

Philip R. Lane: Interview with Les Echos



INTERVIEW

Interview with Philip R. Lane, Member of the Executive Board of the ECB, conducted by Guillaume Benoit, Elsa Conesa and Sophie Rolland

22 November 2020

The European economy is facing further lockdowns. What are the immediate and long-term consequences and do you think there is a risk of another recession?

Our focus is more on the spread of the virus, which is inevitably holding back the behaviour of consumers, and not just on the lockdown measures themselves. However, if you put those two factors together, absolutely, we do think they will lead to a drop in activity. The question is how long this period will last and that will depend on the behavioural response and the degree to which the measures are respected. Compared to the lockdown in spring, these measures are less harsh. Manufacturing has been kept open, construction is continuing, essential shops remain open, and there is not too much disruption to supply chains. So the impact is likely to be less severe this time. However, the situation can change very fast, from one day to the next. This makes it extremely difficult to make any precise estimates of the impact. What does seem certain, however, is that the situation will not materially improve in the last weeks of 2020.

Is the progress being made on coronavirus (COVID-19) vaccines a game changer?

Until the vaccine is fully rolled out we remain in a period of uncertainty. We have already had to undergo two sets of restrictions since the beginning of the pandemic and these will certainly not be the last. The vaccine gives more of a vision for what may be late next year, and what 2022 will look like, but not for the next six months. We have a bit of a paradox, which is that the financial markets have responded instantly, because these price the effects of the vaccine based not just on what's happening today or the next year, but based on future earnings in 2022, 2023 and 2024. From the point of view of a central bank, or for governments, that helps. It's much easier to pursue an accommodative fiscal policy and support GDP growth in the meantime if you know that there is light at the end of the tunnel. Bearing this in mind, 1 May was the first day we published our multi-year baseline scenario given the assumption that a vaccine or a medical solution would be found by around mid-2021. So what we see now is broadly confirming that we were on the right track. The most severe scenarios are less likely now, but there remains a big gap between now and the end. So right now there's a lot to play for.

So when do you think these changes will start to alter the trajectory of GDP growth?

Our projections assume that the vaccine will be rolled out throughout next year. But the full recovery of GDP, back to where it was in 2019, will not happen before the autumn of 2022. So we do not assume that everything just bounces back to where it was before COVID-19, because there's going to be longer-term effects in terms of confidence and savings, and getting people back to work. In spite of the vaccine, there will be some persistent damage and the European economy will not exit this crisis without being weakened over a long period of time.

How is France dealing with the situation? What is the outlook?

Of course, France is a big part of Europe's growth performance, but we primarily conduct our analyses at the euro area level. I would only say here that, where you have a temporary macroeconomic shock, you do need a fiscal response which is suitably aggressive, and one that supports this demand across the euro area, for firms and households alike. The headache for policymakers will be knowing where to draw the line between those firms that are viable and those that are not.

Do you feel that asset purchases were not sufficient to sustain demand?

The general consensus is that central banks should bring down interest rates and purchase assets. This also creates room for fiscal policy, and under these conditions, fiscal measures should have a far bigger impact on the overall dynamics of the economy. The main role for monetary policy this year has been to stabilise the financial system and to circumvent financial market distress. Low interest rates are good news for firms and for households. But only fiscal policies are capable of targeting individual sectors and monetary policy is not tailored to do that.

Do you mean to say that the fiscal policies of European governments are not aggressive enough?

Governments are still finalising their 2021 budgets, and Europe, collectively, needs to make sure that the fiscal policies are sufficiently responsive. In the last number of weeks and months, more and more governments have put in place stimulus programmes for 2021. It is for the government policymakers to take the lead role here. If, for example, France or any other country stimulates its economy, that will also benefit the rest of Europe, and so to have a collective discussion is beneficial.

Are you worried about the current delays in negotiations over the Next Generation EU plan?

We should not attach too much importance to short delays in finalising the Next Generation EU (NGEU) plan. Of course, every EU Member State has to agree and very quickly come to a final decision on it. If it's a matter of a number of weeks, it's not so important, because the governments have already put stimulus packages in place. This plan is not meant to stimulate the economy by bridging the gap between now and when the vaccines are rolled out, but to provide a vision for the next five years. We will need to face the challenges of digitalisation and climate change. There will still be a lot of nervous consumers and also firms will need to rebuild their investment capacity. The NGEU is about showing that the European Union and the euro area have a very strong solidarity: where we have a common shock, part of the way we address that is through a commonly-funded programme, such as the common bond issuance, to help particularly those countries most hit.

