Benoît Coeuré: Interview in *L'Economie politique*

Interview with Mr Benoît Coeuré, Member of the Executive Board of the European Central Bank, in the issue # 66 of *L'Economie politique* (quarterly publication of Alternatives Economiques), conducted by Ms Sandra Moatti in April 2015.

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Concerning the massive public asset purchase programme which was announced on 22 January, why did it come so late? The ECB's balance sheet had been shrinking for months and inflation was moving steadily downwards. Was the wait due to disagreements on the Governing Council?

You have to see this decision in the historical sequence of successive decisions taken by the ECB to deal with the crisis. The issues changed pretty fundamentally in 2013–14. In 2011–12 we were facing a crisis of fragmentation in the euro area. The priority, both from a political and monetary perspective, was to ensure that the euro area remained intact and that monetary policy was transmitted to the countries in crisis. So in late 2011 the ECB decided on LTROs to tackle the problems of interbank funding, since the risk of the euro area falling apart in summer 2012 led Mario Draghi to make his famous statement in London and prompted the ECB to come up with outright monetary transactions (OMTs), a tool intended to prevent self-fulfilling financial crises from pushing a country to leave the euro. This risk of break-up was overcome thanks both to the ECB and also to the will of the heads of state, who clearly expressed their desire to keep the euro area intact and create banking union.

In 2013 the nature of the debate changed and became more traditional, applying to growth and inflation, which were too weak in the euro area as a whole. There must have been a moment in late 2013/early 2014 when the euro area collectively felt the financial crisis was over and the economy was going to pick up on its own. But growth stumbled in summer 2014. On top of that, the tumbling oil price raised fears of possible deflation. We moved from a comfort zone where we thought a cyclical upturn would emerge spontaneously towards a more dangerous zone where inflation rates would be persistently adrift from our definition of price stability (i.e. 2%). That's what finally led us to decide to buy up assets.

In this period, we may have been partly feeling our way, or it could just have been caution. When you are designing an entirely new tool, you have to take time and do it properly. Our concern, both during summer 2012 with OMTs and in late 2014/early 2015 with asset purchases, was to come up with tools that would suit the specific features of the euro area and also find the highest possible level of consent around the table at the Governing Council. That needed a process of maturation and time for debate. So while some people may see a risk of inertia, in fact we ended up with decisions that are better designed, and ultimately stronger and more credible. Don't forget that the ECB's Governing Council has 25 members: there are only nine on the Bank of England's Monetary Policy Committee.

For instance, we had discussions on whether to buy just government securities, or corporate bonds too. We concluded that the trade-off between complexity and impact was less attractive for corporate bonds. We also talked about risk-sharing; who was going to buy, who

was going to shoulder the risk linked to the securities we were going to buy? You need time to have that debate and settle it in a way that satisfies the largest number of people.

There is a great deal of discussion about the effects of the asset purchase programme (QE). What can you hope to achieve when long-term yields are already extremely low?

Within the euro area, the transmission channel that is almost the most important in my view is confidence. Confidence that the ECB will take its mandate to keep inflation below, but close to, 2% seriously. Before we took this step there had been doubts about the willingness of the ECB to respect its mandate. But it was the only substantive measure possible in the circumstances; we had run out of conventional measures because the scope to lower key rates had been exhausted.

The second channel is to lower borrowing costs, which aren't negligible for companies and households. The policies combating fragmentation in the euro area have borne fruit; now when interest rates for government borrowing fall it has a noticeable effect on corporate borrowing costs across the euro area – which was not the case even two years ago. That's essential if investment is to recover. Sure, rates are already low, but since QE was announced and implemented at the start of March long and very long-term interest rates have fallen significantly in all countries, including Germany and France, and even more in Spain, Italy and those most affected by the crisis, such as Ireland and Portugal.

The third channel works through portfolio rebalancing: it's still too soon to assess that. Bank and non-bank investors who sell us their securities have a very strong incentive to invest elsewhere rather than leave their money doing nothing, with deposits at the ECB costing -0.20% p.a. The sharp upturn in the real economy should encourage them to lend more to business. In that sense, the time is right: the impact of QE is being felt just as the recovery is being confirmed, and it will reinforce it. It's a mechanism that is potentially powerful.

The final channel, of course, is the exchange rate: this is not an objective in itself, but it reflects market participants' expectations of the different monetary policies being pursued on each side of the Atlantic. If you include the oil price too, you have a combination of factors favouring recovery and investment. So as things stand right now, there is no reason to worry about the euro area recovering in 2015 and 2016. Mind you, all these factors are short-term. One possible concern is the ability to boost the potential growth of the euro area, which has been hit hard by the crisis. That's more a long-term issue, though.

Aren't you afraid that one of the effects of QE will be to create price bubbles for certain assets? Doesn't that risk clash with the price stability objective? Does the ECB have the means to combat these side effects?

