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ECB

European Musical chairs

Why Draghi succession is not the most interesting ECB vacancy of the next two years

The game is on. The appointment of Portuguese Finance Minister Mario Centeno as new Eurogroup president was just the starting shot for a long musical chairs game in Europe over the next two years. At least seven European top posts will become vacant, with the financial crown jewel being the ECB presidency. However, it is not the Draghi succession which affects the ECB most but another job change in 2019.

Five ECB Executive Board members, the presidency of the European Commission and the presidency of the European Council. In the next two years, at least seven European top jobs will become vacant and a musical chairs game on who will fill these vacancies has already started with speculation about possible successors to ECB vice-president Constancio and will last at least until spring 2019. Predicting the exact outcome of this extensive musical chairs game is impossible and would even bring experienced game theory experts close to a mental breakdown. There are simply too many dimensions or factors to take into account, eg, nationalities, previous appointments, experiences, national combinations, gender, etc.

For financial market participants, the vacancies and the musical chairs game at the ECB should get most attention. However, as exciting as the name dropping and speculation game is, it is like speculating and philosophising about the right line-up or the best player's transfer of your favourite soccer team. In fact, the truth lies on the pitch and therefore the most important question is: does it matter at all? In our view it does.

However, in our view, over the next two years, the single most important appointment for ECB monetary policy will not be the Draghi-successor but the replacement of Peter Praet. The position of ECB Chief Economist (even though the ECB does not officially use this term) has been crucial for the conduct of monetary policy. Remember that in the first thirteen years since its establishment, the ECB was strongly influenced by a typical Germanic approach to monetary policy with two German nationals holding the position of Chief Economist. First, German Otmar Issing, the intellectual father of the two-pillar strategy, held this position, trying to ensure that the ECB follows the footsteps of the Bundesbank. He was succeeded by Jürgen Stark, known as a strong supporter of a more purist approach to monetary policies. When the ECB in 2012 decided not give the Chief Economist job to Stark's successor, Joerg Asmussen, but to the Belgian (and sitting Executive Board member) Peter Praet, it – unconsciously – prepared the grounds for the ECB's unconventional policies of the last years.

Looking ahead, the replacement of Peter Praet by May 2019 will in our view have a bigger impact on the ECB's monetary policy than the Draghi-succession. Praet's successor will have to prepare the groundworks for the first rate hikes, balance sheet normalisation and the further exit from ultra-loose monetary policies. On substance, the next Peter Praet could be more influential on monetary policy than the next ECB president. And who could do the job? From the current ECB habitat, in our view, the Irish Philip Lane and the Estonian Adro Hansson would be most qualified to do the job. Both are from smaller countries without any nationals in the Executive Board so far and both are highly regarded monetary policy experts. It would be choice in favour of continued pragmatism and against a return to dogmatism.

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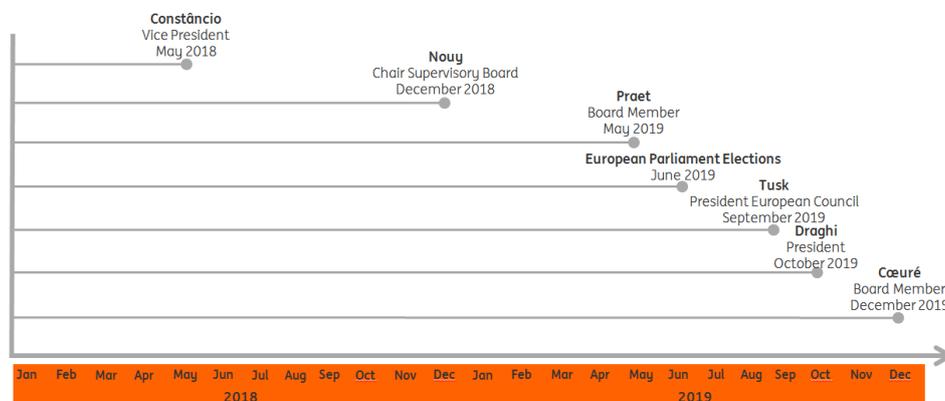
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Written and unwritten rules

