Yves Mersch: Interview in *International Bankers Forum*

Interview with Mr Yves Mersch, Member of the Executive Board of the European Central Bank, in *International Bankers Forum*, conducted by Ms Inken Schönauer and Mr Andreas Scholz and published on 29 December 2015.

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Mr Mersch, how enjoyable is it to be a member of the ECB's Executive Board at the moment?

I have always found work fulfilling.

Recently, market expectations were raised and then not met. Is that a sensible tactic for a central bank?

I always think that decisions are taken at the time and place where they should be taken. Not in public, but by the collective decision-making body, namely the ECB's Governing Council. I don't think it makes sense to comment beforehand on how you are going to vote. That way you lose influence over such decisions.

Is there some sort of opposition from the remaining hawks in the Governing Council?

I don't have a track record of divulging things that are strictly confidential under the Treaty on the Functioning of the European Union, namely the Governing Council's deliberations.

But again, the markets were disappointed by the results of the ECB's last meeting of the year. Share prices fell.

That also quickly calmed down. It's not as if we did nothing. We strengthened the existing measures. But I do sometimes find it worrying how market expectations surge. That sometimes happens because of public discussions about internal papers which have not even made it to the Council at that point.

Is –0.3% now the floor for the penalty interest rate?

The ECB's President, Mario Draghi, has not confirmed that. But we are well aware of the possible negative consequences of our decisions. Every time the Council meets, we check whether the cost-benefit analysis still applies. In theory, –0.3% is not necessarily the lower limit.

The ECB President himself once said that the lower limit was –0.2%. But even he is no longer sticking to that. Why has there been yet another drop?

The situation has changed. Our focus is on effectiveness, and analysis has shown that it would make no sense to do without an instrument that has the potential to be very effective.

So, what does a further small step like this achieve?

The rate of –0.2% was already having an effect. That is now being reinforced.

Switzerland is already down to –0.75%.

There's no comparison at all. The euro area has a much larger internal market. The exchange rate is an entirely different matter in Switzerland. We are working for the euro area.

At the moment, though, it would seem that the ECB has reached the end of the road with its measures.

We have certainly not used up all our powder. In theory, much is still possible. We can step things up at any time if necessary. We still have weapons and ammunition left.

What would they be?

We can calibrate our existing instruments for optimal effectiveness. As for other measures, I don't want to raise any expectations.

But Mr Draghi has already said that more could be done.

He also said "if necessary". The QE programme was set up to run until September 2016. But there was a possibility that we wouldn't get to where we wanted to be by then. That's why we pushed the end date back. It's a simple, comprehensible and logical step.

There was no need to indicate an end point at all.

The programme will run for as long as is necessary to achieve our objective in a sustainable way. It would also be helpful if our measures were supported by other policy areas.

Do you feel supported by policy-makers?

No.

That's a clear answer. Where does the problem lie?

Structural reforms are not being implemented quickly enough; sometimes the existing fiscal leeway is not being used. That also applies to Europe's largest economies.

You mean Germany as well?

Among others.

What is your main criticism?

The low interest rate environment has opened a window. But it is not being used by many European countries – to reduce their debts, for instance. That would build confidence.

There must be an institution or a mechanism which monitors precisely that.

Institutionally, we have the European Commission, which should be the guardian of the EU's treaties. If the existing rules are not respected and nobody feels responsible, there's a governance problem.

And now?

Of course, I can see that the Commission is making efforts to play a stronger political role. That is perhaps legitimate. But that must not be at the expense of its role as the guardian of the treaties.

Again, a follow-up question: what will happen if Europe slips back into recession, with the interest rate level not having risen sufficiently for interest rates to be lowered again. What can the ECB then do?

In theory, it would then be the turn of fiscal policy. I'll pass this question on to the national governments. Consequently, budgetary policy must now be at the top of the agenda. It must be possible to use budgetary policy in the next cyclical downturn. The various economic policy-makers must live up to their responsibilities and not simply rely on monetary policy.

You were not always a supporter of the ECB's current policy, especially the QE programme. Why has your attitude changed?

It has changed entirely in two respects. I can honestly say that the effectiveness of the programme has come as a surprise to me. If we had not started the QE programme, growth might have turned negative again. We would have had recessionary deflation in many parts of the euro area. That would have been devastating for the democracies of the euro area. I also warned about the risks that the programme could entail, but they have not materialised thus far. What we are seeing with property prices, for instance, is not a worry. The BIS [Bank for International Settlements] also noted that recently.

The BIS referred to an uneasy calm.

That's why I would also say that we have to continue to monitor and follow developments. But there are no broad-based bubbles in the real estate and asset markets.

And if there were?

Then we would have to adopt the measures and use the instruments which were necessary. But that is a national competence. The Member States are responsible for financial stability. However, we have a coordination function at European level in order to prevent spillover effects and cushion external shocks.

What should be done if bubbles do indeed form, a phenomenon which unfortunately cannot always be foreseen?

