

Luis de Guindos: Interview with ABC



INTERVIEW

Interview with Luis de Guindos, Vice-President of the ECB, conducted by María Jesús Pérez on 9 June 2020 and published on 14 June 2020

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European economics and finance ministers met on Tuesday to discuss the EU recovery plan to deal with a post-COVID-19 scenario using guarantees. Why wasn't there an agreement?

A consensus has not been reached yet and some countries seem reluctant to sign an agreement, but we are confident that they will be able to do so at the end of July. A strong European response is essential to ensure that every country is included in the recovery.

In any case, the coronavirus crisis is wreaking havoc on the world economy. In Europe, for example, the ECB was expecting the economy to grow by 0.8% this year. But last week ECB President Christine Lagarde acknowledged that it would contract by 8.7% in 2020, which is a downward revision to your projections of almost 10% and an "unprecedented contraction" in the euro area economy. Is the situation likely to worsen or will the support packages approved by the Eurogroup and by the ECB be enough to bring about a recovery?

There is currently a great deal of uncertainty surrounding the economic projections. GDP fell by 3.6% in Europe in the first quarter. Our projections see GDP shrinking by 13% in the second quarter, and we expect the economy to start to recover from the third quarter onwards. That would mean an overall

decline of 8.7%. However, there is so much uncertainty that we are working with three potential scenarios. These range from the mildest, which is very unlikely and entails a decline of just under 6%, to the most severe, in which we see GDP declining by over 12%. The final data will be determined by economic developments once most of the restrictions that we have been living under as a result of the need to impose a lockdown have been lifted. We saw the worst of the situation around the middle of April.

Are you ruling out an increase in the ECB's pandemic emergency purchase programme (PEPP) after the summer, or is another new injection of funds possible?

We have just increased the PEPP. We started with €750 billion in March and we increased that by €600 billion to €1,350 billion on 4 June, with purchases that will be conducted until at least the first half of 2021. It's an enormous purchase volume and comes on top of the Asset Purchase Programme (APP), the ordinary debt purchase programme that we already had, with purchases at a monthly pace of €20 billion, and to which we added a further €120 billion in March. With all of this, our purchases would come to €1,700 billion, which is a huge amount. And, depending on economic conditions and our inflation projections, we are always open to recalibrating the programme.

Do you monitor whether this capital is being used correctly?

Our purchases are not conditional. To decide on the appropriateness and proportionality of the programme, the ECB takes into account inflation expectations, which are now lower than before the pandemic, and financial conditions. We try to prevent a tightening of financial conditions because that would have a severe impact on credit and sovereign bonds and could lead to fragmentation in the euro area. The asset purchases are allocated in accordance with the capital key, which is calculated based on the GDP and population of each country. And in the PEPP we have greater flexibility in its implementation.

In general, countries spend, then they borrow to pay for their spending, and to ensure that the cost of debt doesn't weigh too heavily on their budgets, the ECB buys that debt. Then what? Don't you think we'll be living in a world flooded with liquidity, with lots of social expenditure, very limited productive investment and high levels of unemployment?

The ECB focuses on its inflation aim and on ensuring that there isn't a tightening of financial conditions, because that would have very negative consequences and we must prevent any fragmentation in the bond markets. We are taking the necessary measures to tackle the pandemic. The quality of public finances is the responsibility of governments and the European Commission, which, as it's known, in the current circumstances, will not be calling for the implementation of the Stability and Growth Pact. At the ECB, as I've already said, our actions are guided by our inflation aim of below, but close to, 2% over the medium term. The current projections show inflation at 1.3% in 2022, so we are still a long way from the aim and our stimulus measures are necessary.

It finally seems that support for the southern European countries will come, despite the reluctance of their northern counterparts. Do you think there will be any strings attached to this support? Will the support for Spain come without any conditions?

It's very important that the European Commission's recovery plan for the post-COVID-19 economy is approved, not only because of how much money is involved but also because of the message of united action that it sends out. Monetary policy cannot be the only European policy being used to counteract the impact of the pandemic on European economies. An agreement would send a message that there is political will to do so among all countries. The proposed plan will be linked to the European Semester, which coordinates economic and budgetary policies within the EU. The Commission has initially given carte blanche for fiscal policy action in the short term, but it will ensure that public finances are brought back onto a sustainable path over the medium term.

