

Luis de Guindos: Interview with Helsingin Sanomat



INTERVIEW

Interview with Luis de Guindos, Vice-President of the ECB, conducted by Petri Sajari on 24 November 2020

28 November 2020

What are the key risks for the euro area recovery at the moment?

The fourth quarter of 2020 will be marked by the measures taken by euro area governments to deal with the new wave of coronavirus (COVID-19) infections that started after the summer. While these containment measures are generally not on the same scale as those taken in March or April, they will have an impact on the economy. We had a welcome surprise in the third quarter, but our quarter-on-quarter growth projection for the fourth, which was slightly above 3%, will not be met. Looking at leading indicators such as the purchasing managers' index, negative quarter-on-quarter growth is now the most realistic scenario for the end of the year.

The main issue in the near future will be the availability of the vaccine and the precise details of how and when it is to be rolled out. The news is having a positive impact on market sentiment, but the implementation of the vaccine warrants our attention. Hopefully, a very high percentage of the population will soon be vaccinated and the nightmare of this pandemic will begin to draw to a close.

According to the International Monetary Fund, the pandemic will have the largest impact on the eurozone economy. What do you think the long-term damage of this crisis will be?

There are indeed factors that cause concern. The first long-term consequence of the pandemic is that public debt-to-GDP ratios will increase by between 15 and 20 percentage points. Similarly, leverage in the private, mainly corporate, sector will also increase. And there is a risk, which we need to avoid, of long-term scars in the labour market. Currently we see a decoupling between the drop in economic activity and the evolution of the labour market, i.e. unemployment levels have not risen by as much as you would expect with such a deep decline in activity. This is because the temporary work schemes implemented by governments across Europe are avoiding a sharp increase in unemployment.

We believe the economy will start to recover in 2021 and continue its revival in 2022. It will be essential that those who are currently on furlough schemes continue to belong to the labour force, and that those who have lost their jobs can rejoin the labour market. We can then not only recover the level of economic activity we had before the pandemic, but also the level of employment.

If the crisis gets worse, which now seems inevitable, what more will the ECB be able to do?

As I've mentioned, the fourth quarter will be worse than forecast, but the medium-term outlook – mainly because of the ray of hope brought by news of the vaccine – looks brighter. However, when we assess our instruments we do not only look at economic output. We also look at the evolution of inflation, which is our primary mandate. Inflation will be negative until the end of the year and we expect that it will turn positive next year because some drivers of this negative inflation will be reverted, for instance the reductions in value added tax or the sharp decline in oil prices caused by the lack of economic activity. All in all, we expect inflation to be close to 1% in 2021 and to see it moving up towards 1.2% or 1.3% in 2022.

As President Lagarde indicated after the last Governing Council meeting, we will recalibrate our instruments in December and this recalibration mainly involves our targeted longer-term refinancing operations (TLTRO), which is an instrument to inject liquidity into the banking sector, and the pandemic emergency purchase programme (PEPP), which right now comprises an envelope of €1.35 trillion to be implemented until mid-2021. These are the two main tools if the situation gets darker, although the arrival of the vaccines brings hope regarding the medium-term outlook.

Is there a risk that low interest rates, combined with the asset purchase program and the PEPP, are creating zombie companies that would not have survived under normal financial conditions and are therefore an obstacle to creative destruction?

The interest rate environment is not only a consequence of monetary policy decisions. It is also the consequence of a combination of other factors, such

as globalisation, digitalisation and demographics. These have made the natural interest rate, which is a real variable rather than a monetary variable, decline over time. This, combined with very low inflation expectations, has created a situation where nominal interest rates, which are the ones we observe in the markets, are very low. But this is not only a result of monetary policy – it also reflects a decline in the natural interest rate.

Furthermore, low rates have been very useful in sustaining economic activity. Without them, the process would most likely not just have been one of creative destruction but one of simple destruction of companies and a decline in GDP.

Some might also say that the high debt levels in the economy will lead to zombie banks and zombie companies that constrain growth because of extraordinary debt burdens. What is your assessment of this?

