

Sabine Lautenschläger: Interview with Deutschlandfunk



EUROPEAN CENTRAL BANK

EUROSYSTEM

Interview with Sabine Lautenschläger, Member of the Executive Board of the ECB and Vice-Chair of the Supervisory Board of the ECB, conducted by Klemens Kindermann and broadcast on 30 December 2018

Ms Lautenschläger, the euro is now 20 years old. On 1 January 1999 it became legal tender for 11 out of 15 EU Member States, initially in electronic form and then as cash as of 2002. Germany has participated from the outset, alongside countries such as France and Italy. Has the euro been a success?

Yes, the euro has definitely been a success, and indeed a success on an economic level. Many people merely associate the euro with being able to travel more easily to other countries without having to exchange German marks for French francs or Spanish pesetas, but it has most especially had economic benefits for our business enterprises and our firms. We are now truly an export-driven country. Trade within the euro area has increased and, thanks to the single currency, firms find it much easier to estimate the value of the payments owed to them. They do not run any exchange rate risk. But the euro has also been a success in political terms. We should not forget that the EU, and therefore the euro, has also been immensely important in preserving the peace that we have enjoyed in the euro area, in the EU, for the past 70 years. And since we are stronger together, and as part of the EU and the euro area are able to play a greater role in the global arena, also on the political front, we can do more to ensure peace for the political environment. So, in my view, the euro is a huge success.

According to a survey, even now around a third of German people still mentally convert German euro prices to German mark, at least for larger purchases. Can you understand that some Germans are still pining for the D-mark?

I'm not so sure that this mental conversion really is a sign that people are missing the D-mark. Especially for the older ones among us, it is simply a better way of estimating the value. Some people also do it out of habit. So I don't think that Germans really want to have the D-mark back. I've heard that more than 80% of the German population have a very positive view of the euro..

On that note, the latest survey conducted by the EU Commission indicates that the German people's acceptance of the euro is on the decline. Has a slide set in? In 2018, some 70% thought that the euro was good for Germany, compared with 76% in 2017. Those levels of acceptance are still high, but they have begun to slip back.

Yes, there are fluctuations here and there and of course there are years when some Germans feel more at ease, and more nationalistic, in their own country and some may then prefer to have their own currency. But, as you say, the levels are still at 70%, 76%, so I see no grounds for concern. I think that firms and younger people greatly appreciate having a currency that not only facilitates travel but also cross-border trade and payments.

Your reference to national sentiment actually brings us to the topic of the euro and populism. It is easy to forget, but the Alternative for Germany (AfD) party actually started out as an anti-single currency party. The refugee issue followed. Are you afraid that, in Germany too, an anti-euro stance might be rediscovered by the AfD?

I'd rather not make any statement on the political aspects. That is not a task for the ECB, although we do of course observe and take on board the fact that people in many countries have concerns and harbour a certain fear of globalisation.

I don't think it's about the euro, but rather that some people fear that they will be left behind in a global context and that they will no longer be able to control the situation. And then they believe, wrongly so in my view, that they will find more security by retreating to their national domain, their own sector and their own region.

But anti-euro sentiment has been explicitly stirred up in France and Italy during the respective electoral campaigns of Marine Le Pen, the Five Star Movement and the right-wing Northern League. Do populist movements pose a threat to the euro?

I would not say that it's under threat but I think we must take the matter seriously and we must give a much better explanation – as this interview today enables me to do – of the benefits of the euro, the degree of prosperity and security that it brings and the number of jobs that depend on it. We need to explain that the euro simplifies trade between euro area countries and brings economic prosperity and jobs. All this is extremely

important to me and it shows that we need to state this more often and much more clearly. In essence, however, I really believe that nationalistic tendencies – and I don't just mean in Germany, but in the whole world, as we don't need to confine ourselves to speaking about the EU – result from the fear of globalisation, that people can no longer control their own independent inner domains in the way they could before.

Let's stay with Italy which had promised to limit its budget deficit next year to 0.8%. The target is currently set at 2.04% of GDP and the European Commission has now accepted that figure. Can the stability of the euro be preserved in this way?

I believe it is extremely important for all of us to adhere to the commonly agreed European fiscal rules.

Italy too?

Every country, including Germany, for example. It's important because for a functioning economy, for sustainability in the euro area, all countries need to keep to certain budget limits and have sound public finances. That's very important for the euro, but it goes beyond that because it also concerns the sustainability of government debt, etc. That's important for every country, for Italy, for France, but also for Germany. And you may wish to remember that we were one of the first countries to infringe these rules.

Speaking of France, the French President Emmanuel Macron has made commitments in the order of billions of euro to the "yellow vest" protesters. France will next year have violated the new debt rule for the eleventh year in a row, apart from in 2017. Shouldn't an excessive deficit procedure be launched against France?

