Luis de Guindos: Interview with Corriere della Sera

Interview with Luis de Guindos, Vice-President of the ECB, conducted by Federico Fubini on 13 June 2019

The 5y5y forward inflation rate is at an all-time low and clearly below where it was when Mario Draghi first hinted at quantitative easing (QE) in 2014. The ECB has already done some more easing and President Draghi himself mentioned that there was an interesting discussion at the latest Governing Council meeting on different tools to do some more easing – the asset purchase programme (APP) and others. What do you need to see in order to decide to do more?

What we need to see is a de-anchoring of inflation expectations. This has not yet happened, despite the fact that there has been a drop in market-based inflation expectations. If you look at the survey of professional forecasters, the situation is a little bit different – expectations have remained stable. Then we need to see if there is a significant additional drop in economic activity – a crystallisation of the downside risks that we have indicated. We can always try to look forwards to get an idea of what might happen, but ultimately the reality is the reality. And, well, let’s see what happens. But I think the important part of our stance is that we are totally ready to react. We will have time enough to know the future when it arrives.

Does that imply that the current stance is appropriate, if your staff forecasts are confirmed?

Yes. And if there is a further deterioration, then we will react. But for now, our monetary policy stance is fully compatible with both inflation and real activity. The important element is that we are totally ready to react. And I would add another element, if I may: risks are tilted to the downside.

Do you mean, in terms of real activity?

Both in terms of real activity and in terms of inflation. So if those risks materialise, then we will react.

Can you think about different monetary policy tools to address different problems? If the issue is with the exchange rate, official rates are probably the answer; if it's real activity, then QE; if it's monetary transmission, then it's targeted longer-term refinancing operations (TLTRO)…

We do not allocate our instruments to different objectives. Something that I think is relevant, but is sometimes a bit overlooked, is that monetary policy is not almighty. If there is a problem with price stability, that's within our mandate. But this is something everyone has to keep in mind to avoid creating expectations that will not be met: we do not have the philosopher's stone.

Are you implying that having something of a policy mix would be good, in total respect of the ECB's independence?

Sure. But my point is that wherever there is a problem, for instance a problem with trade disputes, that is a real economic problem that is going to have real consequences. You can certainly smooth the impact with monetary policy, but you will not be able to address and fix this kind of problems with monetary policy. The real role of monetary policy is price stability. And in order to guarantee price stability, we have to monitor the evolution of the real economy – domestic demand, external demand, the exchange rate, and the rest. But you cannot fix all the economic problems of the world with monetary policy.

President Draghi hinted recently that if there is a slowdown and those downside risks materialise, fiscal policy might also play a role.

Yes, sure. It's the policy mix. Of course there is monetary policy, and we have been the main game in town since 2012. Monetary policy has been key to understanding the recovery of activity and employment creation, among other things. But it's not the only policy in place. Fiscal policy has to play a role, as do structural reforms. And in the case of fiscal policy, it's not only the nominal deficit level, it's the composition as well: the quality of public finances.

Are you saying that the public investment-to-GDP share, which has remained flat, at 2.6%, during the QE years, could now increase?

It's not even only public investment. One of the problems in Europe now is low productivity, which is caused by the fact that we are not investing enough in education, R&D and public infrastructure. But public infrastructure is not a stabilisation instrument. When you start building a road, for instance, the project is delivered much later, when the business cycle may have already turned. But education and R&D are levers that have to be used. And at the same time I think it's important that we look at the composition of taxation and its impact on long-term growth and productivity.

Do you mean it would be better to have lower taxation on labour, compensated by other areas of the tax base?

It depends; there is no single recipe. But you can't take the tax structure that we have now as a fait accompli. You should use a combination that takes into account new elements, such as climate change. All these aspects have to be taken into consideration. That is why fiscal policy is very relevant; it's not only the nominal deficit that matters.

So when you and President Draghi go to Eurogroup and Ecofin meetings, you might have concepts to share with the ministers in this respect?

Sure, when we go to Eurogroup and Ecofin meetings we are fully coordinated, also on fiscal policy matters.

Italy and Spain were trading at very similar levels during the crisis. Today the Bonos-BTP spread on 10-year maturities is over 180 basis points. What do you think explains such divergence: the fiscal situation, growth rates or redenomination risk?

First, I do not want make comparisons between Spain and Italy. But focusing on Italy, I think the main problem has been very low growth. You have not recovered the level of GDP that you had in 2008.

What do you think is the reason for that?

I think there are two elements. The first is the extremely high level of public debt, which is a sword of Damocles hanging over your head. Second, there is a problem with structural reforms. But there are pros and cons in the Italian economy. The cons are slow growth, public debt, a lack of structural reforms and so low productivity growth. But Italy also has some advantages that we have to acknowledge. The first is that it has a current account surplus. The net investment position is good, and that reduces the vulnerability of the economy. And when one looks at the country's budgetary track record, it has not been bad because it has had a primary surplus almost every year. This is not something that is very easy to achieve, so it's a very good track record, especially when compared with other countries. So we come back to the problem of slow growth, which immediately leads us on to structural reforms, barriers to market entry, labour market efficiency… These are the kinds of things that are sometimes a little bit overlooked.

