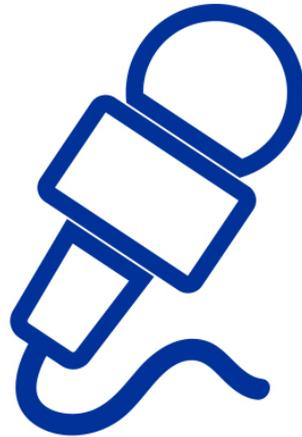


# Isabel Schnabel: Interview with Expansión



INTERVIEW

## **Interview with Isabel Schnabel, Member of the Executive Board of the ECB, conducted by Andrés Stumpf on 16 July and published on 21 July 2020**

21 July 2020

**The last meeting didn't lead to any new stimulus measures. Has the ECB already done enough?**

Our decisions are guided by the incoming data, so we continuously monitor what is happening in the economy and financial markets. We calibrate our measures based on these data. Our latest macroeconomic projections were published in June, which was when we decided to expand our measures because we saw that the economic and, in particular, the inflation outlook had deteriorated substantially.

We've now seen some upside surprises but they are not sufficient to make us change course from our baseline scenario, which projects an 8.7% drop in real GDP in 2020. There was hence no reason to revise our decision from the previous meeting. In any case, we have certainly seen an improvement in the financial data, compared with the situation back in March. Markets have calmed down quite a bit. Nevertheless, financial conditions are still somewhat tighter than they were before the pandemic.

**And are you comfortable with that situation?**

Our measures take time to fully take effect. That does not happen overnight. Besides, monetary policy is not alone in providing support to the economy. Fiscal policy also plays a very important role, and we have seen a lot of action there as well.

**The asset purchases have slowed down in the past few weeks. Does this have anything to do with the improvement that you mentioned?**

Markets must be careful not to read too much into data that show short-term variations in the pace of our asset purchases. These purchases are determined by various factors, including seasonality. There is typically less activity in both the primary and secondary markets during summertime. That's one reason why the monthly volume of purchases may drop.

**There are doubts about whether or not the ECB will use the full envelope of the pandemic emergency purchase programme (PEPP), which now stands at €1.35 trillion.**

The PEPP envelope was calibrated to meet two objectives: to counter the risks to the medium-term inflation outlook due to the pandemic, and to prevent market fragmentation and ensure the transmission of our policy to the entire euro area. As long as we remain in the baseline scenario of our projections, it's likely that the envelope will be used in full. Of course, upside or downside surprises are both possible in a situation with so much uncertainty.

The balance of risks is currently still tilted to the downside in our view. It would be very good news if we were to see such an improvement in the outlook that we could use less of the envelope. That's not the case for the time being, so the size of the current envelope remains appropriate.

**If the situation were to worsen, does the ECB have any tools left? You always seem to have something else in your toolkit.**

Let's not forget that, not so long ago, many people were saying that the ECB had run out of ammunition. Our response to this crisis has clearly shown that we have a large and effective monetary policy toolbox at our disposal. We have, in fact, expanded our set of tools during this period, to be able to fulfil our mandate. And we can adjust our existing tools or create new tools in the future if necessary. I can assure you that we are in no way constrained in that sense.

**By increasing the purchase volume again? The markets are already discussing the possibility of that.**

Whenever we take a new measure, some market participants already predict that we are going to do more. It is important that markets properly understand our reaction function. We link our decisions to the developments that we see in the data. It is crucial to avoid a situation in which the markets end up dictating what decisions we take.

The current purchase programme has been calibrated on the basis of the data in the current macroeconomic environment. This won't change just because investors are expecting more. What would have to change is the data.

**In the current environment, when we're already talking about trillions of euro in purchases, does an increase by hundreds of millions still have an impact?**

We are seeing that this programme is very effective and it does make an important difference how much we buy in addition to the total purchases that have already been conducted.

