Luis de Guindos: Interview with Market News

Interview with Mr Luis de Guindos, Vice-President of the European Central Bank, and Market News, conducted by Mr Luke Heighton on 7 October 2019, and published on 9 October 2019.

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How pessimistic are you about the state of the European economy at the moment?

We have a sort of two-tier economy: on the one side, we have manufacturing and exports, and on the other, we have services and domestic demand. Manufacturing and exports are clearly underperforming the rest of the economy; that's why we have some differences among euro area countries. Germany, for example, is much more exposed to the external sector. That's our baseline scenario. But I think the most important point is not so much that the projection has been revised downwards several times, but that we have not included in the baseline the possibility of a no-deal Brexit, or even an escalation of trade tensions. If these downward risks materialise, the growth outlook will deteriorate further, from already very low levels.

Global economic activity has been slowing for some time. The United States and China are engaged in an ongoing trade dispute and the manufacturing sector in Europe, and Germany in particular, has been hard hit. How much longer can the ECB – and indeed fiscal authorities if they were to loosen the purse strings – continue to prop up the eurozone economy under those circumstances?

The capacity of monetary policy to address these types of shocks is not unlimited. We are not almighty; we have to be humble. Other actors have to step in. I'm referring to structural reforms, to fiscal policy, the completion of the capital markets union and the completion of the banking union. If we have an orderly Brexit, if trade disputes are de-escalated, that will be positive for the European and world economy. But the message is that monetary policy cannot address all the problems in the world. We are not the saviours of the world.

You've been portrayed as a rather reluctant supporter of the package that was announced on 12 September. Is that fair? Were there aspects of the package that you supported more or less than others?

I've always had a very clear approach to the way we make our decisions. This is a collegial institution, a collegial forum. It's very simple: once a decision has been taken – and the majority of decisions are taken with unanimity – you have to defend that decision. There are 25 of us and, for sure, there are sometimes different views, but when a decision is taken by a clear majority, it is important to defend it. It would be much better if we tried to reduce the level of surrounding noise.

Would it have been difficult for President Draghi to push the package through had a majority of the Executive Board been against it?

The basis of the package was the outlook. Inflation expectations are not de-anchoring, but there is a potential risk that they could do so, and the threat of deflation could come to the fore. That's why we reacted. The core element of the package was forward guidance. People have not paid much attention to that, but in my view, that was the main, important message. And afterwards we took other measures: cutting the interest rate, "tiering", targeted longer-term refinancing operations, and finally the asset purchase programme (APP). But forward guidance is the main element and the core reference for how things can evolve in the near future.

One central bank governor recently suggested life would be much easier for the ECB if it simply accepted inflation rates at closer to 1% than 2%. Where do you stand?

Our remit is to achieve price stability, and price stability according to our present definition is below, but close to, 2%. Whether it is symmetric or not is a different question – while it's not a minor question, it's not the most important one either. The third element we are perhaps overlooking is the reaction function: how powerful our instruments are in their ability to push up inflation. I think that's the real point. We have not entered into discussion over whether the target should be modified. It will be discussed by the Governing Council and perhaps with a new president it will be different. But for me the kind of monetary policy decisions you take and the tools you have to achieve the target are much more important.

It's been argued that tiering is in effect a rate increase…..

No, I don't think so. Tiering is a form of mitigation. That's why it was set.

Is it a form of mitigation that lays the ground for further rate cuts?

We haven't discussed it, but my impression is that –0.50% is the correct level at present, and as to any further cut, we will have a good, in-depth discussion in the Governing Council. One point that I think is particularly relevant is that although we can reduce interest rates further, the side effects of monetary policy are becoming more and more evident and more and more tangible. That's why we have started to say that other actors have to jump in.

Does tiering help or impede the process of banks restructuring in ways that might offset the negative effects of negative interest rates?

This is a good question. Tiering is some relief, but the reasons for the banks' low profitability are different. Low interest rates are having an impact, but they're not the main cause of European banks' problems, which are much more structural. Some have argued that even tiering, by offering relief, delays the implementation of the instruments that could improve the European banks' profitability. That is a big problem. We are in a changing paradigm. Low interest rates are going to be around for longer, and this has very little to do with monetary policy. Monetary policy has to adapt to the lower level of the natural interest rate, and we are going to hit the zero lower bound much more often than in the past. This has implications for monetary policy, but also for the banking industry, for the insurance business, for everyone.

Following the restart of the APP, Philip Lane said recently that the question of a shortage of bonds "may not become a problem for an extended period of time, and in any case not for at least as long as we can project bond availability conditions with some confidence." How long is an extended period of time?

Our calculation is that we have enough time.

But there are some who might argue that the APP was only introduced at the level it was [€20 billion per month] because any higher and you run out of things to buy very quickly indeed…

I don't think so. Our assessment was that €20 billion was enough in terms of the current situation and the evolution of the ECB's balance sheet, and not just in terms of the restrictions that we could hit.

So there is still further headroom should it be necessary. Is that the message?

Headroom is there, and €20 billion per month dovetails perfectly with the headroom we have. It will be in place for a period of time. This is a package, and the concept of a package is that you can't move it every two weeks. The package has to be stable, and we have to be predictable. So if we start saying that we can modify some elements or some parameters within it, we start to undermine its effectiveness. But, again, we are not the only game in town.

It sounds like you're ruling out any changes at the next meeting.

That will depend on the Governing Council. We will have to see what happens with the outlook. And we will have to see what happens with the downside risks.

Is helicopter money something you would ever consider appropriate, or does it blur too much the boundaries between fiscal and monetary policy?

We need to have an independent budgetary instrument at euro area level with a countercyclical function and institutional governance that is different from the present set of rules. There should be an independent fiscal authority that can determine when there is an asymmetric shock or a problem across the euro area, and then react. And that is something that could be decided as we decide monetary policy. It would simultaneously reduce the burden of national fiscal policy.

Does that mean that it's going to be difficult for Christine Lagarde to make any changes to the package we have?

The president is very important, because the president sets the agenda and sometimes even the timing of the decisions we take. And afterwards he or she has a very important role in creating consensus, as the more consensus we have, the better for the institution, also in terms of effectiveness of the decisions. But the president aside, the rest of the Governing Council is going to be more or less the same, and this is a collegial institution. And the concept of a package is something you can use perhaps once a year, but not every month, because otherwise you undermine its effectiveness.

Is there a sense in which a new president is like pressing the reset button? Or is it more a straightforward case of institutional continuity?

Strong institutions always have a certain kind of continuity, but the new president is the new president, and she will have her own ideas and approaches to the organisation. But a policy U-turn is something I would discard. And it would not be good anyway.