Benoît Cœuré: Interview in *Politis*

Interview with Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, in *Politis*, conducted by Mr Yannis Seitanidis on 8 March 2015.

*   *   *

The ECB's Governing Council had a meeting in Nicosia, two years after the "bail-in" agreement on the recapitalisation of Cyprus' banking system. Many questions about the role of the ECB during the crisis of March of 2013 still remain unanswered. Did the ECB play a constructive role or did it put pressure on the Cypriot government through the emergency liquidity assistance (ELA) mechanism?

Under the rules of the Eurosystem, ELA can only be provided by national central banks to solvent banks. So, what was the situation in March 2013? The Central Bank of Cyprus had been providing ELA to the two largest banks, which the central bank, as the supervisor, had deemed solvent. But the negotiations on an EU/IMF programme, which had started in June 2012, had dragged on until the situation of the banking sector had become critical, and the solvency of the two largest banks came under much closer scrutiny. The ECB simply implemented the existing rules when it concluded on 21 March 2013 that a programme would need to be in place in order for the ELA provision to continue.

The bail-in was something unexpected two years ago and now is a part of the resolution procedure for European banks. Was Cyprus a laboratory where the resolution of banks was tested?

No. The truth is that the financial sector of Cyprus was exceptionally large – in relative terms – by European standards, and its capital needs were significant. The two largest banks were estimated to need fresh capital in excess of 40% of GDP, as an independent due diligence process revealed. If the sovereign were to shoulder this burden, on top of already strained public finances, public debt sustainability would be critically endangered. Burden-sharing with private investors was not only inevitable, but it also significantly reduced the financial impact on Cypriot taxpayers and protected the vast majority of depositors. I wouldn't expect this to happen again in any other place, given that the Bank Recovery and Resolution Directive now requires banks to build a significant buffer of so-called "bail-in-able" debt, meaning that investors will be hit before depositors have to pay.

The unpleasant legacy of the banking crisis – which still causes pain in the real economy – is the huge number of non-performing loans. There is an ongoing debate in Cyprus about how the country will handle this problem, a debate which practically "freezes" the last review of the Cypriot economic adjustment programme. Do you see any signs of a derailment of the Cypriot programme? What might be the effects on the banking system?

Cyprus has a remarkable track record in implementing the conditionality of the programme. One of the key objectives of the programme is to reduce the high level of non-performing loans and restructure the excessive indebtedness of the private sector. This is a key condition for the banking system to be in a position to finance economic growth and job creation. In this respect, a swift adoption of the insolvency framework and application of the foreclosure framework are not only key elements to guarantee compliance of Cyprus with the programme, but also essential to support the economic recovery.

The main political goal of the government is to conclude the programme and the financial assistance provided by the Troika earlier, probably before the end of this year. The ECB is part of the troika. As such, does it consider this goal achievable?

Whether or not there should be a follow-up arrangement is for the Cypriot government to decide. What matters to the ECB is to establish the conditions for sustainable growth and for a lasting return of Cyprus to market funding when the programme ends, i.e. in the spring of 2016. To this end, it will be essential that the banking sector has turned the corner and the non-performing assets have been addressed.

The ECB is starting its programme of quantitative easing (QE). How and when can Cyprus benefit from that?

Cyprus should and will benefit from our asset purchase programme. This will be possible whenever the review is successfully concluded.

Many analysts interpret QE as Europe's first step away from austerity programmes and towards more growth-friendly policies. I also read that inflation is the safest way for European countries to reduce their debts and the ECB will help them move in that direction with its QE. In that respect, is QE a programme created as a result of economic need, of political pressure, or as a result of fear for the future of the euro?

The ECB's sole mandate is to maintain price stability for the euro area as a whole, which we define as consumer price inflation being below, but close to, 2%. The Governing Council saw there was a risk of inflation being too low for too long and decided to act under its mandate. This has nothing to do with politics, nor with the future of the euro. As all Governing Council members have acknowledged, QE is just an instrument of monetary policy.

Considering the experience in other countries, such as the US, under what conditions will QE have an impact on the real economy?

Purchases of public securities reduce the borrowing costs of the private sector given that many financial instruments are priced with reference to the domestic sovereign yield curve. They also provide an incentive for banks to supply more credit to firms and households through the so-called "portfolio rebalancing" effect, which in turn supports consumption and investment. And finally, they signal that the ECB – in line with our forward guidance – is committed to maintaining an accommodative monetary policy for an extended period of time, which pins down interest rates at a very low level – again benefiting firms and households. We have already seen, after the announcement, some positive effects of our measures in these directions. Lending rates to households and firms have come down since the summer across the entire euro area. And credit growth to the private sector turned positive in December – on a month-to-month basis – for the first time since mid-2012 and continued to recover in January.