Do you have a view on what kind of resources you can fund this new debt with?

Well, this is just going to be a choice for the European governments. But in a low interest rate world, the amount of revenue that needs to be raised by the European Union to cover the interest rate cost is very limited.

Are the new EU bonds finally the European safe asset that the markets have long been expecting?

What's important for Europe is that the pool of safe assets expands – and we are already seeing it with the SURE bonds, which they're issuing at different maturities – so that you have a good yield curve and can respond to investor expectations. Around that, you can develop the derivatives market. But it's important not to set up a kind of a contest between the EU bonds and the national bonds. The supranational and the national bonds are to coexist and it's important that the national bonds are also classified as high grade. I can see, by the way, that the announcement of Next Generation EU has been very good news for the national bond markets. Global investors are recognising that this will strengthen the euro area as a whole.

Some observers have taken Christine Lagarde's speech at Sintra as a turning point in strategy, opening the door to implicit control of the yield curve by the ECB. Should investors now expect the ECB to intervene based on European sovereign yields?

In October we said we would recalibrate our monetary policy instruments at our meeting in December. In the context of the pandemic, our role is to

provide favourable financing conditions. Sovereign yields are important for governments and the private sector. But we're also looking at the credit conditions on the market and the terms and conditions banks are offering, since the European economy is still very bank-dependent. So when we consider favourable financing conditions, we also look at the credit margins applied to small and medium-sized enterprises, large corporates and households. We don't look at just one sovereign yield indicator. It is important to avoid euro area fragmentation.

What metrics will you look at to decide when to terminate the pandemic emergency purchase programme (PEPP)?

It takes time for monetary policy to filter through to the economy. There is no exact mapping between the dynamics of the virus and our monetary policy measures. However, we closely study the impact of the pandemic on economic activity: for example, further interruptions of economic activity would clearly suggest that it would be too early to terminate the PEPP. We won't terminate the programme until certain conditions have been met. First of all, the pandemic must no longer interrupt normal economic activity. We will also have to establish other conditions in terms of economic recovery and inflation dynamics, but it's still too early to do this. The programme was originally designed to last until the end of June, but we have always said that it would continue until the crisis phase is over.

Is monetary policy now focused on providing support to fiscal policies?

At a time when we are experiencing a common shock and governments are running higher deficits to support their economies, our asset purchases under our various programmes enable us to maintain favourable financing conditions. Monetary policy and fiscal policies are moving in the same direction. But this may not always be the case. Monetary policy and fiscal policies may move in opposite directions again in the future. Remember that in 2015-2019 governments were shrinking their deficits, while there were significant asset purchases. As we say in our forward guidance, our net purchases (under our asset purchase programme) will continue until we are in a position to raise interest rates, which will require inflation to be back in the neighbourhood of our aim. The first phase will then be to stop adding to the stock of debt. Then after that point, at some point, there could be a discussion about shrinking the balance sheet. So, ending asset purchases depends on what's happening to inflation. In our September projections – which will be updated in December - we don't see inflation reaching our aim in the next two years.

The ECB is currently struggling to convince markets of its ability to achieve its inflation objective. Shouldn't this objective be redefined?

Since the summer of 2019, our monetary policy introductory statement has explicitly referred to our symmetric approach to maintaining price stability. Looking to the future, the definition of price stability and our objectives in that area are being examined as part of the monetary policy strategy review. All of the Governing Council members and many of our teams throughout the Eurosystem are involved in this review, which is still ongoing, and it is still too early to say what the outcome will be.

Several market participants consider that there won't be any more rate cuts and that the deposit rate has reached floor level. Is that a good interpretation of what the ECB is saying?

We don't think we are at the lower bound; we do think there is room for further cuts in the future. That's why we continue to say that we expect rates to be at their current or lower levels until inflation has returned robustly to where we want it to be. We still believe lowering interest rates is a viable option. But we have to decide which instruments are currently the most effective. So far, we've been indicating that the pandemic emergency purchase programme (PEPP) and the targeted longer-term refinancing operations (TLTROs) have been very effective.

