# Isabel Schnabel: Interview with Financial Times

INTERVIEW

## Interview with Isabel Schnabel, Member of the Executive Board of the ECB, conducted by Martin Arnold on 25 May and published on 27 May 2020

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**Thank you for making time to talk to us. I know you have been incredibly busy recently. It has been an extraordinary few weeks. I'd like to start by asking you about the recent German constitutional court ruling against the ECB's public sector purchase programme (PSPP). How is the ECB going to respond to this?**

The ECB is under the exclusive jurisdiction of the European Court of Justice and therefore this court ruling does not directly affect us. It is directed at the German government and at the German parliament, who now have to respond. The ECJ ruled in December 2018 that the PSPP is legal. Therefore, it is clear for us that we can and have to continue our monetary policy in line with our mandate to make sure that in the medium term we are getting back to our inflation aim of below, but close to, 2 per cent and that our monetary policy is transmitted to all parts of the euro area. So we are not adjusting our monetary policy in any way in response to this ruling.

**I understand that as an independent central bank you can't adjust your monetary policy to the ruling of a national court. But isn't the easiest way to resolve this situation for the ECB to provide the proportionality**

**assessment the court has requested?**

I would argue that we are already doing this. This is what central banks do. They design monetary policy measures, they discuss them, they weigh the pros and cons. This is all documented in various texts that can be found on our website. We publish the monetary policy accounts, which show very clearly that there is always a discussion regarding the pros and cons of different monetary policy measures. In addition, we are accountable to the European Parliament. The president has a monetary policy dialogue every three months, which is streamed on the internet and the transcript of which is available on the website of the European Parliament. So we take transparency and communication very seriously. And we are in a constant process of improving our communication. The question of the proportionality of our actions is part of that.

**You say that the ECB is constantly assessing the proportionality of its policies. But the highest court in Germany – the biggest economy in the eurozone and largest shareholder in the ECB – is not convinced that the ECB has done a good enough job of explaining this proportionality, which as you know is a key legal concept in German law. So don't you need to do more to explain this to the court to resolve the situation?**

We try in any of our decisions to make very clear why we are taking them, what are the pros and cons. We also produce research papers and plenty of them are discussing the potential side-effects of monetary policy. And there is the monetary policy strategy review coming up. Unfortunately it had to be postponed a bit. But these kinds of questions naturally will figure prominently in the strategy review.

**What would be the impact if the Bundesbank is ordered to stop buying bonds?**

I don't think it will come to that situation. We are in a monetary union, and Germany and the Bundesbank are an important part of that. We have to avoid a situation in which one national central bank cannot participate in our asset purchase programmes.

**What would be the impact on Germany bond yield if the Bundesbank did stop buying Bunds?**

As I said, that is not going to happen.

**Okay, so how are you going to stop it happening?**

The Bundesbank is more directly affected by the ruling. But it is also an independent institution. I'm sure there is going to be communication between the Bundesbank and the German parliament and the German government, and one will have to find a solution. If the ECB can be constructive in supporting that process, we will of course do so.

**Does the court ruling reflect the general mood in Germany on monetary policy?**

I must say that currently I perceive the general attitude towards the ECB's monetary policy in Germany to be rather positive, and this is also reflected in the reactions to the court ruling. In my view, it was quite balanced. Of course there were some who were supporting the ruling but there were also quite a few critical voices. I think it is appreciated how the ECB is contributing to alleviating the impact of the current pandemic. This appears to have helped to improve the attitude towards the ECB's monetary policy more generally.

**Why is Germany so much more sceptical than other eurozone member states?**

I have been worried about some of the narratives in Germany regarding the ECB's monetary policy for quite a while. I think one of the reasons why this is more visible than in other countries is the role that the Bundesbank has always played in the perception of many German citizens. Therefore, the ECB has been under special scrutiny in Germany. It is perfectly fine to criticise the ECB's monetary policy, but I was always worried about partially misleading narratives about it. This is why my first big speech in my new role was on exactly that point, trying to put data on the table and to confront all the narratives that are floating around with the data. The result was that many of the narratives that are very popular in Germany cannot be maintained because they simply do not match the facts. It is a bit ironic that some of these narratives appeared in the court ruling, but this shows how deeply rooted they are in Germany. We will have to work even more on our communication in order to explain what monetary policy does and what the positive effects of monetary policy are. Germany is one of the countries that has benefited a lot from the euro and therefore it shouldn't be the country that is most critical about it.