That said, monetary policy can support short-term growth but it cannot lift production and living standards in a durable way. This can only happen if euro area governments use this window of opportunity to step up reforms in their economies.

Last, but not least, some questions regarding Greece. The Greek government has declared that the Troika and the Memorandum of Understanding no longer exist. How would you describe the state of play?

On 24 February, the European Commission, European Central Bank and International Monetary Fund considered the list of reforms presented by the Greek government as a valid starting point for a successful completion of the review under the current arrangement, and the Eurogroup agreed to extend it by four months. In this context, the authorities have committed to fully cooperate with the three institutions, in order to allow for a speedy and successful conclusion of the review. We are looking forward to working with the Greek authorities. Time is running short.

The new government looks determined to boost reforms. Besides, this is the only way in which to restore trust with the European authorities. But the country has and will have specific financing needs over the next 18 months. Is a new programme for Greece a scenario that's being considered?

The Eurogroup has outlined a clear sequence. When the current review is concluded successfully, and if the Greek authorities so wish, a follow-up arrangement will be discussed with the Eurogroup. But it is first and foremost the responsibility of the Greek government to create growth and regain financial independence. This requires in my view a clear resolve to boost economic reforms, a prudent fiscal path and an unequivocal confirmation that Greece will honour its international commitments. Doubts about the country's creditworthiness will then recede and foreign investors will return to Greece.

The new government is negotiating with the European Commission, the ECB and the IMF in full awareness of the fundamental hypothesis that in the end no one would want a Grexit. If that is true, why didn't Europe realise earlier that the Greek programme was not working effectively? The recession and unemployment in Greece cannot be compared with the recession and unemployment in Cyprus, Ireland, Portugal and Spain. My question is: would a failure of the programme eventually undermine the future of the euro area?

From a very difficult starting position, and through painful efforts, Greece has made good progress in restoring fiscal and external sustainability, as well as in putting banks on a sound footing and strengthening the basis for growth and job creation. By the end of 2014, economic indicators were clearly pointing to positive growth and better prospects ahead. Indeed, in its forecast released one month ago, the European Commission expected Greece to grow by 2.5% in 2015 and 3.6% in 2016, one of the highest growth rates in the euro area. And the arduous efforts of the Greek people need to be recognised here. But let's not fool ourselves: adjustment was inevitable and, believe me, it would have been much worse without European and international support.

That said, we should always learn from the past. For instance, I believe that the programme should have put more emphasis, at an earlier stage, on reducing rents – in the economic sense – and fighting vested interests in the Greek economy, to allow for a fairer sharing of the adjustment burden. Also, in its crisis-fighting toolbox, Europe did not have at its disposal instruments available to institutions such as the World Bank, which supports social safety nets when countries undertake structural adjustment.

According to some rumours, the ECB played a key role after the Greek election, accelerating the developments by exerting pressure on the Greek government through the ELA mechanism. Are you happy with the impression (given by various media) that the ECB is "manipulating" elected governments? Is this appropriate for a central bank? (The US President and the Chair of the Federal Reserve, for example, sit on the same side of the table, not on opposite sides).

If you are referring to the decision taken by the Governing Council on 4 February to suspend our waiver for Greek government-related collateral, the intention was exactly the opposite: it was a decision to enforce our rules in a transparent and accountable way, free of political interference. Let me explain. Given their low credit rating, Greek government-related bonds should in principle not be eligible at all as collateral for our refinancing operations. In 2010, the ECB took an extraordinary decision to suspend the minimum rating threshold for such collateral (the so-called waiver), and allow them as collateral, on the premise that an EU/IMF economic adjustment programme for Greece would be in place and implemented. After the election, given the intention of the new government to substantially change or even terminate the programme, the Governing Council could no longer assume that the programme review would be successfully concluded, and the waiver was lifted. It will of course be reinstated when such a prospect can again be assumed, based on the outcome of the discussions between the Greek government and the institutions. I hope this will be the case soon, when these discussions have made progress.

As for your comparison with the US: indeed, the ECB is the central bank of Greece, and we have shown our commitment by continuing to provide liquidity, as a matter of fact, in increasing amounts, to Greek banks, provided that they use it to fund the economy. The central bank funding of Greek banks has doubled since end-2014 and today stands at more than 100 billion euros. But the ECB is also the central bank of 18 other countries and we are bound by the EU Treaties, which require us to lend to solvent banks, against adequate collateral, and to refrain from financing governments. This applies to all euro area countries; Greece is no exception in this respect.