Philip R. Lane: Interview with El País

INTERVIEW

Interview with Philip R. Lane, Member of the Executive Board of the ECB, conducted by Luis Doncel on 11 May 2020 and published on 18 May 2020

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Since the coronavirus (COVID-19) outbreak spread throughout Europe, the ECB has flooded the market with massive debt purchases and liquidity for the banking sector, but it doesn't seem to have been enough. What tools do you have left?

What we observed in response to the spread of the virus and the containment measures that have been implemented across Europe and the globe is that financing conditions tightened significantly. For policymakers it is crucial to both counter forces that could amplify the shock and to avoid the temporary shock hurting economic performance in the long run. Our monetary policy is making an important contribution here: making sure that the necessary monetary and financial conditions for the restoration of economic activity are in place, in line with the easing of the containment measures. The contribution of our pandemic emergency purchase programme (PEPP) is to make sure that financial conditions remain sufficiently accommodative and to help stabilise markets. Our asset purchases are complemented by our targeted lending programme and our collateral easing measures, which ensure the smooth transmission of our monetary policy through banks to firms and households. So the ECB has done a lot already. And we are continuously monitoring the situation and are ready to adjust all our instruments if necessary.

At its June meeting, the ECB is expected to announce an increase in the PEPP, which was launched in March to the tune of €750 billion.

We are a goal-oriented institution and this applies equally to our monetary policy measures. So the precise configuration of the PEPP is guided by the two tasks it has: improving monetary conditions and stabilising financial markets. The exact figure is of secondary importance. We are constantly assessing whether we are doing enough and if there is a risk of instability. The June meeting is still three weeks away, and we are in the process of analysing the situation. If we see that financial conditions are too tight, or the pressure on individual bond markets is not reflecting economic fundamentals, we can adjust the size or duration of our purchases, which we can anyway allocate flexibly over time and market segments. Our aim is to ensure that financial conditions are appropriate for all markets and to help counter rather than amplify the impact of the pandemic shock on the economy.

The German Constitutional Court just declared the debt purchase programme launched by Mario Draghi to be partially unconstitutional. Although this verdict does not explicitly mention the new bond purchases launched in response to the pandemic, doesn't it significantly reduce the ECB's room for manoeuvre in future decisions?

No, I don't agree with that. Following the judgment of the German Federal Constitutional Court, we said that we remain focused on our mandate. Whenever we act, whether through interest rates or asset purchases, our aim is to ensure price stability over the medium term. We are certain that everything we do is necessary to fulfil our mandate. And we will do what we have to in order to fulfil our mandate.

Can the ECB go against the most important country in the euro area?

We are an independent central bank. The ECB is a unique institution, with 19 member countries. Sometimes, this can lead to headaches. But the fact that 19 countries are watching each other also helps to ensure that we are independent. At the same time, independence comes with accountability: towards the European Parliament, and, of course, we are subject to the jurisdiction of the European Court of Justice, which ruled in favour of our public sector purchase programme.

How do you respond to the accusation from Germany that you are mixing fiscal and monetary policy and overstepping your powers?

Monetary policy acts on interest rates and, by doing so, it always has implications for the financing conditions of all sectors in the economy: firms, households and also governments. What the Treaty explicitly rules out is that we directly finance governments, in other words that we conduct monetary financing. But we are careful to remain at a good distance from that, and this has also been confirmed by the court rulings. It is important to recognise that inflation has been very low, and we have had to implement expansionary monetary policy measures to lift it to levels that are closer to our inflation aim. Let us also not forget that in the past, in different circumstances, the ECB has had to take decisions that were not universally popular, including with governments, such as raising interest rates. So our independence is crucial if we are to fulfil our mandate.

Christine Lagarde was heavily criticised in March when she said that the ECB isn’t here to close spreads. Hasn’t the institution, through what it has done and contrary to what its President said, shown that this is, in fact, its task?

Before this crisis we could see significant differences in the interest rates different countries had to pay on their own debt. In normal times, interest rate spreads across countries reflect the economic fundamentals of each country, including the levels of public debt. This is not something we are trying to get rid of. But in March spreads were widening rapidly, in a way that could not be explained by fundamentals. When there is market turmoil and spreads widen rapidly due to market dislocation, the central bank has to act as a stabilising factor for the markets. This is especially true in a monetary union, where you can easily switch from the bonds of one country into those of another country in the same currency. The stabilising presence of the central banks can then rule out self-fulfilling flight-to-safety dynamics and illiquidity in individual sovereign bond markets, and this is what we pledged to do.

