

Luis de Guindos: Interview with El Independiente



INTERVIEW

Interview with Luis de Guindos, Vice-President of the ECB, conducted by Casimiro García Abadillo on 21 July 2020 and published on 26 July 2020

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What do you make of the agreement reached in the early hours of Tuesday morning to launch a European recovery fund?

It is a good deal. It sends the right signal for the exit from the crisis. This is the first time that a plan of this kind will be funded by mutualised debt. This aspect should not be understated, as it is extremely significant. It shows that there is a willingness to reach an agreement. The markets reacted to the agreement with relief, although they had already priced it in to some extent.

Will the €750 billion be enough to deal with an economic downturn as sharp as the one brought about by the coronavirus (COVID-19)?

We must bear in mind that this fund comes on top of the plans that have been implemented by each Member State. Even though it's important, it's something additional. The European Commission's own calculations show that the national stimulus packages alone are equal to 8% of European GDP.

The agreement involves clear conditionality. How is it going to affect the

Member States that hope to access the grants?

I have never understood the debate about conditionality. There have always been conditions in European solidarity policies. Member States seeking this support will have to submit their investment plans to the European Commission, which will decide whether or not to give them the green light. There are two predefined priority areas: climate change and digitalisation of the economy. No single Member State will have veto powers, but the Commission – and ultimately the European Council – will have an oversight role to ensure that the money is earmarked for investments that boost competitiveness.

Will the agreement mean putting the brakes on the repeal of the Spanish labour market reforms that were introduced by Mariano Rajoy's government?

It falls to the Commission, not the ECB, to pronounce on that issue. What I can say is this: the Commission took a very positive view of the 2012 labour market reforms, which helped to create almost half a million jobs each year over six consecutive years.

The COVID-19 crisis has tested EU institutions. Which of the ECB's measures would you highlight?

The ECB acted decisively. And we did so in three ways. We provided banks with liquidity at favourable terms in order to prevent a credit crunch for businesses and households. We also launched an emergency asset purchase programme, of mainly public debt, which will continue until at least mid-2021 and which amounts to €1.35 trillion. Moreover, measures to improve capital and liquidity ratios in the banking sector were also encouraged.

These policies have had a positive impact, especially if we look at developments in government bond yields and the spreads between countries. And this policy of decisive action has been supplemented by the policies that national governments have put in place both to provide liquidity and support the smooth flow of credit and, through furlough schemes, to prevent mass redundancies.

Will what has been done so far be enough?

We are experiencing an unprecedented situation. With the lockdown, there was a huge drop in activity over a period of two and a half months. The economy wasn't prepared for the lockdown, but in our view it has not suffered any structural damage. A rebound will be possible, but our calculations show that it will take us two years to return to pre-COVID-19 levels of output.

Some countries, such as Spain and Italy, have suffered the consequences of the pandemic more than others, in terms of both public health and the economy, and it seems that they will face a more challenging recovery. Could this disparity create a two-speed Europe?

The pandemic is a common shock, but its impact has varied across countries. The variation stems from objective factors, such as the importance of tourism in the economy, the severity of the lockdown measures or a country's ability to provide a fiscal response. This is why the plan approved on Tuesday is so

important, as it seeks to redress these differences to ensure that no country is left behind. So, in this respect, the recovery fund reduces the risk of a two-speed Europe. Evidently the recovery will not be uniform, but the plan will reduce divergence between economies.

Is there a risk that the decline in activity will have an impact on the solvency of any of the larger banks?

In a few days' time, the ECB will be publishing the outcome of its vulnerability analysis of banks, which is a substitute for the stress tests. The average capital ratio of European banks is around 15%. There is every indication that, with this high level of solvency, most European banks could withstand a 9% fall in GDP and survive the two years it will take to return to the level of output seen before the spread of COVID-19.

Do you think Europe will emerge stronger from this crisis?

Yes, I think so. The European project will emerge stronger because, as I said before, the Member States have shown that they are able to reach an agreement. There was a willingness to compromise, and this was demonstrated by all the Member States of the EU. That sends a very powerful message.

Some economists say that the 2008 crisis was solved using neoliberal strategies and that neo-Keynesian methods are being applied in the current crisis. Would you agree with this analysis?

The cause of the crisis is different. The 2008 crisis was a debt crisis, whereas now we are dealing with a public health crisis which has led to lockdown measures that have resulted in an unprecedented decline in economic activity. Therefore, the response has to be different.

Ambitious monetary policy measures have been implemented in parallel to fiscal policies that have prioritised support to businesses and households. In return, the deficit has increased and public debt has grown. And that will be the legacy of this crisis: high levels of debt to GDP.

An expansionary monetary policy was required and that is what has been implemented. But, later on, when the economy recovers, it will be necessary to rebalance the deficit and start to reduce the debt. That is the only way to ensure that the welfare state is sustainable over the medium and long term.

Should banks pay dividends this year?

Banks need to be extremely prudent when distributing dividends. The measures taken by the ECB were aimed at preventing a credit crunch. And the recommendation to suspend dividend payments is also geared towards this. Bank profits should not be used to pay dividends, but to further support lending.