Peter Praet: Interview in VDI Nachrichten

Interview with Mr Peter Praet, Member of the Executive Board of the European Central Bank, in VDI Nachrichten, conducted by Ms Sabine Seeger and published on 24 March 2017.

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Mr Praet, the European Union is celebrating its 60th anniversary on 25 March in Rome. After a brilliant start and major achievements, the Community is now in a crisis. Can it be overcome, do you think?

The people of the European Union (EU) have got so used to the benefits of open borders and the Single Market that they can no longer imagine what it was like before or what it would be like without it. They live in a stable world and are not always aware that it's a great asset, and one that needs to be preserved.

What has to be done now?

We have to re-convince people that the EU market, with more than 500 million people, forms the basis for our prosperity. When we laid the foundation for it in 1992 with the Maastricht Treaty, the EU was a grouping of relatively homogeneous states. However, as a result of the enlargement, countries were integrated [into the EU] which had much lower income levels or much weaker social safety nets. This has led to distortions which we have to address.

Some examples?

There can be no doubt that trade and a larger market foster prosperity. But we should not overlook the fact that this progress does not benefit everyone to the same extent. This may lead to resentment. Such feelings cannot simply be brushed aside; people's concerns have to be taken seriously. Moreover, the enlargement was linked to the expectation that the Community would continue to come together and that people's circumstances would steadily improve. This has happened for many, but not for all. Also, the financial crisis which occurred at the start of the recession in 2009 has led to a crisis of credibility. So there are reasons for many people to feel discontent. On the other hand, the EU is willingly used as a scapegoat. Some find this a cheap way to distract from national problems, such as undesirable developments on the labour market, in social security systems or in debilitating bureaucracies.

The world is less safe because of politicians such as Trump, Putin and Erdogan. Shouldn't this make people think again?

We have been able to progress peacefully for a long time under the protection of the United States. We have set ourselves up in a multilateral world. But the old world order is being challenged. In the worst-case scenario, there is a risk that power and size will matter above all. In such a system the great powers, the US, Russia and China, would dominate. The voices of smaller countries would lose their relevance if they act in isolation. And let's face it, even the biggest European countries fall into this category if left to their own devices. If we want to protect our interests and our conception of how we want to live together, then we have to stand together. And that's only possible through the EU.

One of the biggest challenges is populism, which takes aim at the EU in many ways. How can we convince people that populism will lead to our undoing?

We are seeing mistrust in and scepticism about the elites. All too often, problems and grievances, which of course exist in our societies, are no longer being addressed in order to seek the right solutions, but are becoming the expression of a general rejection. Populists promise supposedly simple solutions which are, at the same time, specious and ultimately harmful. How can you take a stand against them? First of all, you should listen and take people's concerns seriously, because it's essential to consider carefully the real and supposed grievances and, if possible, resolve them. Lastly, it's necessary to explain the consequences of political action: if people vote for populists who idealise the nation state and make its sovereignty absolute, then those voters have to know that, although they would live in smaller, easier-to-control markets, it would also mean much higher prices for consumers and reduced prosperity. Basically, as I see it, people vote for populists in order to protest, but not to reject the EU as such.

Given the current mood, do you still see any opportunities for further steps towards integration?

Yes, we are working on a deepening of the Single Market to facilitate free trade. For example, if the EU harmonises the performance of vacuum cleaners, then they can be marketed right across Europe, in addition to being a factor in energy efficiency. But people see this as "Brussels" wanting to impose a diktat, as almost some kind of "harassment". Harmonisation cuts the cost of our products, which would otherwise have to be adjusted separately for each national market. So when the talk is about a deeper EU, greater harmonisation and fewer barriers to trade, then inevitably that is at the expense of the Member States' freedom to decide. But in areas where national or even regional institutions are better suited to establish the right rules, then the principle of subsidiarity should be applied to a greater extent. It's not about integration as a value *per se*, but about integration that's appropriate and necessary. I think there is the necessary consensus on this point.

Now that the euro area has wriggled its way out of the crisis, things are improving economically.

Things are getting better but the economic situation still varies a lot. Germany, which has weathered the crisis well because of the low level of government debt and household debt, is in a very good position. But other countries were severely hit and still have some serious challenges. The good news is that the recovery is firming up in all the countries of the euro area and expanding into more and more sectors. Consumer and business confidence is rising, despite all the political uncertainties. That's encouraging. After all the years of crisis progress is being made and people have trust in it.

Is the upturn a result of the ECB's low interest rate policy?

In 2009 we had the biggest recession in the post-war era, with a sharp increase in unemployment. Since that low more than four million new jobs have been created in the euro area. Our monetary policy has supported the recovery as it has made financing conditions for banks and thus also for households and businesses easier. But let us take a step back and consider the economic slump. The sovereign debt crisis resulted from it and caused the countries to fall into a recession again in 2011 and 2012. The ECB's monetary policy and its intervention played a decisive stabilising role. It averted a depression.

If there had been no intervention, what would have happened?

To give an example: if the ECB had not given the Spanish banks liquidity assistance in 2012, when a lot of money was withdrawn, capital controls would have resulted and creditors from other euro area countries would have found it difficult to gain access to their assets. People have forgotten just how dangerous the situation was at that time. Many are unaware that the ECB and governments too acted in a carefully considered, reasonable way and prevented a worse outcome. The European institutions were not at all prepared for such a crisis, which is why decisions were also quite chaotic at the outset. But in the end, also thanks to the creation of the European Stability Mechanism (ESM), a collapse of the Single Market was prevented.

