Benoît Cœuré: Interview with *Cinco Días*

Interview by Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, with *Cinco Días*, conducted by Mr Bernardo de Miguel, published on 10 September 2014.

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Q: The ECB's projections envisage less growth and lower inflation. Is there anything else in the pipeline if the measures adopted so far fail?

A: New measures were adopted on Thursday and I cannot speculate on what can be done in the future. The ECB staff projections for 2014 and 2015 have been revised downwards, both in respect of growth and inflation, and the Governing Council is also seeing risks to growth being on the downside. Growth lost momentum in the second quarter and we want to prevent this weakness feeding into a fall in investment and creating a vicious circle. Furthermore, we have recently seen a change in inflation expectations, which have moved further away from 2%.

Q: Isn't it a little late to realise that, after a year of inflation below 1%?

A: We have to decide on the basis of the data. And until the summer, growth in the euro area was expected to accelerate. Then came other, more worrying data showing that it was at risk of losing momentum.

Q: However, the measures were not adopted unanimously by the 24 members of the Council. Who voted against?

A: We don't comment on that. You know that from January onwards we will begin to publish accounts of our meetings. But even for that it has been decided not to give details of the voting.

Q: To avoid the vote being interpreted in terms of the country of origin of each Council member?

A: Personally, I would be in favour of publishing all the details, since governors are independent and should vote in the interest of the euro area, but I realise that there are also very good reasons for not doing so.

Q. Might there be resignations from the Council like in 2010 and 2011 when the programmes to purchase public debt were approved?

A: At that time the euro area was under great pressure due to the severity of the crisis. There was a risk of a euro break-up and the ECB was facing very difficult decisions in this respect. We are not in a comparable situation today. We have a low growth, low inflation and little credit. They represent major challenges, but are part of the normal monetary policy debate. I see no big differences among governors when it comes to analysing the situation. The discussion on Thursday was focused more on whether it was advisable to wait for more data before reacting. But I don't see any substantive differences at this point in time.

Q: Draghi has called on governments to go for fiscal expansion and reforms – it sounded almost like a desperate plea.

A: Mario Draghi's speech at Jackson Hole in August and the conclusions of the Governing Council last Thursday reflect the seriousness of the situation. The euro area faces risks to its economic growth on such a scale that it's necessary to use all available tools to support the economy. And that means using the instruments on the demand side and the supply side. On the demand side, you have monetary policy. And what the ECB has announced shows that we are committed to taking steps and that we have instruments we are ready to use. You have also fiscal policy, in those countries that have space to expand it. But what matters most are the structural reforms, because without them no supply or demand measure will have an effect.

Q: Is that message aimed at France and Italy?

A: We are not asking anything from anyone in particular. There is nothing of a give and take here. The ECB is independent and does not enter into this kind of bargaining. We do what we think we have to do and we expect others to do their job. We are just highlighting the conditions for it to be effective. For example, in our view, the countries that want flexibility in applying the Stability Pact should announce reforms beforehand, because flexibility is useless if it isn't backed by reforms. Fiscal policy should be used to support aggregate demand – but within the framework of the Stability Pact, and that's an important "but". The Pact creates confidence. And stretching it or infringing it until it is no longer credible would undermine confidence and, in the end, be counterproductive for growth. In other words, flexibility without damaging the credibility of the rules.

Q: Germany does not seem to share this need for fiscal stimulus.

A: Our measures will be much more effective if we see structural reforms and a fiscal position appropriate for the euro area. This should be discussed and evaluated at the euro area level. It is normal for the ECB to say this because it monitors the situation across the euro area and is interested in its stability and growth.

Q: Its measures have flooded the market with liquidity. But it will be difficult to have a demand for credit if there are no jobs or if employment is at wage levels of the 1980s.

A: People will end up getting work if companies manufacture good products and provide good services and there are customers to buy them. Monetary policy can help by providing sufficient liquidity and by steering that liquidity to where it is most needed. This is what the targeted longer-term refinancing operations adopted in June and the measures announced last Thursday, namely the programme to purchase asset-backed securities from the private sector, are aimed at. We want there to be sufficiently ample liquidity and for the ECB's balance sheet to move back towards previous levels [note from the editor: to go up to €3,000 billion from the current €2,000 billion]. And we want to do this in a way that is meaningful for the economy. That is why it is not a quantitative increase in liquidity (quantitative easing or QE), but is targeted and aimed at facilitating the flow of credit. In a way, I would describe it as a qualitative increase rather than as a quantitative one. However, we should not get into a debate over terminology. At the ECB, we do not believe in magic words, QE or otherwise. What we want to do is to devise a monetary policy that is effective in the current economic situation and that fits Europe's economic framework. Thus, inevitably, the ECB's monetary expansion is unlike that conducted in the United States or the United Kingdom. We are at a different juncture and our economy is structured differently. In fact, we cannot draw too many lessons from what other central banks have done, because our situation is so different.

Q: Has an actual target been set for the expansion of the ECB's balance sheet?

A: No, we have not set a particular target, because we will do whatever is useful to facilitate the flow of credit to the economy. We have announced a programme to purchase asset-backed securities and covered bonds. Depending on its impact on growth and inflation, this programme can be expanded. The Governing Council will monitor developments, discuss them, and take decisions as appropriate.

Q: You have been accused by some of instigating a bubble, particularly of public debt.

