

# Isabel Schnabel: Interview with LETA



## **Interview with Isabel Schnabel, Member of the Executive Board of the ECB, conducted by Ingūna Ukenābele on 22 February 2021**

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### **How would you describe the current economic situation in the euro area?**

In the course of the pandemic, we have experienced the deepest economic downturn since World War II. After the strong decline in economic activity following the first wave of infections in the spring of 2020, we saw a strong rebound, supported by the decisive fiscal and monetary policy response. This positive development was interrupted by increasing infection numbers towards the end of last year, also affecting economic activity at the start of 2021. With respect to the health situation, we continue to face substantial uncertainty due to the new variants of the virus, which is posing some downside risks to the short-term outlook.

That being said, it seems that we are now much better able to deal with lockdowns than the first time around. There has been some adaptation, which means that the second lockdown will have less severe economic consequences than the first one.

Moreover, we are seeing quite a few encouraging signs. First of all, we now have a vaccine. The vaccination is progressing slowly, but steadily. The world economy is recovering more quickly than we had anticipated. And the sizeable fiscal package envisaged by the Biden administration will likely have positive spillover effects in the euro area. So we are seeing light at the end of the tunnel.

Looking ahead, fiscal and monetary policy support will remain crucial and must not be withdrawn prematurely. As regards monetary policy, we will ensure that there is no unwarranted tightening of financing conditions. A too abrupt increase in real interest rates on the back of improving global growth prospects could jeopardise the economic recovery. Therefore, we are monitoring financial market developments closely.

**Once the pandemic starts to decline, can we expect to see a recovery as fast as the one we saw last summer?**

It was encouraging to see how quickly the economy rebounded last year, and there is potential for a comparably quick recovery once the health crisis has been broadly contained. But the risk of scarring increases with the duration and frequency of lockdowns. This means that containing the virus must take absolute priority. Moreover, we should use the crisis as an opportunity for structural change. For example, we have seen a push towards a more digital economy. These shifts could support productivity growth in the future. That is why the efficient use of public funds, especially those of the “Next Generation EU” instrument, is so important. These funds should be used to foster the transition to a greener and more digital economy.

**By how much will the euro area grow this year? When might it see a return to pre-crisis levels?**

In our latest staff projections in December, we projected economic growth for the euro area to reach 3.9% in 2021. Due to the continued lockdowns, economic growth in the first quarter of 2021 may be somewhat weaker than expected. But in light of the positive developments to which I have alluded, the historically favourable financing conditions and an expansionary fiscal policy, annual growth is likely to be in the same ballpark as projected in December.

Based on our current projections, the euro area economy should be back at its pre-crisis level by mid-2022.

**Is there a risk that the crisis caused by the pandemic could lead to greater inequalities in development within the euro area since wealthy economies have invested more in aid and development programmes than their less wealthy counterparts?**

At the beginning of the pandemic, one of the fears was that those countries hardest hit by the pandemic would not respond appropriately due to a lack of fiscal space. Contrary to these expectations, this has not been a general pattern during the crisis. The fiscal support package at European level plays an important role in this.

But at the end of the day, what matters most is how public funds are used. Will they be channelled into productive investments? Will they be used to foster innovation? This is the best way to counter any potential divergence. Therefore, European funds need to be paid out quickly and then be used wisely.

**Does the ECB pay attention to Member States' programmes? In Latvia, for example, there has been a lot of criticism about the programme drafted by the Ministry of Finance.**

These discussions are taking place in every country, and it is the European Commission's role to evaluate these programmes. Overall, the policy response that we have seen in the euro area has been well-suited to counter the pandemic shock. Job retention schemes, which have kept around ten million people all over the euro area in work, have been crucial to prevent a sharp increase in unemployment. Another important component has been the support to corporates to avoid that firms that would be viable in normal times would be forced to file for bankruptcy. These were some of the most important steps taken and they have worked very well, particularly in combination with monetary policy, which has provided favourable financing conditions for firms, households and governments – thereby reinforcing the fiscal response.

**Are there differences in how the crisis is being overcome by euro area countries and non-euro area EU countries?**

Overall, the response to the crisis has been quite similar. EU countries outside the euro area have faced a serious second wave of infections, resulting in renewed lockdowns. As EU members, they also have access to the "Next Generation EU" programme. Monetary policy in those countries has responded to mitigate the consequences of the pandemic. And the ECB has supported this response by providing euro liquidity through swap and repo lines.

**Baltic states are some of the youngest members of the euro area. Is it easier for them to go through this crisis as euro area members given that some people still have their doubts about the single currency?**

The Baltic states have also experienced a severe economic downturn due to the pandemic. But compared to the euro area as a whole, they have performed better: the decline in real GDP in 2020 has been among the smallest in the euro area. It is of course worth mentioning that their starting position was relatively good.

The ECB has provided crucial support to all euro area countries. During the financial market turbulence in March 2020, the ECB's reaction was essential in order to prevent a severe financial crisis. Systemic risk indicators were at levels comparable to those observed at the time of the global financial crisis. Due to our swift policy response, the ECB was able to calm financial markets relatively quickly.

