INTERVIEW

Interview with Le Monde

Interview with Philip R. Lane, Member of the Executive Board of the ECB, conducted by Eric Albert and Marie Charrel

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The eurozone has gone through a double-dip recession. After the huge recession of the first half of 2020, GDP fell again in the fourth quarter of 2020 and the first quarter of 2021. What is the state of the eurozone economy?

Rather than looking at this quarter by quarter, we should look at how far the economy is below its 2019 level. Right now, we're probably four or five per cent below that. This is a huge downturn. In comparison, in a normal recession, it is maybe one or two per cent.

I think we are now, in May and June, at an inflection point. From now on, the economy will be growing quickly, but from a subdued level. So even with pretty rapid growth for the rest of this year, the euro area would only get back to its 2019 GDP level around this time next year. For the labour market, we think unemployment will only fall back to its 2019 levels in 2023. It is a long journey, which requires a sustained effort by fiscal and monetary policymakers to support the recovery.

How much scarring do you fear the economy will have?

There are reasons to be optimistic. Compared to the decade following the 2008 financial crisis, the pandemic will only be a two or three-year event. So scarring can be limited because the recession will be shorter. At the same time, there are sources of concern, because there was not just the shutdown of the economy. Education and healthcare have been disrupted, which will have a lingering effect. The effects of the pandemic have also been very concentrated in some sectors: hospitality and travel, for example, will be very disrupted for a long time.

The world will not be the same after the pandemic. There will be structural changes and some losers and winners. For example, if you were in a city centre location providing services for offices, or in the travel industry, you face long-term challenges. On the other hand, there'll be those who gain from supplying services for working from home, like IT for example.

You said that a lot of fiscal support is necessary. There is a €750 billion package from the European Union, Next Generation EU (NextGen). The problem is that it was agreed in principle in July and is still only being ratified. Is the EU doing too little, too late?

When you look at the European fiscal response, you have to look at the national responses and this extra layer at the EU level together. While we wait for NextGen to be implemented, national fiscal policies can act in the meantime, providing disaster relief and general macroeconomic support. It was always clear that NextGen had a medium-term orientation. It is essentially a five-year project, focused on investments, to make sure that we have a sustained recovery over five years.

But when we compare it with the Biden plan (USD 1.9 trillion) and the stimulus packages launched by the former US president, doesn't the EU plan seem very small and less ambitious?

I take a different view. Economic performance is not a race, a stronger US recovery is good news for Europe. At another level, for Europe, it also illustrates the potential of having a common fiscal framework and deeper fiscal integration. NextGen is a step forward in fiscal union, but in a limited way. It shows the potential that could be unlocked if we had a more common approach to fiscal policy.

In the United States, the ability of the government to finance any scale of deficits is not questioned. If we did have more of a fiscal union in Europe, the ability of European governments not to worry about how to finance deficits would be a lot stronger. But the EU has already played a positive role. What would Europe have looked like during the pandemic without the European institutions and the ECB? What we were able to do last year would not have been possible if we had 19 national currencies in Europe. It shows the value of having a single central bank. Similarly, without the euro, many small European countries would have had to borrow in foreign currencies, which is more restricted in terms of scale. The common currency has increased the fiscal capacity of all euro area countries.

On top of that, Europe has demonstrated it is willing to have a degree of joint financing like NextGen. It should not just be seen as €750 billion. The world's investors have understood that Europe will stand together. The signal NextGen has sent had an immediate effect of lowering risk premia across Europe. The value of that is many times the value of the fund itself.

However, isn't there a danger that, after the pandemic, European Union countries withdraw their stimulus too early and make the same mistakes as in 2010 after the financial crisis?

It remains important that everyone recognises that the recovery is not going to be a super-quick process. It will require sustained fiscal and monetary support. But the challenge is quite different from ten years ago. Many of the fiscal measures, the subsidy programmes for firms and workers, will automatically expire as the economy recovers. Then, tax revenues will recover. So large fiscal deficits will self-correct to a relevant extent in an automatic way.

