

Philip R. Lane: Interview with Expansión



Interview with Philip R. Lane, Member of the Executive Board of the ECB, conducted by Andrés Stumpf on 22 February

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After the Christmas holidays and a third wave of the pandemic, what's the current situation of the European economy?

2021 is an unusual year. Some of the current restrictions on economic activity are going to be extended. But, while we're facing these short-term risks, there is the prospect of vaccinations bringing a sea change in the second half of 2021. In the second quarter activity will already start to recover compared with current levels. The timing of this rebound will depend on how the public health situation develops, in terms of both the vaccinations and the delays that the mutations of the virus could cause.

If the restrictions are extended, will you revise down the macroeconomic projections at the next meeting in March?

It's a bit early to answer that because we haven't finished preparing them yet. The more severe the impact of the virus, the more prolonged will be the lockdown measures. And that can affect the projections in the near term. But we know from last year that when the economy is unlocked and activity recovers, there can be a fast rebound. The effect of the lockdown on economic activity is less than it was last year. The European economy has had to learn to live with these measures. It's very difficult for the sectors most

severely affected, but there are other sectors that are coping with the pandemic. China is growing at a good pace, which is good news for the world economy. So if the lockdown lasts a few weeks longer it won't have much of an impact on the final growth picture in 2021. We think a lot of the pandemic shock will have been offset by the end of the year.

Doubts have recently arisen about a potential pick-up in inflation in the United States. Is this a concern in Europe too?

We are looking very carefully at measures of inflation compensation. What we are seeing is a mix of a rise in expected inflation and an increase in the inflation risk premium. And this is actually good news, because it shows that scenarios of the world economy heading into deflation are much less likely. Our December projections had inflation at 1.4% in 2023, so it is still very low and lots of support is still needed for it to climb upwards. What we're seeing now is not a significant and persistent change in the path of inflation. At this stage, an excessive tightening in yields would be inconsistent with fighting the pandemic shock to the inflation path. That's what we said, and that's what we will be continuing to keep an eye on day by day.

Is there not a risk of the European economy overheating after unprecedented stimulus?

That's an interesting debate for the United States, with the approval of new fiscal measures, but not so much for Europe. Here there's no risk of overheating the economy with the stimulus. A lot has been done on the monetary policy side and fiscal policy has been very active, but at levels that are nowhere near the scale of the US stimulus.

Together with the inflation expectations, there has been a rise in yields. Could this become a problem if they continue to rise before the economy recovers?

This is the paradox of the financial markets and the overall economy. It can be problematic if market optimism moves ahead of the current state of the economy. We are carefully monitoring the rise in yields. These questions all come into sharp focus, especially when we have a new inflation forecast. In any case, it's important to remember that our pandemic emergency purchase programme (PEPP) will be used flexibly in response to market conditions. We have our regular monetary policy meetings, but our market operations can also be conducted in a flexible way between meetings, if necessary.

Will debt purchases be able to address increases in bond yields if they are caused by a rise in expected inflation?

If you look at the size of the ECB balance sheet, the cumulative impact of asset purchasing has had a very large downward effect on the interest rates in Europe. This is a balance sheet view – that the overall stock of what we hold has a significant downward impact. The other mechanism, the “flow view”, is that if there are significant market movements – as there were in March 2020, for example – then the central bank stepping in can play a stabilising

role. There is more than one mechanism through which asset purchasing can influence the market. But at the same time, it is crystal clear that we are not engaged in yield curve control, in the sense that we want to keep a particular yield constant. With the purchase programme we are trying to move the curve in a certain direction and with enough force to support inflation dynamics.

Do companies need more credit to survive?

Clearly there are limits to the amount of debt that firms can take on, and these limits are partly set by the firms themselves. The specifics depend on the individual country and the nature of the industries in that country, but there is a recognised role in this crisis for outright transfers or equity conversions. It is a major challenge for governments and there is no one way to tackle it.

The drop in demand for credit makes it difficult for banks to meet the ECB's funding conditions with regard to maintaining lending volumes.

The targeted longer-term refinancing operations (TLTROs) have a big incentive built in to maintain credit and lending to the real economy. In return for that, there's a very low interest rate on offer. The banks might say that they would prefer less demanding targets but we have to strike that balance. In any case, funding conditions are still very favourable, even for those banks that don't meet the TLTRO requirements.

Have you accepted that the take-up of liquidity by banks will be lower than in 2020?

It is not a proper comparison. In 2020 there was an extremely high demand for credit, whereas the current situation is different. What we should be looking at is whether our decision to extend the programme is benefiting the European economy, and we absolutely think it is.

How do you see the economic situation in Spain?

