Philip R. Lane: Interview with the Financial Times

Interview with Philip R. Lane, Member of the Executive Board of the ECB, conducted by Martin Arnold

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What impact has the pandemic had on the eurozone?

A pandemic recession is unique because a lot of the decline in output results from public health measures. When these measures are lifted and the virus is contained, you should expect to see a very large recovery. We saw glimpses of that last year, especially in the third quarter. As the economy was unlocked and while infection rates were at a relatively low level, there was a strong recovery above what we had predicted.

Once we get better control of the virus we should expect to see most of the economy just go back to normal. There can be exceptions, though, such as the question of office work versus working from home. We all talk about a new normal, which will be somewhere in between. I think it is definitely not going to be fully back to the office, but, at the same time, the value of office life will probably be more appreciated now than it was a few months ago. That has both positive and negative implications for the economy: negative, maybe, for certain types of commercial real estate; and positive perhaps in terms of digitalisation.

Another sector that will probably take time to recover is international travel. By this I mean the airline industry and the hotel industry, whether business travel or tourism, which have taken a big hit. Those firms that have not been earning usual levels of revenue will have weaker balance sheets coming out of this and we know a big factor in investment is the strength of the balance sheets of firms. It will probably take time for those sectors to go fully back to normal in terms of their financial capacity.

Coming back to the narrative of inflation in the euro area and to the 2015 to 2017 period, when the recovery of inflation and the economy was quite muted, it was due to a combination of the time it takes to recover from a financial crisis on one side and the prioritisation of fiscal consolidation on the other. This time, however, there is definitely an intention to secure the recovery – in the European context it is built into the EU recovery fund with a five-year horizon. It is not just about getting through the pandemic. In this context, you might be more optimistic about inflation dynamics, even if the pandemic itself is definitely a severe negative.

What percentage of output could be permanently lost after we come out of the pandemic?

Our staff projections published last week foresee that euro area GDP will have recovered to 2019 levels by mid-2022. This goes back to the unique nature of the pandemic. It is not like the global financial crisis, where there were many years of lost output. The whole logic of the very extensive fiscal and monetary accommodation is that you don't want to amplify the significant temporary losses in the pandemic by being too reluctant to provide policy support. And again, you can be quite extensive in policy support because it's only for a relatively short period of time. Then, with enough policy support the damage to the economy should be as little as possible. I am not putting the long-term damage to zero, but it is relatively contained.

With the Biden administration planning a $1.9 trillion relief plan in the United States, does Europe's economy risk falling further behind the United States and other big trading partners?

There are different ways to do it, but the numbers show that, between automatic stabilisers and special measures, the United States offered fiscal support in 2020 of around 10 per cent of GDP and the euro area of around 7 per cent. You could spend time comparing these, but in each case this was a big effort and there was a lot of support provided.

Now, the United States is bridging the pandemic and going into the recovery phase. In Europe, too, a bit later but not that far away this year, we think it is going to be the same kind of transition from dealing with the pandemic to securing the recovery. If you use the European Commission numbers and compare what they were saying in the autumn to what they said in the spring forecasts, Europe has also been moving in the same direction in terms of having more extensive fiscal support.

That said, it is relevant that the euro area has 20 fiscal policies, the 19 national ones and the common fiscal element. In the United States, the fiscal union makes a dramatic difference, there is so much risk-sharing embedded in a fiscal union of the scale of the United States. A combination of greater macroeconomic coordination of national fiscal policies and more joint fiscal action would be effective in unlocking more fiscal capacity in Europe.

As you know, across Europe a lot of the fiscal support for firms is now turning from guaranteed loans towards more kinds of equity-type support or transfers. So I wouldn’t be fatalistic about it. There is a policy decision about protecting the financial health of the European economy through wage subsidies, loan guarantees and other forms of supports for workers and firms. Of course, it is not easy, because you always have to differentiate and be selective. You cannot have an unconditional approach. Clearly you had firms that were in good shape before the pandemic and, with the randomness of who gets hit by the pandemic, you might argue there is a public policy case to make sure that a very high proportion of those firms can get through this.

Then there is the EU recovery plan, which has two important attributes. It is a five-year programme – so it is not just for the pandemic but also to secure the recovery. And it is joint funding. You have a unique initiative in Europe now, which we may all have normalised, but if you go back to the debate last May it is really quite something.

