

‘At some stage the bond-buying will have to end’

INTERVIEW DER SPIEGEL Oct 2021 (Publication End October)

SPIEGEL: Mr. Marsh, how do you rate the first two years of ECB President Lagarde's term of office?

David Marsh: I would give her a medium grade. On the one hand, she has pacified the most important body, the long-divided ECB governing council. On the other hand, under her direction - mainly because of the Covid crisis, for which she naturally bears no responsibility - the ECB's dependence on euro area governments has increased. She doesn't have any deep fundamental principles when it comes to monetary policy.

SPIEGEL: What do you mean by that?

Marsh: She says that she is neither a hawk, i.e. a monetary policy hardliner, nor a dove. Someone like her, who can live with an ultra-loose monetary policy for a long time and who also reflects the overriding somewhat dovish character of the council, may be appropriate for the current situation, but it's an open question whether this will be just as useful for the remaining six years of her mandate.

SPIEGEL: First things first: How did she pacify the governing council?

Marsh: Her predecessor Mario Draghi was a thoroughbred economist and central banker, convinced that he was right, and hardly interested in what his council colleagues thought. His economic arguments bore the intellectual rigour of his doctoral studies at the Massachusetts Institute of Technology, also of his Jesuit upbringing. Lagarde follows a different, more chalarous approach. From the beginning she tried to accommodate hawks like Dutch central bank president Klaas Knot and Bundesbank chief Jens Weidmann, to show them that she took them seriously. She is a lawyer and can get on with other people, deploying empathy, charm and humour.

SPIEGEL: Lagarde has a reputation for being a good communicator. Has this impression been confirmed?

Marsh: Internally, definitely yes. The hawks believe the climate has greatly improved. They know that Lagarde understands less about the technical side of monetary policy than they do, but also that she has other talents.

SPIEGEL: Which do you mean?

Marsh: Her persuasiveness, her many years of experience as managing director of the International Monetary Fund, her contacts in politics, especially with French President Emmanuel Macron. But also the connections she has established in the US, Germany and Italy.

SPIEGEL: The mood may be better, but Weidmann has now announced his resignation for the end of the year. He seems frustrated by his powerlessness in the council. So in fact nothing has changed under Lagarde.

Marsh: That's right. Weidmann did his best to convince the other council members of the validity of his conservative monetary approach. But in the end - given his permanent status as leader of the council's orthodox minority, the results are rather meagre. In addition, because of his ordo-liberalistic principles, he has fallen out with Europe's most powerful politicians - Macron and Italy's Prime Minister Mario Draghi.

SPIEGEL: So his move now is now an elegant way of breaking free?

Marsh: It seems so. After all, despite his young age of 53, after 10-1/2 years in the job, he is the third longest-serving president of the Bundesbank after Karl Blessing and Karl Otto Pöhl. On the other hand, he has now unnecessarily way brought the office of the Bundesbank president to the negotiating table of the coalition talks. The issue will be tied up with unseemly political skirmishing that has precious little to do with monetary policy.

SPIEGEL: Weidmann's predecessor, Axel Weber, also gave up in 2011 out of irritation over ECB policy. Doesn't that show that the Germans, or at least parts of the political class, never really came to terms with euro membership?

Marsh: I would put it in a more nuanced way. The Germans have had to face up the fact that they are not alone in the world. Thirty years ago I wrote: 'The Bundesbank is much too powerful to be controlled by others. But it has too much power to rule alone.' In 1999, Germany would not have accepted an immediate takeover of the Bundesbank by the ECB, which at that time did not have its current significance. Instead, we have seen a slow transformation, a gradual de-Bundesbankisation of the German central bank. Weidmann's departure is the latest step in a long journey. Germany's leaders should have prepared the electorate for the final destination on this voyage. Angela Merkel did not want to - or could not - do this. She leaves this duty to Olaf Scholz. Perhaps that is Jens Weidmann's farewell gift to the new Chancellor.

SPIEGEL: What kind of successor should the federal government appoint: another hawk for the German public? Or a dove who won't resign in frustration in a few years?

Marsh: The successor will have to be a new type of president. If Isabel Schnabel, professionally qualified as she is, switched from the ECB to the Bundesbank, it would be a setback for Claudia Buch, who in return would have to go to the ECB to maintain gender policy, a rather inefficient changeover. I would prefer a tandem solution, as has already been successfully practised at the Bundesbank over the years.

SPIEGEL: What could this look like?

Marsh: The rather apolitical Claudia Buch would take over the presidency for two years until the end of her eight-year mandate. Marcel Fratzscher - close to the SPD, president of the DIW, a man of great renown well beyond Germany's borders, and a former ECB official, would become vice president for two years with a strong international focus and then would take the presidency. But the longer the procedure goes on, the more political it will become.

SPIEGEL: Why?

Marsh: Because there is a risk that the appointment will be decided only at the end of long and complicated rounds of coalition talks. Even in more normal times, without the current coalition poker games, such processes are often accompanied by disagreements, setbacks and surprises. The last time an SPD chancellor choose the head of the Bundesbank was in 2004, when Ernst Welteke had to leave. There were three initial candidates, Peter Bofinger, Ingrid Matthäus-Maier and Hans Reich, before Gerhard Schröder and Hans Eichel could agree on the fourth, Axel Weber.

