

Benoît Cœuré: Interview in *The Irish Times*

Interview with Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, in *The Irish Times*, conducted by Mr Arthur Beesley on 12 January, published on 16 January 2015.

* * *

How deep is the recovery in Ireland and to what extent can we be sure that this kind of very positive growth is going to continue?

Ireland has a potential to be the fastest growing euro zone country in 2015. That's clearly a recognition of the success of the adjustment programme... This has been done by the Irish people and they have paid the price so it shows that this now comes with a reward, that it was worth it.

Does it mean that everything is done and that Ireland is on the safe side? Well I hope so. I wish the best for the Irish economy but there are still some challenging areas, like obviously the labour market is still adjusting, youth unemployment is very high, which in most European countries is an issue. That's an issue that Ireland faces. It's being addressed but it's not done. It's not over yet.

I would also flag banking sector issues, in particular the high level of non-performing loans which remain to be addressed, I guess what I'm saying is consistent with what the Central Bank of Ireland says anyway. But I would certainly encourage banks to be very forthcoming in addressing non-performing loans, in using their buffers to accept losses when they restructure loans and I would also encourage borrowers and lenders to engage directly, not waiting to go to court to settle. The more forthcoming collectively borrowers and the lenders can be in addressing non-performing loans, the faster the banking sector will restart and the more they can create room on their balance sheet to extend new loans to the economy because that is what the economy needs. The economy needs fresh money. For that you need to reset the system.

One last observation to make is on the fiscal side. A lot has been done obviously, but when the economy bounces back in any country there is always a risk of being over-optimistic and of spending money that is not yet there. I'm not saying that this is what is being done but I certainly think the Government should guard against this risk of spending money that has not come yet. They should err on the side of caution given the level of debt, which remains high.

Do you have any concern about the budget for 2015 which was a modestly expansionary budget in a scenario where the original plan was to retrench by €2 billion?

I think all institutions in the post-programme monitoring – the ECB together with the Commission and the IMF – have advised the Government to be really on the side of caution here.

Were you unhappy with the budget?

We would like the budget to be as conservative as possible. That's our advice.

Was that budget not conservative enough?

It's more advice for the future I'm making here... At the moment it is positive but you really have to be extremely cautious.

The plan is to continue decreasing income tax again in the budget for 2016. Is that a matter of concern to you given your expressed preference for as conservative a budget as possible?

What really matters most is the fiscal stance in general. I am not in a position and I don't want to pass a detailed judgement on what the Irish finance minister is doing. The ECB is not a fiscal institution. We're not managing the Irish budget. We give advice given the macroeconomic situation. That advice is on the fiscal stance generally.

The Government has also indicated very clearly that it will invite the public sector trade unions into discussions around the unwinding of emergency laws to cut public pay. Is that – to your mind – premature?

Again, I would have the same answer here. Ireland is out of the programme, right? So we've moved out of this close monitoring mode by the troika. Fiscal policy is in the hand of the Government, while remaining in line with the EU requirements. We give advice on what we see fit, given the macroeconomic situation and our advice is to err on the side of caution when it comes to the fiscal balance. I'm not going to give advice on the composition of the budget. That is certainly for the Irish Government to decide.

Irish politics at the moment is in a mode where people are increasingly starting to think about the general election to come... What would your observation be to people who will be campaigning to get into government in Ireland?

I certainly have no advice to give to elected politicians or to incumbents or candidates in a political campaign. What matters for us in a euro zone perspective is the continuity of policies. As we've just discussed, Ireland is not out of the woods. A lot has been done. It has started to yield benefits. We are seeing the benefits. However, fiscal consolidation is not over. So here we need continuity. Our best advice is to ensure continuity in the implementation of reforms. Now, it's certainly not for us to prejudge the content of policies. The different parties have different policies. That is just normal. That's democracy, as everywhere in Europe.

Are you saying that this is the economic reality in which whatever Irish government is in power after the election must work? The reality it must deal is that the fiscal position is going to remain constrained – is that what you are saying?

Let me phrase it positively. I would say that these efforts have been successful. Ireland has reaped benefits not only in terms of growth but also in terms of restoring market access and lowering the cost of government funding and this is about consolidating this success and building on the successes, and for that you need continuity in policies.

Is there any danger to your mind that some of the progress made could be lost if Ireland gets it wrong?

There is always this danger. There is always a risk of complacency. There is always a risk of things turning wrong. But given everything that we've seen in Ireland over the last years... We've seen so many achievements so much commitment, not only by the political elite but by the Irish people themselves, they've paid the price, they've made the efforts, they're now seeing the first effect of these policies. So I'm extremely confident that this can go on.