Our actions do have an impact on asset prices; you just have to look at the way markets have risen since the public asset purchases started. We monitor risks to financial stability very closely: Tommaso Padoa-Schioppa used to say this was in central banks' DNA. But let's not forget that the objective of monetary policy is price stability. Financial stability involves different tools. As far as we are concerned, it's a question of bank regulation and "macroprudential" tools.

There is one effect you didn't mention: this policy cuts governments' interest rate costs and potentially gives them room for fiscal manoeuvre again.

That is not our objective. Monetary policy serves to guarantee price stability and support the productive economy. Where countries have room for fiscal manoeuvre, lowering rates increases the scope that can be used to support growth, particularly by increasing investment. Where countries do not have this room for manoeuvre, such as France, my advice would be to use the lower rates to lend credibility to debt reduction, rather than to

increase spending or cut taxes. However, that's not a matter for the ECB to decide. It's the European Commission that is the guardian of the fiscal policy framework in the euro area.

Is sustainability of public debt one of the objectives of QE?

No, it is not! First, it would be wrong to judge the sustainability of government debt, which is a long-term concept, using current yields and growth rates. The only way to make public debt sustainable is to cut deficits in a sustainable way and improve the productivity of the economy. Also, this is clearly not the philosophy enshrined in the treaties; these actually contain a whole series of provisions aimed at protecting the ECB from fiscal dominance, or in other words ensuring that monetary policy is not subject to the objectives of fiscal policy.

OMTs and QE are monetary policy tools and have a number of safeguards to stop them from becoming fiscal policy instruments. With QE, for example, the ECB cannot buy more than one third of a country's debt. This cap is intended to preserve market mechanisms and market discipline, and also to ensure that the ECB does not become the states' lender of choice.

Monetary policy always has a distributive impact on all economic agents, whatever the tool used. But every decision about QE, whether it be starting it or increasing or decreasing its scale, or its duration, will only be taken in line with the objectives of monetary policy, primarily the medium-term inflation outlook.

If countries are counting on QE to gain some time, they are making a mistake. They need to make use of it to push through essential reforms so growth is sustainably higher.

The ECB seems to have broadened its objectives considerably in order to preserve the euro area. In fact it seems to be concerned about financial stability and growth as well as price stability. Is the ECB now pursuing a triple objective?

Not at all. First, in the current environment, where inflation is too low, the objective of growth is equivalent to the objective of price stability. Ultimately, what we have been doing since the start of the crisis has been aimed at ensuring price stability, but this has been done by supporting aggregate demand. There is no contradiction. Of course there may be situations where the central bank is caught in a dilemma between the objective of price stability and the objective of growth. But that's certainly not the case today. In addition, looking beyond the current situation, the treaties specify that the Eurosystem lends its support to general economic policies in the Union, without prejudice to the objective of price stability.

The situation today as far as financial stability is concerned is pretty clear. The ECB has three functions: a monetary function with both conventional monetary policy tools (interest rates) and unconventional ones (liquidity, asset purchases, etc.). Since banking union was put in place the ECB has also had a micro-prudential function regulating banks and a macro-prudential role.

So these three functions give it both an objective of price stability and also objectives of financial stability, but these are clearly distinct and involve different tools. They are also separate in terms of governance, since the EU rules entrusting banking regulation to the ECB make great efforts to ensure that the decision-making processes be kept apart. So we are attached to the principle of separation: different tools for different objectives.

Isn't it a little more complicated with macro-prudential policy?

In macro-prudential matters the ECB intervenes to complement action taken at national level, but on a fairly limited basis – regulating banks (technically, using tools identified in the Capital Requirements Directive or CRD IV). For instance, it can decide to impose higher capital requirements on banks in a country if it feels loan growth is excessive and the

national authorities have not reacted. But it does not have the power to get involved in fiscal, structural or regulatory affairs or with players such as insurers and investment funds.

There are plenty of people who think that a central bank with several potentially conflicting objectives cannot remain totally independent. What do you say to that?

Well it's true that an institution which has more objectives than tools has to constantly arbitrate between those objectives. That arbitration needs a political discussion the ECB is not equipped for, which is why for monetary policy we have a narrow mandate and for financial stability we have other tools. But there's more to it than that.

The ECB manages the single currency of 19 countries which do not have the same degree of coordination in fiscal, structural and regulatory issues as there is for monetary policy. Hence it has to be independent. The fact that we have a narrow mandate, price stability, allows us to explain what we are doing and clarify our relationship with the political sphere. It protects us from a very real temptation: asking the ECB to do everything. Given the lack of coordination between Member States and the incomplete nature of political institutions in the euro area, this is an irresistible temptation within the European system. The ECB holds a kind of fascination for all players, not just the economic ones but also those at the political and social level too; they all project their disappointment with economic policy onto it. When there is a political vacuum, fascination with the central bank flourishes.