**There has also been a lot of talk about the possibility of you buying fallen angel debt (debt that has lost its investment grade rating), but you haven't discussed that yet. Is it a controversial measure?**

The truth is that, at least for the moment, we have not seen waves of rating downgrades for companies or countries that are on the brink of losing their investment grade ratings. So there is no urgency for us to discuss this now in relation to our asset purchases. But we are, of course, aware of the risk that credit rating downgrades could have procyclical effects, and this is something that we are monitoring very closely. And we are accepting this type of debt as part of the collateral that banks can provide when seeking central bank liquidity.

**So it might be a possibility in the future?**

I would not rule out this possibility completely, but it's not on our agenda at the moment.

**One concern about the programme is the capital key. How will the purchases converge towards the capital key? Could it be done through the reinvestments? We don't know much about those...**

Our only decision on this issue is what was published in the press release following the June Governing Council meeting. Maturing securities purchased under the PEPP will be reinvested until at least the end of 2022 and the decision to stop reinvestments will depend on the situation that we find ourselves in at that time. The end of the reinvestments should not interfere with our monetary policy stance.

Our purchases of public debt securities under the PEPP are guided by the capital key and we are currently using the flexibility of the programme to deviate from it, if necessary. The question that we will have to answer in due course is how, and to what extent, we will later converge back towards the capital key. It seems clear that the reinvestment phase can play a role here, but we haven't decided on this yet.

**Moving away from the purchases, the liquidity injected into the banking system (targeted longer-term refinancing operations, or TLTRO III) is another of the measures that you have taken. There has been a take-up of €1.3 trillion. Has the limit already been reached?**

There is still capacity for some banks to ask for more liquidity. But there was clearly a huge incentive for banks to take part in the first big operation, which ensured the maximum benefit from the extremely attractive conditions. In my view, we have already seen the largest part of the take-up

although we might still see some additional demand in the upcoming operations of this kind.

**This liquidity is conditional on loans being granted, but quite a few people are concerned that the banks are using it to purchase sovereign debt. Are you monitoring this? Is it something you're worried about?**

The design of the programme is very clear. It provides incentives for banks to continue lending to the real economy, which is what makes this tool so attractive from our perspective. We know that banks can be reluctant to lend in times of crisis, which could reinforce the downturn, so the conditionality linked to this liquidity is very important. Having said that, the funds allotted through the TLTROs cannot be earmarked for a specific purpose.

**But is the ECB at all interested in banks purchasing sovereign debt to relieve the pressure on your purchase programme?**

That is not our objective. The aim is to ensure that credit continues to flow despite the crisis, and that banks are lending to the real economy. If you look at the potential returns that banks can generate from lending, it continues to be more attractive on average, even when adjusted for risk, to lend to non-financial companies than to purchase domestic public debt. Therefore, we believe that this is a sufficient incentive to lend, even if banks have already reached the minimum lending threshold required by the conditions of the programme.

In any case, the volume of debt issuances of both sovereigns and firms has shot up, and we are aware that some of the new bonds will be purchased by banks. This can be a stabilising factor in times of crisis, but the previous crisis taught us that a strong interconnection between banks and domestic sovereigns can cause other types of problems. Therefore, such a situation should generally be avoided, and breaking this link was and is one of the main aims of the banking union. To achieve this, all the pillars of the banking union need to be completed.

**Credit is currently flowing at record levels.**

Our measures seem to have worked very well so far, and we have indeed seen a strong increase in lending volumes. This was absolutely crucial, especially in the first few months, because during the lockdown period many firms suffered a total collapse in their revenues, and the banks played a crucial role in allowing firms to draw down their credit lines to weather the storm. Banks are a key part of the solution to this crisis.

**You have signalled that you do not want monetary policy to be conditioned by the markets. But is it not conditioned, in some fashion, because of the most indebted countries? Their debt levels are being described as unsustainable...**

This is clearly exaggerated. Even at the height of the crisis no Member State was close to losing market access. There is a debate about fiscal dominance and some have raised doubts about whether we will ever be able to stop our purchases. In fact, we have shown in the past that we can stop our net asset

purchases. When the time comes, we will reduce our asset purchases, depending on the inflation outlook. We have a clear legal framework that prevents us from conducting monetary financing, so every decision we take has to be linked to our mandate of maintaining price stability over the medium term.