You know what? We at the ECB use Ireland as a model for larger euro zone economies. This is a country that has been hit extremely hard by the crisis, has made a lot of efforts and is now starting to reap the fruits – or the benefit – of the efforts. Such cannot be said of all euro zone countries, in particular not of the large countries so that's really an example we use in the European discussion of how things can work.

Is there any concern at the level of the ECB – as an institution – about any danger that there could be political instability in Ireland?

Again, we don't pass judgement on political outcome or political risks. Politics are fragile all throughout Europe in all countries, large and small, and this is because of the crisis. The crisis has shaken the foundations of our societies, in particular through high unemployment everywhere. And politics are now fragile. So the only advice we can give because we are not

a political institution is to design and implement reforms that can restore growth and create jobs, that's the only way to make politics more solid.

You mentioned labour market policies. What specifically would you like to see?

I'm just saying that we need continued implementation of what was agreed in the memorandum, nothing more.

Labour market activation policies? That kind of stuff?

Exactly.

Turning to the banks, how crucial is for them to bite the bullet and use their capital buffers to confront the question of loan losses?

Banks have to navigate between different constraints. I'm not saying that it's an easy job to do. There are constraints. We ourselves as supervisor of the four largest banks, we would be the first to say that they needed some capital. They were right to replenish their capital. In one case this has been mandated by the stress test. It is being done. So strong capital is a protection in today's world. It is mandatory, mandated by regulation and it is a protection and it is something that allows you to lend more contrary to what bankers sometimes suggest. Strong capital is not money that is divested away from the economy. It's quite the contrary, something that makes it possible to lend more. So they need strong capital but they also need to be forthcoming in addressing the non performing loan issue and sometimes there are different ways – depending on the kind of loan we are talking about – sometimes loan restructuring involves recognition of loan losses and then they have to be ready to use their P& L and their capital to do it, because it's an investment, it's an investment into the future, it's not money being lost. It's an investment to recreate capacity to lend into the economy. It's also for the benefit of all so it has a social purpose.

Why in your view haven't they done this?

Because it is complex. Because in many cases discussions between borrowers and creditors are difficult and you don't have an incentive to be forthcoming. Sometimes you just want to wait until it comes to court and wait for the court decision, which is perfectly legal but it just postpones the resolution of the issue. So it creates uncertainty which is bad for the economy.

Is that a concern throughout the banking sector or do you have concerns in respect of particular institutions?

It is a priority throughout the banking system.

Are we in a space in which you as ECB – as regulator – could set targets for the banks in this space?

From what I can see, what the Central Bank of Ireland has done has been effective in accelerating this process so it's certainly moving in the right direction.

But you want banks to go further, faster?

Yes.

Mario Draghi said the ECB will not be participating in the inquiry but Enda Kenny said he approached Mr Draghi at the last European summit and asked him to reconsider. Has there been any reconsideration? Is the position of the ECB settled? Will the ECB be cooperating in any way with the inquiry?

The position of the ECB is settled. It is settled for fundamental institutional and legal reasons – and I would like to clarify that there is no lack of good faith on our side. What we're saying is that we have clear rules that for good reasons frame the accountability of the ECB and that is accountability to the European Parliament, accountability under European law. So ECB officials – president, board members, staff members, including the former president by the way, if you would ask the question – are accountable to the European Parliament, to

European citizens. They cannot be bound by parliamentary procedures under national law in any EU country. This is not the way it works.

We've said extremely clearly that we are ready to engage with all stakeholders, starting with the Irish parliament in informal discussions outside of this inquiry because it is of course possible to have conversations with any national parliaments. We've done it in the past. It is just not possible to bind the ECB through a national procedure, a national parliamentary procedure.

Governor Honohan is absolutely the right person to account not only for the decisions of the Central Bank of Ireland but also for the decisions of the Eurosystem because he's a member of the Governing Council.

You say there's been an informal engagement with the inquiry?

I am saying that there can be an informal engagement with the Irish Parliament outside of the inquiry. We're open to that.

That strikes me as a change?

I don't think so.

And what might such an informal engagement encompass – a willingness to have meetings but not necessarily in open session in a committee room in parliament?

...That's a discussion to be had with them. I haven't seen such requests. That's a discussion we should have with the Oireachtas.

There's the avenue of private meetings with the inquiry or officers of the inquiry? There's the question of providing paper records, the account of the ECB?

Whatever can be useful provided that it's consistent with our legal framework notably in terms of confidentiality.