As I mentioned earlier, there will be a legacy of debt after this crisis, in both the public and the private sector, and we will have to take this into consideration. But there is no alternative in the short term. The first line of defence against the consequences of the pandemic has been, and had to be, fiscal policy. The alternative – doing nothing – would have had much worse consequences in the short term and also in the medium and long term.

Regarding private debt, when you experience a decline in revenues as substantial as that experienced by many European companies, you need to try to bridge the gap and survive until the pandemic is over. And to do that you need to take on debt. There's no alternative. Once the pandemic is over, issues such as fiscal sustainability and private lending will come to the fore, but in the short term there is no alternative.

Let's move to the banking system. What are the main vulnerabilities in the eurozone banking system?

European banks have more capital and are more liquid and resilient than before the global financial crisis. But their weak point is very low profitability, which is reflected in very low valuations. This is not trivial, as it has an impact on their capacity to raise capital in the markets or generate it organically. It also makes it challenging to achieve an adequate level of provisioning that is in line with developments in the economy. Profitability was already the key weak point before the pandemic, and the crisis has aggravated it. Banks will also suffer a decline in revenues and the level of non-performing loans (NPLs) will go up. We expect the bulk of the NPL wave to come in the first half of next year.

Do you believe there will be consolidation via mergers and acquisitions in the eurozone banking sector?

We have started to see some consolidation, for instance in Italy and Spain. So far it's domestic consolidation. It would be good if we also saw some cross-border consolidation. Consolidation is not a target in itself, but it could be a way to reduce excess capacity and costs.

The ECB started its asset purchase programme in early 2015 and abandoned it in late 2018. In autumn 2019, it was started again, but inflation remains very low. What are the key factors behind this extraordinarily low inflation?

Both headline and core inflation have been low over the last ten years and, as I mentioned, there are some structural factors, such as digitalisation, globalisation and demographics, that help explain why. In 2015 and 2016, there was a clear risk of deflation and the ECB acted to avoid it and to anchor inflation expectations. It remains to be seen what will happen with some of these factors. For instance, globalisation will likely not be as intense as it has been in recent decades, as the pandemic could make value chains more regional, which might have an impact on inflation. However, according to our projections inflation will remain low, and we will therefore keep monetary policy accommodative so that inflation can converge to our medium term aim.

In July 2020 the European Union introduced a recovery plan worth €750 billion. What is your take on that? Is there a risk that States may use it in a manner that does not promote structural changes?

The Next Generation EU fund is a very positive response, not only because of its size but also because it sends a very clear signal of the common willingness to defend Europe and the euro area. And regarding the funds, indeed, it's not about spending but about spending properly, through programmes that can transform the European economy and accompany the structural reforms needed to improve productivity and enhance competitiveness. The European Commission will monitor this spending. If this money is not spent properly, we will be missing a great opportunity to make the European economy greener, more digital and more competitive.

Since introducing the PEPP in March, the ECB has definitely been able to calm the markets, but many people might still wonder how the programme has supported the real economy and households. What is your answer?

Calming the situation in the sovereign debt markets also brought reassurance to other markets, which has had a positive impact on the financing conditions that banks offer to their clients, households and companies. By avoiding fragmentation in the sovereign debt markets, we also avoided a credit crunch. Furthermore, PEPP also includes corporate sector purchases such as bonds or commercial paper.

Do you believe the attitude towards public debt has changed for good? Or is this change temporary, based on the fact that extraordinary times require extraordinary actions to support the economy?

Fiscal policy has to be the first line of defence, and fiscal deficits will be the consequence of the measures that governments have taken and will continue to take to address the impact of the pandemic. Public expenditure has to focus on the pandemic, for instance on furlough or public guarantee schemes, healthcare, etc. As a result, we will see larger public debt ratios. But in the medium term, once the pandemic is over, the situation will need to be addressed to ensure the sustainability of public finances.

So, basically, your answer is that you don't believe that there has been a major shift in attitude towards public debt?

The big change is that the pandemic has caused a public health crisis which demanded a fiscal response. There was no alternative and, in the medium term, we will see higher public debt ratios. We will have to deal with that once the pandemic is over.