The Banco de España's projections for the Spanish economy and its recovery have been another heavy blow. It previously warned that extending the lockdown would mean a longer recession and higher unemployment, but nobody listened. Yesterday it made further downward revisions to its GDP and unemployment forecasts given the lack of effective measures from the government. You said that if things are done correctly, we will see a rebound and a return to pre-crisis levels of activity. Have you changed your view after seeing the Banco de España's forecasts?

At the ECB we are constantly in touch with the national central banks. The Banco de España's projections are in line with what we have published for the euro area as a whole. There are signs that economic activity is picking up as countries are reopening their economies and lifting restrictions on movement, lockdown measures and the like. What's key is knowing how quickly countries will be able to recover what was lost during the four months from March to June. And for that recovery to take place as soon as possible, every country must ensure the survival of most of the businesses that were active before the crisis.

How can they do that?

One way is by introducing liquidity support measures, such as government loan guarantee schemes – like through the ICO (Official Credit Institute [in Spanish: Instituto de Crédito Oficial]) in Spain – and by trying to minimise the costs borne by companies at a time when they have practically no income. And through temporary unemployment schemes, such as the ERTE temporary layoff scheme [in Spanish: expedientes de regulación temporal, or ERTE] in Spain. The shock received has been huge. The Banco de España sees the Spanish economy shrinking by between 15% and 20% in the second quarter. And the ECB sees a contraction of 13% in the euro area as a whole. The main question is: how can we reboot economies with as much force as possible and ensure that countries are quick to address the gap in income, unemployment and the economic downturn brought about by the pandemic? For that to happen, it's vital that as many businesses as possible survive. Businesses that were solvent before the pandemic must still be solvent afterwards, because they

are the ones that must drive the economy.

And is Spain doing the right things to bring about this rebound? Are the measures taken the ones that we need? Are they the right ones? What still needs to be done?

I'm not going to comment on specific countries. Generally speaking, every country should have loan guarantees, support measures such as tax moratoria, the possibility of postponing social security contributions during this period, and temporary employment schemes like the ERTE. All of these measures will lead to a very significant increase in the public deficit and fiscal policy planning will be needed to address this expenditure. After all the fiscal efforts required right now, once the pandemic is over, countries will of course be left with something they won't be able to avoid: a very significant increase in the government debt-to-GDP ratio. On average, the debt-to-GDP ratio for the euro area as a whole could increase by between 15 and 20 percentage points. This situation is the result of an expansionary fiscal policy required to tackle the pandemic, and it will have to be addressed in the future so that the public deficit can return to a path that is considered to be sustainable over the medium term.

By cutting public spending and putting up taxes?

It will depend on each country. But every euro area country will have to deal with this new economic situation after heavy public spending programmes and a significant dip in tax revenues. This will lead to a larger hole in the public finances which will have to be covered by government debt. The ECB's debt purchases are preventing a fragmentation of bond markets and a tightening of financial conditions, which is greatly helping all countries prevent the health and economic crisis from being exacerbated by a debt crisis.

Once we see a return to growth, countries will have to address the situation by reducing this extraordinary spending and recovering tax revenues. This will be an individual task for each country. But it will be of vital importance and, as the Governor of the Banco de España said, it will require a fiscal consolidation plan lasting several years.

You were in favour of a minimum income, but one which was temporary and linked to the length and impact of the pandemic. What do you think about the minimum income that has finally been approved in Spain?

I am personally in favour of a temporary emergency minimum income for those hardest hit by the crisis. This has been done in a structural way in Spain. It is a legitimate social policy decision which, as ECB Vice-President, I am not going to comment on. Generally speaking, it's important that these kinds of support measures don't discourage people from seeking employment and that they are funded in a sustainable manner over the medium term. And, in any case, job creation is without a doubt the best social policy to tackle poverty and emerge from this crisis.

In your view, what have other countries done better than Spain to manage the

crisis?

When you look at the action plans of each Member State, their basic principles are all very similar. There are three key courses of action. The first is government guarantees so that the banks will grant loans. The second is moratoria on tax payments, social security contributions and the like. And the third is temporary employment schemes, such as the ERTE.