To the best of my knowledge, the budget plans have not yet been fully decided on in France. It would be important to know whether if they spend more on one side, they may save more on the other side. I'm not aware that France has already discussed compensatory measures and presented them in a European context. So I don't think the French government has got to that stage yet and we will have to wait and see,

The EU Commission wants to strengthen the euro's role as a global currency. Is that possible and if so, how?

Yes, it is possible but is not the ECB's role to do so. Our mandate is to maintain price stability. But we have just spoken about the euro's importance for the economy, also for the German economy. And the European economy, i.e. firms in the euro area, who would benefit from as many payments as possible being made in euro rather than in US dollar or in other currencies. That would remove the exchange rate risk. They would not have to calculate exchange rates and so it would be to their advantage if the euro gained in importance. Your second question was how that could be done. Well, we could create circumstances that would make it easier to use the euro as a currency. Infrastructure, more payments in euro, would then mean fewer risks. That could be achieved by promoting the capital markets union, by advancing the

banking union, by harmonising insolvency regimes. All of these things help enormously.

You are listening to Deutschlandfunk's interview of the week, today with Sabine Lautenschläger, Member of the ECB's Executive Board. Ms Lautenschläger, the US Federal Reserve raised interest rates shortly before Christmas, for the fourth time this year. They are now between 2.25% and 2.5%. The ECB is taking no action at all on interest rates, why not?

The US economy is different, as are US price developments. It is not our task to copy the Federal Reserve; our mandate is to maintain price stability in the euro area...

But many people are waiting on an interest rate hike here, too.

Yes, some people are waiting while others are very happy that the interest rates for housing construction in Germany or for investment in companies, in new jobs, remain low. It completely depends on whom you ask, Mr Kindermann.

Yes, there are many savers who are concerned about their pension plans because interest rates are simply not going up. What would you say to them?

Well, I'm a saver myself. I understand their position very well and I will be the first to vote in favour of further normalisation of monetary policy once the necessary conditions are in place. Our asset purchase programme ends in January. That means we have taken a first step towards the normalisation of monetary policy and I hope that the data that we receive in 2019 will be such that we can take further steps in 2019.

When you say the end of the asset purchase programme, it's actually not the end at all, because the ECB is still blithely purchasing assets. It just means that no additional assets are being purchased, but those maturing will be replaced. So we can't actually say that this programme is stopping.

We're stopping net purchases. This means that our balance sheet will not increase any further. We will keep it stable in the first instance because an expansionary, accommodative monetary policy is still needed to stimulate investments, including in Germany, and to continue to support economic growth in order to achieve inflation rates within our very narrow corridor of below, but close to, 2%.

Will you also continue to purchase corporate bonds?

We will continue to purchase maturing corporate bonds and then reinvest again.

Even corporate bonds?

Yes.

But with these steps it will take a relatively long time to return to normality. Is it perhaps possible that you've already missed the turning point? The Federal Reserve is already much further ahead. Interest rates can

only be reduced to combat a possible recession if they have previously been raised.

Yes, but the United States is in a completely different stage of its economic cycle. Its economy is much more mature, and its economic upturn started much earlier than ours and has been going on for much longer. The inflation rates you see in the United States are much more stable, exactly where the Federal Reserve wants them.

But here in the euro area, inflation has also been where you'd actually like it to be at for several months now.

Yes, but you need to look further ahead. You can't just look at the current month or one or two or three months ahead. You need to look at how prices develop over a longer period looking forward. Otherwise you would have to change the interest rates every month, and I don't think that would do the economy any good. You'll also see that the inflation rates are projected to fall again next year. This is because some effects, particularly those resulting from higher energy costs, drop out of the calculation after a year – this is called the base effect.

But then we will have to wait even longer for interest rates to increase here in the euro area.

We have to see how the situation develops.

Do you think that interest rates will increase above 0.0% in 2019?

It depends on the price inflation data we receive in the first and second quarters of 2019. Personally, I hope and assume that we will see a change in 2019, but I won't try to suggest I know exactly where we'll be, say, in the middle of next year.

When will savings interest rates increase for savers, provided that interest rates are raised in 2019?

It all depends on which interest rate adjustments are made and how quickly the institutions pass them on. But for deposits interest rates are actually negative, and so it will obviously take longer to increase these gradually (as this cannot be done in one go) to a level that resembles where rates for savers were 10 or 20 years ago. It will take some time to be honest.

So savers still have to wait another one or two years?

Again, it depends on how the inflation rate develops.

In the United States we're seeing signs of a recession. Yields on longer-term government bonds in the United States are sometimes lower than the yields on those with shorter maturities, which is a completely abnormal situation. Normally you get more money the longer you lend. This is what is referred to as an inverted yield curve. This has happened eight times since the Second World War. In the United States this has always resulted in a recession. The Federal Reserve is already actively preparing itself for a recession. What is

the ECB doing to protect us here in the euro area from a downturn?