And yet, the ECB's role remains controversial and its expansionary monetary policy heavily criticised.

The ECB has played a leading role, not least because of the fact that it was capable of acting at any time during the crisis. The decisions were never simple and there was much discussion about the right course to follow. But at the ECB we were always aware of our responsibility and managed to craft a monetary policy supported by all members of the Governing Council. This paid off during the crisis. But this success has been double-edged: the ECB has not only had to repeatedly take on new tasks, such as banking supervision. But also it is being held responsible for problems the more it is seen as an especially influential European institution that can take action. This is the case even if in reality it is not responsible.

But you are now facing the challenge of finding a way out of the expansionary monetary policy. This includes an increase in interest rates, as has just happened in the US. Is the Fed's step a signal for the ECB?

We have a clear mandate and it relates to the euro area. And we have to watch developments closely before we take action. So far, we can only say that the economic situation is improving. That gives us confidence, but the upward trend and hence the normalisation of inflation are still very dependent on monetary policy stimulus. While inflation is temporarily close to the desired target, it is based to a large extent on short-term fluctuations in energy prices. The underlying inflation trend is still noticeably weak, and we have to monitor it in order to fulfil our mandate in a sustainable way.

Inflation in Germany is over 2%. Shouldn't that be taken into account and the low interest rate policy, which has a serious cost for German savers, be brought to an end?

We are indeed very aware of the criticism – and by the way it exists in other countries – and we take it seriously. Of course, interest rates could be higher for Germany's economy and in some other countries as well, if they were alone. But they aren't – we have a single currency. Therefore, the ECB is committed to conducting a monetary policy for the euro area as a whole, and sometimes that requires everyone to be patient. As always, there are some for whom monetary policy is too loose, while others would specifically like to see more support. But let's not forget the times before monetary union, when we had fluctuating exchange rates, which brought a lot of instability. That was very costly for economies such as Germany's. Today, by way of our monetary policy, we are contributing to the continued existence, stability and functioning of the Single Market. That's really important for Member States that are major exporters. And that's even more relevant in times when free trade is being called into question internationally.

But the low interest rate policy is creating market distortions, as we see in Germany's housing market. Aren't there dangers looming?

The price increases should be seen in context. They were preceded by an unusually long period of stagnating house prices in Germany. This has changed in the last seven years. And the question now arises as to whether there is some overheating. That may be the case in the most popular cities, but overall there are no clear signs of that. A dangerously speculative, destabilising overheating would, moreover, only occur if the price rises were being increasingly and excessively financed by credit. One would see that from strongly growing home loans, but which is not the case. And if it got to that point, then it would not in the first place be the task of monetary policy to react, as its primary commitment is to price stability. But there are other means available to national governments and supervisory authorities to curb overheating, should a worst-case scenario arise. For instance, by tightening the rules on lending or via fiscal policy.

The UK's exit from the EU now lies ahead. Could Brexit endanger the financial stability of the euro area?

No, I don’t think that Brexit poses a risk to financial stability. First, it will be a thoroughly controlled exit and, second, we have learnt from the crisis how to handle dangerous situations. One must always be concerned about stability should there be abrupt events which have an immediate impact. But with the UK’s expected exit this is precisely not the case. We will have time to organise the break and the related adjustment. And from a purely organisational perspective the adjustment brings for the regulators such as the supervisory authorities an enormous amount of work. What concerns me are the massive costs that the withdrawal will cause for the EU27 and, above all, for the UK.

But there could also be winners. Frankfurt could become the EU’s largest financial centre. Do you agree?

Frankfurt is a friendly place, multinational, well-organised and convenient. The city offers a good working environment. I value that, as do some private sector bankers. But no doubt you could say that about Madrid, Dublin, Paris or other European cities. In my view, what matters is something different: if the financial centres of the euro area hope to play a more prominent role, then they will have the best chance of doing so only in the context of a fully fledged European banking union. And there’s no point in hoping for that in some distant future. We need a strong and complete banking union within the next four to five years.

What’s needed to complete it?

We need a clear road map, showing where we want to be in four or five years’ time. Brexit is regrettable and harmful, but it is also an opportunity for the banking union. Having a strong and reliable regulatory framework and a single supervisory body that is both strict and fair are big competitive advantages in the banking sector – for that creates trust of a sustainable kind, the bankers’ most important “currency”.

How optimistic are you then that the banking union can be completed before the next financial crisis?

Banks are now much better capitalised than before the crisis. Furthermore, the supervisory authorities have also learnt to respond quickly to avert risks to financial market stability. A bankruptcy like that of Lehman Brothers in 2008 is much less likely nowadays. The banks protect themselves as well by making better provisions.

What does it mean that some banks are withdrawing from the European market and focusing on their domestic market? That there’s no European banking system after all?

I am also concerned about that, because we in the monetary union need cross-border banks which are subject to common supervisory and resolution rules. When there is common banking supervision, you also need burden-sharing in case something goes wrong. We don’t have that at the moment. We indeed have common supervision, but if something starts keeling over, the individual states still have to step in. We won’t have a banking union with real risk sharing until we have a common backstop, i.e. a credit line from the European Stability Mechanism, for instance.