike other major currency areas, which are at a completely different phase of the economic cycle. And this rebalancing is likely to be reflected, over time, in the external value of the euro.

A Portuguese bank has triggered turmoil on the European markets. Are the euro area and its banks still a cause for concern despite all the firewalls that have been put in place?

The banking union that the European Central Bank is actively preparing for will boost confidence in the euro area's banks.