

Jean-Claude Trichet: Interview with the Financial Times and the Financial Times Deutschland

Interview with Mr Jean-Claude Trichet, President of the European Central Bank, conducted on 14 May 2007 by Mr Lionel Barber, Financial Times editor, Mr Ralph Atkins, FT Frankfurt bureau chief, and Mr Mark Schieritz, Financial Times Deutschland.

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FT: It would be interesting to hear your thoughts about the German economy, because it was the sick man of Europe, that's what everybody said, and nobody's saying that any more.

JCT: I never said that myself. I was struck by the fact that Germany seven, eight years ago, and particularly at the moment of the setting up of the euro, was in the position of having lost a lot of cost competitiveness, which was very easily understandable because of reunification. But then during the first seven years of the euro you had, I would say, hard work being done, and certainly hard work being done on unit labour costs and the cost competitiveness of the economy as a whole. So it seems to me that the overall judgement that Germany was the sick man of Europe, for structural reasons, was not exactly the right diagnosis. Germany had a lot of difficulty to grow again at a pace which would be reasonable and encouraging, essentially because of the loss of cost competitiveness.

It remains true, of course, that Germany, as well as the full body of the euro area and probably the full body of the European Union, has a lot of structural reforms to embark on, to implement. We all agree on that. We are calling for that. We are repeatedly asking for those reforms to be implemented. Germany was doing reform in a way which was not negligible, but was not necessarily extraordinarily rapid. But the area where Germany did really a very, very good job was again this recovery of cost competitiveness of the private sector, accompanied by restructuring, reshaping, internationalising, actively. That last remark is also partially true for the rest of Europe, in my opinion. During the last years, observers have had a tendency to underestimate the level of restructuring and reshaping of the private sector in all the economies in Europe. That was not yet showing up in terms of macro figures, and I often told colleagues here and there in various European or international fora, don't be misled. Remember the US in the second part of the eighties – the macro figures were not necessarily flattering, but a lot of good work was being done in terms of reshaping and restructuring the private sector. And this is something which is happening in Europe in the present period, much more than you suspect. So don't take it that nothing is being done. It's, of course, much truer in the private sector than in the public sector.

FT: Are we underestimating potential growth right now, do you think?

JCT: No. Well, on this particular point, which is very important, I would stick myself to the previous range that we had – 2 to 2.5 per cent would be the growth potential of the euro area. Say, 2.25 or 2.3 per cent would be an appropriate proxy. But we would not say at this stage – and this is the position of the ECB's Governing Council – that we have substantiated and documented a real significant structural increase in productivity, in total factor productivity, or in our growth potential. We consider that what we have observed during the last year may be a pickup in productivity that is probably more of a cyclical nature. This of course calls for more research, but again we think it would be premature to conclude that we have a higher growth potential. It seems to me that other entities, particularly the international institutions, are not saying something different from us, and they also have more or less the same order of magnitudes for our growth potential. Something which is quite striking is if I compare the US and Europe from 1980 to 1995 and from 1996 to 2004, we have more or less exchanged labour productivity figures with the United States. We were registering or observing, labour productivity at the level of 2.4 per cent during the 15 years from 1980 to 1995; they were at 1.2 per cent. We are now during the last ten years at 1.1 per cent when they are at 2.3 per cent. They have multiplied by two their average yearly labour productivity figure and we have divided ours by two.

FT: These changes that you alluded to were driven by the private sector almost in the absence of clear efforts by the political class...

JCT: I wouldn't say "almost nothing". I mean undoubtedly there is an area where structural reforms have been fostered by executive branches, –and by parliaments, where necessary – which has been the transformation in the labour market, aiming at augmenting job creation in the unskilled labour segment of the market. There, undoubtedly, significant structural reforms have been implemented. It

was overdue because we had a level of unemployment in the unskilled segment of the market which was very, abnormal, very high. But I'm impressed to see that it has really played an important role in permitting a significant creation of jobs and reduction in unemployment.