The response to this crisis has been quite different from what it was ten years ago, when the eurozone crisis began, because then the constant narrative was that we cannot allow public debt to increase.

This time is different. This crisis hasn't been triggered by banks or financial stability troubles, as was the case in 2008. This is an exogenous shock of a magnitude we have not seen since the end of the Second World War. The policy response was the only one available: fiscal measures as the first line of defence, accompanied by monetary policy. Not acting rapidly on the fiscal side would have provoked an even deeper decline in GDP, and fiscal policy would also have had to react to that.

[Yves Mersch: Interview with Le Monde](#)



INTERVIEW

Interview with Yves Mersch, Member of the Executive Board of the ECB, conducted by Marie Charrel and

Eric Albert

28 November 2020

How do you feel about the euro today compared with your hopes and expectations at the time of negotiating the Maastricht Treaty?

At the time, it was a leap into the unknown. The international financial markets were sceptical. And we didn't know whether citizens would embrace the new currency. Today, I am very satisfied with the outcome. First of all, the euro has won the wholehearted approval of more than 75% of Europe's citizens. And even the most eurosceptic of political parties have changed their opinion on this given that Europe's citizens do not want to "undo" what has already been accomplished.

What's more, it's a currency valued by the corporate sector and sought after by the financial markets. Only a few years ago, there were still concerns that the euro area might fall apart. The political response to the crisis and the steps taken by the European Central Bank quelled those concerns. Today, the differences in interest rates across countries, across firms in those countries, have been reduced. And there is heightened demand on the part of international investors for euro-denominated assets, even though we do not have the same financial market depth as other countries, such as the United States.

There is still scepticism surrounding the euro. Are you at all concerned by the mistrust of Monetary Union voiced in Italy at the start of the pandemic, or in Greece during the 2012-15 crisis?

It is always easier to blame Europe for what's not working and attribute success to national policies, and that can fan the flames of this mistrust. In spite of all that, public support for the euro is strong. In some Member States, it is even close to 90%. We shouldn't forget about the permanent transfers that flow within the EU from its more developed to its less developed members. If the latter were not in the euro area, their debt would undoubtedly not be financed at such low interest rates. Leaving the euro area would increase their debt servicing costs through interest rate levels and devaluations, which would mean less money for investment, research and education. And by the way, we can also ponder whether or not the younger Member States would remain intact if they left the single currency and the EU.

The euro nevertheless went through a major crisis between 2010 and 2015, which led to huge social upheaval...

The initial agreement was that we would have a single currency, but that fiscal, economic and structural policies would be kept at national level. We were aware that it was a source of tension, which still exists today. But we learned lessons from the last financial crisis. The response to the pandemic has led to much closer coordination, as it happens, between monetary policy and national fiscal policies. And the Stability and Growth Pact (which caps the budget deficit at 3% of GDP) has even been temporarily put on hold.

The EU has also reached an agreement on a €750 billion recovery package. Talks to finalise the package are ongoing. Is this a “Hamiltonian moment” for the EU in terms of taking a step closer towards federalism?

It is a very important step. Europe has shown that it is still capable of employing its political capital to respond with solidarity. This has had a considerable impact on non-European investor confidence. But the European recovery package is temporary in nature, for use only in response to the pandemic. To say that it marks the beginning of the “United States of Europe” is going a bit far. The situation is very different from when Alexander Hamilton advocated for US federalism in the 18th century in the wake of the civil war. At that time, there was a very clear financial benefit to consolidating the debt of the southern states funded by their northern counterparts.

From an economic perspective, has Europe fallen behind the United States since the 2008 crisis?

We can make up the ground that we have lost. The gap has come about due to structural factors. There are strong trends such as demographic change (moving at a faster pace in the United States) behind the difference in per capita GDP. There is also the proportion of funding to the economy provided by banks in Europe. When a banking crisis occurs in an already weakened sector, it has a knock-on effect on the entire economy, and the recovery takes even longer. We have learned from this, which is why we set up the banking union and insisted on the need for a capital markets union. Moreover, European fiscal policies have been excessively procyclical. As a result, countries that built up their reserves are currently in a much better financial position to deal with the pandemic crisis, whereas those with the highest levels of debt know that there are limits to the action they can take.