Should the flexibility of the PEPP also be applied to your other asset purchase programmes?

The starting point is the capital key (which determines the share held by each Member State in the ECB's capital according to each Member State's share of euro area gross domestic product and population). The capital key should continue to be the natural guide underpinning our asset purchase programmes, there's a very strong validity to that. But under conditions of market stress it also makes a lot of sense to not impose restrictions on ourselves that would basically damage the efficiency of monetary policy, particularly given that the most important key word of this year is uncertainty. And even though deviations from the capital key have come down in recent months, retaining flexibility under the PEPP is important to reassure everyone that the central bank will do its job in terms of market stabilisation.

Is there any concern that if the PEPP is maintained for a long period, even after the public health effects of the pandemic have subsided, that this could lead to further protests from the Federal German Constitutional Court, for example?

I think everything we do needs to be proportional and efficient. The approach we take is that we have to be able to explain the logic of our decisions. There is very strong logic in building flexibility into the PEPP. And it's important that we were able to implement it. But it will come to an end once the pandemic crisis ends, as will the associated impact on the economy and inflation. The temporary nature of the PEPP allows much flexibility.

Is the cancellation of sovereign debt held by the ECB an option? Some people in the economy are calling for a measure of this kind.

The answer is very simple: it is prohibited by the Treaty. We cannot do monetary financing. But over and above this question, I think that every part of the policy world, civil society and the financial system needs to absorb the implications of low interest rates. The cost of issuing debt is very low, which lowers the cost of debt servicing.

Do you think that you should increase the liquidity programme for banks? The last quarterly lending survey shows that the first signs of tightening financial conditions are visible.

We take the results of that survey very seriously. Between now and our meeting in December, we will continue to look at the possibility of redesigning our targeted lending programme, which has been very important. We will look at a possible redesign, continuation or extension. But we must also learn from previous TLTRO operations - for which the take-up rate has been very high - and study how these are affecting the balance sheets of the banks. The very basic condition is that you only get the low rate if you maintain credit to the private sector, to households and firms. We do have to study this to make sure the programme is as efficient as it should be.

Should TLTROs be even more accommodative than they are at present?

The TLTRO has many dimensions: the volume of loans required to qualify for the programme, the duration and the interest rate. I think you would have to take all of these into account.

Do you think banks should benefit from another round of softening of prudential measures?

I think you will have to ask my banking supervision colleagues that question. We maintain a strict separation between monetary policy and prudential supervision. What I will say is: this year, the supervisory decisions were quite important.

Do you believe non-performing loans should be removed from bank balance sheets and ring-fenced in a specific vehicle?

Again, I'll point you to the work of Andrea Enria who has been advocating certain solutions. Asset management companies can play an important role. But again, I think I'll defer to my banking supervision colleagues on that.

Are QE policies leading to greater inequality in the euro area?

That's an important question. Asset purchases are the main vehicle of our stimulus policy, along with low interest rates. This has an instant impact on asset prices in the form of higher stock market valuations and higher house prices, which will benefit those who own these assets. In contrast, the amount of interest income earned from owning bonds is much lower. This could be a cause for concern from a wealth distribution perspective. For example, it could be an issue in countries where employees need to save a lot for retirement...

...That is worrying...

...At the same time, by lowering the cost of debt for governments, asset purchases lower the cost of debt servicing. If interest rates were higher, governments would have to run austerity policies by raising taxes and making public expenditure cuts. Savers would benefit from higher interest rates, but those with mortgages, student loans or car loans would lose out. We believe asset purchases have helped to save many jobs in Europe and led to faster wage increases, and through those dimensions it's been good for many households in Europe.

The euro recently came close to its highest level against the dollar for quite some time. What level would give you cause for concern? And what can the ECB do?

The euro area economy is an open one. It is mostly driven by domestic factors, but the exchange rate does of course matter for the future of the GDP and inflation dynamics. That's why we refer to it in our recent statements. It feeds in with lots of other things that can have an impact on prices. If the inflation projection is not satisfactory then we respond. But we do not target the exchange rate.