**So if inflation were to shoot up next month, would the ECB be obliged to abandon its stimulus programmes?**

We look at inflation over the medium term, so if there is a sudden increase in prices, but it is a one-off event, it will not affect our decision-making. It has to be something persistent.

If that were to happen, we would carefully assess what the appropriate response is. The aim of all our decisions is to bring inflation closer to a level of below, but close to, 2% over the medium term. However, we can adjust the speed at which this happens. And there we have to take the side effects of our measures into account, for example the effects on our secondary objectives that are also defined in the Treaty on the Functioning of the EU or on financial stability. So even if inflation were to increase, we would not raise interest rates immediately if doing so would tip the economy into a recession. Over the medium term, such a rate hike could be even more damaging to price stability. So we have some flexibility.

**I understand that the ECB is much less constrained by one-off increases in inflation than it was in the past. Is that the case? Because in the past we saw the ECB raise rates in such a situation...**

This is not so much related to constraints; it is a policy decision. The Governing Council has to continuously discuss the pros and cons of its decisions, within the flexibility permitted by our mandate.

**Public opinion of the ECB in Germany has improved a lot recently, hasn't it?**

In Germany and elsewhere in the euro area, people are acknowledging that the ECB has done a lot to avert a financial crisis, which is what we were facing in March. Our actions seem to have had a positive effect on how the ECB is perceived. I put a lot of effort into communicating better with the citizens of the euro area, especially those who view our measures critically, to try to explain why we do what we do and how it is helping all parts of the euro area.

**On the other side of public opinion you have the ruling of the German Constitutional Court, which indicated that the ECB has exceeded its competences with its debt purchases. The conflict seems to have been resolved, but did it condition your actions?**

The Federal Constitutional Court argued that we had not sufficiently demonstrated the proportionality of our measures. In reality, we are constantly doing just that. So one of the factors that appear to have led to this ruling was that we have not been sufficiently transparent about the reasoning behind the decisions we take. Therefore, it makes sense that we are talking more openly about all of this, so the public understands that we are

always carefully considering the proportionality of our actions and that we take this very seriously. In that sense, the ruling of the Constitutional Court has been positive. In any case, it has not constrained our actions.

**This crisis seems to have struck Spain especially hard. How do you see the situation there?**

Spain is one of the countries that has been most affected by the pandemic and the crisis. Relative to the severity of the crisis, the fiscal response may prove to be insufficient. The fiscal space is more limited than in some other countries because debt levels were already high before the crisis, and it is important to avoid them becoming excessively high. Therefore, the European recovery fund is incredibly important, especially for Spain. This virus has already caused too much suffering, and Europe has to make sure that the economic consequences are cushioned as much as possible, also to avoid a divergence of economic developments in different parts of the euro area.

Spain was one of the euro area's success stories before this crisis broke. There were many challenges, but the country managed to handle them well. I think it is important that Europe shows the same level of determination now to fight this crisis. The ECB is playing its part. The measures to ensure the flow of credit are particularly relevant for a country like Spain that has a large share of small and medium-sized enterprises.

**How do you assess last European Council's discussions?**

It is good news that the European Council seems to be coming closer to a solution even if the initial proposal has been watered down somewhat. The proposed package is likely to include a substantial grant component, which is particularly important for those countries that have been hit hardest by the pandemic and that have more limited fiscal space, such as Spain. There are still many details to be determined but discussions appear to be moving broadly in the right direction. I hope Europe will show that, in spite of all the differences among Member States, it can stand together and provide a common solution.

**What about Spain's financial sector?**

Spain's financial sector has become much stronger after the restructuring efforts launched in 2012, and this has helped Spanish banks enter this crisis with fairly solid levels of capital. Therefore, they should be able to support the Spanish economy through this crisis.