Monetary policy applies to the whole of the euro area and aims to maintain price stability. That also applies to our flexible liquidity-providing instruments.

But if the bubble bursts, that ceases to work, and then more liquidity is needed again.

We have standard and non-standard instruments; both can be used. But I'll say it again: financial stability is a matter for the national authorities. After all, bubbles initially occur at regional and national level. Solving the problems at that level is also much more efficient. Compared with national financial stability measures, monetary policy is a rather blunt weapon.

Now you are making the ECB's monetary policy seem less important than it is.

No – it does of course get in all the cracks, but unfortunately, despite the ample central bank liquidity, loans in individual countries which should be granted are not being granted.

The way QE works was once visualised as a marathon. How many kilometres have we run so far?

We have come a long way since summer 2015. Even though we have pushed back the end of the QE programme, we have already covered quite a distance. We can see the effects in lending, for instance, where figures have turned from negative to positive.

But that's still not enough.

Small and medium-sized businesses in particular no longer have financing as their primary problem, and that is very positive. The problems tend to be in other policy areas, for which we are not responsible. That's why we are pushing so much for structural reforms.

The ECB has a price stability objective of "below, but close to, 2%". Is this objective still appropriate?

The answer to this question is in two parts. Does it make sense in times of crisis management to change your strategy? I don't think that would foster confidence. However, it is indeed the case that it is more difficult to measure inflation today than it was 15 or 30 years ago. There are factors which we over- and underestimate when it comes to inflation.

Why?

It is not so easy to distinguish between improvements in quality and increases in prices. That is especially true in the digital age. It has probably never been as difficult as it is today to establish how changes in consumer behaviour affect productivity and prices. We need further studies on all these issues. If you draw premature conclusions, you end up zigzagging around, which destroys confidence. Confidence-building is the key precondition for us to return to a stable growth path.

Why, then, is the "close to 2%" so important? An inflation goal of 1.5% would also suffice. Prices are stable, so why is the ECB putting itself under pressure? We are, after all, a long way from Japan-style deflation.

There were deflationary risks. When these are accompanied by a recession, things get difficult. Then you are permanently driving along the edge of the precipice and the risk of having an accident is greater. That's why potential growth must be pushed up. But that is not a task for us; that goes hand in hand with the structural reforms I've been talking about.

Then do away with the "close to". 1.5% would also be OK.

That's precisely the strategy discussion that I mean. You don't have a discussion like that during a crisis; you have it afterwards. The definition of price stability must not be seen as a moving target. It is important to have an institution which sets objectives that the general public can understand.

People are not concerned about price stability; they are concerned about the very low interest rates. That's what they are worried about.

There are a number of countries which are still in the adjustment process and experiencing deflation. That also has to be borne in mind.

Which countries do you mean?

Greece has been in a deflationary recession for five years.

But doesn't the ECB conduct monetary policy for the whole of the euro area?

Yes, but this problem also existed in Spain for a long time. And the euro area as a whole was threatened by this deflationary scenario.

Let's go back to the ECB's mandate for a moment. The low interest rates and regulation are significantly affecting the performance and strategies of banks and insurance companies. Is the ECB allowed to do that?

On the specific subject of regulation, the rules are not made by the ECB; it just implements them. It was the G20 that drafted them. What concerns us in this context is the need for a level playing field. We in Europe have established protectionism for banks which is no longer acceptable and is fragmenting Europe. We need a level playing field in order to achieve the necessary adjustment. Europe is still "overbanked". Further consolidation is necessary.

Let's turn to the euro. Isn't the ECB also conducting an exchange rate policy? The euro is weak, and a number of ECB representatives have long made no secret of the fact that they welcome that.

In some countries, exchange rate policies were pursued before the euro was introduced. The ECB has no exchange rate target. However, the exchange rate does have a major impact on inflation and growth.

Don't you see a risk of competitive devaluation worldwide?

In fact, the Governor of the Reserve Bank of India recently said that there should be a discussion and an agreement on this issue. We have a legally binding mandate under the Treaty on the Functioning of the European Union, which specifically states that we conduct monetary policy for the euro area.

The diverging monetary policies of Europe and the United States will be a major issue in 2016. How do you see this divergence, however slowly it may develop?

We don't coordinate our actions, but that doesn't mean that we don't talk to each other. The occasional additional phone call may be made in such a situation. In any case, the United States will continue to pursue a very accommodative monetary policy which adapts to the circumstances. There can be no talk of tight monetary policy even there. The divergence reflects the different cycles.

What risks do you see coming from China?

I am very confident that China is well aware of its global responsibility. China's economy is on a manageable path, and we do not anticipate a crash.

Has the ECB changed you? You were known as a hawk, but that no longer seems to be the case.

I have never said that I'm a hawk. I was always stability-oriented, and I still am today. It's always a question of how you can best exert influence: sulking in the corner or actively shaping policy. It's also a question of being loyal and committed to an institution.