# Peter Praet: Interview in *Neue Zürcher Zeitung*

Interview with Mr Peter Praet, Member of the Executive Board of the European Central Bank, in *Neue Zürcher Zeitung,* conducted by by Ms Claudia Aebersold Szalay and Mr Peter A Fischer and published on 19 September 2015.

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***Mr Praet, you have been Chief Economist of the ECB for the past four years now. During this period, the policy of the ECB has changed somewhat. Does it make a difference who the Chief Economist of the ECB is?***

Both the President and the Chief Economist have changed, but what has changed most of all during this period is the economic environment in which we find ourselves. At the onset of the crisis in 2007, we still thought we were simply dealing with an external liquidity shock. So, the central banks across the globe reacted accordingly, and at the time the ECB also focused on providing liquidity to banks. I can still remember the headlines back then, saying that the ECB was providing €100 billion in liquidity, which seemed an incredible sum at the time.

***The crisis nonetheless escalated.***

Yes, it quickly turned into a credit crunch, which in 2012 escalated into a euro crisis. However, to come back to your first question: the circumstances have changed dramatically; the identity of the Chief Economist plays a minor role in that sense. ECB decisions are not a "one-man show", but rather the result of discussions amongst the members of the Governing Council. That is an open, professional and collegial exchange, and this is the basis on which the ECB's Governing Council makes its decisions.

***You give the impression, however, that you take a more Anglo-Saxon approach, whereas your two predecessors, Issing and Stark, were rather more of the tradition of the Deutsche Bundesbank and were, therefore, more stability-oriented in their thinking.***

I would firmly disagree. I and the entire Executive Board of the ECB have utterly committed ourselves to price stability. That is our mandate, the task enshrined in the European treaties. We see price stability as symmetrical; it works in both directions. We fight inflation – when prices rise too quickly – with the same determination as when prices rise too slowly. And with our policy we have certainly been successful in terms of counteracting fears of deflation, I should like to think. All of our policies, including the less conventional ones, are aimed at maintaining price stability. By the way, during the time of my predecessor Otmar Issing, the ECB defined more precisely what is meant by price stability: below, but close to, 2%.

***However, on the issue of the purchase of government bonds, there has been a true break with past tradition. Your predecessors were strictly against it, whereas you and Mario Draghi are clearly in favour of these purchases.***

Who knows what my predecessors would have done in my position. They were not in a situation in which key interest rates had reached the lower limit, thereby leaving hardly any room for manoeuvre in terms of interest rates. However, I am sure that they would also have done everything necessary to fulfil the mandate. Besides, there was also a government bond purchase programme under the former President Jean-Claude Trichet, only it was much smaller than the current one.

***Critics say that the ECB has gone too far and that, with its ultra-expansionary policy, it has sown the seeds of the next crisis.***

We are well aware of the fact that an expansionary monetary policy entails some risks to financial stability. We are, nonetheless, convinced that we have acted in the right way, as we have followed our mandate. As we are not seeing a strong rise in lending, nor any signs of widespread speculative bubbles, the risks for financial stability are currently limited.

***But monetary policy has taken over too much of the burden from politics during the crisis.***

It is true that too much weight has been placed on monetary policy in managing the crisis. I would also have liked other stakeholders to have taken more responsibility in this respect. But that does not change the fact that the ECB must act first and foremost in order to fulfil its mandate.

***The euro area has not given a good impression of itself during the crisis?***

One of the biggest problems was that the architecture of the euro area was not yet complete. We simply did not yet have all the institutions that are needed for quick and effective crisis management. The euro area already had important principles, such as the no bail-out clause, the prohibition of monetary financing and the no-exit clause. But serious design flaws also became apparent, which nurtured excesses and contributed to the scale of the crisis.

***And when several Member States faced financial difficulties…***

… the right structures were not in place in order to deal with them. No efficient mechanism to, if necessary, refinance public and private debt or restructure or resolve troubled banks. Nor were there any supranational institutions that were in a position to do so.

***Except the International Monetary Fund.***

Yes, there was the IMF, but to start with, many people in Europe were not too happy about the IMF being involved in the euro area. I was always in favour of having the IMF on board, because in Europe, we simply did not have any institution that could have taken on this role.

***In the meantime, has the institutional framework improved in the euro area?***

Yes, very much so. We now have the European Stability Mechanism, we have made good progress with the banking union, and we have a European supervisory mechanism. That is an important step and more will follow. The euro area needs more integration.

***Was the absence of an institutional framework the main problem behind the crisis?***

One of the main problems. The other problem was that the governments in the euro area had little fiscal room for manoeuvre in order to respond to the crisis.