There is nothing unfair in comparing Italy to Spain in June and July 2012. The situation was very similar.

We were very close, we were on the edge…

The situation was the same and the two countries took two different paths. Spain decided to take an EU programme for the banks, whereas Italy committed

itself to making it on its own. Do you think that decision explains the divergence between the two countries since then?

Again, I don’t want to make a direct comparison. The situation in Spain in 2012 was different – the government had an absolute majority in Parliament, we were lucky in that. And the clean-up of banks in Spain was far-reaching. It was not easy; it was bloody, I can assure you. But we did it and, after that, we were able to deal with an issue like Banco Popular. That was not easy, either. Then, Spain gained a lot of competiveness because of labour market reforms. Those are the two factors. But I don’t want to make a comparison with Italy. I am only focusing on Spain now. By 2013 Spain had started to grow again, and it has outperformed its peers for the last five or six years.

So do you think frontloading that effort paid off?

Yes, I think so. In Spain there was a government with an absolute majority, but even then we had a difficult time, politically speaking, after that. But in Spain, regardless of the political party in power, the pro-European approach is guaranteed, even when you look at the two extremes, Vox and Podemos.

They don’t question the euro.

Maybe they have different approaches regarding fiscal policy, but they don’t say they want to leave the euro. No, not at all.

In fact, when you look at credit default swap (CDS) markets, the implied probability of Spain leaving the euro is very, very low. In the case of Italy, it is not very low. Is it possible, then, that part of the spread between Bonos and BTPs is due to that redenomination concern for Italy?

Again, it’s not a matter of making comparisons between countries. In the case of Spain, the main reforms were labour market reforms and cleaning up the banks. Those are the drivers of Spain’s good performance, in my view. And those are the elements that have to be maintained over the coming years.

De Nederlandsche Bank President Klaas Knot recently said that divergence among euro area countries is making it increasingly difficult to set a single monetary policy that fits all of them. He expressed concerns about the sustainability of ever-diverging trends. Would you agree with him?

There are no ever-diverging trends. There is the concrete case of Italy, which is underperforming. But six or seven years ago the underperformers were Spain, Greece and Ireland, and now they are overperformers. It’s changed quite a lot. For instance, now in 2019 Germany is going to be one of the countries with a lower growth rate. And yet it was the euro area’s growth engine two or three years ago. There is not an accumulation of divergences, but situations change. Some countries that were underperforming are now overperforming, and vice versa. And this is not going to depend on monetary policy. Monetary policy has to take care of price stability and some real factors that can explain inflation levels across the euro area. But it’s exactly the same in the United States.

Do you think a single currency area can work in the long term without having a single budget to address shocks, banking problems or competiveness issues?

I think the institutional architecture of the euro area has not been finalised at all. We have made some progress with the creation of the European Stability Mechanism, and we have launched the banking union, but this project is not complete. We have to finish the European Deposit Insurance Scheme (EDIS) and we need to complete the capital markets union. I am fully in favour of having an instrument with a stabilisation capacity. It can take different forms.

Of the kind French president Emmanuel Macron is proposing?

If you look at what was agreed in the European Council, it was a first step in the right direction. But that should not be the steady state of the instrument. It could grow and have a very clear purpose – countercyclical stabilisation. Now it's more like a sort of competiveness instrument. We have to share more risk, for sure, if we want to improve the performance of the euro area and reduce the burden of monetary policy because, as I said, monetary policy is not almighty. And there is one element that is going to be key to achieving these steps: trust.

You have to trust other countries to behave. But when a country misbehaves, as seems to be the case with Italy now, are you concerned that this may hamper trust?

In the case of Italy, if you look at the fundamentals there are pros and cons. Italy is not a very vulnerable economy on financial grounds, if you take into account the net investment position and other factors. If you want an example of a vulnerable economy, look at Spain in 2010. It had an external deficit of 10% of GDP and a net investment position of 90% of GDP in the red. That's not the situation Italy is in now. My point is that trust sometimes depends on the political intentions of the government.

You mean the Italian government must provide some clearly stated objectives that are acceptable to the rest of the club.

Yes, on both sides. This is a bilateral game, so it's from both sides. And I think it's very difficult to make progress if we can't build trust. And since we are talking about trust and uncertainty in difficult times, I think this idea of discussing mini-BOTs was a mistake. President Draghi said that if it's legal tender, it's illegal and if it's debt, then it piles up more debt. Also, in my view, the worst consequence of this kind of decision is that it destroys trust.