The ECB forecasts a fall in euro area GDP of between 5 percent and 12 percent this year. There are risks of new outbreaks and it’s becoming increasingly clear that we will have to get used to strict measures that will damage the economy even more. Are we witnessing the worst-case scenarios that will bring about this 12 percent fall?

The scenarios we presented reflect the current situation. In March the pandemic and the measures to contain it had already led to a substantial contraction of activity. This situation got worse again in April, where we saw a deep fall in activity everywhere. Now the picture is changing: some countries are beginning to loosen their lockdowns. How this will develop in the future depends a lot on how quickly the restrictions on economic activity can be eased, but also on how we adapt to living with the virus. The speed at which the economy bounces back will then hinge on whether consumers are more reluctant to consume and businesses hold back on investment. From today’s perspective, it looks in any case unlikely that economic activity will return to its pre-crisis level before 2021, if not later.

What form will the exit from the crisis take?

This crisis is truly unprecedented, which makes it harder to predict the precise shape the recovery will take. What we know for sure is that the steepest fall will be in the first half of the year, and these terrible economic conditions should recover little by little, week by week, month by month.

The exit will differ greatly between countries, according to their economic strength and how robust their public finances are. Will Europe’s north-south divide increase even more in the wake of the crisis?

The fiscal response has been centre stage: all governments have been able to implement fiscal policies, although not all to the same degree. One point that I think is important is that Europe as a whole benefits when a country like Germany responds to the crisis more emphatically because, for example, it can boost Spanish or Irish exports. So we shouldn't necessarily see these differences as negative: it is good news that countries with strong finances are responding forcefully to the crisis. But it is also important that all countries recover, and policymakers play a central role in this respect. We at the ECB will ensure that financial conditions are sufficiently accommodative and stable for all countries.

The EU is currently discussing what form the recovery fund should take to avoid a depression. If the agreement is ultimately based more on loans than on transfers, will it help to pull heavily indebted countries like Spain and Italy out of the slump? What ratio of loans to transfers would be sustainable?

Rather than focus on the question of transfers or loans, I think it is useful to look at this more in terms of the following question: what should be financed at European level and what at national level? One of the proposals under discussion is to increase the EU's budget and have the European Commission distribute the funds. One advantage of this proposal is that it would not entail an increase in national public debt, and keeping the cost of debt low will help governments tackle the pandemic and support the recovery. Instruments like the Commission's SURE programme, the European Stability Mechanism (ESM) or the European Investment Bank also make an important contribution in this respect.

Many people in Spain and Italy are awaiting the European response and seeing it as a test of solidarity. Are you concerned about a wave of nationalism and anti-European sentiment if this response is not as emphatic as expected?

There is no doubt that Spain and Italy have been on the front line of this battle. And I understand the critics who are saying that the initial response has been somewhat slow, but I would also say that there are many different aspects to European solidarity. Being part of the monetary union has meant that the shock has been less severe in economic terms than it would have been if those countries were outside the union. The ECB has intervened and has been a very important source of stability, benefiting all euro area countries. The creation of the banking union and the ESM has also provided stability. I think it is clear that without a single European banking supervisor, we would not have seen such a fast and effective response. So there are clear advantages to being a member of the euro. But I agree that there is still more to be done to deal with this unprecedented crisis. In particular, it is important to make sure that the funding is in place to guard against downside risks and support the recovery in all EU countries. Joint and coordinated policy action has a crucial role to play here.

The Spanish government is finalising its minimum income scheme, which is designed to help one million vulnerable families. What do you think is more suitable, a temporary instrument or permanent support that reduces inequality over the long term?

It’s not for me to get involved in Spanish politics. At a general level though, we often see that debates about safety nets change when a country is going through a recession. In a downturn, a safety net provides solidarity, but it also matters from a macroeconomic perspective: a large-scale shock to household income is destabilising for the economy as a whole, so buffering the shock helps. In these situations, possible concerns that a safety net could interfere with the efficiency of the labour market is not the most immediate concern.

In Spain, more than 3.5 million workers have benefited from the furlough scheme [in Spanish: expedientes de regulación temporal, or ERTEs]. To what extent do these temporary protection mechanisms help avoid the permanent destruction of jobs?

Everyone agrees that it is important to establish protection mechanisms for people whose jobs have been affected by the current circumstances. There are a number of ways of achieving this: one is to provide generous unemployment benefits, and another is to fund wages publicly in order to keep workers connected to their employers. Which of these measures is most appropriate in a given situation will depend on a host of factors, including whether firms are viable in the long run and whether there is sufficient demand for workers.