***Exactly, the governments had to save. Was austerity wrong, because it forced governments to save?***

No, the return to sound national budgets was necessary, because, during the sovereign debt crisis, it was all a question of regaining confidence in the public finances in the euro area in order to curb speculation of a break-up of the euro. But, of course, the fact that the governments had so little fiscal room for manoeuvre led to a worsening of the crisis and meant the ECB had to do even more to still fulfil its mandate.

***Now the ECB is even pursuing quantitative easing, and, over the past six months, has been buying government bonds. Thus far, the ECB has purchased a good €400 billion worth of assets, by the autumn of 2016, it is supposed to amount to over €1 trillion. What is your assessment after six months?***

The ECB's purchase programme is a success. It is already having an effect in terms of inflation expectations, for example, which have recovered again, and in terms of the general financing conditions, which have eased somewhat.

***But Mario Draghi is already talking about expanding the programme.***

He is repeating what we have said from the beginning, i.e. that the programme is flexible and can be adapted if necessary.

***Is there any point in already thinking about an expansion?***

The only important thing is to emphasise our readiness and our resolve to act if necessary. At the moment, that would be premature, but the risks in the world economy have grown significantly. We have had to lower our economic forecasts, and we simply want to be ready to act if the circumstances so demand.

***Were you too optimistic with your economic forecasts in the spring?***

We were accused of that, but I don't think so. The downward adjustment in September was not large and was mainly due to the correction in the emerging markets. The economic recovery in the euro area itself is intact.

***On Thursday, the US Federal Reserve System decided not to raise interest rates. Does this decision make life easier or more difficult for the ECB?***

The euro area is in a very different cyclical phase from the US economy. Therefore, our monetary policy cycles are also not synchronised. Nonetheless, we share the concerns about the prospects for the global economy. If we judged that shocks were sufficiently severe and persistent to weaken the inflation outlook for the euro area, we would not hesitate to act.

***How much of its growth potential did the euro area lose during the crisis?***

The potential had already weakened before the onset of the crisis, because productivity growth had slowed down. The crisis then made everything even worse, so today the euro area is on a much lower growth path.

***But monetary policy cannot change that.***

Monetary policy can only cushion the problem by, for example, making liquidity available and thereby helping to avoid a banking crisis. Monetary policy cannot create sustainable growth. For that, it is necessary to have intelligent structural reforms which strengthen the growth potential of the economy. However, that is not the task of the central bank, but of the governments.

***What should the latter do specifically?***

They must undertake structural reforms to lay the foundations for higher productivity and growth. Europe needs intelligent reforms.

***But these reforms seem to be taking a long time.***

You are being too pessimistic. We can see encouraging signs in the euro area, particularly in countries like Spain and Ireland, but also in Portugal. Italy was admittedly late in starting reforms, but is now on the right track.

***Are you also as confident about Greece?***

The situation in Greece is still difficult, but with the new programme we have made a step forwards.

***And will the new programme bring relief?***

The programme is indeed demanding, but we are convinced that the reforms will help Greece to create growth again and make its way out of the crisis. However, in view of the forthcoming elections, I do not wish to add anything further on that.

***Let us focus on Switzerland. It is clear that the policies of the ECB have a strong influence on a small, open economy like Switzerland. Is it still at all possible for the Swiss National Bank to pursue an independent monetary policy?***

There can be no doubt that every monetary policy also has an impact on other currency areas. However, the biggest impact on Switzerland does not come from the ECB, but from the policies of the euro area countries. The weak crisis management by politicians in the euro area has led to investors seeking safe havens such as Switzerland, which has strongly pushed up the price of the Swiss franc.

***And has the expansionary policy of the ECB not played a role?***

I believe our policy has helped to allay fears, and has thus tended rather to reduce the flight to the Swiss franc. When the euro area does better, the Swiss franc is under less upward pressure.

***Are you not making it too easy for yourself?***

The ECB took responsibility in the crisis and thereby helped reduce uncertainty in the financial markets and even avoid panic. In doing so, it also took the pressure off currencies like the Swiss franc. Naturally, all of this would have been much more effective if European governments had also done better with their crisis management.

***But the ECB's quantitative easing did also weaken the euro and thereby strengthen the Swiss franc?***

Bear in mind that the Swiss National Bank also introduced a kind of quantitative easing and expanded its balance sheet – long before we did, by the way. In spite of this policy, for a long time the inflation rate in Switzerland has been even lower than in the euro area. It is difficult for a central bank in such a situation to avoid the appreciation of its currency in the long term.

***Should there also be rules governing an orderly exit from the euro area?***

I believe that there is need for a crisis management system and a resolution mechanism for overindebted institutions, whether private or public.

***What will the euro area look like at the end of your period of office at the ECB?***

We will again have inflation rates below, but close to, 2%, because our policy will achieve its goal. And the banking union will be complete, meaning that the resolution regime and the deposit protection will be fully Europeanised. For me, this is a precondition for a well-functioning monetary union. In four years, Europe will be in a much healthier state than today.