A: It is true that there is currently an enormous amount of liquidity at the global level in general and in the euro area in particular. And there are very low risk premia across all asset classes, not just for public debt. This necessitates great vigilance on the part of investors and authorities in order to avoid encouraging excessive risk-taking. And it will also be very important to exercise macroeconomic vigilance, because there is going to be abundant liquidity in the next few years. To achieve this, macro prudential instruments should be used to their full extend.

Q: Spain is issuing bonds at historically low interest rates, but its debt is standing at around 100% of GDP and within ten years it will be faced with enormous payouts upon maturity. What is going to happen then?

A: It is no mystery: debt sustainability depends on a sound fiscal policy, and Spain is on the way to achieving this. It is taking time, but Spain has already made good progress on reducing the deficit. This work is not yet done and should continue until equilibrium is reached. Debt sustainability requires a significant increase in nominal GDP growth. The ECB's contribution is to bring inflation back to levels below and close to 2% for the euro area as a whole, as set out in our mandate. However, in the long term the most important thing is real growth and this can only be achieved by increasing productivity. So, the only way to ensure debt sustainability is to raise productivity, invest and increase the employment rate, and this implies structural reforms.

Q: None of these factors are present. There is hardly any growth, investment or jobs.

A: I am aware that the situation is still very difficult in Spain and that the Spanish people have suffered a lot in the process of reducing imbalances and implementing reforms. However, they can rest assured that Spain has turned the corner, and that the outlook is once again improving. This will encourage firms to invest and to start recruiting again, not only Spanish firms but also foreign ones. In a way, Spain can stand as an example not only for other countries that have been hit by the crisis, but for other large countries at Europe's core, that have not been so active in reforming their economies. Spain is an example of how, through reforms, it is possible to redress imbalances and get out of the doldrums.

Q: Which reforms are urgent?

A: It depends on the country. The European Commission has already issued so-called "country specific recommendations". The worrying thing, as the Commission acknowledges, is that these recommendations are too rarely followed. It would be preferable if countries took them seriously and felt collectively committed. In the case of Spain, my personal view is that much remains to be done to support the young people and help find jobs. They are the future.

Q: Would you be in favour of the binding agreements proposed by Angela Merkel?

A: Binding agreements are one way of achieving this. However, in my view, it is better to stay within the Community framework. It should be a multilateral discussion and not a bilateral one between the Commission and each Member State. There should be shared sovereignty as far as structural reforms are concerned, because there is a common interest.

Q: The stress tests are nearing completion. Can we expect many failures and are there likely to be any surprises?

A: We are checking the results, which will be available in the second half of October, so I cannot make any comments on them at present.

Q: Will the tests be credible after what happened with Portugal's Banco Espirito Santo (BES)? It collapsed despite the fact that the ECB and the rest of the Troika had been supervising Lisbon for the past three years.

A: In the BES case, it appears that information was being kept from the supervisor, which was the Banco de Portugal and not the ECB. The ECB, the European Commission and the IMF were in Lisbon to analyse financial stability and macroeconomic outcomes. The ECB had neither the instruments nor the mandate to supervise banks, as this was the role of the national supervisor. I do accept, however, that the BES case has served as a reminder that there are risks beneath the surface in the European banking sector, and I am convinced that the Single Supervisory Mechanism will be able to examine the financial health of the institutions in depth.

Q: Could something similar to the BES case happen in other countries?

A: This is always a possibility. Risks are inherent in banking activities. The only solution is a robust management framework within each bank and on a European level, coupled with instruments such as the Single Supervisory Mechanism or the Single Resolution Mechanism, which will be available in case of crisis.

Q: Some analysts are comparing the situation in the euro area to that in Japan.

A: I would imagine that they are referring to the situation in Japan in the 1990s, rather than to present-day Japan. At that time, Japan did not have anywhere near as expansive a policy as ours and it did not have the definition of price stability that we have to anchor inflation. Its approach to the financial sector was also different, as we have banking union, resolution rules, stress tests, etc. To put it plainly, European supervisors, in particular the ECB, are not going to allow European banks to turn into zombie banks lending to zombie businesses, as was said in the case of Japan in the 1990s.

Q: I understand that you met with Syriza, an aspirant party for government in Greece. How do you view them as an alternative?

A: I would prefer not to make any comments on the political situation in Greece. I do believe, however, that the appearance of protests in countries subject to financial assistance programmes [implemented by the Troika] is the reflection of the huge demands that have been placed on the population. Being in a democracy means that people have the right to voice their complaints. Yet it is also a warning to leaders that when an economy is undergoing reform, sharing responsibility and effort is key. It is key to both the economic efficiency and political sustainability of the reforms. Social protests are there to remind us that we cannot reform an economy by placing all the demands on workers and the most fragile parts of society.

Q: Can the euro survive without debt mutualisation?

A: The debate on the future of the euro should not be centred on instruments such as mutualisation. This is in my view the tail that wags the dog. The question to consider is to what extent we should share risk and sovereignty in order to make monetary union sustainable. Since the beginning of the crisis we have made a lot of progress in creating various instruments to establish effective solidarity within the euro area, as well as governance that establishes responsibility at a national level. The process is not yet completed. For the euro to be sustainable, we need a stronger framework, particularly in relation to structural reform, where we need a strong and shared decision-making mechanism. Fiscal union is part of this debate, but it can only be implemented when there is a sufficient degree of homogeneity between countries and when a mechanism for political responsibility becomes available. Fiscal union without democratic control is not possible and is incompatible with democracy. This subject will come up, but not until further down the line.