The inquiry is likely to look at what happened in the lead in to the bailout, which remains controversial. Did Jean-Claude Trichet go too far in the letter?

First as you know the letters have been disclosed on our website with all kind of accompanying documents which I hope help inform the discussion, also in Ireland. We've done it also to inform the discussion in Ireland.

In substance what the ECB president did at the time was to clarify the framework under which the ECB operates. The ECB is a rules-based institution. We have to make it clear what are the constraints under which we are operating. Some of them are legal, some of them are practices or long-standing practices and ECB decisions, which altogether constitute our organisational framework. At the heart of this organisational framework, we have the principle under which the ECB lends – under monetary policy – and the national central banks lend – under emergency liquidity assistance when that happens. Both the ECB and the NCB can lend only to solvent institutions because lending to an insolvent institution would be doing the government's job to resolve it and circumventing the prohibition on monetary financing, which is a treaty requirement. And, when they lend, both have to lend against good collateral. What the President of the ECB did was to restate these constraints and to explain a number of conditions that would need to be met to fit into these strict criteria. So that was about reaffirming the rules. To be clear: the ECB did not take a decision. The ECB did not invent a new rule. That was just about enforcing existing rules in that particular very new case. In an unforeseen, untested situation, there was a need to clarify how the rules would apply.

You had an ECB president saying emergency support for Ireland's banks could be withdrawn if there's no bailout. And yet once there was a bailout – and this remains very controversial in Ireland – a demand to impose losses on senior bondholders was refused on three occasions.

That's a totally different discussion, in terms of size. We are talking of bailing in or not bailing in senior bondholders which would have been in the order of €3 billion or €4 billion, when in late 2011, the issue of burden sharing of senior debt issued by Anglo Irish Bank was on the programme's agenda. You can compare this figure to the total ECB and Central Bank of Ireland lending – Eurosystem lending, all in all.

At the moment when the programme started, in November 2010, this was in the region of €140 billion if I'm right, which is 85 per cent of Irish GDP and which was one-fourth of all Eurosystem lending, given that the capital key of Ireland in the ECB is 1 per cent.

You should also bear in mind that in late 2011, the Irish government was in the process of undertaking a very significant recapitalisation of Irish banks to an amount of around €24bn, or approximately 14% of GDP. Had confidence been shaken by the bail-in, more money could have been required for recapitalisation, ultimately impinging on the Irish taxpayer. So these are the numbers.

So we are talking of something which would have been limited in size anyway and which would have come on top of something which has been decided. – The bailing in of junior bondholders, which took place, was also significantly larger, €14 billion I would say. We are talking of something which would not have made a difference in terms of programme funding... I say *at the time* because you have to judge the discussion based on the information and based on the constraints that were there at the time, right? You cannot revisit the past and the environment has changed.

I'll tell you why. At the time, the situation was that there was international and European consensus that the senior bondholders in a restructuring should not be bailed in at European level. This had been said at G20 level, if I'm not wrong, and there were significant – or very elevated – financial stability concerns related to contagion, not only within Ireland but also throughout the euro zone generally. I was not there. I'm just explaining the arguments. The issue was to weigh the potential benefits of adding €3 billion–€4 billion or decreasing the burden by €3 billion–€4 billion or shifting €3 billion–€4 billion to one particular stakeholder, which were the senior bondholders, against the fact that there was no international consensus. Or rather, the international consensus was against it. There was no European framework and there were significant financial stability risks. So that was the judgement at the time.

If the same question were to be asked today, the answer would be extremely different because now we do have international consensus, we have European consensus, and as a matter of fact we have European law (i.e. the Bank Recovery and Resolution Directive). So we've moved on. The system has moved on from the bailout culture to the bail-in culture. You can say it is unfortunate, that the question was asked in these terms at the time and I would agree but that was the situation at this time in Europe and also at the global level. Now we've moved on and these kind of questions hopefully will not be asked any more, anywhere.

Do you feel, given the intensity of debate on this question in Ireland and the extent of ECB support for Ireland's banks, that the ECB received a bad rap in the debate?

I can understand why the discussion has taken place and it just highlights the importance of this bail-in discussion. In a sense it vindicates everything which has been done since ... at the European level and ... at global level, most lately this new G20 decision on the Total Loss Absorption Capacity which is also about bailing in bondholders. It shows how careful we have to be when it comes to sharing the burden in a crisis. It shows how political the discussion can be and it shows the need for a clear framework before the crisis happens. But we didn't have it then. It's just unfortunate that this happened at that place and at that moment. Now hopefully we have a stronger framework. So we've learned. Not just the ECB, we collectively as public authorities. Collectively we have learned from this and we now have a stronger framework.