SPIEGEL: Back to Lagarde. Right from the start, she declared she would communicate more transparently to the general public and explain the ECB's monetary policy as simply and jargon-free as possible. Is that realistic?

Marsh: She wants to be popular and accessible and tries to communicate in a down to earth way. If, however, central banks' broaden their positioning becomes too much, they run the risk that the electorate will consider them to be over-powerful. When the phase of low interest rates finally ends, governments' debt problems will increase. Since central banks seem to be responsible for everything, politicians will tend to blame them for general economic setbacks. In addition, the idea that everyone should understand central banks contradicts real-life experience. We are talking about extremely complex issues and interactions. Telling the public that monetary policy is really very simple doesn't help educate the masses.

SPIEGEL: Perhaps not everyone is interested in the intricacies of monetary policy. But people are realising that prices are rising rapidly and that the ECB may have something to do with it. Surely it makes sense to explain yourself in this situation.

Marsh: Indeed, that's what the ECB does in regular publications that are translated into the respective languages. But ultimately, monetary policy remains something for specialists. It would be more important, for example, if the Bundesbank president would speak to the finance and / or budget committee of the Bundestag every three months. Then the public could actually learn more, in the German language, about the ECB's way of thinking and future direction.

SPIEGEL: That proposal has been on the table since summer 2020.

Marsh: Yes, but it didn't seem to work out. However, the accounts of the monetary policy discussions, which are usually published three weeks after the council meetings, are now more precise and accurate than under Draghi. During his tenure, the hawks' objections were often played down. But it would be better if the ECB published the verbatim minutes of its council meetings after a longer period of time, for example five years, as the American Federal Reserve (Fed) does, including by stating which national central bank governor said exactly what. A modern central bank, which has now grown up to the age of 23, should be able to do that.

SPIEGEL: You said that the ECB is more dependent on politics today than it used to be. Isn't that logical after 18 months of pandemic and economic upheaval?

Marsh: It's true that, in the fight against the pandemic, coordination between monetary and fiscal policy has been a success. During her time as head of the IMF, Mme Lagarde has always spoken out in favour of this. Moreover, I've never supported the idea that the central banks should be totally 'independent' of governments.

SPIEGEL: The Germans won't like to hear that.

Marsh: Instead of pure independence that was somewhat mythologised by the Bundesbank in the past, I prefer the word 'autonomy'. This is what Karl Klasen, president of the Bundesbank under Chancellor Helmut Schmidt, rightly did in the 1970s. Now the question of coordination between governments and central banks is becoming more difficult. Brakes will have to be applied to both monetary and fiscal policy. If the last two years have been difficult, the next five will be even more so. The ECB has to think about how to tighten monetary policy, for the first time since 2011. But the path is also getting narrower for fiscal policy. The future German government will no longer find it so easy or cheap to issue debt.

SPIEGEL: Why is that? Bunds are still yielding negative returns, which means that investors pay the government money to buy German national debt.

Marsh: Yes, but if the European Commission issues as many of its own bonds as it has announced, then investors may prefer to buy these instead, which would drive up their price as the main alternative to Bunds. If the ECB and the national central banks can then buy up to 50% of these EU bonds as is the case, and not just a maximum of a third as currently with German federal bonds, then the European issues could become more important than Bund, and take on the role of a 'safe haven' in troubled times. Then German bond interest rates would rise, and it would be more expensive for Germans to take on new debt.

SPIEGEL: Back to the ECB. What exactly do you think Lagarde has to do?

Marsh: The ECB has already announced that it will 'moderately' reduce the monthly purchases of government bonds under the PEPP purchase programme, launched in the wake of the pandemic, compared with the last few months' €80bn. The programme has lowered interest rates and stimulated the economy, which was a good thing. But now we need a route to the exit.

SSPIEGEL: The term 'moderate' is extremely vague.

Marsh: Yes, in September, PEPP purchases were still a significant €75bn. But it was a step in the right direction. Ideally, the ECB should let the PEPP run out as planned at the end of March 2022. The PEPP may have to be extended by three months, until the end of June, for political reasons - for example, because of the need to avoid financial market turbulence shortly before the French presidential elections in April 2022. But then it must be ended for good. Mme Lagarde should announce this at the council meeting on 16 December, without any ifs or buts. The ECB still has the Asset Purchase Programme - used to buy bonds, which will run until the ECB finally increases key interest rates again.

SPIEGEL: And when will Lagarde raise key interest rates?

Marsh: The ECB has to end PEPP first, then at some point there has to be an end to negative interest rates on overnight deposits by commercial banks. But apart from that, the inflation debate is getting hotter because inflation is becoming stuck at a higher level.

SPIEGEL: That drives Lagarde into a corner.

Marsh: Yes, then she will get problems not only with the ECB hawks, but also with politicians from right and left. When, in a period of accelerated prices, people no longer get the returns they need on standard savings products, then they will switch to real estate investments, fuelling house and apartment price rises, including rents, with painful results for many consumers. Then the ECB would have to reckon with criticism from Germany's 'traffic light' coalition too, and not just from people like Friedrich Merz, Markus Söder and other opposition politicians.

SPIEGEL: It goes without saying that Lagarde faces a critical time. Will she manage her task of integrating doves and hawks and normalising the ECB's monetary policy within the next two years?

Marsh: People say the British like to bet: I would put the probability that she will make it at 65%. So I'm cautiously optimistic. Typically British, even if I now have a German passport.