Welcome to the arena of European top jobs. In this arena at least seven crucial financial and economic posts will be filled in the next two years. It is an arena in which national and European interests, nationalities, geographical balances, previous jobs and expertise would even give weathered game theorists a hard time. In this note, we will keep our main focus on job changes at the ECB, where five jobs will become vacant in the next two years: four Executive Board positions, including the President's seat, plus the chair of the Supervisory Board of the Single Supervisory Mechanism (SSM). However, note that the succession of European Commission President Juncker will also enter the ECB musical chairs game as it is more than unlikely that one country will have both the ECB and the EC presidency.

Let's start with the formal aspect. As so often in Europe, there are official rules and there are unwritten rules when it comes to appointments at the ECB. Just as a reminder, the ECB's Executive Board consists of the ECB president, the vice-president and four other members. The Executive Board runs the ECB's day-to-day business and together with the nineteen national bank governors, it forms the ECB's main decision-making body, the Governing Council. At the Governing Council, all Executive Board Members have a permanent voting right, while the nineteen central bank governors share fifteen voting rights, based on a rotation scheme.

Fig 1 Timeline of European top jobs vacancies



Source: ING and ECB

According to Article 283 of the European Treaty, the six members of the Executive Board are appointed for a non-renewable eight-year-term by the European Council (Heads of State and Government), acting by qualified majority. The European (not Eurogroup) finance ministers recommend a candidate. The European Parliament and the ECB do not have a formal say in the appointment but are consulted. Executive Board members have to be EU nationals and "...persons of recognised standing and professional experience in monetary or banking matters."

So much for the official part. The unwritten rules are more complicated. Here are some unwritten rules and some stylised facts:

- since the start of the ECB in June 1998, the three largest Eurozone member states, Germany, France and Italy, have always held a position in the Executive Board.
- Spain, as the fourth largest country, held two consecutive positions (until early 2012).
- The combination of president and vice-president has always been a combination of large and small-to-medium-sized member state, never two small or two large countries.

- No single country from the so-called new EU Member States from the East has ever held a position in the Executive Board.
- Ireland is the only founding Eurozone country which so far has not had an Executive Board member.

A final interesting aspect of the unwritten rules is gender. The gender balance within the ECB's Executive Board has been far from equal. Back in 2012, the European Parliament had already delayed its agreement to the appointment of Yves Mersch in protest against the lack of women at the Executive Board. This issue is likely to return with the upcoming five appointments. Currently, there is only one female Executive Board member: the German Sabine Lautenschlaeger.

Constancio succession is only the first step

In the next two years, at least four positions in the ECB's Executive Board will become vacant. It starts this year with vice-president Constancio's term ending at the end of May. Next year, the terms of Peter Praet (May 2019), Mario Draghi (October 2019) and Benoit Coeure (December 2019) will all end. Filling in one vacancy will have consequences for the others.

After the Portuguese finance minister Centeno had been appointed as new Eurogroup chair, the game is on for Constancio's post. Eurozone finance ministers are expected to come up with nominations in the next six weeks, before agreeing on one or more candidates by the end of February. The March meeting of European leaders should then bring a preliminary settlement on one candidate. Previous experiences showed that government leaders could also take a written decision in case the process is delayed.

A delay, however, does not look likely. The Spanish government already threw its hat in the ring, when Prime Minister Rajoy last month announced that Spain would put forward a candidate. While current Finance Minister De Guindos looks like the government's preferred candidate, Rajoy also said that the Spanish government could also offer a female candidate. The next EU finance ministers' meeting on 22 January will show whether other countries are also interested in the position. Potential countries to also put forward a candidate could be Ireland or a country from the East. With vice-governor Sharon Donnelly, Ireland would have a candidate with a track record in banking, similar to Mr Constancio. It would also tick the gender balance box. However, being the fourth largest country of the Eurozone and after a five-year absence from the Executive Board a Spanish candidate clearly has high odds to make it.

