

Peter Praet: Interview with Bloomberg TV

Interview with Peter Praet, Member of the Executive Board of the European Central Bank, and Bloomberg TV, conducted by Ms Jana Randow on 27 March 2019 and broadcast on 28 March 2019.

* * *

The President is talking about mitigating the side effect of negative rates. Does that mean tiering is coming?

Praet: Well, I think don't rush. I think it's a bit premature to take that conclusion. What is clear now is that the perspective of low rates for longer has triggered that debate about the side effects of negative rates. I think it's fair to say that this issue has to be analysed carefully. But you need in any case to find a monetary policy case; you cannot just conclude let's do the theory because the economy is slowing down and the rates are low for longer. I think it's fair to say that we have to go into this issue but we need to have a convincing monetary policy case to do that.

Now, when you look at the economy today and the lending channel, we don't see any particular problem in the lending channel today. As we know with the weakening economy it may happen in the future so you have to be ready and to look at the possible instruments or decisions you may need to take in case. So readiness, yes, but I think don't rush too quickly to conclusions but it's fair to say that the conversation has started.

If the conversation has started, does it mean that interest rates will stay low for even longer?

Praet: I think it's difficult to say today. When you look at prices, market prices, yes the date of the first lift-off has been pushed further by market participants, so this debate on the tiering has been coming. As I say, the perspective of rates for longer is something you have to look at, all the consequences of that.

Does tiering make the tool of negative interest rates less effective?

Praet: The negative rates have been extremely useful to support the economy basically because the opportunity costs of saving have been low. So you push people either to spend or to go into more risk and supporting the economy, going into investment and all that. We have been big effects of the negative rates on the economy, which is good also for the banks themselves because if their customers do better it's also good for them. The question that comes today is that with the slowing of the economy, because of international and geopolitical factors, you get lower growth, then you get also the negative effect of the rate situation on the intermediation margin. That's how the debate has been triggered. Now, on the economy you have to see how the things will evolve.

Now, German Bunds are yielding negative; is that a red flag for the ECB?

Praet: Well, it reflects concerns because basically, our policy – our communication has not changed recently. We have this forward guidance which basically says that the rates are going to stay at the present level until through the end of the year. But the recent increase of Bund prices where the rates really fell to zero or even negative rates, reflects concerns in the market and some flight to safety. So they reflect a concern about the economy in general, yes, so it's an indication of uncertainties in the market, yes.

Are you particularly concerned about Germany?

Praet: I am not particularly concerned about Germany. I think balance sheets in general of NFCs

– non-financial corporations – of households and of the state actually are in good shape. I think this is a country that can absorb a number of shocks. Of course on the other side the German economy is very much depending on manufacturing, as we know that manufacturing has been really hit by the international uncertainties related to protectionism and also the slowdown in China and also the UK. One has to say that in the UK there has been a visible slowdown of investments, so the investments have come to a halt. Germany of course is a big exporter of investment goods, equipment goods and Germany has been hit already today by the Brexit-related uncertainties. So yes, I think the country is resilient. On the other hand, they're exposed to manufacturing. I think they can go through but it's of course a more delicate phase in the business cycle for them.

What about Italy?

Praet: Italy is another case. It's a different case. Italy is weak since a long time so Italy has a number of recessions before. They had I would say three recessions. They have a new recession now. I think it's a difficult case where you need really more structural reforms of course, but that's a different sort of situation.

Talk to me about risks: there is China, there is trade, you mentioned Brexit. What is your biggest concern?

Praet: Yes, well, the concerns in general are of political nature. I think the persistent character of all these uncertainties, and you listed a number of uncertainties, are weighing on economic sentiment and business sentiment in general. So you can say it's only for the persistence of these uncertainties, at some point have real effects. For a time, businesses continue their investment plans and it is business as usual but at some point it hits confidence and has real effects. That worries me indeed. It's about time that we reduced a little bit this political uncertainty

What can the ECB do to do that?

Praet: Well, there is so much that a central bank can do. We have a mandate which is price stability so we use the instruments we think are the best suited to reach our objective but it's only limited. If you get fundamental uncertainties related for example to the trade regime and the Brexit-related problems, the central bank cannot do much about this. It also needs to be supported by other policies in general.

Do you have anything specific in mind?

Praet: Well, I think it's time that this Brexit ends and I hope in a satisfactory and orderly way. That would probably restore confidence quickly if you do it in an orderly way. It could be the other way, but these things really sends very, very negative signals for everybody to say how is it possible to have so much uncertainty lasting so long about that issue. That's one example. The other examples in the trade sphere, it would be of course very good for confidence if the trade negotiations between US, China ended in a satisfactory way. Also we have uncertainties about the trade regime Europe is having with US, so these uncertainties really dent confidence. They have an impact on confidence and that's the worry.

The ECB have been working on a lending programme and I want to talk to you about timing. The announcement of the programme came a lot sooner than many people expected. The start of the programme will be somewhat later than people expected. Why is that?