**Have those benefits been explained properly in Germany?**

It apparently has been done too little. However, it should not only be done in Germany but in all euro area member states. We see that there is a lot of support for the euro in general. But we have to work on this on a continuous basis. Monetary policy is very complicated. For the citizens it is hard to understand and therefore it is important that we learn to explain monetary policy in simple terms. That is crucial. Our communication is very technical and it is full of acronyms. We have to learn to find a language to explain these things in simple terms. It is also part of the monetary policy strategy review to improve our communication to the citizens. Then it becomes much harder to build such misleading narratives because people start to better understand why the euro benefits them, and how our actions protect its value. For example, if anything, inflation has been too low in the past years, while originally the German fear had been that inflation would be too high. We have gone through very unusual times: there was the big financial crisis, there was the euro area crisis and now we are facing this huge pandemic. These are difficult and extraordinary times. They require constant adjustments to our toolkit and it is difficult for citizens to keep track of that and to understand what is going on. And the numbers involved are so huge, which tends to scare people.

**Is the Franco-German proposal for a €500bn European recovery fund sufficient?**

The short-term collapse in economic activity has been huge, but now the big open question is what the recovery will look like. One very important point, and we have frequently stressed this, is that we have to avoid an increasing divergence within the euro area. This is why the European initiative is absolutely crucial, because it must not happen that certain countries cannot react properly because they simply do not have the fiscal space. This situation is politically easier than what we had in the past because there is little concern of moral hazard, which played such a prominent role in earlier times. Bundestag president Wolfgang Schäuble also stressed that particular point and very strongly supports the European response. There is actually quite broad support for the proposal in Germany and I very much hope that it will come through.

**Why is divergence such a serious risk?**

We have a single monetary policy, which works much better and is more easily transmitted to the entire euro area if there is convergence in economic terms. From the ECB's perspective, a divergence would be highly problematic. But also if you think about growth and trade, we know that the euro area is so closely interconnected that the overall outlook is likely to be much more subdued if the recovery is very uneven.

**The early signs on this are not great, are they? The countries with the weaker fiscal positions seem to have been hit harder by the crisis than some of the stronger, northern countries, like Germany.**

We are facing a symmetric shock, but this shock is having asymmetric effects. The ultimate impact depends, among other factors, on the fiscal response and the sectoral composition. For example, countries that rely heavily on tourism are affected particularly strongly. This is exactly why a joint European response is so important and why it needs a transfer element. This is not just about giving more loans, which risks exacerbating divergence. We need transfers to those countries that are hit hardest. This is a question of European solidarity. We are experiencing the most severe humanitarian and economic crisis since the Second World War and Europe has to be there to help. But also from a purely economic perspective, it is clear that this asymmetry has to be countered by an appropriate policy response.

**Some people have talked about this Franco-German proposal as Europe's Hamilton moment. Do you see it as a step towards debt mutualisation and even fiscal union?**

I certainly think it is an encouraging step in the direction of more European integration. But we shouldn't overstate it. As the proposal stands, it is only a temporary measure. Nevertheless it shows Germany's willingness to move in such a direction at a time of substantial economic challenge. There is a basic understanding that we need more integration in Europe in order to be able to deal with such shocks. Debt mutualisation has always been politically very difficult. But this clearly is a sign that there is a willingness to think about constructions at European level that go in the direction of a joint fiscal policy and deficit spending at EU level, which many economists have argued is very important to make the European Union and the euro area more resilient.

**Are investors right to be worried about the sustainability of government debt levels?**

If you look at markets, I do not have the impression that there is serious concern about debt sustainability. We have seen an increase in sovereign spreads in the market but there is no restriction of market access in any member state. In fact, across the euro area we are seeing very large demand for the bonds that are being issued with often very high bid-to-cover ratios. The European fiscal response is certainly helpful. And it is not just about debt-to-GDP ratios; it is also about the interest rates that have to be paid and economic growth. This is why the recovery fund has to be designed smartly to make sure that the European economy gets back to a higher growth path that is sustainable. It should focus on investment in digitisation, healthcare systems, the carbon-free economy in order to provide an impulse for economic growth.