There is also the issue of private debt. At the beginning, it was higher in the United States, but it has been brought down much faster there than in Europe. Last of all, Europe needs to implement structural reform at national level. Recommendations have been made, but they haven't resulted in action being taken. The same goes for the Stability and Growth Pact: the rules are not being complied with. To me, there is a significant lack of governance which needs to be fixed. To be master of its own destiny and compete with the United States, Europe needs to solve its structural weaknesses.

Since the euro area was created, it has remained an unfinished project, edging slowly towards completion, and only during times of crisis. Do you know why?

The differences across the economic, financial and political cycles, which are never aligned in the various Member States, are holding back progress. This poses a challenge to the task of building Europe, which, as Jean Monnet pointed out, only picks up speed in times of crisis. But once you've been working this way for 30 years, it becomes second nature! It is difficult to avoid these delays and complexities when you embark upon a project as colossal as building the European Union in peacetime. Similar projects in

other countries have often been the result of civil wars.

In the long run, will the EU Treaties need to be amended?

We can already implement significant reforms without changing any Treaty, such as creating the capital markets union a must for us or completing banking union. Reform in other areas will be more challenging. Transferring some powers that have remained at the national level up until now, such as budgetary authority, or taxation – still subject to the unanimity rule – will thus be very difficult to do without transferring a degree of national democratic representation – sovereignty – to the European level. The issuance of common European debt is a sign of significant progress, but common budgetary capacity or a European budget worthy of the name are still a long way off. Currently, the European Parliament is above all else responsible for expenditure, but very little revenue: the system is therefore flawed. During the discussions held prior to the Maastricht Treaty, we were convinced that the single currency would act as a catalyst for European integration. We were hopeful that the markets would push in that direction. But in this respect, they have at the very least...been slow to respond.

Many people today are calling for a review of the Stability and Growth Pact at the very least – the target of 3% of GDP for the budget deficit and of 60% of GDP for debt – a target with which Member States are no longer able to comply. Should the Maastricht rules be reviewed? If so, in what way?

The less we have complied with these rules, the more complex and confusing they have become for the general public, which is not very democratic. However, it is true that they are a reflection of the situation in the 1990s when inflation and growth hovered around 2%. We can simplify and revise them to take into account the effects of globalisation, demographic change, and the fall in the equilibrium interest rate. But it is also worth noting that there is currently a debate in Germany to bring the budget deficit to below the 3% mark in 2022 or 2023. At the end of the day, compliance with the rules has nothing to do with the economy. It is more a matter of political science and law. Abolishing the Maastricht rules will not improve the functioning of our economies. For that to happen, we need to improve our capacity for growth, and therefore implement structural reforms.

By aiming to comply with these fiscal rules at all costs, isn't there a risk that we may make the same mistake we made in 2010 by reintroducing austerity policies too early?

Making public spending more efficient is not the same as austerity. The temporary budgetary support measures are not sustainable if there is no recovery in activity levels. From the outset, the Stability and Growth Pact required a balanced budget. Is that a bad thing? We need to find a common response to this issue. If it is the norm to have a budget deficit of, let's say, 5% of GDP, this means that national as well as international investors need to be found to finance it. International investors like policies that are predictable, robust and sustainable over the long term. We have the benefit of a stable currency that has the backing of our citizens. This should not be undermined by an unsustainable fiscal policy.

Over the next few years, what changes would you like to see within the EU?

Structurally, we need to continue with our efforts in education and research which are crucial for our future. But we also need to provide a more tangible response to the issues that are of major concern to our fellow citizens. How will Europe deal with matters of internal and external security? How will it deal with healthcare? Are we convinced that the response to the pandemic should be purely domestic, as should the response to terrorism? The problem is that as the Treaties currently stand, we cannot respond at the European level.

You have attended more than 500 Governing Council meetings. Do you have any regrets or are there any particular success stories that come to mind?

