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ECB

European Musical chairs – Update

Vitor Constancio's succession is the first piece in a big puzzle of the almost total overhaul of the ECB's board

When Eurozone finance ministers agree on a single candidate for the succession of ECB vice-president Vitor Constancio next week, an important first piece of the puzzle of an almost total overhaul of the ECB's Executive Board will finally be on the table.

Next week, Eurozone finance ministers will present the candidate for the ECB vice-presidency. The position, currently held by Portuguese Vitor Constancio, will become vacant at the end of May. On 19 February, Eurozone finance ministers are expected to agree on a candidate, who then officially will have to be embraced by all European finance ministers, before EU leaders will officially appoint the next ECB vice-president (probably at the European Summit of 22/23 March).

There are two applications on the table at next week's finance minister meeting: one from Spanish finance minister Luis De Guindos and one from Irish central bank governor Philip Lane. The Spanish politician is widely seen as the frontrunner, given the unwritten rule that the four largest Eurozone countries should be represented in the ECB's Executive Board. Spain has been absent in the Board for almost six years and currently does not hold any high-level post in any European institution. At the same time, however, the ECB is not really keen on having a former politician on the board. In the eyes of most central bankers, a former central banker can become a politician but a politician should not become a central banker. In fact, even though some former Executive Board members served as senior officials in governments, De Guindos would be the first active minister joining the ECB.

As Ireland is the only founding member of the Eurozone that has never had a post in the Executive Board, Philip Lane's candidacy is also not unwinnable. However, given his strong academic and economic credentials, his candidacy is in our view mainly an attempt to create IOUs in order to go after the Chief Economist post of Peter Praet next year.

The appointment of the next ECB vice-president will be an important piece in the bigger puzzle of what will be an overhaul of almost the entire ECB Board in the next 18 months, with the grand prize being the ECB presidency. In our view, De Guindos as vice-president would narrow the geographic options for the next ECB president probably more than Philip Lane. With De Guindos, the odds for a Northern European like Jens Weidmann to succeed Draghi would increase. However, even though on paper Jens Weidmann is currently still the front-runner for the next ECB presidency, there are several considerations why this is far from being a done deal: i) support from Southern European countries will be weak ii) it's part of a bigger musical chairs game at the European level with too many dimensions or factors to take into account iii) it would further weaken the gender balance as currently the only woman on the board, Sabine Lautenschlaeger would then probably step down "voluntarily" and iv) it would weaken market credibility of "whatever it takes" and the ECB's OMT programme. If the German government really wants to get Weidmann as president, it might be well-advised to push for a female appointment for any of the first two vacancies.

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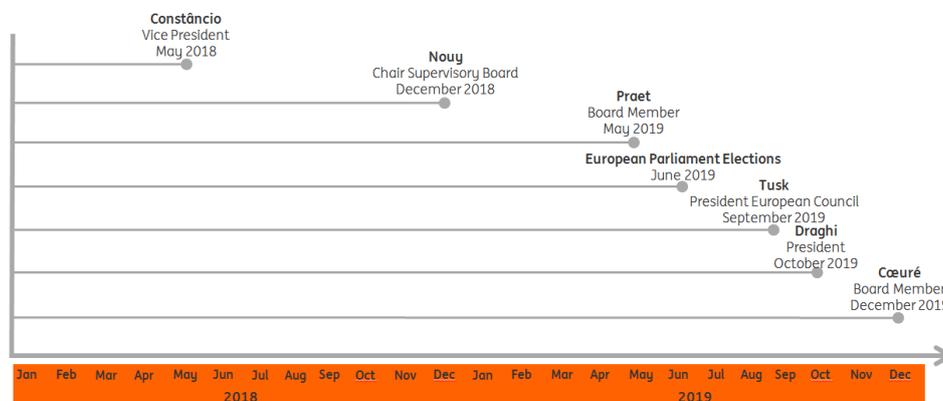
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Written and unwritten rules

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 states, 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 on 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. On Monday, Eurozone finance ministers will come up with their nomination. There are only two applications on the table: one of the Spanish finance minister Luis de Guindos and another one of the Irish central bank governor Philip Lane. 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. Luis de Guindos is widely seen as a front-runner and Ireland would probably be happy to have gained some IOUs at the European level to later safeguard the vacancies at the ECB board when either Peter Praet or Benoit Coeure leave the ECB next year. Also, do not exclude Philip Lane as a potential compromise candidate in the race for the ECB presidency. One question, however, will be how the Eurogroup and then later European leaders will deal with the gender balance. With only one woman out of a total of six ECB board members, political pressure to get more women on the ECB board has and will further increase. The gender balance could also leave its marks on the other appointments in the next 18 months.

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 of 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 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. Even with an Irish vice-president, these arguments would hardly become weaker.

However, there are also several arguments against a Weidmann-presidency. The strongest is probably 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. If the series of appointments really looks like De Guindos for Constancio and Lane for Praet, Weidmann as ECB president would then mark the end of any female representation in the Executive Board. If the German government really wants to get Weidmann as president, it should push for a female appointment for any of the first two vacancies.

Finally, 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, with Weidmann at the helm of the ECB, the credibility of Mario Draghi's "whatever it takes" and the subsequent OMT programme is likely to suffer.

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 thought probably held for the ECB under Duisenberg and Trichet, it no longer holds for the ECB under Mario Draghi. Over the last few years, crucial decisions have been kick-started by a small inner circle around ECB president Draghi. Therefore, one could argue that the president does matter.

But there is more. 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. 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, who eventually stepped down after disagreement with Draghi and others on the board about the ECB's monetary policy stance. When the ECB in 2012 decided not to 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. In fact, Peter Praet in our view has been the first non-dogmatic Chief Economist of the ECB.

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 groundwork for the first rate hikes, balance sheet normalisation and 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 a choice in favour of continued pragmatism and against a return to dogmatism.

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