The other very important difference is that we've seen very large fiscal deficits but no current account deficits. The large fiscal deficits essentially have their counterpart in large household savings. We will have a kind of internal rebalancing over time. Households will start to spend more and that will offset governments which are spending less. So it's totally different to the kind of twin deficit problem we had ten or 15 years ago.

Nevertheless, sovereign debts have increased a lot during the pandemic. How worried should we be?

In 2008 interest rates were still relatively high and the most indebted countries faced the prospect of using a lot of their tax revenues and national income just to pay the bondholders. Now, we have a world in which many countries issue long-term debt at very low interest rates, so the financial burden of high sovereign debt is going to be very low.

What happens if the world changes and interest rates trend upwards?

We don't see this risk on the horizon. And even if it did emerge, much of the debt issued now is long term. International investors understand this: they are not requiring high risk premia to hold sovereign debt. So current levels of debt in today’s environment are not a source of concern to global investors – but, of course, governments will have to rebuild fiscal capacity once the recovery firmly takes hold.

If sovereign debt is not an issue, what is the main financial risk?

Staying with the pandemic, I would highlight the risk around corporates. Many corporates have lost revenues and survived only because of extensive fiscal support. We have to make sure that the phasing-out of these fiscal supports is not so quick or so severe that firms are unnecessarily pushed into insolvency.

What about a financial bubble?

I don't think we have the ingredients for that in Europe, I am not discussing what is happening elsewhere. For a true bubble, the usual risk calculations have to be ignored, like before 2008. We do not see that kind of loss of risk awareness. Today, European investors remain relatively cautious. Furthermore, various assets have gone up in value, but that's a rational response to a low interest rate world. And finally, a bubble is also usually amplified by a lot of debt. And, by and large, we’ve not seen debt-driven speculation on a pan-European basis.

Coming back to your point about yields being low, in Europe rates have steadily increased since December. The French ten-year bond yield went from -0.2% to +0.2%, Italy's is close to 1%, Germany's is getting close to zero. Shouldn't the ECB intervene more?

It's true there have been increases in the ten-year rates, but it's important to recognise that yields remain relatively low and anchored, and we have a lot of stability in interest rates thanks to that. Also, all parts of the yield curve are important, because many firms might take out one-year loans, or three or five-year loans. Our overall commitment is to maintain favourable financing conditions. In March we concluded that we needed to step up significantly our asset purchases within the pandemic emergency purchase programme, and this higher level will continue over the coming weeks. We will review it again at our June meeting, when we assess the favourability of financing conditions together with the inflation outlook. And we can increase or decrease our purchases depending on what is necessary to keep financing conditions favourable.

The pandemic has brought to the fore the concept of European economic sovereignty. What does it mean? What are its limits? Should Europe do more for its main industries?

There is some confusion between the concept of sovereignty and the concept of being open. Having a very open economy is actually a very good platform for sovereignty. In the context of monetary sovereignty, the common currency is a very strong platform for sovereignty. Again, imagine what Europe would look like without a common currency. That said, sharing sovereignty, which is the basic definition of the European Union, would be reinforced by having a more complete banking union, a capital markets union, more integrated payment systems, a central bank digital currency...

Before we think about European champions in the global marketplace, we must also ask ourselves: are we doing enough to make sure that the best firms in Europe can grow on a pan-European basis? We're far away from that. We do not have a true single market in Europe, in terms of the different types of goods, in services, but also in banking union and in capital markets.

There's been a lot of disruption in global trade because of the pandemic. Are we seeing some kind of deglobalisation?

Rather, we are now seeing a strong recovery in global trade. Trade has been very resilient and globalisation has played a powerful role in the most important issue for all of us now: the production of vaccines, which has been a global effort. It proves that the answer is not to build redundancies and closed loops in Europe, America or Asia. But we should minimise bottlenecks. If everyone is reliant on the same small number of producers for some essential components, or on exactly the same shipping routes, then there is clearly a concentration risk for trade.

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