2-15-2015

Beno®t Cœurè: Interview in Delo

Benoit Coeure

Benoît Coeuré: Interview in *Delo*

Interview with Mr Benoît Coeuré, Member of the Executive Board of the European Central Bank, in *Delo*, conducted by Mr Miha Jenko and published on 15 February 2014.

* * *

Delo: Mr Cœuré, your last visit to Slovenia was in October 2012 when it hosted an ECB Governing Council meeting. How do you see developments in the country since then, over the last 16 months?

Benoît Cœuré: Over the last 16 months, Slovenia has been through a very difficult period, with many serious challenges both from an economic and also from a financial standpoint. The Slovenian authorities have acknowledged and understood the challenges and have been addressing them in a systematic and serious way. The first appropriate and important steps have been taken, in particular when it comes to the restructuring of the banking sector. By completing the asset quality review and the stress tests they have reached a milestone, allowing for the restructuring of the banking system. But there remains a lot to be done.

Indeed, what else should be done? What are the tasks that still lie ahead?

Both the Slovenian government and Banka Slovenije have a very good understanding of what has to be done. This relates to three key issues. The first is financial sector restructuring. This is well advanced. The asset quality review and the stress tests have been important and have been done in a serious and professional way, but this is only the first step. From now on you need a comprehensive reform of the banking system as part of a broader strategy for the entire economy. In this respect there are quite a few further steps to be taken. Second, there is the fiscal dimension, where you need to bring down the fiscal deficit, but it is also very important to bring down the public debt. In this respect, Slovenia must observe the recommendations issued by the European Commission regarding the reduction of the structural deficit. This fiscal effort should be aimed towards a visible reduction in the debt level. And the third aspect is obviously economic reform and improving the efficiency of the economy. No other effort will be successful if the economy does not become more efficient.

Yes, the IMF has also warned Slovenia in its latest report about the risk of rapidly increasing public debt which could soon go beyond the hard-to-manage level of 85%. What are the necessary steps to reduce this risk of unmanageable public debt and high interest rate costs?

One of the key policy actions is privatisation, which can be very useful both to improve the efficiency of the companies and banks and also to reduce Slovenia's debt level.

Slovenian banks were subject recently to a very strict and a very conservative review by auditing companies Roland Berger and Oliver Wyman. In the end, there was the impression that we are forced to apply the most extreme, the most pessimistic and the most costly scenario as calculated by Oliver Wyman. Do you agree?

I don't want to pass a judgement on the stress test itself which was done by the Slovenian authorities. In principle we are in favour of a strict approach to the stress tests. It is important to be on the safe side, to be prepared for the future and it is important that the banks are sound again so that they can lend to companies. So recapitalising banks should not be seen as a cost but as an investment in the future, so that banks can extend new loans to the economy. Slovenia has to address its banking legacy issues and be on the safe side.

Are you also going to support such a strict, conservative approach this year when 128 key European banks will be analysed? Are these banks going to be examined as rigorously as ours?

Absolutely, it will be the same philosophy. We will discuss all the parameters with the 18 supervisors – the so-called “national competent authorities” of the 18 euro area countries – within the ECB’s new Supervisory Board, which met for the first time on 30 January. This will be the place where all the assumptions, parameters and choices will be discussed. This will be the first important contribution made by the Single Supervisory Mechanism to the euro area. The principles will be the same and they will be very strict, to make sure that we know everything about the situation of the banks this time – and to be sure that measures are taken to prepare for the future.

Several critical reviews of the Oliver Wyman financial consultancy appeared recently in the foreign press. Why has the ECB decided to use Oliver Wyman, of all companies, to carry out such a demanding task and what were the selection criteria?

There was an open, competitive selection process and Oliver Wyman came first.

Taxpayers in Slovenia have paid over €3 billion, nearly 9% of GDP, for the recapitalisation of troubled state-owned banks alone. Banks are now full of capital. But on the other hand they are not lending money to companies for their working capital and investments. How do you see this controversy?

Part of the explanation has to do with the weakness of aggregate demand not only in Slovenia but also across the euro area. Slovenia is a very open economy, selling a lot to European markets. The overall weakness of growth in the euro area also weighs on Slovenia. Now, it is true that the low level of ECB rates today translates very slowly to the real economy. This is happening in many countries and it is not specific to Slovenia. It will improve over time as we see convergence in the euro area and as we see reforms being implemented in the countries. And this you can already see taking place in Slovenia in the decrease in yields on the sovereign bond market. There has been a significant improvement in the long-term interest rates on bond markets. Slovenia is one of the best performers in the euro area in terms of decreasing bond yields, so that’s a sign that convergence is taking place. It takes time to feed into the real economy but it will happen; things are going in the right direction.

What should be the main priorities for the Slovenian government and Banka Slovenije to boost economic growth and improve lending to companies? Are there any Keynesian recipes for fostering growth which you could recommend to us?