Since then, the focus of monetary policy has shifted to providing favourable financing conditions in order to bring inflation back to a level that is consistent with our medium-term aim. The pandemic has put downward pressure on inflation, which we have countered through the introduction of various crisis measures, particularly through our new asset purchase programme, the pandemic emergency purchase programme (PEPP), and our longer-term refinancing operations.

The Baltic states have benefited substantially from all these measures. The euro has provided stability at a time of great uncertainty.

**How long can the era of low interest rates last in your view? What will be the preconditions for this to change?**

The low interest rate environment is driven by long-term structural trends such as demographics, which play an important role in the Baltic states, globalisation and a decline in productivity growth. There is a relatively strong desire to save and a subdued willingness to invest, which is putting downward pressure on interest rates not just in Europe, but across all advanced economies. These trends can of course reverse. For example, ageing societies may start to consume more, for example when it comes to medical services or long-term care. We may also see innovation, for example in green technologies. Such innovation could push up productivity growth, which would also boost investment. Whether this happens depends to a considerable extent on government policies, namely on structural policies and public investment.

We do not expect these long-term macroeconomic trends to reverse in the short term, but we shouldn't think that it will not happen at all. Anyone who has studied economic history knows that such trends can reverse. However, the timing is difficult to predict.

**Do you see money being invested in the economy? In Latvia there is a feeling that low interest rates are not enough to lift the bank credit market, for example.**

The pandemic is a time of exceptionally high uncertainty. In times like these, people typically save more. This could be forced saving due to the lockdowns, but of course part of these savings are precautionary because people are uncertain about the economic outlook. So there is typically more saving, and at the same time there is less investment because of high uncertainty. For the recovery, it is very important that consumers start consuming and firms start investing again. Confidence is key here, and both fiscal and monetary policy can help restore lost confidence and thereby stimulate demand.

**How would you describe what is happening in financial markets, including the banking sector? How stable are eurozone banks at the moment? In many people's minds, the word "crisis" means that there are problems with banks and their savings.**

This crisis is very different from the global financial crisis. Banks entered this crisis in relatively good shape. That is also true for the Baltic banks. In particular, banks were relatively well capitalised, which meant that they could be part of the solution to this crisis rather than being the cause of the problem.

This rather benign development was supported by fiscal, supervisory and monetary policy.

On the fiscal side, we saw loan moratoria and guarantees, while supervisors

relaxed their requirements. Both types of measures played a decisive role in supporting the banking sector. On the monetary policy side, central bank measures provided ample liquidity at highly favourable terms, which enabled banks to continue lending.

Due to the support measures, the number of insolvencies is currently very low. The critical point will be reached when these measures are phased out. There is the risk of a cliff effect that could spill over to the financial sector, and we could see an increase in non-performing loans. Our analysis shows that euro area banks should be able to cope with this as long as the support is not withdrawn too early and too abruptly, and as long as the overall conditions remain favourable, including the financing conditions provided by the ECB. But we should expect many firms to come out of this crisis with much higher debt levels.

### **How do the Baltic banks look in terms of this risk of non-performing loans?**

The Baltic states are facing the same risk of a cliff effect. Many firms are experiencing rising indebtedness, and not all of them are going to survive. The pandemic creates challenges in all euro area countries.

### **In the Baltic and Nordic countries, preventing money laundering was a very hot topic before the pandemic. There were a number of scandals and strict rules were adopted. What is your assessment of the fight against money laundering in the euro area as a whole? Where are the biggest problems now?**

The fight against money laundering and terrorist financing is crucial to preserve the integrity of the financial sector and public trust in financial institutions. This is primarily the responsibility of national authorities, while the ECB is responsible for supervising significant banks in the euro area. Of course, we collaborate and exchange information.

However, when it comes to cross-border issues, national responsibilities may not be sufficient. If there is limited enforcement in any single country, this can lead to negative spillover effects to the entire euro area. So I think a more European approach may be needed. This starts with further harmonising national rules. Moreover, it should be considered whether the fight against money laundering could not be conducted more efficiently at the European level. These ideas are also included in the European Commission's action plan on anti-money laundering.

### **Don't you think the European Commission is being too slow here? We have been talking about these issues for years.**

There are good reasons to argue that these issues should be tackled quickly. But elevating powers and responsibilities to the European level is a difficult political issue and takes time. Regarding harmonisation, some progress could be achieved more quickly.

### **When can we expect a digital euro?**

The introduction of a digital euro is still an open issue. In October 2020, the ECB published its first report on a digital euro. This report served as

the foundation for a public consultation process, which generated a lot of interest. We will most likely take a decision by the middle of the year as to whether we will launch a digital euro project, starting with an investigation phase. Of course, we are closely coordinating our plans with the European Commission. There are also important technical aspects that still need to be clarified. Let me stress that these discussions are still ongoing. No formal decision has been taken yet. The whole process will take several years.

**Will there be public trust in a digital currency?**

Public trust in a digital currency will be determined by the public trust in the central bank that issues it. There is a very high level of trust in the euro, and I have no doubt that we can generate the same level of trust in a digital euro.