The choice for the vice-presidency in our view will have clear implications for the choice of ECB president in 2019. Remember that up to now, the duo president/vice-president always tried to reflect a geographical balance between larger and smaller countries, between the North-South divide regarding monetary policies. Duisenberg/Noyer and Trichet/Papademos were clear examples for this pattern. Also, don't forget that when Constancio was appointed as vice-president, the odds were still for Axel Weber to become next president. The combination Draghi/Constancio was probably not selected on purpose.

Weidmann for President?

With a Spanish ECB vice-president, the chances for Bundesbank President Jens Weidmann to take over from Mario Draghi at the end of 2019 would increase. He obviously ticks almost all boxes: of the three largest Eurozone countries, Germany is the only country, which has not had an ECB president; a Northern European nationality would be a counterweight to a Spanish vice-president, he is currently central bank governor and has government experience.

However, the strongest argument against a Weidmann-presidency is the current over-representation of Germans in other important European financial institutions. The EIB, the ESM and the SRB are all headed by Germans (Hoyer, Regling and König), who were all reappointed last year. To pave the way for Weidmann at the helm of the ECB, at least one of the three might kindly be asked to step down. Weidmann as ECB president would also distort the gender balance as Sabine Lautenschlaeger would have to step down.

Even though Weidmann ticks all traditional boxes and in our view looks like the number one contender, nothing is carved in stone. Weidmann's opposition to the ECB's QE programme, both in public and behind the scenes, will not have benefitted support for his candidacy from Southern European countries. Also, the recent US experience shows that patterns and experiences from the past are no guaranteed path for future appointments.

Other potential candidates for the succession of Mario Draghi are in our view the French central bank governor Villeroy de Galhau or a compromise candidate from a smaller Eurozone country with a rather hawkish monetary policy conviction, like for example Ireland (Philip Lane or Sharon Donnery), Estonia (Ardo Hansson) or the Netherlands (Klaas Knot). A German candidate, other than Weidmann, should also not entirely be excluded. Nevertheless, a Weidmann-presidency currently looks like the scenario with the highest probability at the bookies.

Does it matter at all?

Under the ECB's rules, Executive Board members do not represent a particular country. They are all responsible for conducting monetary policy for the Eurozone as a whole. Against this background, the president should be no more important than other members of the Executive Board or national central bank governors. Except for the fact that the ECB president is the face and main voice of the ECB for financial markets. While this line of thoughts probable still held for the ECB under Duisenberg and Trichet, it no longer holds for the ECB under Mario Draghi. Over the last years, crucial decisions had been prepared and kick-started by a small inner circle around ECB president Draghi. Therefore, one could argue that the president does matter.

But there is more. In our view, the position of Peter Praet, the Chief Economist of the ECB, is even more important for policy decisions than the president. No matter who the president is, he or she will always need economic backing from the Chief Economist for the envisaged path for monetary policy. In fact, Peter Praet in our view has been the first non-dogmatic Chief Economist of the ECB. Do not forget that his predecessors, the two Germans Otmar Issing and Jürgen Stark, were known for a rather dogmatic approach to monetary policy. With hindsight, Mario Draghi's most important institutional decision was probably to give the role of Chief Economist to Peter Praet and not to Jörg Asmussen in January 2012. Back then, Asmussen succeeded Jürgen Stark, who stepped down after disagreement on the ECB's monetary policy path. As Asmussen also seemed to have a preference for the international portfolio and European politics, it was at least partly a matter of coincidence that the German hegemony on the ECB's Chief Economist post came to an end.

We would argue that the single most important vacancy is not the one of Mario Draghi but the one of Peter Praet. Praet's successor will have to prepare the groundworks for first rate hikes, balance sheet normalisation and the further exit from ultra-loose monetary policies. On substance, the next Peter Praet could be more influential on monetary policy than the next ECB president. And who could do the job? From the current ECB habitat, in our view, the Irish Philip Lane and the Estonian Adro Hansson would be most qualified to do the job. Both from smaller countries without any national in the Executive Board so far and both highly regarded monetary policy experts. It would be choice in favour of continued pragmatism and against a return to dogmatism.

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