Praet: Well, what we call the TLTRO, the funding for lending, is a very flexible instrument and there are many parameters in that instrument. What we have decided in the Governing Council is to disclose some of the parameters. First is the TLTRO is available; that means it's basically a funding instrument. So borrowers, banks will be able to borrow for two years up to two years.

This is a funding side. It basically responds to the concerns that we have about congestion on the bond market, linked to two cliff effects; one cliff effect will be in June of next year, the other, March of the following year. That we have addressed.

The other issue with the TLTRO is to what extent do you want to use it as an instrument to support lending conditions? That's the incentive scheme that you need to put in place. That's premature because you want to have more clarity about the evolution of the economy and the lending part that supports the economy. For the time being now we don't see anything special in terms of lending, banking intermediation to non-financial corporations or for households. Things are okay on that side. Of course the central bank pre-emptively has to look how the situation potentially will evolve and with the weakening of the economic growth you must be ready to act the instruments needed if you want to support lending. I would say in terms of pricing, for the TLTRO you want to first make an assessment; what is the pricing that corresponds the best to the problem you want to address? If it's lower lending at that time, the pricing has to take that into account. It's a bit premature now so we're going to decide in due time, as we say.

Can you translate due time? How much time do you have?

Praet: The first allotment will be in September of this year so you have to do it before. That will be decided maybe, I don't know, but maybe I will be gone. That means for the Governing Council of June, because we also will have the projections at that time. That would be one opportunity before September, but this being said, the Governing Council can always decide to change the incentive scheme of a programme. We did it in the past, given the evolution of the economy. We can do it in the future. As I said it's a very flexible instrument so you can do that, but it must be adapted to the problem you want to address, which is a monetary policy issue that you have to have in consideration.

You've talked to the banks about this tool in the past. Do you have any idea about take-up? What's your estimate?

Praet: Well, you see, the TLTRO-II is extremely advantageous for banks because they can borrow money at minus 40 basis points, so there is still a maturity of about one year. There is no incentive to go in a new one for a bank that could borrow at minus 40 except if you put the condition at minus 40, of course. But you see here, there is no need to rush for the banks. They maybe use it as a funding instrument but in terms of supporting lending for the time being, it's not the primary purpose; it's something we keep, we are aware of course of the slowdown of the economy, of the downside risk that we flag so that instruments can be designed and calibrated in a proper way when times come. That's a little bit what we have now, so the fact that the take-up for the September is far away, but for the September allotment it's not a major issue there because that's more a funding device. The question will be how you price it and what are the conditions of the pricing? That will depend on the assessment of the Governing Council about the lending conditions in general.

Now, we've talked about the risks to the economy. You've talked about what you've done so far and what's in the pipeline. If the Eurozone was heading for a recession, if the situation deteriorates significantly, what's actually left for the ECB to do?

Praet: We don't like to speak too much about the toolbox. There are many questions about the toolbox and they say, oh, what is this mysterious toolbox and all that? Once you start talking about something, you get a lot of speculative attitudes and speculation about what we do and how far you are going to go. You just say the path we always control that when we need to do something with our mandate, we find a way to do that. I think more realistically the situation which is more in probabilistic terms is an economy that will not recover in the coming quarters, because that's our scenario, and basically what you would see is an increase of credit spreads. You would see some impairment in the lending conditions, the standards would tighten. Then the

appropriate instruments are for example the TLTRO and how the central bank can influence lending conditions. That's how the tiering discussions came back to see if at some point the conditions evolved in such a way that you see some impairments in the lending part or on the corporate bond markets. Then the central bank may wish to use some of these instruments. That's the context. Speculating about the big crisis, I think that's something I don't want to do.

Is QE still a possible tool?

Praet: Well, we say that all instruments are available, even new instruments are available; QE is of course available as we say, but I think it's needless. All the instruments are available as we said, even new instruments are possible, but I think it's not a time to speculate about this.

You are looking back to eight years at the ECB and I am just wondering, what was your worst possible day on the job?

Praet: I don't have a worst day at the ECB, really. I thought about these things, now that I'm reaching the end. I had difficult days, that yes, sometimes because of the sovereign debt crisis. I would say a worst day, you know what helps very much in difficult circumstances, and I must not complain; it's basically when you work in a group, in a team and it makes a whole difference. I had it all my life; also in the banking crisis in Belgium, it was sometimes extremely stressful. When you are in a team it changes totally the situation at least for me. I cannot speak about the worst day.

If you really push me, the thing about the worst day, I would immediately say when there was less unity. You see, these are the situations where the stress goes up; because you feel that the team is disunited. Well, I don't see that really as a worst day because the team was in general, the team – that means the Governing Council – was very strong even for those having different opinions. There was a sense of unity in general in the Council, believe it or not, but that's how I feel.

Now, your successor is already known; Philip Lane from Ireland. Any preference as to who will replace Mario Draghi?

Praet: No, I have nothing to say on this. It was a fantastic cooperation with Mario, but that's for the others, that's for the politicians to decide.