Let’s switch to monetary policy, an area over which you have more control. The ECB’s 2023 eurozone inflation forecast of 1.4 per cent is still below your target of just under 2 per cent. Doesn’t that imply that you need to do much more than you are doing?

We have an ongoing two-stage challenge – counter the negative pandemic shock to the inflation path and subsequently finish the task of raising inflation to our aim.

We are doing quite a bit – we have a policy rate of minus 0.5 per cent when most major central banks are hovering around zero. Even before the pandemic we had a significant quantitative easing programme and we had already accumulated nearly 30 per cent of the European sovereign bond market.

We always say, and our internal feasibility calculations show, we could do more in terms of providing additional stimulus. What is most important is converging to the target in good time, with the speed of convergence ensuring that inflation expectations do not drift further away from the target. While we don’t think we are at the lower bound, there is clearly less room to deliver monetary stimulus when interest rates are already low, compared to historical norms. Under these circumstances, it is important to take decisive action to keep up the inflation momentum, while recognising that patience is required. By and large, I don’t see any policy statement from any major central bank anywhere in the world saying they are going to deliver sustainable inflation at 2 per cent super-quickly – it is an uphill climb.

The ECB has switched in the past few months to a focus on maintaining “favourable financing conditions”. Does that indicate that you don’t think the cost-benefit analysis of trying to lower rates further is worth it?

No, I don’t think so. Let me try to rephrase it. Everyone would agree that by our December meeting what we had was a pretty flat yield curve compared to our deposit rate. If you look at the risk-free rates going out ten years, that curve had never been so flat. What is true is that we could lower the deposit rate. In that sense, we don’t think we are at the lower bound. To me it is an efficiency issue: rather than focus on pushing down the curve compared to the mid-December level, monetary accommodation could be better provided by preserving favourable financial conditions, especially in responding to a tightening that would be inconsistent with offsetting the pandemic shock to the inflation path.

That is already happening.

Yes, and our objective is basically to make sure that yield curves – which play an important role in determining overall financing conditions – do not move ahead of the economy. Because, as you know, financial markets are very forward-looking and you can have a steepening in yield curves which is not conducive to maintaining progress in terms of the inflation dynamic. It is really a shift in monetary policy away from focusing on just the short-term rate by looking at all financing conditions. For many economic decisions, especially under the conditions we have now, the longer end also matters.

I should say that our favourability assessment of financing conditions is dynamic. It does depend on how much progress we are making in terms of the inflation forecast. It is not yield curve control in the sense of saying we want to keep the yield curve at some fixed value; because over time the relation between the appropriate level of yields and inflation will move.

We have quite volatile inflation during the pandemic but we look past most of that. If you are the type of firm, or household, or government that needs to rely on medium to long-term financing, you should be reassured by this forward guidance on maintaining favourable financing conditions.

Wouldn’t it be more reassuring if you did as the Japanese and Australian central banks have done and commit to keeping yields at a specific level?

By and large, with the exception of Japan, the yield curve control debate globally is focused on the two to three-year horizon – the Reserve Bank of Australia has a three-year horizon. The ongoing question that is always worth considering is whether it is enough to have forward guidance on our policy rates. Markets and survey participants don’t think we are going to raise rates in the next two to three years. So in that sense we have secured that two to three-year part of the yield curve through forward guidance.

Japan is a special case as the Bank of Japan offers a fixed value for the ten-year yield. You might say that, in a highly dynamic context, where you know there is going to be a recovery – and with the pandemic you are much more certain there is going to be a recovery than after a financial crisis – committing to a fixed value seems unnecessary.

Why is it unnecessary?

Because we are not in such a knife-edge situation that it makes sense to keep the 10-year yield at a permanently fixed value. The important point here is that we provide enough monetary accommodation to make sure that financing conditions are favourable so that the pandemic shock to inflation is offset and we deliver a path to convergence with the inflation target.

Another debate at the ECB as part of your strategy review is whether you should follow the US Federal Reserve and commit to allowing inflation to overshoot your target to make up for a period of undershooting. The early signs are that you will not go that far and opt for a more symmetric inflation target instead. Is that right?

We are right in the middle of the strategy review and everything is still under analysis. The interesting question is if there is a strategic commitment that following a period of undershooting you signal that the correction phase is not just going to the target but going moderately above the target for a period. I think there is a very strong logic to that.