Once again, the US economy has achieved a different level of maturity. The country's upswing started much earlier – years earlier – and was much stronger.

But a recession in the United States would also affect us here in Europe.

Yes, but if you take a look, we have become much more independent. So I wouldn't want to draw or confirm the same parallels that you saw in the economic cycles 20 or 30 years ago for today. The euro area economy is much more diversified in terms of partners, in terms of trading partners, and we are no longer quite as dependent. We are in a different economic cycle. So you can mention US interest rates another 150 times, but it's not going to help us, because we need to base our assumptions on data in the euro area.

You are listening to Deutschlandfunk's interview of the week, today with Sabine Lautenschläger, Member of the ECB's Executive Board. Ms Lautenschläger, you're not only a member of the ECB's Executive Board, but also Vice-Chair of the Supervisory Board of the ECB. I would therefore like to put the question to you: are our banks safer than they used to be?

Yes, they are. They have much more, and higher-quality, capital. They hold much larger liquidity reserves. Risk management practices have improved. So yes, a lot has been done in the euro area, and even internationally, as a lot of rules have been changed and tightened globally. They are therefore safer.

Banks really like to buy government bonds, as these are given a zero risk weighting. As such, banks currently do not need to hold a loss buffer for these bonds. Is this the next problem waiting to happen, especially for Italian and Spanish banks?

I can tell you that the institutions have all actually reduced their shares of government bonds in the last ten years.

Would they not still have to back these with capital?

I agree with you here – I am very much in favour of institutions backing risks with capital and also taking into account concentration risk, i.e. considering the amount of specific government bonds an institution has per country.

Ms Lautenschläger, on the subject of Brexit the Governor of the Bank of England, Mark Carney, warns that an unregulated Brexit on 29 March 2019 would have massive consequences for the economy. According to Mr Carney, it could cause more damage than the financial crisis did ten years ago. What provisions has the ECB made for the event of an unregulated Brexit?

Of course, we have looked at all of the possible consequences for the financial sector in depth, particularly for banks. This is because, as a central bank, we naturally maintain an overview of the financial sector and, as a banking supervisor, we supervise banks. And I can tell you that there are obviously still risks in this respect. You should therefore never just

sit back and relax and stop watching what's going on. But I think we're also quite well prepared. We've been working to prepare institutions for two years, ensuring they submit contingency plans and alternative options, for example for certain trading activities. The European Commission is working on a regulation on clearing and payment processing, for example. So I think we're well prepared, at least as well prepared as you can be in such situations.

The British pound will probably end up crashing.

No one knows that.

No one knows that, but the Bank of England is expecting it in any case. That means you'll also be asked about it.

We're not responsible for the pound; we look after the euro here.

But there's an exchange rate between the pound and the euro.

Yes, but again, I think it's better that Mark Carney speaks for the pound and we speak for the euro.

How many foreign banks have already applied for a banking licence in Germany to retain access to the European markets after Brexit? Can you give a figure?

I think it's around 20, if I'm not mistaken, and we're in regular contact with 40 institutions. Some only need their licence extended, some need a completely new licence and some don't need a licence at all, but want to substantially expand the business that's covered by their existing licence, and this all obviously also entails work, as we then impose other conditions on their set-up here in the European market.

Will Frankfurt, Germany's financial centre, become more important after Brexit?

Yes.

Why?

Because quite a few banks will move parts of their business from London to Frankfurt, or to Paris, Amsterdam or Dublin, so not only to Germany's financial centre. London will always be a very important financial centre, but continental European business above all will be relocated in part – and perhaps to a larger extent over the years – to Germany, France, Ireland and Spain, and therefore also jobs.

And finally, the eight-year term of the current President of the ECB, Mario Draghi, will be coming to an end at the end of October 2019. Has the time not come for a woman to head the ECB?

The time is ripe to appoint women to all kinds of positions, not only at the ECB. There are lots I could list.

But also at the ECB?

Yes.

The previous ECB presidents have come from the Netherlands, France and Italy. Shouldn't it be Germany's turn next?

I don't see it so much from a national perspective. First and foremost I'd like to have someone – a man or a woman (a woman would of course be nice) – who is an established expert in monetary policy and ensures stability. I think that's really important, and then nationality takes more of a backseat, as we're not working as representatives of our own countries, but as representatives of the euro area as Europeans.

Mr Draghi has had to navigate through a number of crises during his time at the ECB. What do you think are the most important qualities a new ECB president needs to have?

As I said, definitely expertise in monetary policy and national economy, steadfastness, stamina, strategic thinking, and I think a talent for communications is extremely important.

In that case, wouldn't Deutsche Bundesbank President Jens Weidmann be the right candidate?

I'm sure there are several people who possess these specific skills, but Mr Weidmann, President of the Deutsche Bundesbank, also has these skills, yes.

Ms Lautenschläger, thank you for the interview.