What people in Ireland or elsewhere who would say that's all very well but that it's a little bit late now in terms of the cost of Ireland's rescue?

We are preparing for the next crisis. We have to learn the lessons. It's our duty to learn the lessons. As I said, meanwhile, Ireland has been supported. It has been supported by the euro group, by the ESM, the EFSF, it has been supported by the IMF, and it has also been supported by the ECB within our own mandate, in numbers, in size...

In this period you were in Paris. Do you have any observations as someone working in the French system about what was going on in Ireland at this time? It's clear that the Irish government – in the weeks after Lehman Brothers failed – guaranteed the liabilities or the entire Irish banking system.

What I can say is that there was a certainly a lot of proximity between the views of the French government and the views of the ECB at that time, on several accounts.

First, that the decision, that the blanket guarantee on deposits was not the right decision to take. This was also the ECB's view because it created issues elsewhere in the euro zone. And second, that there was high financial stability risk, that there were contagion risks which justified a very careful look at these burden-sharing issues, so I think that the view was not different in Paris. And certainly that Ireland had to be supported, which the French government did also by supporting the programme and by being instrumental in the creation of the EFSF...

What would have been the preferable route for the Irish government to take at that time?

It's so difficult to take these kinds of decisions. I certainly would not claim to pass a moral judgement here. You have to take decisions based on the information you have. There were many negative consequences, and I take it that these consequences were not foreseen when the decision was taken...

That remains the view?

From a European perspective, many of the interactions and cross border consequences and effects were not properly understood initially and that's one reason why, in a sense, the euro zone authorities collectively let the crisis develop and deepen. These kinds of interactions and spillovers were only gradually understood. It was only late down the road for instance that the ESM was created, finally, with adequate size. So it has taken quite some time for Europe to understand what was going on and that this was a regional crisis. It was not only a set of local issues, but one with the potential to disrupt the system as a whole. That's a collective responsibility, not only an Irish one.

On deflation / Greece...

...The starting point is not deflation, but inflation being low, far away from our definition of price stability which is below but close to 2% in the medium term. So the discussion is on the risk of inflation being too low for too long and on the available instruments if we have to do more. Deflation would be a compounding factor, I would say, because if the euro zone were to fall into deflation, which is not the case today, but it certainly is a risk, it is a limited risk but it is a risk...

We don't need to be in deflation to worry about low inflation, low inflation is bad enough. So we have that discussion. An important part of that discussion relates to the impact of the low oil price and whether this is a temporary or permanent shock to inflation...

The usual answer in the ECB would be to see if that's temporary ... and this is what we've done, usually faced with commodity price shocks to commodity prices, up or down. This is what we've done in 2009 for instance, the last time we saw a significant decrease in commodity prices.

This time may be different. It may be different because we are starting from a different place which is extremely low inflation, extremely low headline inflation and also decreasing inflation expectations in the medium-term, and we see a stronger link between medium term expectations and short term inflation numbers/outcomes. So anything that happens to headline inflation rates has potential to feed into long term inflation expectations and that's what we have to be wary of, where we want to be careful.

And then when it comes to possible instruments, the Governing Council has been clear already that if anything additional had to be done, this would be about changing the pace and composition of our asset purchases, meaning that we don't see scope to cut interest rates further. We are at the lower bound in terms of interest rates.

We therefore have a discussion in terms of how to expand the universe of assets which we are buying if needed and, as I think I've said already publicly, if we want to significantly expand the universe of assets which we buy, the base-line option is to buy sovereign bonds. Then you have all kinds of technical questions which are being discussed by ECB staff and the Eurosystem more generally so that's where we stand.

Newsires say a programme of €500 billion may be in play?

I don't really comment because that's a technical decision going on, we'll discuss it on January 22nd and no decision has been taken in this respect.

Is it fair to say that the question must be if opening the door to QE the question must centre whether you have a programme large enough to achieve what is required but which isn't too large to disrupt the economy and to stoke too high an inflation rate?

Let me put it extremely simply: for it to be efficient it has to be big. How big is big enough? This has to be an informed decision based on what we know are the transmission channels: is it more a direct impact on interest rates, is it more on the so-called portfolio rebalancing effect, that banks would buy other kinds of assets, etc? Given the persistent degree of fragmentation that we have in the euro zone, this would also depend on the scope, on the universe of assets, on which government bonds we buy. So you have a set of connected decisions which are being studied. The only thing I can say is that for it to be efficient it would have to be big.

