Philip R. Lane: Transcript of interview with Portuguese public broadcaster RTP3

INTERVIEW

Interview with Philip R. Lane, Member of the Executive Board of the ECB, conducted by Maria Nobre, broadcast on Tuesday, 17 November at 12:00 a.m. CET

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How do you think Portugal is doing during this crisis?

We know the global crisis. We know the European crisis and we know that of course those economies which are service-based, those economies which are big producers of tourism, of course are going to be harder hit than those economies which are maybe more manufacturing-based, less dependent on what we call high-contact sectors such as tourism, recreation and entertainment.

So in that context, Portugal of course is very much a part of the wider European experience. Some countries have suffered less than others, but from an ECB perspective, the bigger picture is, it’s a collective European recession. It’s a collective European shock and essentially the monetary policy we’re following, I think, is there for all member countries.

So can you tell us how long will it take for Portugal to recover from this crisis?

Well I can tell you what our baseline is, which by the way has been reinforced, I think, by the good news about the initial indicators from the vaccine result. We have since spring taken the view that this is going to take all of next year, all of 2021, for essentially these medical solutions. So whether the vaccine improved the treatment of those who contract the virus, we do think that all of next year there will be interruptions to normal life, but by the end of next year, early 2022, I think there should be a return to normalisation. Even at that point, in early 2022, there is still going to be incomplete recovery. So in our modelling, in our most recent models in September, we took the view it’s going to be late 2022 before the European economy has returned to where it was before the pandemic. So at one level, we still have a bridge to close over this year, 18 months before then. So it’s that kind of timeline, a year to 18 months, which is at one level still a significant period, but we also can see the light at the end of the tunnel.

You have talked about tourism services, but Portugal has a great deal of small and medium-sized enterprises. Do you think that’s also a problem?

So, I think there’s a lot of variation across the different industries. So of course, maybe it’s interesting to think about this year that we saw in the spring very heavy lockdowns and a lot of disruption to many activities. Then when there is some relaxation there was a fairly good recovery in some sectors, less so in other sectors. So I think it very much depends on business sector, but what is true is individual firms do face a challenge here. The loss of revenue, especially if you’re a firm which is in a low-margin industry, is an issue and that’s why the low interest rate policy and the credit support policies that we are following, and many governments are following, are important. But let me emphasise again the most important issue for the recovery is whether these economic sectors recover. So in other words, it’s not the case that every firm necessarily will survive, but if the sectors in the aggregate recover, then there will also be new opportunities, but I think the prospects for most sectors should be fairly good. It’s not the case that this pandemic should permanently damage the economic capacity of Europe or Portugal.

Are Portuguese banks solid enough to face this crisis?

So, I think we always take a pan-European perspective and let me again come back to these basic realities: Number one: the European banking system in general entered this crisis with much higher levels of reserves and capital compared to the last crisis. And it’s also the case when we think that there’s only another year or year-and-a-half in terms of recovery to go, the challenges for the banking system are much less now compared to the trauma that so many European countries faced in the last crisis. So it’s important to accept that there will be challenges for our banking systems across Europe, but also to put into proportion that the challenge on this occasion is not in the same category as the challenges of the last crisis.

In doing a lot of work with the NPLs, do you think we will have this problem to deal with again and because of this crisis?

So, let me again repeat that, yes, it has been the case that there will be some degree of non-performing loans because of the size of this pandemic and recession. On the other hand, the fact that so many countries now have a lot of experience in handling non-performing loans does mean that there is more of a recipe, more of a playbook, more experience now in how to address this. So again, I think it's important that everyone has a good understanding of the size of this challenge. To put it into proportion, there will be non-performing loan challenges across Europe. That's why the supervisors of the European system and the banks themselves, everyone is paying attention, but it is not the core of the economic problem. The core of the economic problem is the pandemic itself. Please remember also, given the very low interest rates, the credit support of the ECB and across Europe a lot of fiscal support – there's a lot of policy reactions. So again, it's important to put this into…

I want to talk about them in a bit. Let me just ask you, how does the pandemic impact public finances?

So what we have here is, again coming back to the most basic point, the pandemic is a large shock, but it's temporary in nature. It's a very different situation when you see countries running large deficits for a year or two of that nature. A short period of large deficits is something I think that can be understood and can be seen as a very correct and natural response to the pandemic emergency. Again, going back to previous crises, the problem with previous crises were, if you like, unresolved fiscal problems. If you have an open-ended fiscal problem then you need some kind of adjustment programme. On this occasion, when the European economy recovers next year or the year after, then a lot of tax revenue will recover and a lot of the temporary support schemes that are in place now will naturally expire. So, if you like, we do think that this is a short period of large deficits. Yes, there will be more public debt at the end of this, but in fact that is the correct response to this type of pandemic emergency.

Do you think our finances are in good shape to deal with this crisis right now?

