

With rate hikes on the horizon, attention turns to the question of Draghi's successor

20 FEBRUARY 2018

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1. Introduction

Mario Draghi's term as president of the ECB will expire on 31 October 2019. He is not eligible to serve again. It may yet be 18 months away, but the choice of his successor is increasingly drawing attention as the euro zone adjusts to the prospect of higher interest rates for the first time in almost a decade.

Under Draghi's tenure, the ECB has slashed rates to record lows and has expanded its balance sheet by more than €2tn. This enormous dose of stimulus has bolstered the euro zone economy. Unemployment is falling and business confidence is at long-term highs. Despite this, the ECB's guidance is that interest rates will "remain at their present levels for an extended period of time, and well past the horizon of our net asset purchases". We expect net asset purchases will end in December 2018.¹ Therefore Mario Draghi could spend his entire eight year term at the helm of the ECB without ever overseeing a rate hike. The question of who will replace him has clear implications for market expectations about future rates. And it is not just the presidency that will be changing hands. Several other vacancies at the top of the ECB are due to open over the next 24 months (Table 1) which increases uncertainty.

¹ See <http://www.bk.mufg.jp/report/eceou2017e/BTMU-Economic-Brief-Euro20171213.pdf>

Table 1: Members of the ECB Executive Board

Title	Name	Country	End of term
President	Mario Draghi	Italy	31 October 2019
Vice president	Vitor Constâncio	Portugal	31 May 2018
Chief economist	Peter Praet	Belgium	31 May 2019
Other members	Benoît Cœuré	France	31 December 2019
	Yves Mersch	Luxembourg	14 December 2020
	Sabine Lautenschläger	Germany	26 January 2022

Note: The ECB does not officially use the term 'Chief Economist' but this is Peter Praet's role.
Source: ECB, BTMU Economic Research Office

2. A German president?

The current front runner to replace Draghi is Jens Weidmann, the president of the Bundesbank. He has been on the ECB's Governing Council (which is formed of the six members of the Executive board plus the governors of national central banks from the 19 euro zone countries) since May 2011. Prior to this, he was chief economic adviser to Angela Merkel, the German Chancellor. He is also the current Chairman of the Bank for International Settlements (BIS).

Weidmann is one of the most hawkish members of the Governing Council, and his words carry particular clout as the head of the central bank of the largest economy in the currency bloc. He has been particularly critical of the ECB's QE programme. In 2012, he said of sovereign bond purchases that "such a policy is too close to state financing via the money press". In 2015, after an extension to the public sector purchase programme (PSPP), he said it "might lead to the perception of some finance ministers that it is not necessary to consolidate the budget promptly". More recently, Weidmann has given little suggestion of a more pragmatic approach as Draghi's term approaches an end. He was critical of the decision to leave bond purchases open-ended and would have preferred a definite stop in September this year. At an event this month he said "some in the euro zone have been sceptical of sovereign bond purchases. As you may have heard, I would count myself as one of them", also stating that "fiscal discipline is absolutely essential" but that "consolidation has in effect stalled in the euro zone member states".²

² Speech made in Frankfurt on 8 February 2018. Full text can be found at https://www.bundesbank.de/Redaktion/EN/Reden/2018/2018_02_08_weidmann.html

Some of his thinly-veiled criticism of southern European countries and their perceived fiscal profligacy may play well with domestic German audiences but will not endear Weidmann to many other euro zone member states. Indeed, with the benefit of hindsight, his public opposition to Draghi's '*whatever it takes*' approach may seem poorly-judged and parochial.

3. Musical chairs

There will inevitably be behind-the-scenes political horse-trading which could help Weidmann's case – but it also makes it hard to predict.

Importantly, there has never been a German president of the ECB. The post has been held by nationals from the Netherlands, France and Italy since the establishment of the bank in June 1998. There is a feeling that Germany has waited patiently but is now probably next in line. Weidmann is presumably the choice of Angela Merkel given he worked as her chief economic adviser. This should count in his favour in the presidency race. But we note that Merkel's influence on the European stage is weakened somewhat after the inconclusive German election result. Also, a German candidate other than Weidmann cannot be excluded (perhaps from a more academic background, such as the economist Volker Wieland of Goethe University Frankfurt).

The perceived balance of representation between core northern and southern euro zone member states is important. Vítor Constâncio, the Portuguese current vice president of the

ECB, will have his term expire in May this year. Spain's economy minister, Luis de Guindos, is set to replace him. Euro zone finance ministers have endorsed him but it will not be made official until EU leaders formally accept his nomination at the 22-23 March EU summit.

Spain has not had a seat on the Executive Board since 2012 despite being the fourth-largest euro zone economy. The appointment of de Guindos helps Weidmann's cause as it enhances the north/south balance. It also makes it very unlikely that any candidate from a southern European country could contend for the presidency itself. Instead, alternatives could come from peripheral countries that are beyond the normal north/south balancing act. Philip Lane, the governor of the Central Bank of Ireland, impressed the economic committee of the European Parliament during an informal hearing on the appointment of Constâncio's successor. Ardo Hansson, Harvard-educated Governor of Bank of Estonia, has an interesting profile. He has called for the ECB to end net asset purchases in September and would appeal to more hawkish euro zone members. Lastly, experienced Bank of Finland Governor Erkki Liikanen would be considered a safe pair of hands.

One more consideration is the gender balance at the top of the ECB. Currently there are just two women in the Governing Council, and only Sabine Lautenschläger sits on the Executive Board. Her term is not due to expire until 2022 but she would be obliged to step aside if Weidmann, a fellow German, were to be appointed president. It is also worth noting that French president Macron has recently appointed Sylvie Goulard, former defence minister and long-term ally, as deputy governor of France's central bank. It was not an obvious career move for Goulard. The aim may be for her to have a seat on the Executive Board (replacing compatriot Benoît Cœuré who is due to step down shortly after Draghi).

4. Other vacancies

As well as the presidency and vice presidency of the ECB, there are other key roles at European institutions that will be vacated over the next 18 months. First, Danièle Nouy, Chair of the Supervisory Board at the ECB, will step down in December 2018. Then, in May 2019, the influential Peter Praet, ECB Chief Economist, is also set to vacate his position. This will be an important role to fill as the central bank tries to judge an appropriate pace to withdraw monetary stimulus. Philip Lane could be a contender.

And if Weidmann (or a compatriot) is not appointed ECB president, then Germany would probably have to settle for the presidency of either the European Council or European Commission. The terms of Donald Tusk and Jean-Claude Juncker are both due to expire in 2019.

4. Conclusion

The choice of the next ECB president will become increasingly important to markets. The end of Draghi's term in October 2019 is likely to coincide with a change in direction for euro zone monetary policy.

The hawkish Jens Weidmann is the current favourite, but things can change quickly. Fellow German Axel Weber was at one point deemed to be a shoo-in to replace Jean-Claude Trichet in 2011, then ruled himself out after his remarks against the ECB buying sovereign bonds reduced support from peripheral member states. Weidmann has not shied away from similar comments, but the economic landscape looks very different now. A hawkish head could be more acceptable to southern member states against the current background of firm, broad-based growth.

It would be unwise for the new president to forget what the euro zone has been through, though. The hope would be that the appointee shows signs of flexibility and pragmatism while market participants and policymakers work out what the post-Global Financial Crisis 'new normal' looks like. Draghi has these skills and deftly steered the euro zone to recovery. His replacement will have big shoes to fill.

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