There are some open questions too. One is that the ECB has always had a medium-term orientation and there have been plenty of overshooting periods in the past, when the ECB has been above 2 per cent. So I don’t think that 2 per cent has necessarily been seen as a ceiling.

It is also true that there are communication issues here. Now, these are not necessarily insoluble communication issues. But as you know, across Europe there are very different histories of inflation and the history of inflation in some European countries is very different to the American experience.

Are you going back to hyperinflation in the 1920s?

Sure. We are very scholarly people here. We look at how different kinds of outcomes create very persistent memories in populations, not just from the recent past.

No one would go for a strict version of averaging where a period of inflation above target inflation would require engineering a subsequent period of below-target inflation to hit the average. But the history of inflation matters. You need ways to demonstrate that people should believe that you will deliver your target over the medium term. It’s too early in our process to say there is only one way to ensure that inflation expectations are where we want them to be. There is a very strong analytical case for flexible average inflation targeting, but there are other options that may also be successful in anchoring inflation expectations.

Let’s talk about fragmentation. Is it a concern that we could have a two-speed recovery in the eurozone, with growth and inflation surging in some countries while others lag behind? How do you set monetary policy for the whole bloc in those conditions?

We look at the aggregate data. There is no other way to do monetary policy. But what is true is that in addition to the single monetary policy, other measures are needed. We are consistent in emphasising that for those countries where monetary policy is looser than the national economy would need, macroprudential policy or fiscal policy should be set differently. You can’t just have one policy lever, and I think we learnt that in the previous crisis years to great regret.

What is amazing about last year is that we had that divergence, we had a big surge in public debt and yet risk premia came down. To me, a very important element of that – coming back to the EU recovery fund – is that the global investor community could draw its conclusions from the fact that when there was a large common shock, Europe was able to respond in a way that made sure there was that joint support. That is a very fundamental revision of global beliefs about the durability and resilience of the euro area.

Remarks by Paschal Donohoe following the Eurogroup video conference of 15 March 2021

Good evening, everybody. We opened up our Eurogroup meeting by hearing an excellent presentation from Minister Daniele Franco, who updated us on his priorities as a member of the new Italian government. It is customary that when we have a new finance minister joining the Eurogroup, we afford that minister the opportunity to make a presentation on their policy priorities. After that, we moved on to a number of discussions in relation to the budgetary policy response in the euro area to COVID-19.

We looked back to what we have done and ahead to what we will do.

We have issued a statement that reflects the unity of purpose and our determination to fight this pandemic and its economic fallout with all means at our disposal.

For the second time now, in just under 12 months, all members of the Eurogroup, north, south, east and west have issued a statement affirming their commitment to taking the right budgetary decisions to respond back to the challenges of COVID-19 and to put in place and to continue to have in place the policies that are needed to allow the euro area economy to recover.

This statement begins with an acknowledgement of the Commission communication on the fiscal policy response to COVID-19, which provides very valuable guidance to all of us and enables our coordination efforts.

Today, the Eurogroup agreed on the need to keep a budgetary stance in 2021 and in 2022, which will be supportive and which will pave the way for recovery. This will also be facilitated by support from the Recovery and Resilience Facility. We are united, and we are determined in our efforts to protect jobs, to protect businesses and to protect our citizens in this very acute phase of a continued health crisis. We all share the view that this is the best contribution that we can make to longer-term fiscal sustainability at this point. The measures we will take to achieve this will continue to be timely. They will continue to be temporary. And they will continue to be targeted. But we will also ensure that they continue to be effective.

As the health situation improves, the focus of our measures will gradually shift to promoting a resilient and sustainable recovery. Once the recovery is firmly underway, it will be important to address the challenges that are posed by increased debt levels. And we will do this by putting in place the right sustainable medium-term budgetary strategies. And we also recommitted ourselves to the ambitious reform agendas and investments, especially in the green and digital transitions. That will be a crucial part of this.

The rollout of the vaccines does give us hope, but uncertainty remains high until the pandemic is fully under control. We need to remain agile and we need to adjust our response as the health and economic situation evolves. And the centrepiece of this is the immense and intense work being led by Paolo, by the Commission, in response to the recovery and resilience plans. To conclude on this point, I want to again emphasise the fact that beyond sharing a currency, the finance ministers of the euro area, we share our strengths and we share our dependencies with each other. We are coordinating our strength and our interdependence in our statement today, which demonstrates, again, our commitment to act together in times of difficulty.

