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INTERVIEW WITH BENOIT COEURE

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"The stability and growth pact does in fact include some room to manœuvre according to fiscal adjustment and these margins must be used."

Interview with Benoit COEURE, Member of the European Central Bank's Board.

What is your analysis of the situation in the euro area?

The euro area is at a crossroads. On the one hand, it has come through the financial crisis. On the other, it faces major challenges in terms of growth. If we consider, first, the financial crisis, the most crucial point came mid-2012. It was passed successfully thanks to a series of support messages sent to the countries in difficulty. Thus, after the commitment made by all the political leaders about the future of the euro and the integrity of the euro area, came that of the President of the European Central Bank, Mario Draghi ("Whatever it takes") and the introduction of the OMTs (Outright Monetary Transactions), to re-establish the efficacy of monetary policy in countries which find themselves under serious financial pressure. Of course, this support is conditional on a country's commitments in terms of improving its accounts and of reform, which are monitored by the European Union and the IMF. But it allows the ECB to purchase treasury bonds from this State on the secondary market. These two messages have led to a decline in speculation everywhere. And they were credible because the countries were oriented towards reform.

Then there is banking union. In just two years, this organisation that brings together a harmonised banking surveillance within the ECB (SSM: Single Surveillance Mechanism), a harmonised bank crisis resolution system (SRM: Single Resolution Mechanism), which has a single resolution fund, and investor bail-in rules before any call is made for public funds, have greatly strengthened the structure of the euro area. It might even be said that the banking union, owing to its long term effects on the functioning of the European economy, is as important as the creation of the euro. And it was set up in two years! So, from a financial point of view, the worst of the crisis is behind us, with extremely strong, credible commitments on the part of the authorities, as well as these new institutions which strengthen the solidity of monetary union.

On the other hand, however, we have to admit that growth is too weak and unemployment far too high, notably amongst young people. This is why we have to concentrate on stimulating long term growth in the euro area right now. It is that and that alone that will enable the reduction of the unemployment rate for the duration, provide budgetary leeway once more and strengthen confidence in European integration. Of course this is an economic issue, but it is also institutional and political, given the electoral results (of the recent past). The time has come for Europe, both from an economic and social point of view, to act and to "produce some results" beyond the protective role played by the euro in the crisis – a role which

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is underestimated – this is quite obvious. This is the only way to break the present vicious circle whereby the lack of growth maintains the mistrust of Europe, which in turn is preventing us from taking vital joint initiatives to strengthen growth.

Basically then, it's about "how to achieve more growth in the euro area?»

Exactly, in the knowledge that this is the issue facing all European institutions within the remit of their mandate. Regarding the ECB our definition of price stability means an annual increase below but close to 2% in the medium term. But inflation is low at present (0.3% in August 2014). We have to support growth and lending to the economy, which will lead to a rise in inflation.

But are we in deflation?

No, inflation is low, it is too weak, but we are not in a Japanese-like situation. In the case of Japanese deflation most prices were falling. In the euro area, weak inflation comes firstly from energy and food prices which are low, then from the effects of the crisis on consumption and investment. It is also caused – which was to be expected – by the adjustments on-going in some countries after years of too high inflation (notably in terms of wages), and more recently from the strength of the euro. We should note here that when the ECB says it has no exchange rate goal (since it has mainly an objective in terms of price increase) this obviously does not prevent it from taking exchange rate developments into account in its analysis and its actions. All things being equal a stronger euro justifies a more accommodating monetary policy. At the ECB we monitor price changes of course, notably to avoid the danger of overly weak inflation and we want to support activity by the recovery of credit.

How do we proceed?

Firstly by providing economic players with long term visibility: the ECB is expecting to maintain short term interest rates close to zero for an extended period whilst at the same time rates are due to rise again in the US and the UK (forward guidance). The reduction in key rates decided on 4 September supports this visibility: at 0.05% it is clear that the refinancing rate has reached its limit. Second, by fostering the recovery of lending to the economy. This means improving bank balance sheets in the first instance, which the ECB is setting in motion this year as part of the banking union and the results of which will be published in the second half of October. This also explains the decisions taken in June to offer Targeted Long Term Refinancing Operations (TLTRO) to support the recovery of credit. Finally the ECB is encouraging the development of a new form of securitisation (i.e. the refinancing of household and business loans on the loan markets), on condition however that these new products are simple and transparent – in other words that they do not make the same mistakes that led to the crisis. We are going to launch a conditional ECB purchasing programme of asset-backed securities (ABS) and covered bonds. Basically we are using all means possible to repair the banking channel to finance the economy and to develop the capital markets, at the same time increasing significantly the liquidity provided by the central bank to the economy.

But with these initiatives we are still within the framework of monetary policy and the ECB cannot be asked to undertake sectoral policies, by supporting the financing of one sector or another, which would in effect be an industrial policy outside of its remit. If the governments want to do this they can use the instruments over which they have some control like the Public Investment Bank (BPI France) or the European Investment Bank (EIB). For example these institutions can guarantee securitised assets, enabling the ECB to purchase them as part of the programme that we have announced.