But not all countries have the same fiscal capacity. Those countries with less debt and lower deficits have been able to embark on more ambitious programmes. And this is precisely why a pan-European response is essential. We have to avoid a situation in which some countries are left behind in the recovery because they had less fiscal space to address the public health crisis and the ensuing economic crisis.

In your opinion, economic policy in Europe should focus on saving as many businesses as possible. The Spanish government has opted to focus its support measures on workers, with moratoria, the ERTE scheme and subsidies. But in many cases these aren't reaching the workers or are taking a long time to reach them. What do you make of this?

The ERTE scheme also helps businesses. It was reformed in 2012 and is proving to be extremely useful. The government pays part of the wages and social security contributions, which helps businesses and means that, in the event of a downturn, they don't have to make redundancies.

Do you take it as a positive that the ERTE scheme may be extended until December in specific sectors?

That is a decision for the unions, employers and the government. A major advantage of the ERTE is that it limits companies' expenditure but it also has a budgetary cost, which is why it is a decision that must be taken by the government in conjunction with labour and management stakeholders.

Is there concern at European level that Spain has a government with so many diverse viewpoints, and that there is so much improvisation and haste to implement measures which are perhaps not in line with the European project?

I am not going to get into assessing the performance of any government. Member States will have to submit their programmes and action plans for reforms, investment, etc. to the European Commission, and it will be up to the Commission to evaluate those plans, not me.

Some experts, pundits and even politicians with different views to those at the heart of government are raising doubts about whether the issue of nationalisation has been completely resolved at European level. It has been approved that, in certain situations, the government may become a shareholder in companies that are failing as a result of the coronavirus crisis.

As a result of the pandemic, the Commission has waived the application of State aid rules. But some countries are in a better position than others to inject funds, and fragmentation of the Single Market must be avoided. That's why it's essential to restore the core principles for granting aid. We are

currently experiencing an exceptional situation but we must not let it become structural. As things gradually get back to normal, State aid must once again be governed by the principles of free competition and preservation of the Single Market. These common rules must be restored as soon as possible, and I am sure that they will be.

What is your take on the political tension we have recently been seeing in Spain's lower house? Shouldn't there be greater unity and consensus to get the country out of what is the most severe economic crisis it has seen since the Civil War?

The current recession is even worse than the one that occurred between 2009 and 2013. It is the worst on record since the Civil War. It will affect public finances; there will be a drop in incomes, and more poverty. Measures will have to be taken on many economic and social fronts which will require consensus at the highest level. In this respect, it is obviously much better to have a coordinated approach between the government and the main opposition parties. The recovery plan will be very complex, it will have to deal with many different variables, and reaching a consensus will obviously be vital. That would require leaving dogmatic approaches to one side, a great deal of transparency, a great deal of commitment, and the willingness of politicians to achieve that consensus. Clearly, for the future of the Spanish economy, reaching a consensus on the recovery plan will be vital.

The European Banking Authority has confirmed that Spanish banks are facing the coronavirus crisis with the lowest level of capital in Europe, while noting that they were among those with the lowest leverage ratios. How will the banks, and Spanish banks in particular, recover from this crisis? Were they ready to deal with a crisis of this kind?

Europe's banking sector has more capital and is much more resilient than it was ten years ago. It is therefore in a much better position to face the crisis. Its main problem is low profitability. Profit levels were already low before the crisis, and have fallen even further, and this can be seen from banks' stock market valuations; currently banks are priced at 70% below their book value on average. In some cases, the figure is even higher, at 80% or 90%. The crisis will put more pressure on profitability. Consequently, what was essential before the crisis will now be even more so, including the need to reduce cost/income ratios or to proceed with consolidation or restructuring processes. We also have to keep in mind that a bank's solvency is not measured by its capital ratio alone, but by other variables, such as the level of provisions or the efficiency of the system. In the last ten years, the Spanish banking sector has undergone an intensive clean-up and consolidation process, which is why it is currently not giving cause for concern.

Will mergers make a return? How many banks should Spain have for the system to be entirely cleaned up? Should three big banks absorb all the others?