So again, it's very important to put that into the correct analytical framework, which is when we have a situation when across Europe public debt ratios will go up, but in the context of interest rates that are much lower than 10 or 15 years ago, in the context of predictions of a good recovery in GDP, then the nature of the scale, the dimension of this issue is much more contained. So it's something of course a few years from now, the value of having some fiscal capacity, some spare room in fiscal space if you like, will need to be rebuilt. We know that, but again, let me put this in an entirely different category to the difficult fiscal challenges many European countries faced ten years ago.

Portugal's public debt is around 130 percent GDP, could there be another debt crisis?

So again, I think it's very important to put that in the correct context. Again, let me return to those fundamentals. Across Europe I think this pandemic is much more easily classified as a common general pan-European problem to take on. Across Europe there will be significant increase in public debt, but when you look at the very low interest rates right now, the cost of making the payments on this debt in the years to come will be quite contained. If you look at the market, the market also thinks that this can be handled. There is no reason to believe that this has some kind of intrinsic dynamic that will lead us to a return of the conditions of ten years ago. So I think it’s important always to remember this analysis is based on a short number of years of high deficits and as the economy recovers, then the tax revenue comes back, the temporary spending programmes get rolled down and we can return to stabilisation of public finances. So it’s going to be an extraordinary period fiscally, no doubt about that, but I think it’s important that the correct response to this crisis is significant fiscal support. Yes, there will be more public debt, but in the context of very low interest rates, in the context of the macroeconomic environment, the assessment should be that this is something that is sustainable.

ECB projects eight percent recession this year and five percent growth next year. Within the middle of the second wave, do you think this is realistic with all the restrictions Europe is facing during this second wave?

So I think it’s important to take into account that the middle of this year, the summer and early autumn were stronger than we expected. So yes, it looks like the last weeks of this year are going to be worse than expected, but when you average all of that out in terms of the overall 2020 performance, let’s see if it makes a big difference to our current projections. I think it’s a bit early to tell.

Will there be a correction of these numbers or will they stay the same?

Well we update every three months. So we have numbers in early September. We’ll have numbers in early December. So it’s too early for us to comment on that now. I’ll just say that as a matter of calculation, the fact that the summer and early autumn went better than expected does mean that when you make that revision, there will be for sure some kind of adjustment for this final quarter, but when you add it all up for the performance in 2020, let’s see. And then when you think about next year, I think you have to remember probably the assessment now is there may well be more restrictions on social activity in the first part of 2021. On the other hand, to the extent the vaccine gets rolled out over the course of 2021, the overall impact on the speed of recovery which again, as I said to you earlier on, it’s going to be some mix of 2021 and 2022. Let’s see if there needs to be much change to that general profile. Near term yes, of course near term what it looks like for the rest of November, the rest of December and so on, yes, it’s going to look worse than we might have expected, but in terms of the cumulative net impact over the coming months over the next year or so, I think we’ll come to that in mid-December around.

Will the euro area have extra support from the ECB in December?

Well you’ve already heard most recently from President Lagarde, basically giving you the bottom line on this: we know what Europe needs in this period is for the ECB to underpin favourable financing conditions. We know that whether it's for corporates, for households or very importantly right now for governments, that low interest rates, access to credit is so important.

So will the bond buying…?

So we will think about deciding what is needed to deliver that. That's why we say we want to recalibrate our policies in December.

So will the bond-buying programme become a traditional Central Bank tool?

Well I think by the way, globally you've seen all central banks around the world or virtually all central banks doing a lot of quantitative easing right now. So yes, that is the trend in central banking and of course, as you know, we have a strategy review right now which will continue into next year. But again, I think how we choose to deliver favourable financing conditions across our different policies of course it's interesting and technically important from a central bank point of view, but from the point of view of the real economy, the bigger or the most important message to get across is our intention is to ensure favourable financing conditions. This pandemic is tough enough – we shouldn't add to it by having to deal with some kind of credit freeze, having to deal with rising interest rates. So our orientation is to keep financing conditions favourable.

The ECB has €1.3 billion to buy bonds. Will it be bigger?

So under the pandemic emergency purchase programme, the PEPP, right now the size of that programme is €1.35 trillion, but of course we have other programmes as well. Again, it's not so much the overall number that matters. What matters is are we delivering our objective which is to keep financing conditions favourable? So I don't think from a point of view of any household, firm or government, the focus should be on some particular number, because what we always say is, we stand ready to adjust. We always will have some kind of plan, some kind of programme, some kind of volume of purchases, but that basically can always be adjusted to deliver what we need to for those favourable financing conditions.

We're running out of time, but I have one more question for you. The ECB aims that inflation rates close to two percent, will this goal change?

Well that's part of the review, but I think it's fair to say around the world there's a fairly narrow range of choices made by central banks or made by governments. So I think it's too early to give out a final answer. The range of options there remains fairly narrow. So I think there's not going to be any big revolution in that topic. Let's see what we end up with, but behind that it's really the most important commitment for the ECB is to make sure that whether it's a pandemic, whether it's normal times that we deliver price stability, we support the economy of Europe and we make sure that the central bank is doing its job in support of the European Union.

Thank you for being with us in RTP 3.