

## Vítor Constâncio: Interview with CNBC

Interview with Mr Vítor Constâncio, Vice-President of the European Central Bank, and CNBC, conducted by Ms Annette Weisbach in Sintra on 27 June, published 28 June 2017.

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**Mr Constâncio, we're talking about a lot of economic issues here in Sintra: the output gap, productivity, but also innovation. What does that all mean for your monetary policy?**

Constâncio: Beyond the point that these are important subjects for any economy looking ahead, it's also important for monetary policy because this concept of output gap dimension – which is the difference between where output is at the moment compared with the potential output as it could be – this is a very important concept for monetary policy decisions, because what we want when we want to, say, bring inflation closer to 2%, is for aggregate demand to put pressure on supply in order for prices to go up. And when the difference between the actual output and the potential is negative, as is the case, then we have to close that difference.

That difference depends on the way we see and calculate the potential, which is a very difficult issue in economics, and there are all sorts of different estimates, but what it means is that all central banks have to analyse very carefully and take a view on what is the degree of slack in the economy, because that's crucial for the stance of monetary policy being more expansionary, less expansionary: it depends on that. So all this discussion about potential growth, productivity going forward, all that is important to see where this slack in our economies is going, and to take, then, monetary policy decisions.

**Slack in the economy seems to be the buzzword also here in Sintra. Listening to the President's speech, of course slack is super-important to determine whether we can look through a period of low inflation, so where do we stand here now? Can we look through it, or is it still worrisome, where we stand when it comes to inflation?**

Constâncio: It's very difficult for any central bank to have a very firm view on the slack. All central banks struggle to interpret where exactly is the situation, and in central banks we use many variables to try to gauge what is this slack, this difference that is in the economy. What we can say now is that what we observe is that domestic factors of inflation, starting with wage costs and then also price decisions, are not responding the way we would expect in view of what are the more common estimates of this slack. So we have to ask ourselves – are these measures of the economy correct? Should we look to other variables?

The President, in the speech, precisely pointed out that looking to unemployment as an indicator of this slack in the economy, the unemployment rate now is 9.3%, according to the normal international standard of measuring unemployment; but if we adopt, as in the US, a broader concept of unemployment – which in the US they call U6 – then unemployment in the euro area is at 18%, where it is at 9% in the case of the US. Which would imply that the slack is then bigger than we could judge some time ago. That being the case, it justifies fully what the President said at the end of his speech: that we need persistence. If we want to bring inflation to our target of below but close to 2%, then we have to persist in the type of monetary policy that we have been adopting.

**But looking at the market reaction, the market took the speech quite hawkish, meaning concentrating on the optimistic comments about inflation, the economy, perhaps also the political tailwind. So is the market right to read your communication style as more hawkish than before?**

Constâncio: It's always very difficult to interpret the reaction of markets. I will not try to say

rationalise or explain; the reaction of the market was what it was. But I will say that the speech of the President, if one reads it completely, it's totally in line with the statement we had in Tallinn in our monetary policy meeting there; the speech that he also made at the European Parliament; and here it was along the same lines. He recalled that domestic drivers of inflation, measured by the underlying inflation, are still subdued, and that we need to be sure that when we get to inflation close to 2% it's a durable situation and a self-sustained situation that can go on without the high degree of accommodation that we have now: so all these conditions, he reaffirmed them, and then talked precisely about the need to persist and about the need to be prudent in talking about premature withdrawal of stimulus.

**So in other words we are not closer to an exit, not even a baby step closer, with the forum here in Sintra?**

Constâncio: Well, we are not predicting what the Governing Council will do. We are not trying to do that. This is the assessment that we have been producing also as a result of monetary policy meetings of the Governing Council itself, like the more recent one we had. So it's going along the same lines. Personally, I don't see anything in the speech that would be different from, say, the previous two main interventions about monetary policy done by the President.

**Let us talk about one area of optimism, and that's the political tailwind. How confident are you about the state of the political European landscape now? Is there more of a momentum for reforms now?**

Constâncio: Crises are always bad for the social and political mood, and recoveries are always good. And so there is a bit of a recovery, which is becoming stronger, and that, of course, has had its effects, in the mood of societies, of public opinion, and also in the political sphere. That's what I think the President indicated, and indeed, there were fears, especially from outsiders, that some of the political developments in some European countries would go in the direction of creating some doubts, which were dispelled. So that's what he refers to.

But throughout all this period there is one thing that is important to recall: if you go to the Eurobarometer that is the result of surveys in all Member States, you see throughout all these years, all these years, that the support for the euro – being in favour of the single currency, the euro – has been stable at around 70% of Europeans in the euro area countries; and that in all countries there was a majority supporting the euro. A majority in all countries. The numbers are different according to the different countries, but in all they are the majority. So this has been the support that the project has benefited from, and the present recovery has indeed reinforced those views.

**But we are talking about reforms as well. We're talking about the banking sector: the European banking sector is not as strong as it should be. Just over the weekend we have seen two Italian banks getting state aid, so it was hugely criticised. Why did they get that exception, that they're allowed to have state aid?**

Constâncio: It is not an exception. Everything is foreseen in the laws. BRRD, the directive on resolution of banks, was not applied because the Single Resolution Mechanism decided that these two banks did not deserve to be resolved, which according to European law means rescuing some part of the banks, and that the banks should go into liquidation. But going into liquidation means that state aid rules apply, so any public money then requires two things. It requires that shareholders and subordinated debt-holders participate in the costs, which is the case in the two banks, because they go to the entity with the bad assets...

**But not senior bond holders?**

Constâncio: No, but the point – if the solution, for instance, under BRRD, had been applying

precautionary recapitalisation in that case also senior bond holders would not have been bailed in. So it's not much difference from a situation of precautionary recap, which is foreseen in the law. It's not an exception. It's not a special privilege. Everything was decided according to the two laws that apply in these cases, with, in the case of the BRRD, the potential exception of precautionary recap, which is in the law, and state aid rules. This was applied. At the same time, as a result of state aid rules, and logic, policy, the overall capacity of the banking sector in Italy went down. So there was downsizing; there was restructuring. Indeed, everything was applied according to European legislation.

**Is that just the beginning now for the Italian banking sector? As we all know, it has a huge slab of NPLs. Can we be prepared for more of these kind of...**

Constâncio: I don't anticipate anything of that sort. There is the situation which was announced also during these days that is about to be concluded regarding Monte dei Paschi di Siena, but that has been discussed with the European authorities, and very likely it will have, as was stated in the past few days, a solution very soon for that case.