**Do you consider it one of the ECB’s roles to close the spreads in government debt markets?**

The ECB watches financing conditions in the euro area very carefully. A very quick divergence in sovereign spreads poses risks of fragmentation that may threaten the transmission of monetary policy to all parts of the euro area. If we see such signs of fragmentation, we have to react. That doesn’t mean that in the end all spreads relative to the German Bund will be equal to zero – and they shouldn’t be, given different fundamentals. But a quick divergence of spreads points towards market dysfunction with risks of running into self-reinforcing spirals. The ECB certainly has to counter such developments.

**Are you targeting specific spreads?**

We are not targeting spreads, but we are watching them carefully. One useful metric that one can look at is the GDP-weighted euro area yield curve that gives an indication of how tight financial conditions actually are in the euro area. If we see that there is an unwarranted tightening of financial conditions that is not consistent with our price stability objective, the ECB will react. We saw that this curve actually shifted up quite dramatically at the beginning of the crisis and our measures have been able to push it back even though it is not at the same level as before the crisis. You can see that for many of the indicators we look at. You can, for example, look at the funding conditions for corporates or liquidity indicators. Most of them have gone down quite substantially in response to our policy measures but they are still elevated compared to the pre-crisis period. This shows that we are still not in a stable situation and that we have to continue to act forcefully.

**Should we expect the ECB’s €750bn Pandemic Emergency Purchase Programme (PEPP) to run out of ammunition by October if it continues at its current pace?**

As you know there is a monetary policy meeting coming up next week and at the same time we will publish new staff forecasts. We are going to look at the numbers very carefully. One number that is of course of particular interest is the evolution of the medium-term inflation outlook. If we see that the situation has deteriorated, and if we judge that further stimulus is needed, the ECB will be ready to expand any of its tools in order to achieve its price stability objective. With respect to the PEPP, this concerns the size but also the composition and the duration of the programme. We are ready to react to new data coming in.

**What is your view of how the German economy is coming through this crisis?**

At the moment, it looks like the German economy will get through the crisis comparatively well. But the hit will still be substantial. The country’s sectoral structure supports the recovery, as sectors like tourism don’t play a role that is comparable to other euro area countries. So far, the lockdown has been effective. But nobody knows whether there will be a big second wave or many small second waves. Just as other countries, Germany will have the problem that it cannot return to the old normal but that it will have to find a new normal. We cannot be certain what the new normal will look like. We can only be sure that there will be substantial structural change. This has risks and the transition is never easy. But it also opens up opportunities that economic activity shifts towards certain areas that are more conducive to economic growth like digitisation or towards a carbon-free economy. For Germany, that is one of the big challenges given the relevance of the car industry. It is also one of the big vulnerabilities as car demand has collapsed. The question is how this crisis can be used to foster a structural change that provides for high economic growth in the future. The fiscal position in Germany helps but a lot depends on how that money is going to be spent.

**Does the ECB have an estimate of the permanent damage, or scarring, being done to the eurozone economy?**

It is indeed one of the big concerns that there may be long-term damage to the European economy. How deep this will be depends on the policy response, on the fiscal side and on the monetary side. We will do whatever we can to avoid such long-run damages but in the end fiscal policy will play an even more important role in that respect.

**What is your biggest fear for the future? Is it deflation?**

In the short run, there are quite a few disinflationary forces. Falling energy prices have already depressed inflation a lot. The medium-term inflation outlook will likely also be challenging but is much more uncertain because there are countervailing forces. On the one hand, there are downward pressures coming from the consumption and investment side related the lockdown and to uncertainty. On the other hand, de-globalisation may have the opposite effect, and supply-side disruptions may put upward pressure on prices. But my main concern is disintegration, which would be very harmful. Europe needs to continue on the path of economic and financial integration and make progress towards completion of the banking and capital markets union. A safe European asset would certainly help integration and would also foster the international role of the euro. These are the main things we should focus on and we should not allow the European economy to disintegrate in any way.