The ECB does not shape the market. Profitability was low before the crisis and will be further affected by it. Provisions will increase, there will be a rise in the number of defaults and non-performing loans, and this will affect

the profit and loss account, further reducing the bottom line. Faced with this situation, banks will have to react. The ECB believes that consolidation could help to reduce the costs and increase the efficiency of certain banks, but it's not the supervisor's role to say what form specific operations should take. ECB Banking Supervision has taken steps, such as requesting the suspension of dividend payments, so that banks use their funds to maintain lending volumes and don't make the recession worse.

Regarding the cancellation of dividends, will the ECB "recommend" that payments be suspended beyond October? What measures will it take against banks that don't comply with its recommendation?

The ECB Supervisory Board will reassess the situation. At the moment, the recommendation is to suspend dividend payments until at least October, and a decision will be taken before then about a possible extension. The aim is to use the funds that would have been distributed as dividends to grant loans in order to help the recovery and help banks maintain their own solvency levels. It is a recommendation, and as such is not mandatory. But like all the other supervisory recommendations made, the banks pay a great deal of attention to them.

Will the ECB create a bad bank in the end?

Bad banks have been created in some countries. "Sareb" was created in Spain, and it has been a very efficient tool for cleaning up the sector. But the ECB has not taken any decision or entered into any detail about the possibility of creating a bad bank at the European level. It is too early for this discussion at the moment.

What is your opinion on borders opening back up and flows of tourists as the summer approaches?

We must strike a balance between health and the economy. For countries like Spain, where tourism plays a crucial role, opening up the borders helps with exiting the crisis and making progress on the recovery front. It is a vital step to help reboot the economy with as much force as possible and offset some of the contraction seen over the last four months. It is therefore important, but health must always be taken into account and we must be on our guard to ensure the epidemic is kept under control.

To reopen and revive the economy, isn't it a great idea that we're now talking about revoking the labour market reforms?

Spanish labour market reforms have played a vital role in creating employment in the country since 2012. What's more, the ERTE for example, provides clear evidence of how the tools that were improved as part of these reforms are helping substantially. To face the major crisis triggered by this global pandemic, it is important to provide certainty and be predictable.

Given what we've seen and what we've gone through, how many times a day do you give thanks for having left the Spanish government when you did?

That was almost two-and-a-half years ago. I decided to leave the ministry

because the ECB is a wonderful place to work. I was a minister for six-and-a-half years, in fairly tricky economic circumstances. But numerous economic and financial reforms were introduced that laid the foundations for the recovery. From a professional viewpoint, it was excellent, in spite of the difficulties, and I am also very satisfied from a personal viewpoint. And now I'm delighted to be at the ECB.

One last question. Mário Centeno's departure from the neighbouring Portuguese government opens the door to his succession at the helm of the Eurogroup, and apparently the Spanish Vice-President Nadia Calviño is among the candidates. What do you think of her potential candidacy? Spain would once again have several representatives in very important financial institutions.

I don't know who will go for this position, but, generally speaking, I will always be in favour of having Spanish representatives in important positions in international organisations, because it shows that the country can have an influence.

Spain already suffered a "bailout" during the last crisis, although not the entire country, just the financial sector. You witnessed it first-hand. Do you think Spain will end up being bailed out? Some economists are sure it will be, although they say they would not describe it in this way..

Spain asked for a bank rescue package in 2012 of up to €100 billion, of which €40 billion was used. This loan from the European Stability Mechanism was essential to clean up the financial system which, at the end of the day, enabled the economy to grow. It is up to the government to review the situation and decide if it must take that decision.

Still on the subject of Spain, when times were good, the country did not reduce its debt levels and is now facing the crisis from a poor starting position. Will this debt not be a burden for future generations and hamper the recovery and our ability to create jobs again if we don't solve this issue?

The crisis triggered by this public health emergency requires governments throughout the euro area to make a fiscal effort, which will lead to bigger deficits and higher debt levels. By purchasing assets, the ECB is avoiding fragmentation and enabling governments to obtain financing on the market. It is also essential to have a pan-European response to this problem to ensure that all countries can get back on the path to economic recovery. Once this has been achieved, governments will have to adopt measures to ensure that their public finances are sustainable in the medium term.