Benoît Cœuré: Interview in Handelsblatt

Interview with Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, in Handelsblatt, conducted by Mr Jan Mallien and Mr Frank Wiebe on 15 November and published on 21 November 2017.

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Mr Cœuré, the European Central Bank (ECB) took on a very important role in stabilising the euro area during the crisis. How can Europe avoid overburdening the ECB with problems which should be solved by politicians?

To avoid overburdening the ECB, the euro area needs a strong economic pillar and a strong fiscal pillar. And let me add a personal remark: the world today is in disarray. It needs Europe to provide economic stability and political direction. Europe, therefore, has to be strong and have a clear sense of where it wants to go.

In order to become stronger, Europe is discussing the banking union, a euro area budget and a sort of European Monetary Fund. What is your take on these issues?

We are glad that the discussion on the future of Europe and the euro has restarted. As a central bank, we shouldn't interfere in the details of a political debate. But we have a stake in it. The crisis forced us to design instruments that made it possible to address a very difficult situation. We have done this within our mandate, as the European Court of Justice has confirmed. But we don't know what the next crisis will look like. And we don't want it to test the limits of our mandate.

What is the most important issue, if you want to prevent that?

Completing the banking union is a priority. This includes a common deposit insurance scheme and further progress to reduce risks in the banking system. It also means that all banks should operate and be supervised in the same way. It's a whole set of measures. Some may require legal changes, as the ECB's banking supervision and the European Commission have suggested. This will take time.

There have been arguments about non-performing loans (NPLs) in Italy. Italian politicians have criticised the ECB's plan to clean up banks' balance sheets. What is your response?

I am not a lawyer, but I understand the recent guidance provided by the ECB's banking supervision to be a clarification of how it will assess banks' actions with regard to future NPLs. It has provided similar clarity in other areas in the past. Had it not done so, it would now be accused of not being transparent. But I must insist that NPLs are not just an issue for regulators and supervisors. Reducing the stock of NPLs will make the system safer and the recovery more robust. Making substantial progress on this issue will benefit the whole euro area economy. One of the reasons why growth in Europe is lagging behind that of the United States is that we started to tackle problems in the financial system later. The current discussion should not be an excuse to postpone taking action that is important for the European recovery and the completion of banking union.

Let's talk about the other pillars that Europe needs. What changes would you like to see on the fiscal side?

The priority here is for euro area countries to put their houses in order and comply with the fiscal rules, so they can regain fiscal space. Only then can a common fiscal capacity be put in place.

Is there a need for a larger common budget?

I see two different discussions here, which are sometimes muddled up. The first is about how to fund tasks like defence or addressing migration, which may be better managed at EU level. This requires common action, either using existing instruments (such as the European Investment Bank and the European budget) or new ones. The second discussion is about helping the euro area cope with large economic shocks without overburdening the ECB, as I just mentioned. This can be done by strengthening the European Stability Mechanism (ESM) and creating a euro area budget, while making sure that it does not undermine sound fiscal management at national level.

The second point sounds like setting up a sort of European Monetary Fund, a European version of the International Monetary Fund.

I would prefer to call it a European Stability Fund. Let’s not suggest that it can be funded by central bank money creation, because it can’t. It has to be a fiscal instrument.

How could this mechanism work?

The ESM has been a success and there are ways to make it stronger and more agile. For example, one idea which has been put forward is that the ESM could offer precautionary credit lines for countries that have good policies and stick to the fiscal rules. This would be an insurance against external shocks. Another desirable reform, in my view, would be to strengthen the European Parliament’s scrutiny of euro area crisis management.

France and Germany seem to have different visions regarding this framework. Is there a chance of them reaching an agreement?

France and Germany have a duty to agree! In recent EU history, they have always had different starting points, and always ended up agreeing. But the other countries also have to be heard and respected. It will be a long discussion, which is why it needs to start soon.

How long will it take?

My preference is for the discussion to take a bit longer and lead to a strong outcome, as opposed to rushing it and producing only a symbolic outcome. The real deadline is the European Parliament elections in the spring of 2019.

Let’s move on to your core task, monetary policy. At its October meeting the Governing Council decided to halve the monthly asset purchases from the beginning of next year, and keep on buying at least until the end of September. Why don’t you go to zero?

The European recovery is the strongest for the last decade, and the broadest for the last two decades. But inflation remains weak. There are some signs that it is ticking up, but it remains dependent on our monetary support. Also in Germany, inflationary pressures are surprisingly subdued. There is very broad agreement in the Governing Council that monetary policy needs to remain accommodative until inflation moves back towards 2% in a sustainable way.

Some members of the Governing Council have argued for a specific end date of the purchases. Why have you opted against that?

Most members agreed that we need flexibility on the end date because September 2018 is still far away, and many things can happen in the global economy between now and then. But there is a growing sense that the effectiveness of our monetary policy is now less reliant on our net asset purchases.

Why?

As Mario Draghi explained in his press conference, our monetary support relies on three elements: monthly net asset purchases, the stock of acquired assets and forthcoming reinvestments, and our forward guidance on interest rates. In particular, we have now purchased so many bonds that the impact on financial conditions of this very large stock of bonds is sizeable, meaning that we can buy less month after month without jeopardising the effectiveness of our purchases.

Could you explain that in a bit more detail?

