

Peter Praet: Interview in *Süddeutsche Zeitung*

Interview with Mr Peter Praet, Member of the Executive Board of the European Central Bank, in *Süddeutsche Zeitung*, conducted by Mr Markus Zydra on 27 January 2015 and published on 31 January 2015.

* * *

Mr Praet, the ECB has decided to spend €1.1 trillion on purchases of government bonds. Has the euro area now become safer?

I expect economic growth to develop along favourable lines in the coming months. The low oil price and neutral fiscal stance will help, financial markets are more confident, the exchange rate of the euro will support exports and structural economic reforms are having positive effects in some countries. All is not perfect, but thanks also to our decision, there will be a positive impact on the economy.

The ECB is buying government bonds to boost inflation and thereby economic growth. Are low petrol prices bad?

That is a natural argument. When petrol prices are falling, people are happy. However, monetary policy does not focus on individual prices, but rather on the overall price level. On average, prices in the euro area fell by 0.6% in January, and inflation rates will remain negative in the coming months. In Germany, prices fell by 0.5%, year on year, in January. We need to make sure that the euro area does not slip into a self-reinforcing downward spiral of falling prices and wages.

The Bundesbank does not see that as a problem.

If inflation in the euro area were to rise to 4%, everybody would expect the ECB to do something about it. Consequently, the ECB also has to step in when inflation falls to nearly zero. Price stability is threatened from above and below. We have a mandate under European law to maintain price stability. For very good reasons, the Governing Council of the ECB defined price stability many years ago as inflation close to, but below, 2% over the medium term – and it did so with the support of Germany and the Bundesbank.

Why has the ECB set its inflation target at 2%? Stable prices should mean 0% inflation.

With an inflation target of 0%, there would be no buffer. If an economic shock occurs in such cases, you have deflation straight away.

Is that so dangerous? The prices of computers have been falling for years. Surely that is good.

Cheaper computers are a good thing. Deflation means that prices in the economy as a whole are falling steadily. In such a situation, workers' wages are too high in comparison with the overall price level, and collective wage agreements cannot simply be changed. Therefore, production becomes too expensive and businesses stop investing because they assume that demand is falling. It is a vicious circle that leads to sharply declining economic activity and rising unemployment – the Great Depression in the United States in the 1930s has taught us that.

Can the risk of deflation be regarded as real at present?

We are not expecting deflation, but there are risks that need to be addressed. Prevention is better than cure. That is why we had to take action before the damage is done, because the inflation expectations of consumers and businesses are falling. That is dangerous. Also, a period of low inflation that is too prolonged entails significant risks.

People buy what they need, and whatever they can afford. Inflation expectations do not play any role in that.

Oh yes, they do. People are guided by expectations, even though they may not always be aware of it. People have an idea of what their future holds, of what they want, what they will spend and what they earn. They make rough estimates of what they can afford. If these expectations are not fulfilled, they experience a shock. And there was a risk of that occurring in the euro area, because deflation means less growth and lower income.

The ECB is doing all this solely for the benefit of crisis countries, i.e. Italy and co.

No, we work for the euro area as a whole. We have attempted to achieve our goals through low key interest rates, through purchases of covered bonds and through favourable loans to banks. All that has helped, but not to the extent desired, nor did it achieve what was required. That is the reason why we will now start purchasing government bonds. We have to use all instruments of monetary policy to ensure price stability across the euro area.

What makes you so sure?

I do not know what historians will write about the ECB at some time in the future, but every single measure we have taken was taken with due consideration of the risks involved, including the risk entailed if we had not done anything. What is also clear, however, is that the governments must now implement structural reforms.

Why does the ECB not put euro area governments under greater pressure?

This is not our role. If we were to make deals with governments on the basis of the principle that the ECB will do this, if you do that, we would lose our independence through such political give-and-take. And we would lose our credibility.

Couldn't you have put off the purchases of government bonds a little longer?

Some members of the Governing Council are of the opinion that such a measure should only be taken when deflation is a given. Nonetheless, almost all experts believe that it is far more difficult to combat deflation when in the midst of such developments. In that case, the central bank would have to spend many times as much and would still not be sure that deflation will be overcome successfully. That is the risk we wanted to rule out.

The idea of helicopter money has also been discussed in academic circles: the ECB could give euro area citizens a one-off gift of €1,000 in order to boost the economy.

You rightly say in academic circles ... but how is this money then distributed. Should everybody get the same amount of money, rich and poor? It would be for parliaments to decide how to distribute it. But the ECB would then be directly involved in the monetary financing of governments, which it is not allowed to do.