I think the priority currently is not really the Keynesian one. In Slovenia, the priority is to make the economy more efficient, both in the private sector and in the public sector. This also means that some companies should be moved from the public sector to the private sector through privatisation. This will happen and it will also benefit the debt level. Some enterprises will remain in the public sector – but their efficiency must also be improved. All the efforts that are being made today by the government and by Banka Slovenije to restore the soundness of the banking system are not going to achieve their goals, meaning to support growth and employment, if the economy does not work better. It is good to inject capital into banks, but if banks are facing projects that are not profitable they will be creating bad loans and make losses and the capital will be burnt. So it is very important that, alongside the restructuring and recapitalisation of banks, efforts are made to restructure the economy and to make it more profitable. That is also the recommendation of the European Commission to all countries and in particular to Slovenia in the so-called Macroeconomic Imbalance Procedure. It is important that this is respected.

Haircutting the subordinated debt in Slovenian banks attracted a lot of public attention and even anger in recent months in Slovenia. Why was it necessary to perform this haircut in Slovenia, but not, for instance, in Ireland or other countries?

This is not specific to Slovenia. Europe has learned the lessons from the past crises and has adopted a principle of responsibility for investors in bank bonds. All investors who put their money in these bonds have to know that they will be part of the effort if anything bad happens because bonds are an investment, not a deposit. These are the bail-in rules that have been decided by the European authorities and are intended to protect taxpayers, who should not be responsible for the situation of banks. When saving a bank, taxpayers should come last, with shareholders coming first, followed by bond owners. This distribution of responsibilities is now clear. This is not a decision of the ECB, it is a decision of the European Council and the Commission, but one that we support.

True, but the decision is very recent and people didn't know before that something like that could happen at all.

Slovenia is not the first case. It has already happened in Spain, for instance. But it's a change in the regime, with the aim that taxpayers and depositors are better protected and are not liable for the errors committed by banks.

The Bank Asset Management Company (BAMC) was set up last year in Slovenia and is now being criticised for not being transparent enough. What should be the first priorities and challenges for the BAMC?

The BAMC had a good start. It has built up expertise and human capital, started operating and has already been receiving a first batch of bad loans. It now needs to continue its work and to receive the next instalment of bad assets, subject to the authorisation by the European Commission. Secondly, it needs to continue building up the institution itself so that it is credible and independent. It is not only about restructuring the banking sector but also about making the Slovenian economy function better. Bad loans are loans to the economy. For this reason, the BAMC should take decisions that are in the interest of Slovenian taxpayers and of the Slovenian people. It should keep resisting vested interests. For this purpose it has to be independent and in this way it will best protect the interests of taxpayers and workers in Slovenia.

The good news is that Moody's has just increased the ratings of the recently recapitalised Slovenian banks. What should be done now by these banks to ensure further improvement of their ratings so that they can improve their access to funding and extend loans on favourable conditions?

Beyond the ratings, what matters for Slovenia is the renewed trust of financial markets and investors, and the ultimate goal would be for these banks to be able to diversify their funding sources in the market, which would make them more resilient, and in turn support the Slovenian economy. Their objective should be to access to stable funding in financial markets. Banks should now properly manage their loan books and make adequate provisions, if necessary. But ultimately what matters most will be profitable projects in the economy. And this does not depend so much on the banks but also on the government, which needs to ensure a more efficient public sector, and on reforming the economy so that it is more efficient and able to thrive in the European environment. The key to success, therefore, lies in the real economy, not in the financial sector.

I agree. Slovenia's economy generates nearly 70% of GDP from exports. What is the ECB's assessment of our main trading partners, Germany, France, Austria and Italy? Could we expect more demand from these countries this year?

Certainly demand in the largest European economies is steadily improving. This is obviously not enough, but growth is positive again and it is accelerating. All the recent signs from the economy across Europe suggest that this scenario is again taking place. It is a scenario of a slow but steadily improving growth, also in the larger European economies. So demand from these economies is picking up and improving, and should benefit smaller, very open economies such as Slovenia. So there is ground for optimism. The euro area is going in the right direction. Two years ago, maybe even one year ago we didn't have this direction, this steady and improving growth. Certainly it is not enough and everything should be done to prop it up – but it is very important to know what the direction is.

So is the euro safe now after some very turbulent years when there was even speculation it might break up? Is the euro on the safe side now, out of the worst trouble?

The euro is no longer being challenged as a project. This is an important achievement. European policy-makers have confirmed their commitment to the single currency project and to the integrity of the euro area and this has restored trust in the euro in international capital markets. This is why many international investors are now coming to the euro area – it's a sign of trust in the reform process here. That's good news. What remains very challenging is growth, which is too low, and it should be Europe's priority to support it not only in countries with adjustment programmes but also in all other euro area countries. This cannot be achieved through additional public spending but through additional investment. All countries have to restore a climate of confidence that will be conducive to investment, and this includes large economies such as Germany, France and Italy.

According to the latest figures, the inflation rate in the euro area has dropped as low as 0.7%, the lowest level in years. How serious is the problem of deflation for the ECB?