We also discussed how the pandemic has affected various sectors of our economy. The Commission’s analysis has shown how different sectors have been unevenly affected and hence their growth prospects may also differ. The crisis has accelerated some pre-existing trends within our economies, which in turn calls for us to strengthen our ambitions with regard to the green and digital transition.

For the final items of the regular Eurogroup, we briefly took stock of exchange rate developments and of the post-programme surveillance in Greece.

Starting with exchange rates, our strong and united response to the pandemic has driven market sentiment and has continued to contribute to the strength of the euro over the past year. More recently, the euro has continued to perform strongly against the dollar, but this has been offset by movements against other currencies. And overall, the appreciation that we saw in the first phase of the pandemic has been stabilised.

We heard from the institutions on the main conclusions of the 9th Enhanced Surveillance Report for Greece for good progress has been made and Minister Christos Staikouras again made a very thorough and comprehensive presentation on all of the work that he is leading on behalf of the Greek people and our colleagues in the Commission, the European Stability Mechanism responded back to this work.

In inclusive format and as a preparation for the Euro Summit, we discussed how we can continue to build on the role of the euro on the global stage. I want to emphasise very clearly that our objective is not to rival other currencies, but rather to reap the benefits of the valuable international currency that we do have in the euro. In this context, we highlighted the importance of a strong economy, of integrated financial markets and payment systems, as well as in the work to develop and deliver green and digital finance. I will report on these discussions in a letter to the President of the Euro Summit, which we will be publishing in the coming days.

Media advisory EU-Georgia Association Council, 16 March 2021

Indicative programme

Tuesday 16 March 2021

11.45 – beginning of the EU-Georgia Association Council, chaired by Josep Borrell, the High Representative for Foreign Affairs and Security Policy.

At the end (+/- 14.00) of the meeting – press conference in live streaming

Arrangements for the press conference

Please note that there will be no physical press conference. EU accredited journalists will be able to ask questions remotely using this link.

Journalists who already registered for previous Foreign Affairs Council press conferences do not need to register again.

Deadline: Tuesday 16 March 2021, 13.00

Further instructions will be sent to all registered participants approximately half an hour after the deadline.

Visit the meeting page

Press release – COVID-19 variants: MEPs share concerns about efficacy of

vaccines

Representatives from the European Medicines Agency (EMA), the European Centre for Disease Prevention and Control (ECDC) and the World Health Organisation (WHO) updated MEPs on the state of play of existing COVID-19 variants. They shared information regarding how effective authorised vaccines are against different variants, and discussed global challenges and the need for a global coordinated response to addressing variants.

MEPs expressed their concerns regarding fast-spreading variants, especially given the vaccination rate across the EU remains lower than expected. They lamented the lack of data available on the efficacy of administered vaccines. Certain member states have a low or no capacity to analyse virus samples ("genomic sequencing"), many MEPs said, which means the spread of variants and their impact cannot be adequately monitored. Members also quizzed the experts on the authorisation process for updated vaccines, on the role of vaccination certificates, and on the safety and side effects of existing vaccines.

During the meeting, Commission Deputy Director-General for Health Pierre Delsaux presented the Commission's communication on the HERA Incubator, a project designed to monitor variants, exchange data and cooperate on adapting vaccines. The Commission has proposed to amend the current regulatory procedure in order to allow for COVID-19 vaccines that are adapted to new variants to be approved more quickly.

You can watch the recording of the debate here and the video statement of Committee Chair, Pascal Canfin (Renew, FR) here.

Background

All viruses – including SARS-CoV-2, the virus that causes COVID-19 – evolve over time. These changes are called "mutations". A virus with one or more new mutations is referred to as a "variant" of the original virus. The ECDC's latest risk assessment states that variants are more easily transmitted and more severe. Existing licensed COVID-19 vaccines may therefore be only partially effective or significantly less effective against a variant. For this reason, the risk associated with further spread of COVID-19 is currently assessed as "high to very high".

According to the WHO, COVID-19 vaccines currently being developed or already approved are expected to provide at least some protection against new variants of the virus. In the event that any of these vaccines prove to be less effective against one or more variants, the composition of the vaccines can be adapted to protect against these variants.

Eurogroup statement on the euro area fiscal policy response to the COVID-19 crisis and the path forward