Fabio Panetta: Interview with La Repubblica

INTERVIEW

Interview with Fabio Panetta, Member of the Executive Board of the ECB, conducted by Tonia Mastrobuoni and published on 27 July 2020

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The European Union has approved a recovery fund of €750 billion and an ambitious multiannual budget. What do you think of the agreement?

It could mark a turning point. If we look back in 20 years' time, the past few months might look like the start of a new phase in European integration. The approval of the recovery fund was a necessary decision to meet the economic challenges facing Europe. But, above all, it is a decision that shows awareness, including on the part of countries that were initially lukewarm to the agreement, of the need for a common response and the benefits – for everyone – of providing that response. Whether the decisions taken in recent weeks really mark a turning point will depend on the economic policies adopted by individual countries. Italy bears a great responsibility. The EU has given Italy access to significant credit. Now the country must show it's capable of using that European funding to address the structural weaknesses in its economy.

You've written that an inadequate European fiscal response would have placed the single market at risk. Did the "Frugal Four" underestimate this danger?

One thing that struck me in the European negotiations was that, after a really heated discussion, all the leaders went home and claimed victory. In fact, they were right to do so. We did all win, because all of our countries can benefit from a common response that fosters the recovery of the European economy. By acting together, we've generated a sort of 'European dividend'. The eurozone economy is interconnected from a trade and financial perspective, and the recovery of any single part of it has positive repercussions on growth and jobs throughout the area. Export-oriented countries like Germany or the Netherlands are aware of the benefits of the single currency. If a shock arises that is not caused by imprudent policies, it's in the common interest to help kick-start the European economy.

Do the geopolitical situation, the United States' neo-protectionism and tensions with China, as well as the growing nationalism in Europe suggest that the European Single Market should be preserved and safeguarded even more than in the past?

Even before the pandemic, it was clear that multilateralism was in crisis as a result of policies adopted outside the EU. The tendency to base international relations on bilateral relationships benefits those regions that are economically strongest. European integration can ensure that the voices of countries that – on their own – would have limited relevance in a global context, are heard. But we need to build an economic area in which all countries can proceed at a similar pace.

Some people fear that Germany will emerge stronger from the crisis, and Europe more unequal. Do you still see this as a risk, now that agreement has been reached on the recovery fund?

Even countries less badly affected by the pandemic, and that would have had the means not just to tackle the crisis but also to benefit from it – and here I'm thinking precisely of Germany – have taken ownership of the joint initiative. Without the Franco-German engine driving things forward, there would have been no recovery fund. In the past Germany has been reluctant to adopt common recovery policies, but in this case it has looked beyond short-term national interests and provided a decisive impetus for policies that can lessen economic divergences between countries. Now we need an adequate response from the economically weaker countries that have been hit hardest by the crisis.

How do you view the role played by Angela Merkel, who in the past has often been accused of doing "too little, too late" for Europe?

The shift in favour of Europe occurred at two key moments. The first was the prompt intervention by the European Central Bank (ECB), which prevented a devastating crisis and afforded the time needed for a European solution to take shape. The second was the announcement of the recovery fund by Chancellor Merkel and President Macron. And let's not forget the role played by the European Commission: it drew up the proposal for a recovery fund, which then emerged essentially intact from the subsequent debate. The response to the crisis came primarily from European institutions (the ECB, the Council and the Commission), moving beyond the intergovernmental approach followed during the sovereign debt crisis. We have devised a European response to a European problem. And it's working.

In the recovery fund, the balance between grants and loans has been shifted strongly in favour of the latter. Do you think that's a problem?

Ultimately, the €750 billion are still there. Yes, some people wanted more grants, others more loans. But let's remember where we were four months ago. A solution like the one achieved in the last few days was inconceivable at that time. It has gone very well.

The EU will be issuing a huge volume of debt. Is this another epoch-making landmark?

Yes, issuing this amount of debt is a fundamental change. It marks progress towards a genuine capital markets union and will make the euro area more attractive to international investors. In the past capital inflows to the euro area mainly concerned just a few countries and de facto accentuated divergences. That won't happen this time round, because the capital will be able to flow towards securities issued jointly, the proceeds of which will be used to finance the economy of the entire euro area. The euro area is becoming more normal.

A lot of money will be coming to Italy, but our partners expect reforms. What are the priorities?

The Italian economy has been stagnating for decades. Italy missed the boat with the technological revolution and hasn't invested enough in developing human capital. The delays and weaknesses accumulated over time are well known. Now there is a chance to use European funds to modernise the economy and to make it more respectful of the environment, more digitalised and more inclusive. It is possible to reduce – through growth and jobs, and not just subsidies – the inequalities that have emerged in recent years. Southern Italy is a critical challenge. I struggle to imagine a balanced development of an economy in which the per capita income of one-third of the population is half that of the rest of the country, where entire regions are afflicted by widespread unemployment and lack of infrastructure. The introduction of a favourable tax regime in southern Italy is being actively discussed. This is an ambitious goal, which I examined previously during my time at the Banca d'Italia. It will need to be assessed at both the national and European levels in view of its implications for public finances and competition. But it's a project that could significantly contribute to the recovery of southern Italy's economy.

The money from the recovery fund won't arrive until next year. In the meantime would it be right for Italy to seek funding from the European Stability Mechanism?