The Governing Council's assumption is that the rate of inflation will gradually increase towards our target of close to, but below, 2%. We are however closer to the area where inflation expectations could be altered and create downside risks to price stability. So we are very vigilant regarding risks to our baseline scenario, which envisages inflation slowly going back to 2% over the medium term. This is our primary mandate and we take it very seriously. At its last meeting, the Governing Council firmly reiterated our forward guidance, whereby we expect the key ECB interest rates to remain at present or lower levels for an extended period of time. We remain firmly determined to maintain the high degree of monetary accommodation that is appropriate for the euro area economy, and will not hesitate to take further decisive action if required.

Could you explain why an inflation rate of 2% is better than, for instance, 0.2%?

Inflation being below 2% and close to 2% is the definition of price stability that the ECB has chosen. In the uncertain environment with the euro area in transition and the participating economies undergoing a lot of structural change, it is very important that the ECB sticks to its inflation objective and maintains its credibility as an anchor for the reform efforts in Europe. The reason why the 2% number has been chosen is that this is a level that is neither too high nor too low. We know that inflation which is too high can be detrimental for the economy as it can lead to destabilising feedback loops, for instance, through wage settlements and price indexation, and ultimately erode trust in the currency. But very low inflation can also be destabilising. That's why inflation which is too low is also contrary to price stability as it can create a self-fulfilling spiral of expectations that prices will continue falling. That would discourage households from consuming and companies would stop investing. This is the definition of deflation. So we want to be in the safe area between high inflation and deflation, and below but close to 2% is exactly the right level. Note that since 1998, when this number was chosen, most of the major central banks around the world have converged towards the same number: it has been adopted by the US Federal Reserve, the Bank of England and most recently by the Bank of Japan.

In short, 2% inflation is some sort of a lubricant for the economy.

Such steadily increasing prices do not distort economic choices. My personal definition of price stability is a rate of inflation which does not distort economic behaviour.

To come back to Slovenian issues: our authorities have taken the decision to avoid using the ESM funds, which also carry certain conditionality. Based on the philosophy that we will solve our problems by ourselves, we have also tried to sell bonds in the US market. What is your view of that? Would it be better for Slovenia to return to the

euro market and issue euro-denominated bonds? After all, we are a euro area country…

I don't have any advice to give to your finance minister. He certainly does what is in the best interest of Slovenian taxpayers. In the medium term, stable funding for the Slovenian budget would benefit from a mix of dollar issuance and euro issuance. But so far the funding strategy has been successful.

The biggest opposition party in Slovenia has proposed changes in central bank legislation to allow a representative of the political opposition to attend sessions of the Governing Board of Banka Slovenije. Is this proposal in line with ECB policies?

We are in the process of looking at that particular proposal but it is clear that in every euro area country, small or large, the independence of the national central bank has to be ensured.

According to one estimate, the 128 largest European banks which will undergo the asset quality review and stress test this year will require up to €500 billion of additional capital. Is this a manageable amount?

It is absolutely premature to comment on any number. We are at the start of the process, getting organised and collecting the data.

Once these tests have been completed, will European taxpayers be on the safe side? Will they have any guarantee that such a banking crisis will never happen again?

The best safeguard to make sure that the banking crisis doesn't happen again is tough supervision, which will be ensured through the Single Supervisory Mechanism that will start operating in November. This is the best protection. The ECB, as the single supervisor in the Single Supervisory Mechanism, will have to be tough. Together with the new banking rules, this will be the best way of preventing future crises. I very much believe that taxpayers are now much better protected than they were before the crisis, in particular thanks to the new bail-in rules that make sure that investors in banks will be the first to cover any losses. If any capital shortfall is identified by the ECB stress test and asset quality review, it will have to be covered first by the private sector.

The ECB is a part of the troika, together with the IMF and the European Commission. What is actually the ECB's role in the troika?

The ECB has had a very clear role since May 2010, when we were invited to join the troika and advise the European Commission on matters where we have specific expertise. Those are generally financial sector issues, the situation of banks and also the general macroeconomic balance. This has been our role, but otherwise all the decisions related to financial support to countries have been taken by the Eurogroup and by the countries themselves. The Eurogroup is the politically and democratically accountable authority. Key decisions can only be taken by authorities, or politicians who are accountable to their parliaments. Decisions on reforms in individual countries can only be taken by local governments under the scrutiny of national parliaments. The work of the troika has to be accountable to democratic institutions. The ECB can explain what it does in the troika, but we only act as an adviser.

The ECB is this year moving to a beautiful new building in Frankfurt. How many people will work in the new building and what will change with the move?

The ECB's new building is a long-term project. All of our staff, some 1600 people, except those in charge of banking supervision, will move to the new building. The new banking supervisory body within the ECB will be located in another building in the centre of Frankfurt because its staff have to be together. It is also good that the monetary policy part of the ECB and the supervisory part are separated, as they are two different functions.

Additional question: Mr Cœuré, what is your comment on the key decisions taken by the Governing Council of the ECB on 6 February?

The Governing Council has confirmed its main scenario of a steady recovery, with inflation gradually moving back towards our policy objective of below, but close to, 2% over the medium term. As explained by President Draghi, we didn't see enough reasons for policy action at our last meeting. Over the next weeks and months, if risks to our main scenario materialise, we will be ready to act, consistent with our forward guidance.