The virus is affecting all countries in Europe. But when you look more closely at the economic structures, the hardest-hit countries are those at the forefront of travel and tourism. Spain is in this group and there is no doubt that the pandemic has posed a bigger challenge here. This should be fully recognised. And it has been in the design of the Next Generation EU fiscal stimulus package and definitely will be in any type of forward-looking assessment. Spain's path to recovery will look different from that of countries with economic structures that are not so focused on these sectors.

So the recovery will take longer then?

One of the differences will be the timing of the recovery, yes. But the nature of the recovery will also be different because of the importance of travel and tourism. It is a sector where there is pent-up demand – many people will want to go to Spain again. In other countries some sectors may be affected by structural changes, but I doubt that there will be a permanent shift away from tourism.

Spain will come out of the crisis with a high level of debt. Are you concerned about countries with debt-to-GDP ratios above 100%?

It is important to distinguish between the near and medium-term challenges. In the near term, in this environment of extremely low interest rates, the challenge is not the level of debt; the challenge lies in ensuring that the European economy makes it through the pandemic, in the sense of keeping as many workers and firms as possible in good shape, and in having a sustained recovery. Only once we have managed that, at a much later date, should we go back to thinking about the usual challenges related to fiscal policy. Right now the focus clearly should be on getting through this pandemic phase and having a good recovery.

Is a 60% debt-to-GDP level, as enshrined in the Stability and Growth Pact, still desirable?

It is written into the EU Treaty and designed with the long-term perspective in mind. In the current situation of extremely low interest rates, debt levels that are higher than what we have become accustomed to can be considered sustainable. Once the pandemic is over, there should be a discussion about reducing debt ratios. But the important topic is not the preferred debt-to-GDP levels, it is the speed of adjustment, the measures taken and the macroeconomic context in which they take place.

With the private sector saving a lot, we are not seeing the current account deficits we saw in the mid-2000s. So from a macroeconomic point of view, this situation is totally different. And, because this debt has been raised at very low interest rates, the financing of it is being absorbed by investors. It is not creating, at the moment of issuance, a significant immediate burden, in contrast to previous episodes. So in a lot of the debates progress has been made in updating beliefs about deficits and debt, but that conversation is not yet over.

What do you think about the surge in bitcoin? Could it pose a threat to central banks?

I think it is interesting to look at bitcoin as a crypto-asset instead of a crypto-currency because it is not particularly easy to use it to make payments. It has gone up considerably and we have seen similar situations before in the markets. If you ask somebody why they invested in bitcoin, in most cases the response will be that they expected the price to go up, and not that they did it because of the monetary policy situation. So we do not view the rise of bitcoin as a warning to central banks. An asset with no intrinsic value can go up in price because of the collective belief that its price will continue to rise, but that market has a risk of generating dramatic losses, and anyone thinking of investing in bitcoin needs to understand this risk.

If the recovery is delayed or there is another shock to the economy, does the ECB have any ammunition left?

Without a doubt. First, the ECB's ability to create euro liquidity is a huge

asset for Europe. Second, we always remind people in our policy statements that we retain the option to move the key policy rates lower. We remain confident that if we decided it was the correct decision to make, we could move interest rates. We have the asset purchase programmes and the TLTROs could be boosted, depending on the nature of the shock. Throughout this pandemic, the ECB has been quite effective in stabilising the European financial system and in creating the conditions for those who can benefit from low interest rates to take advantage of them. Under the current conditions, of course, a very large sector that can benefit from low interest rates and take advantage of them is the government sector. If there's a negative shock, fiscal policy has a very powerful countercyclical role to play.

Does the ECB reiterating the need for fiscal policy to take a leading role suggest that monetary policy has reached its limit?

There is no limit of the sort that many people imagine. There is no hard limit. The issue is more about the efficiency or the scale. The recovery will be faster and the efficiency will be better if fiscal policy makes its contribution. In a low interest rate world (enabled by the ECB), fiscal policy is more effective in dealing with adverse macro shocks.

You always repeat this, but is lowering rates further really an option?

We wouldn't say we could use this tool if we didn't believe it. When we say that we can move rates lower [the deposit facility rate is currently -0.5 per cent], we do all sorts of calculations and analytics to make sure that it's a credible and honest statement. What we have been saying all year is that, in the context of the crisis we have been going through, protecting credit through the TLTROs and making sure that the yield curve is at a low-enough level through the PEPP is the best combination. That logic still holds but the pandemic is of course not the only shock that could hit the economy and we have to be prepared. All the tools are available.

And what about the ones that have never been used, like purchasing bank debt or even shares?

We have a group of experts at the ECB and the national central banks who look at all the options. But under the current conditions we remain confident that the tools we have deployed up to now are the right ones for dealing with this situation and preserving the favourable financing conditions that are necessary for the recovery.