We have created, during the eight years after the setting up of the euro, more than 12 million jobs. We had created less than three million in the eight year period before the euro was set up. The number of jobs which have been created in Europe after the euro was set up, 1st January 1999, has been superior in the euro area to what it has been in the US during the same period. That might surprise because public opinion had not heard that before. And we are now at an unemployment level of 7.3 per cent, and you have to go back twenty-five years ago to find such a low level of unemployment. Unfortunately, as you remember, after the first oil shock in 1973 unemployment increased massively and remained at levels which were quite high. So we have had, as I said, active job creation during those eight years. I don't pretend that it is the euro that made it, but at least those who were saying that the euro is playing against job creation should look at the figures and reflect more. But, that being said, it's clear that the structural reforms that were implemented in Italy, in Spain, in Germany, in France, in the Netherlands and all over Europe, to facilitate job creation in, particularly, the unskilled segment of the market, have been operative and have undoubtedly been a success. Now, in a number of other areas, clearly, we still have a lot of homework to do and that homework is particularly visible, I have to say, in the domain of the labour market in general. It's true that our labour market is less flexible in the euro area than in most advanced industrial economies, including Commonwealth countries. And Denmark demonstrates that it is possible to have a very flexible labour market together with social protection.

FT: Before we talk about France in a minute, why would you be satisfied, though, with 2.5 or 2.3 per cent [economic growth]? Why not aspire to American growth rates, which are necessary, really, to bring down unemployment further? Why not aim higher?

JCT: We certainly are aiming at that. The Governing Council of the ECB considers that our main strategic goal is precisely to elevate the growth potential of the euro area. And we see no reason why we would not have a total factor productivity which would be substantially higher, and why we couldn't go back, after all, to the levels of the early labour productivity progress that we observed in the 15 years before 1995, 1996 and that the US economy is observing since 1996 as an average. So I fully agree with you. Our main aim is to elevate growth potential and the way to obtain that seems to us clearly to embark, across the board, on structural reforms. The single market is a structural reform of the first importance. And the single market with a single currency is an extremely natural way of fostering single market integration. You know that the main problem there is certainly services sector integration, achieving the single market in the services sector. And I would say, to respond very clearly to your question, we call for elevating the growth potential of Europe. The means to elevate the growth potential of Europe is to resolutely embark into achieving the single market, and delivering the so-called Lisbon agenda, which, again, has been considered as a major structural drive for Europe. We all agree on that, all executive branches, the council, the commission. We encourage them all. The problem is the delivery!

FT: But that structural reform does mean a more flexible labour market, doesn't it?

JCT: Yes, certainly.

FT: It does mean dismantling matters like the 35 hour working week in France, does it not? Or do you think that, actually, in the private sector, employers found all sorts of ways around the 35 hour working week...?

JCT: Firstly, let's not forget that we are living in very vivid democracies. And that we are in the ECB issuing the currency for all sensitivities in the euro area as a multi-partisan Institution. And that we have full respect for the decisions of our democracies. The normal duration of a parliament or government is four or five years, say five years. That means that on average, over a period of every five years there are 13 elections of importance in the euro area. Since I was appointed ECB president, just to give you an example, I remember the general election in Spain, changing the government, the general election in Italy, changing the government, the general election in Germany, changing the coalition, the general election in the Netherlands, the general election in France ... On 35 hours let me say that there is an overwhelming consensus the world over to consider that it was a bad decision.

FT: You talked about a vivid democracy. Remember 1992-94. These were tough years for you, as governor of the Banque de France, and you stayed with it despite all sorts of political

criticism. You must have thought that that period was over. And then suddenly the French presidential election, and you're back in the firing line.

JCT: I had from time to time to explain tirelessly what we were doing, why we were doing it. You are absolutely right to say that the public debate in those years was particularly vivid. What was vindicating what we were doing was that we were very much backed by the people. Each survey that we did in these years was really giving us around 70 per cent of the population, of our fellow citizens, saying, "Okay, we back their activity to deliver price stability". And it is the way I am explaining myself that that strategy came along and was not modified, even after several changes in power.

I can tell you that today the Governing Council has exactly the same sentiment. We embarked on a survey, and I have made those figures public already, saying that 73 per cent of the fellow citizens of the euro area approved the following sentence: "we approve the independence of the ECB from executive branches to deliver price stability". And there is the same percentage exactly in France – 73 per cent. The same in France, the same in the euro area, the same for the 318 million people. The sentiment of the people in a modern democracy is that it's good that there are guardians of the currency that are given the mandate of ensuring price stability and are independent from executive branches to do that.