There are several reasons for this. We will reduce the pace of purchases but will still buy more bonds than will be supplied next year, which will keep long term interest rates low. For example, there is ample excess liquidity, which is keeping short-term interest rates down. Moreover, bond supply and demand conditions matter. We will still buy a multiple of the net supply of new bonds in 2018. That will keep long-term interest rates low despite the reduction in the pace of monthly purchases. We are also seeing a change in the nature of the investors who sell us bonds. In the first months of our asset purchase programme back in 2015, we bought many bonds from overseas investors. Now our counterparts are increasingly buy-and-hold euro area investors, such as pension funds and insurance companies. They are more eager to keep the bonds because of regulatory requirements and their own asset-liability management constraints. That means that they are only prepared to sell at a higher price, which makes our action on interest rates more effective for each euro we spend. And finally, we will reinvest all bonds coming to maturity for an extended period of time. All of this makes additional net asset purchases less and less necessary.

In the introductory statement to the October press conference, the ECB retained the link between asset purchases and inflation, namely that asset purchases will continue until there is a sustainable convergence of inflation towards your definition of price stability – below, but close to, 2%. Why?

I expect this link to change when the Governing Council is sufficiently confident that net asset purchases are less needed for inflation to return towards 2% in a sustainable way. We were not ready to make that change in October, but I expect it will come at some point between now and September 2018.

But there are also Governing Council members like Peter Praet who have quite strongly emphasised this link. Is there disagreement in the Council?

I expect our interest rate guidance to gain importance over time, up to a point where the delinking you mention will become possible. Some members thought it would be possible now, while others thought that it would only be possible later. In my view, the discussion is more about the timing than the substance.

And you are in the first camp?

I am part of the large majority of Governing Council members who believe that a substantial degree of monetary accommodation is still needed. But I think that we can better exploit the trade-off between our different instruments, while also being mindful of potential risks to financial stability.

Recently you said that you hope the asset purchases will end in September. That sounds more hawkish than Mario Draghi.

For me, it’s the logical conclusion. The economic environment is improving, price pressures are building up and we’ve become less reliant on our monthly net purchases. So we can be hopeful that the October extension was the last one.

Do you think asset purchases should be a permanent instrument of monetary policy?

Asset purchases have been an extraordinary answer to an extraordinary situation, and they've worked very well. But capital markets in Europe are different to those in the United States. They are not as deep, which is why I believe that asset purchases will remain an exceptional instrument, but they will not be a permanent part of our monetary policy. At some point we will come back to "normal" monetary policy where we move rates up and down.

A crucial model for central banks is the Phillips curve, which essentially assumes that lower unemployment will lead to inflation. Does the Phillips curve still exist?

I think that we need to show a healthy degree of restraint because the world is changing and there are many things that we do not understand. We have been through the worst economic crisis since 1929. It has had a huge impact on European economies in terms of the level of unemployment and the persistence of the impact on the labour market. It is no surprise that the patterns we had become used to over the last 20 or 30 years have become weaker. Moreover, technological and structural changes in the economy are affecting the way the labour market functions in ways we don't yet fully understand.

But it is still a puzzle why inflation is not picking up when unemployment is going down.

I find it less of a mystery in Europe than in the United States, because the labour participation rate has been going up throughout the crisis, partly due to increases in the retirement age. In Europe, unemployment being high means that many workers have remained in the labour market, which puts downward pressure on wages. In the United States, workers have been pushed out and many won't come back. The labour market is close to full employment so there should be wage pressures which we are not yet seeing.

But what is behind low wage growth in the United States?

It must be related to ongoing organisational and technological change, global forces and low productivity gains. The US situation should be a warning to us: there is a risk that nominal wages will remain subdued even when pressures build up in euro area labour markets, because of low productivity gains. Incidentally, this is what we're also seeing in Germany.

For many years central banks have pushed very hard to boost inflation. But despite the fact that they are still not satisfied with the level of inflation, the economy is doing very well. Can't we be satisfied with that and be a bit more relaxed about inflation?

I can understand why politicians may think that way, but as central bankers we can't. Our mandate is narrow, and it is a price stability mandate.

In the United States there is quite an open discussion about the inflation target. Isn't it time to start that discussion in Europe as well?

I really do not think that it is the right time to start a discussion on the ECB's definition of price stability, in either direction. Throughout the crisis we have been an anchor of stability. If you look at longer-term inflation expectations, they have been very stable, and this has helped avoid deflation. This anchor remains needed at a time when the euro area is still coping with the legacy of the crisis.

Another topic that is currently the subject of heated debate is the possibility of Bitcoins replacing cash. How important is this topic for the ECB?

There are different forms of digital currency. Bitcoin is not a currency; it is a financial instrument which creates major risks for investors because its value is highly unstable, not to mention the issues of tax evasion and criminal activity. This is not a monetary policy discussion. On the other hand, new technologies are being developed on wholesale financial markets, such as the use of

Blockchain for clearing and settlement, which may one day require digital money to settle transactions. We are looking into it because we have to follow all technological developments. Finally, whether there should be a shift out of cash and towards digital currencies issued by central banks is yet another discussion.

What is your view on that?

I believe that central banks should be extremely cautious when they deal with such issues, because they concern trust in the currency. There are different views on the use of cash. Germany, for example, is a country where people remain very much attached to cash. Different societies will have different opinions.