Vítor Constâncio: Interview in *Het Financieele Dagblad*

Interview with Mr Vítor Constâncio, Vice-President of the European Central Bank, in *Het Financieele Dagblad*, conducted by Mr Marcel de Boer and Ms Saskia Jonker on 29 April 2015 and published on 4 May 2015.

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The ECB's controversial purchase programme will not be halted prematurely, even if the economy in Europe is picking up more rapidly than expected, said Vítor Constâncio, Vice-President of the European Central Bank (ECB), in an interview with Het Financieele Dagblad.

"The programme is working well. Why should we think of discontinuing it when inflation is negative and inflation expectations are nowhere near our medium-term goal of close to 2%?" So that option is not even on the table for the Executive Board of the ECB. "We only started it a few months ago. It would be very strange if we were already talking about stopping."

Critics argue that the ECB is creating bubbles in asset markets because all markets are being driven up by the large-scale purchase programme (known as quantitative easing). But the Portugese central banker is not afraid of that. "There is no generalised asset overvaluations in the euro area." He acknowledges that quantitative easing is making investors take more risks because that is more profitable. "That is partly what we want to achieve through our programme, this so-called portfolio shift. The only danger is that the "search for yield" might get out of hand. We need to keep a close eye on that. It is the job of macroprudential policy, not of monetary policy, to avoid the build-up of bubbles".

Article/Q&A

The view from the 41st and top floor of the European Central Bank's new premises is overwhelming: huge buildings that suddenly look quite small, bright green patches of spring foliage, and aeroplanes in the distance glistening in the sun as they take off from Frankfurt. Vítor Constâncio contentedly takes in his surroundings as he enters the meeting room, slightly late but completely relaxed. Slight of stature and wearing a grey suit, Constâncio, a Portugese national, has every reason to be pleased: the ECB's purchase programme is working, he says. "The European economy is moving in the right direction." And he has the data to support that statement at his fingertips.

"The sale of durable consumer goods has grown by 4.5% in a year, share prices have risen by 13% since the start of this year, the price of capital for non-financial firms is 7.7% – which is similar to pre-crisis levels. For banks, too, funding has become considerably cheaper." In short, financial conditions have improved. "Even though some critics said that quantitative easing would be less effective here than in the United States, because much of the financing is provided by banks. They forget that banks are listed on the stock exchange too."

But Constâncio disagrees that things are going well enough to already start tapering off quantative easing – inflation expectations are too low for that. Until inflation comes sustainably close to 2%, the ECB will continue to intervene in the financial markets, with the attendant risks such as rapid asset price increases and the disadvantage of low returns for pension funds.

The sharp depreciation of the euro is another side effect. Does Constâncio think that will result in a global currency war?

"Exchange rates reflect the economic situation in the various countries. The US economy, for example, is in a completely different phase of the business cycle than Europe. That explains why monetary policy here is not the same as in the United States. The G20 also look at it that way.'

Do you feel responsible for the fact that Dutch pension funds and insurance firms are struggling with the current low market interest rates?

"All policy measures have their side effects. There is collateral damage, but we have a mandate and that states that we must maintain price stability. Having said that, it is important to note that insurance firms especially have not done so badly in recent years. The value of their assets increased precisely on the back of the lower interest rates and they were able to push up the profit per share, more so than the banks could in any case. Low interest rates are now causing problems, but it is exactly our objective to bring things back to normal. Once we have price stability, interest rates will also go up again."

"Here and there, we see that the maturity of the investments is out of sync with the maturity of liabilities. We also see that few strategies have yet been designed that would render insurance firms immune to this mismatch. That is why they should be cautious about the promises that they make to their customers."

Talking about promises, are sufficient securities available for purchase?

"The stock of available securities is vast. The universe of eligible assets which we could buy amounts to €600 billion in covered bonds, €400 billion in asset-backed securities and more than €3,000 billion in sovereign bonds. It is true that we are not purchasing any securities on which the interest rate has dropped below –0.2%. But there is still plenty of securities available for purchases. What we could do if that changes is hypothetical, and you know that policy-makers don't discuss hypothetical situations."

Wouldn't it have been better if the ECB had simply given a cheque to households? Then not so much money would have been pumped into the financial system, but would have flowed directly into the real economy.

"First and foremost, the purchase of securities is an instrument that we can use because it is in line with our statute. There is nothing that controversial about it, but the same cannot be said for your "helicopter money". Moreover, with our programme we are injecting money into the economy. That money will bring about an improvement in market conditions and thereby make it easier for private parties to access financing.

"Helicopter money has had different meanings in various contexts, from giving money directly to households to financing of public infrastructure. But all these options would bring us very close to pursuing fiscal policy. And that's what we cannot do."

Are you concerned about Greece and, if it comes to a Grexit, do you fear the spread of contagion effects to other euro area countries?

"Like everyone else, I am concerned. But I am also absolutely convinced that the worst-case scenario will be avoided. At the same time, everyone acknowledges that the degree of stress and vulnerability in the euro area has totally changed. There are no signs of contagion."

But if it goes wrong and a Grexit does come about, wouldn't the ECB incur huge losses?

"The Eurosystem (the ECB and the national central banks, ed.) has lent a total of some €110 billion to Greek banks. But the risk on just over €70 billion of that amount has been shifted to the Greek central bank. We jointly bear the risk on the rest of the amount. But bear in mind that collateral has been provided. We are talking about securities that are not linked to the Greek sovereign and which, on top of that, are subject to a “haircut”. This should offer sufficient protection.”

Last year saw the start of the banking union. What is the next big project for the ECB?

“That would be the capital markets union. Although it is not our direct responsibility – the European Commission is responsible for the proposals – it is very important for us. A well-integrated and deep capital market would facilitate the functioning of our monetary policy, as our key interest rates would then be transmitted more smoothly. And there would be more risk-sharing via ownership of assets. If an economic recession arose in a euro area country, an effective capital markets union would soften the consequences of that recession. But the benefits of a capital markets union can only be reaped if a truly ambitious approach is taken here.“

Could you explain that some more?

“An effective capital markets union requires the harmonisation of company law, of bankruptcy law, of taxation of financial products and of regulatory and supervisory frameworks. That is an enormous task. This way firms could issue shares and debt across the union, to a much greater extent than they do now, as a result of the level playing field for all stakeholders (the shareholders, the issuers, etc., ed.). But we must not forget that the European countries have already come far in harmonising policy, especially the euro area countries.”

Did EU Commissioner Jonathan Hill not say that a capital markets union would not be in place before 2019?

“If it is completed in 2019, I would be very happy.”