I think it's necessary to hold an objective and informed debate on whether it's appropriate to use the low-cost resources made available by Europe, including those provided by the European Stability Mechanism (ESM), for health expenditure, especially in the light of the ongoing risk of a second wave of infections. The ESM and the European Commission have published all the information on the conditions offered by the ESM on their websites. This information is public and can be analysed by experts, of which there is no shortage in the Italian public administration. When all the implications of applying to the ESM have been fully clarified, I’m sure the government and Parliament will take the right decision.

What effect have the special measures adopted by the ECB to tackle the paralysis caused by the coronavirus (COVID-19) pandemic had?

These measures were needed to prevent financial markets running out of oxygen and to support consumption and investment by households and businesses. If we had tolerated a tightening of financial conditions, the already very serious crisis we expect to see this year would have been even worse, with unpredictable consequences. The ECB took action to prevent financial fragmentation in the euro area and safeguard its monetary policy transmission mechanism. In that way, we have protected the production capacity of the European economy.

Without our measures, the pandemic would have pushed inflation well below 2%. By the end of 2022, we estimate that the measures decided since March – both the purchase programmes and the refinancing operations – will produce a cumulative increase of 0.8 percentage points in inflation and 1.3 percentage points in GDP. We’re seeing a normalisation of the cost of financing the economy, which is a necessary condition to prevent the crisis intensifying.

So is the euro area out of danger?

It’s too soon to declare victory. In the first quarter GDP in the euro area experienced a very sharp contraction of 3.6% compared with the previous three months. In the second quarter things will get worse, and the contraction will be more acute. Recent data certainly indicate that we’re making progress: in May industrial production grew by 12% and retail sales by 18%; qualitative indicators such as the Purchasing Managers’ Index are also improving. But we need to view these improvements with caution, because they are an effect of the rebound that was to be expected after the earlier disastrous fall in economic activity and reflect the large-scale intervention of economic policies. Moreover, they don’t diverge from our forecasts. So they don’t give us sufficient grounds for satisfaction.

Economic activity is still well below pre-crisis levels and, on the basis of our projections, we won’t see a return to those levels before the end of 2022. There is also uncertainty over the outlook for the economy and for jobs. Finally, growth is uneven: the last thing we need is for divergences between countries to be accentuated, because if that were to happen monetary policy implementation would become pretty difficult. And let’s not forget that we don’t know how the pandemic is going to evolve: in a number of countries there is still the risk of a second wave. Until we’re sure that the effects of the crisis have been reabsorbed we will need to go on providing a strong monetary stimulus to consolidate the recovery, thus bringing the inflation level back up.

But would a second wave, a second lockdown, be sustainable for the euro area?

I can't make predictions about a phenomenon that I've never experienced before and that I could never have imagined living through. However, it's important to underscore that the health authorities have gained valuable experience to manage any future emergencies. In addition, the euro area countries have tackled the pandemic decisively and effectively. This applies to Italy too, even though, as the first European country to be badly hit, it wasn't able to draw on other countries' experiences.

Might the ECB decide to deploy only part of the firepower of the pandemic emergency purchase programme (PEPP), as some members of the Governing Council have suggested?

When we approved the extension of the PEPP in June, our projections were no different from at present. So I expect we'll use the resources available under the programme in full unless there are significant upside surprises. We can take advantage of the flexibility envisaged by the PEPP by changing the distribution of purchases over time, across different asset classes or across countries. So far, we've only done this to a limited degree, as our interventions have been effective. The programme is working well, and I don't see any economic reasons to change our decisions or actions.

Christine Lagarde claims that the targeted longer-term refinancing operations (TLTROs) are working and that credit is flowing to businesses. Can you explain to us what's happening in the banking world, which was the first to collapse during the financial crisis?

We need to remember that this crisis was not triggered by the financial sector, but by a health emergency. In addition, the ECB acted promptly, and with very powerful measures. We're now providing funding for banks at negative rates that can be as low as -1%, but on one condition: that banks in turn use this financing to provide credit to households and businesses. This is a strong incentive, and the scope of the measures is very broad: through TLTROs, we can deliver nearly €3,000 billion of funding to banks. Intermediaries are making ample use of this facility and are markedly increasing lending to the economy. In the quarter from March to May the growth in loans to businesses was the highest since the launch of the single currency: about €250 billion for the euro area and €22 billion for Italy. And banks are issuing loans at very low rates, on average below 1.5%.

What risks are banks facing? Looking forward, do you see a new wave of non-performing loans?

Banks are starting from a better capital position than in 2008, when the financial crisis broke out. The ratio of Common Equity Tier 1 (CET1) capital to risk-weighted assets is just below 15%. But if the recession were to persist, banks would find themselves having to cope with a sharp deterioration in credit risk and a resurgence of impaired and bad loans. We need to kick-start the economy quickly, before we find ourselves in that situation. For this reason too the measures decided by the ECB are of fundamental importance.

Some commentators are complaining about low interest rates, which they say could harm savings and put pension funds, insurance companies and banks at risk. But it’s not as if low interest rates exist only in Europe.

You’re right, low rates are a global phenomenon, not a European one. They’re the result mainly of structural factors, such as the ageing population, surplus savings with respect to investment opportunities and a shortage of risk-free assets. In the euro area, low growth had an impact, as did the accommodative monetary policies linked to inflation trends. But imagine what would have happened if the ECB hadn’t adopted expansionary monetary policy measures. Growth and inflation would have collapsed, and savers and intermediaries would have suffered a great deal more. Employment and lower income citizens would have been hit hardest.