This is both unrealistic, because in most cases we don't have the tools to respond to their expectations and to do so would frequently breach the mandate we have been given, and also be democratically dangerous, because we do not have the governance that would authorise us to do so. So having a narrow mandate allows us to spell out what the ECB can and can't do and remind other players of their responsibilities and, in some cases, their shortcomings. It also gives us a great deal of flexibility, since the objective of price stability leaves us plenty of scope to choose our tools, as has been seen during the crisis.

The ECB has found itself very exposed politically at certain times during the crisis. Recently in the case of Greece, its decisions to no longer accept Greek securities as collateral and then to limit the volume of government securities held by banks have been perceived as an attempt to put pressure on the Greek government. Is it legitimate for a supposedly apolitical institution to hold the fate of democratically elected powers in its hands?

The ECB is not a political institution. Our code of conduct must be that we should avoid taking political decisions and refer them to the politicians.

The best solution over the long term would be to strengthen the coordination of fiscal policies and perhaps to move towards a form of democratically legitimate fiscal union, which would make it possible to provide monetary policy with full protection against the risk of a Member State defaulting. But this is not where we are at present.

What we are trying to do is protect ourselves and respect the boundary between what is technical and what is political by referring to a political framework, in this case the decisions of the Eurogroup (the group of euro area finance ministers).

The new Greek government wants to change the content of the structural reforms, which is perfectly legitimate because that's what it was elected to do. But this creates a transition period while the contract between the country and the rest of Europe is being redefined. That transition creates uncertainty, and during this time the country is no longer able to obtain funding on the markets.

On 20 February the Eurogroup agreed on a discussion framework, and it is up to this body to decide whether to release some of the funds from the European assistance programme and think about a possible further programme. We have been working within this exact

framework. It is not up to the ECB or the Bank of Greece to finance the Greek government and we will make sure that this does not happen. Not only because it would be illegal – the Treaty explicitly prohibits a central bank from financing a government – but also because the opposite decision, i.e. to finance a government while a political agreement is being reached, would amount to a circumvention of the Eurogroup's decision. The latter, which represents the democratically elected governments, has decided not to grant a bridging loan to the Greek government: what right then would the ECB, which does not hold a political mandate, have to do so? We are well aware that we will always be caught between a rock and a hard place: our decisions, whatever they may be, can always be interpreted politically by one side or another.

However, the Eurosystem is completely fulfilling the role it has as a central bank, which is to finance the Greek economy. Week after week the liquidity provided to Greek banks has been increased. Just one figure: last December the loans granted by the Eurosystem to the Greek banks amounted to €45 billion. Now, in mid-April, they are at €110 billion, well over twice as much. So we are doing our job as a central bank for Greece but it is not our role to get involved in a political discussion about financing the Greek government. That discussion is taking place in Brussels, not in Frankfurt.

Would you say that QE is helping immunise the euro area against the risk of an exit by a Member State, even if this is not its objective?

I wouldn't put it like that. It is certainly reducing the risk of contagion in the euro area, but the context right now is very different from 2012. The problem for countries such as Portugal, Spain and Ireland is no longer an exit from the euro area, far from it. Their main concern now is how to capitalise on the return of growth in order to step up the reduction in unemployment and return to normal as quickly as possible. I am leaving out Greece, which is a very specific case in the light of the discussions ongoing at the moment.

It was Greece that I had in mind... Isn't QE making the euro area immune to the risk of an exit by Greece?

The exit of Greece is not a scenario we are working on. All the efforts being made at the moment are aimed at updating the relationship with Greece in the light of the new priorities of its government, within a framework which remains that of the euro area and which implies rights as well as the duty to respect the common rules. So we are not putting the question in those terms.

On the question of risk-sharing, why does the ECB, through arrangements as the provision of emergency liquidity by the Greek central bank or the public asset purchase programme, pass the risk onto the national central banks? Isn't this a sign of fragmentation of the euro area?

I don't think that's at all the case. First of all, there is nothing new here: there have already been transactions where the risk was not entirely shared. For example, when we decided in 2011 to broaden the range of collateral by allowing corporate debt (additional credit claims, as we call them) to serve as a guarantee, the risk was not shared.

Furthermore, all parameters – the timetable, the volume, the intervention strategy, the maturities – are decided in Frankfurt by the Governing Council.

We opted for QE on account of the specific characteristics of the euro area. Such questions did not arise in the United States. But we have to ask these questions because the European treaties clearly state that there needs to be a separation between fiscal and monetary policies, and that monetary policy must not fulfil fiscal objectives. The treaties also stipulate that there are 19 separate fiscal policies and that there is no fiscal union, no eurobonds, no common debt. We operate within this system, which we all decided upon in 1992.