Before joining the ECB, I also attended several hundred ECOFIN meetings and around a hundred EU Council meetings. Europe is part of who I am, so please forgive me. The success stories are always collective, never individual. At the ECB, a young institution, we have always favoured a more federal-style and consensus-based decision-making process. It works very well. And it also makes it possible to overcome the all-too-often intergovernmental approach to European decision-making.

CAP transitional regulation: informal deal on how to fund farmers



The Council concluded today an informal deal with the European Parliament on how to extend current CAP rules until the end of 2022 and disperse the extra €8.07 billion of the European recovery instrument to European farmers. This informal agreement is a follow-up to an initial agreement in June.

The informal deal outlines a split of the recovery money within the next two years: 30% of €8.07 billion will be available in 2021 and 70% in 2022. It also tasks member states to secure around one third of the total budget (37%) for green and animal welfare measures and more than half of the total budget (55%) for social and digital transformation measures. The negotiators expect that these measures would help speed up the transition to practices such as precision and smart farming, improve access to high-quality ICT in rural areas and strengthen local markets.

The negotiators also agreed to extend the application of the exceptional temporary support to farmers and SMEs affected by the COVID-19 crisis by six months. They also agreed that the EU's outermost regions and the smaller Aegean islands will keep receiving in 2021 and 2022 the same amounts of financial support as outlined in the current rules.

The negotiated text still needs to be endorsed by the Council's Special Committee on Agriculture and will then be submitted for final adoption by the Council and the European Parliament, as soon as possible.

Forward look: 30 November – 13 December 2020



Overview of the main topics and events at the Council of EU and European Council.

The location and the format (physical or virtual) indicated for each meeting are subject to change.

30 November 2020

Video conference of youth ministers

Youth ministers will discuss youth mobility during the pandemic and beyond and will be briefed about the ongoing work in the area of democratic awareness among young people and the European Youth Work Agenda

Video conference of education ministers

Education ministers will express solidarity with the victims of terrorist attacks in Europe and will discuss the European Education Area and the European cooperation in education and training beyond 2020

1 December 2020

Video conference of economics and finance ministers

Ministers are expected to discuss administrative cooperation in the field of taxation, the Banking Union, the Capital Markets Union, European Semester 2021, international debt relief, in particular for African countries, and international tax issues

Video conference of culture ministers

Ministers will discuss the recovery of the culture and media sector from the pandemic and will be briefed about the conclusions on gender equality in the field of culture, and on safeguarding a free and pluralistic media system

Video conference of sport ministers

Ministers will discuss the international sporting events during the pandemic and will be briefed about the EU Work Plan on Sport 2021-2024 and the conclusions on promoting cross-sectoral cooperation for the benefit of sport and physical activity in society

2 December 2020

Video conference of justice ministers

Ministers will discuss the justice aspects of counter terrorism, as well as rule of law developments in the field of justice. They will be informed of the state of play on the proposal for a regulation on assignments of claims and of the latest developments in the setting up of the European Public Prosecutor's Office (EPP0)

Video conference of health ministers

Ministers will discuss ways to build a European Health Union and will exchange views about the pharmaceutical strategy for Europe

3 December 2020

Video conference of employment and social policy ministers

Ministers will discuss social protection in the Platform economy and how to implement the Commission's Gender Equality Strategy 2020-2025

7 December 2020

Foreign Affairs Council

EU ministers of foreign affairs will be briefed about current affairs and exchange of views on transatlantic relations and strategic autonomy

Video conference of telecommunication ministers

Ministers will discuss the proposal for a data governance act, published by the Commission on 25 November

Video conference of European affairs ministers

European Council and (poss.) EU-UK relations will be on the agenda of the videoconference of EU Affairs ministers

8 December 2020

Video conference of transport ministers

Ministers will discuss a proposal to revise the EU road-charging directive (Eurovignette), and the Commission's proposals concerning the Single European Sky

10-11 December 2020

European Council

EU leaders will meet in Brussels to discuss further coordination on COVID-19, climate change, security and external relations

For video coverage of Council sessions and audiovisual material, please see the following Council websites:

[Fair and effective taxation: Council adopts conclusions](#)



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