There must be a preference for unanimity yet the Governing Council is far from unanimity?

If you would need unanimity all the time, we would not need a Governing Council. That's a serious answer. We have monetary policy committees all throughout the world, and the reason we have monetary policy committees is to have diversity of views, an exchange of views, because nothing is ever that simple. And that particular decision is probably even less simple than usual. It's a new instrument.

There may be unintended consequences, there may be negative impacts. It might create risks to financial stability because it will drive assets prices up. We want to know precisely. So we want to exchange views. We want to make sure we've answered all questions, that whenever a negative collateral effect is identified that we have an answer... that we know how to mitigate it... At the end, certainly the larger the number of governors who vote for it the better because it shows that we've taken all concerns on board and found the answers, so certainly it's preferable to have as many governors on board.

Mr Weidmann in particular has concerns about this?

I will not comment on Jens Weidmann who sits in the Council in a personal capacity but throughout this crisis there have been concerns raised by the Bundesbank, which are legitimate concerns and which had to be addressed. These are good questions to ask, and then it is our duty to try to find answers.

We have the precedent of OMTs, which was also a new instrument designed to face a new situation in our monetary union, which was redenomination risk, the risk of countries being pushed to exit by financial markets. This instrument raised many questions.

We've spent some time to have a broad discussion in the Governing Council to have the right way to design it to have a broad discussion, answer as many questions as possible, and at the end it seemed as if we had answered almost all questions and all but one governor agreed to it, this is public knowledge.

How big a decision is this now, is this test faced by the ECB. How big a test is this of the ECB's credibility and from the perspective of the credibility of the European authorities that you have it within your capacity to turn the ship around and engineer recovery?

The way you ask the question is exactly the right way. The situation we are facing is a test for European authorities, all of them, including but not only the ECB. They have to make the case in a convincing way to the European people that they use all available instruments to move the European economy out of the situation it's in today, before it becomes a trap for the economy, which is low growth and low inflation.

So we have to make the case in a convincing way that we have the resolve and the instrument to move the European economy out of the low growth, low inflation situation before it becomes a trap... And then all institutions have to contribute according to their mandate. The ECB has a mandate which has to do with inflation. We certainly have to act and show in a convincing way that we have instruments to act to deliver on our mandate. When it comes to growth, this is really up to governments to answer given their instruments. That has to do with fiscal policy and with structural reforms but the answer has to be collective.

Then there is the matter of Greece. Will the uncertainty surrounding the Greek election on January 25th delay any decision on quantitative easing to be taken that day?

Not at all, not at all. These are two different discussions.

What's the position of the bank in respect of Mr Tsipras? He is ahead in opinion polls. He is looking to increase the minimum wage, to decrease the burden of the debt. He's looking for a number of things yet there are whispers out of Berlin saying Greece will be on its way out of the euro zone if Mr Tsipras doesn't play ball?

First, any talk of Greece exiting the euro zone is unreasonable and unrealistic. There has been an extremely strong commitment by European leaders to maintain the integrity of the euro zone, back in June 2012 and ever since this was confirmed. So there is no discussion on an exit and nobody in Europe is working on an exit. So that's really not a discussion.

Now when it comes to policies the ECB is not a political institution, so we'll take the outcome of the election as it is. This is a matter for the Greek people to decide. We'll engage with the new government whenever it is identified or in place or in charge to know more about their policy programme and the continuation of the programme. And certainly different government will have different conceptions about what a reform programme should look like, which is just democracy. But I don't want to pass a judgement here.

What we've said is that whatever happens in Greece, the ECB will have to abide by its rule but that's nothing new. This has been made public last week. We have a rule that any government collateral can be accepted under monetary policy operations either only if its credit is rated well enough or, if it's not well rated enough, if the country is under an EU/IMF programme. And this is not new. This has been ECB policy since 2010.

Second we've made it clear that the so-called Securities Market Programme portfolio of Greek bonds bought by the ECB cannot be restructured because that would be equivalent to granting an overdraft to the country and that would be contrary to article 123 of the treaty.

The liabilities are in the order of €25 billion?

Close to €20 billion.

We're not passing judgement, we are not putting pressure on anybody, we are making clear what our own constraints are in the discussion. These are constraints on us, not pressure we would be putting on others.

The current Greek programme ends in February. So a new Greek programme is required then for the ECB – under its own rules to continue – supporting Greek banks?

That's absolutely right. But it's not for us to lead the discussion on a new programme. That's between the new Greek government and the euro group and the Commission.