The debate about eurobonds or about fiscal union is important, and justly so: it is too important to be decided by 25 governors one Thursday morning in Frankfurt! It is a fundamental topic, a deeply political one, and one which needs to be debated in every single Member State. Should the decision be taken one day to mutualise budgets or debt, such a step will require constitutional reforms in many countries. We cannot take decisions on large-scale mutualisation of fiscal risks until there has been a political debate on the issue. I don't think the political debate would benefit if such decisions were taken by unelected civil servants.

And yet there is something very ambiguous about this. On the one hand, OMTs work on the promise of shared risk, which you reject in the context of QE...

The two programmes have different objectives and are a response to different contexts. By their very design, OMTs are launched when there is a risk of a country leaving the euro area under pressure from the markets. So they are the expression of a need for solidarity or at the very least for the cohesion of the monetary union. Incidentally, the countries which are put under pressure by the financial markets only have access to OMTs if they have a European Union or IMF adjustment programme.

QE is different. It's a programme which is aimed at the euro area as a whole, it is in no way targeted. Its intention is not to affirm the cohesion of the euro area; it has a purely monetary intention, namely to support activity and, ultimately, inflation. There are no centrifugal forces within the euro area at present. QE does not respond to the same problems. Incidentally, QE does provide for mutualisation of 20% of the risk, between European institution bond purchases and government bond purchases by the ECB.

Let's go back to the question of fiscal union. Do you think that such a development is realistic?

The ECB President contributes to the "Four Presidents' Report" (with Donald Tusk, Jean-Claude Juncker and Jeroen Dijsselbloem) on the future of Economic and Monetary Union requested by the European Council. But the ECB is obviously not a decision-maker: constitutional questions such as this go well beyond our remit.

In my opinion, the history of the euro area shows that the Member States have not fundamentally understood the level of responsibility implied by taking part in a single currency. National policies – fiscal as well as structural – fail to take sufficient account of the reality of the euro and the fact that the decisions taken in one country have an impact on the others and on the stability of the single currency. The responsible national policy-makers are not only accountable to their own parliament but also to all their partners and have to accept advice and judgement. So far, the response has been to create ever more complex rules. These rules lend themselves to a great deal of discretion and creativity in their implementation, which does nothing to promote trust and credibility. The risk is that the governments no longer really know which rules they have to apply.

My personal conclusion is that if sovereignty were more shared in the fiscal and structural area, this would re-create space for the political dimension. Rather than applying rules that are barely understood and then subject to obscure deals in Brussels, a certain number of decisions would be debated at community level, with transparency and responsibility vis-à-vis the European Parliament and the national parliaments. I believe, for instance, that a common fiscal capacity within the euro area would be a good thing if it enjoys this democratic legitimation.

Obviously, there is still a long way to go. We have to think about how the person who manages the budget (let's say, the "finance minister" of the euro area) would be monitored by the national parliaments and/or the European Parliament. The ECB cannot answer

questions like that. All we can do is to point out a gap in a system which has not yet reached maturity and so remains a fragility factor.

You expressed your concern about long-term growth. Couldn't the ECB do more to relaunch investment in Europe, in particular in ecological transition?

The issue of ecological transition is a major one, even though it is not yet really on the radar of the central banks, wrongly so in my opinion. The Bank of England has incorporated it into its research programme, which seems to me a very good thing.

A certain number of issues linked to the way in which our societies and economies will manage the ecological transition ought to be better integrated by the central banks. These questions have a huge impact in terms of potential growth as well as financial stability (the climate risks can be covered more or less well by different types of financial instrument) and, ultimately, price stability. Monetary policy is linked to the general price level but it cannot ignore the structure of relative prices. We can see clearly today that one of the most important questions we are facing is the fall in the oil price. These questions, such as the consequences of a European energy policy or of different energy policies within each euro area country, different energy mixes, between the use of nuclear power or renewable energy...all these choices have an impact on the structure of relative prices and on convergence or divergence at the heart of the euro area. We have to understand better how this issue will change the way the economy works so we can adapt our monetary policy accordingly.

It is not for the ECB to encourage particular investment decisions which are carbon-saving to a greater or lesser degree or which form part of this or that policy. To do so would be to cross the line between monetary and economic policy and give way to the fascination I mentioned earlier. And yet we can see clearly that there are very deep political disagreements which the ECB cannot settle, on the energy mix, the terms of the ecological transition, etc. However, everything we are doing at the moment forms part of an approach aimed at rekindling investment. Compared with the traditional policies of central banks, which are geared to the short term, QE is an extension of the intervention horizon of monetary policy. For instance, the average term of the securities purchased as part of QE is nearly nine years. So monetary policy is having more impact than before on the financing conditions for long-term investments. This is particularly crucial for financing investments linked to the energy transition. In short, we are creating favourable conditions for long-term investment, and it is up to the governments and the European institutions to take advantage of these conditions.