Will giving credit to SMEs be enough?

Of course not. The potential GDP growth of the euro area is undoubtedly below 1% per year at present, it could possibly rise to 1.5% over the longer term but it is clear that we have to be more ambitious. Monetary policy can and must support short term growth but it cannot change long term growth which depends on investment, the mobilisation of work and the organisation of the production process. Hence, to go further and achieve more growth we have to improve the way our economies function. These structural policies comprise a set of reforms which involve the opening up of the goods and services markets (it is the role of competition to eradicate in-built advantages and to direct more resources towards investments) and helping the labour market function better to increase the employment rate. These policies are liberal, if you like, in the way they are formulated, but they enable the means to support growth and employment and they can and even must address in-built advantages which imply that the creation of wealth does not benefit the greatest number. In other words they are social in terms of the results they produce. They are especially necessary to protect the social model which forms Europe's identity. This model has been weakened by the crisis but we have to admit that even before the crisis it was no longer on a viable trajectory. It had been built in the 30 years following the Second World War and with slowing growth it was increasingly financed by credit.

Isn't there a danger of "suffering first" before we see the results of these reforms?

But there has already been too much suffering and for too long– and this has been due to a lack of reform! 11.5% unemployment, 23.2% of youth unemployment in the euro area, even though these figures are now dropping – it is not and will never be a choice of society. Undertaking reforms that make it possible to provide young people with the opportunities they deserve, to the 18 million unemployed in the euro area – that is alleviating this suffering. Many measures of which we have just spoken have rapid effect, not forgetting that they will be supported by entrepreneurial expectation, then by employees and households when they see what the effects are. Moreover the exceptionally favourable conditions on the euro area financial markets today can only be understood as the expectation of a continuation of these reforms: if this does not happen the countries of Europe run the risk of an adjustment which would penalise recovery. We should look around us and see that the countries which have had to adjust – sometimes harshly given their imbalances – are now reaping the benefit of their efforts and are taking part in the euro area's revival. I'm not just thinking of Germany which is still benefiting from the reforms it made in the 2000s but also countries that bore the brunt of the crisis, like Spain, which has reformed and is now witnessing growth coming back faster than expected – even though the unemployment rate is still very high.

Can't we ask for extra time for some countries in terms of their fiscal adjustment policies?

The stability and growth pact does in fact include some room to manœuvre in terms of fiscal adjustment and these margins must be used. More generally the euro area's difficult economic situation demands that all growth levers be activated: the monetary lever, of which the ECB is in charge, the fiscal lever for countries which have the possibility to use it, and the structural reform lever. These three levers are complementary and the most important one is that of reform. This was the meaning behind Mario Draghi's speech in August in Jackson Hole. Supporting a country's supply capacity means re-creating fiscal resources and providing fiscal room to manœuvre in order to, for example, reduce taxes on modest households. We cannot expect miracles of fiscal "flexibility". First, the stability and growth pact text speaks of "major structural reform" the cost of which has to be quantifiable. Then this cannot affect the goal of fiscal balance which is not one of Europe's inventions but which is inevitable to prevent debt from spiralling, especially in a period of low growth. And finally there is the issue of equal treatment. How can we explain to countries which have made the necessary effort without any preferential treatment, and which are now starting to reap the benefits that the countries which are starting their reform later will be treated differently? In my opinion the best way to limit the negative effect of deleveraging on growth is to work on the quality of budgetary adjustment (i.e. reducing unproductive spending without sacrificing tangible and intangible investment) and to design reform in the shape of a programme as a whole that fosters investment and employment. Incidentally this is what the French government is doing.

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There is however a limit to these plans: they are national and benefit indirectly from the reform policies of others, therefore very little. There is not really any European logic being implemented to support European reform projects and programmes.

You are right. Drawing up a European approach to reform is the immediate priority. Much has been provided via the stability of the euro and will be provided as of this year by greater stability in the banking sector. But we need greater coordination in terms of economic policy; I think that this is the main lesson to be learned from the crisis that we have just experienced. This means that collective surveillance has to be stronger, taken more seriously and that this common governance covers both budgetary and structural policy. We believed that in order to share the same currency, co-ownership rules would be enough. But we needed a marriage contract! We might achieve this after another convergence process which would see the countries which use the euro harmonising according to best practice in every domain – I spoke of this in a speech I gave in Athens on 9 July last. At the end of the day we might consider new ways of sharing sovereignty, also in fiscal matters, for example by creating a common financial intervention capacity for the euro area countries. But prior to this we need greater convergence and more growth, via reform and investment, as suggested by Jean-Claude Juncker. These are the necessary conditions to re-create confidence between countries and to win back citizens' confidence in Europe.

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