FT: You've got a solid foundation and public support. So how are you going to deal, then, with President-elect [Nicolas] Sarkozy?

JCT: As you know, President Sarkozy has said that he was not calling himself to change the Maastricht Treaty. He was not calling to change the legal foundation for the ECB and I have noted that as something which was, of course, very important.

FT: So what was he trying to do? Can you just ignore what he says, just as the campaign?

JCT: No. What he, and the French government will say will be examined very carefully through the European institutions. We have 13 executive branches that are discussing together. They have themselves their own organisation: the euro group of eurozone finance ministers is a meeting that certainly is important. And you have the council at the level of heads of state and government

FT: The French said [in the run up to the euro], "when the euro enters force there will be a serious political dialogue between the Eurogroup and the European Central Bank". But my impression today is it's a bit sterile, it's a dialogue of the deaf. You want these structural reforms, that's what you're putting on the table, and they want lower interest rates. Obviously that's a crude formulation, it's simplification, but that's...

JCT: Yes, I would say it's an over-simplification. First of all, governments have an immense stake themselves in us ensuring price stability. They have an immense stake themselves in us being credible in delivering price stability. This is contributing to a financial environment which is, for most of the countries of the euro area, exceptionally favourable, because it incorporates inflation expectations – over five years, ten years, 20 years – that are in line with our definition of price stability. Several countries are issuing securities, issuing bonds, of a duration of 50 years. It is because we are credible over the next 50 years that they can obtain the favourable financing which corresponds to that. And they know that. Don't forget, also, that all the national central banks that are now making up the Eurosystem were made independent more or less early, but Banque de France, for instance, was made independent by the will of the French democracy as early as 1st January 1994. It was on the basis of a bipartisan accord between the left and the right. And it called for a very solemn moment in this active democracy that I mentioned, and particularly it called for a change of the constitution of General De Gaulle, the constitution of the Fifth Republic, to permit independence of the Central Bank. And that was done five years before having the ECB itself being created. I would also like to mention, because you mentioned the relationship between the executive branches and this institution, that we have an organisation of meetings, of physical encounters which is probably the most well and scrupulously established in the world. According to the Treaty I invite myself the president of the Eurogroup, Jean-Claude Juncker, every fortnight to ECB's Governing Council meetings. He can participate fully, listening to all our arguments, and make his point if he wishes to – of course, in full respect of the independence. But the existence of these frequent meetings is important. I am invited myself to the meetings of the Eurogroup, together with the Vice-President, and then again, this meeting with all the ministers, and again the president of the Eurogroup, is organised once a month. That makes three meeting every month. Of course it is also true with the Commission, with the Commissioner Joaquin Almunia, the EU monetary affairs commissioner. So we have a scrupulous organisation of very frequent meetings. And if there is any sentiment or message of the 13 eurozone

countries which they would wish to pass on to the ECB, they can do that. On top of that we also have the very same scrupulous organisation of the dialogue with the European Parliament. I have meetings with the European Parliament at least five times a year – de facto even more frequently because I can participate once or twice a year in colloquiums including some which are organised with the MPs of the national parliaments. So that makes, perhaps, five, six, meetings a year including – which does not happen in the US – a hearing with the plenary session of the European Parliament.

FT: You mentioned the Banque de France. There's this rather interesting work being done, which I think Christian Noyer, governor, has alluded to, on the monetary aggregates, and this sort of suggestion that they may not be so useful in measuring inflation, or at least giving us a guide to inflation. What's your view on that?

JCT: I really think that it's, again, an over-interpretation. The part of your remark on the fact that we would be divided amongst us is not the reality. We have very much the same view in the Eurosystem. What is to be mentioned is that here and there you have publications, with appropriate disclaimers, and to the extent that this is a very, very interesting and stimulating issue, you have a lot of elaboration on what is published here and there. I consider myself that we have to be as open and as candid as possible in this domain, as we have been since the very beginning. We never said that we would have a mechanistic approach to the instrumentation of the monetary pillar. We always said, and we repeated it at the time of the clarification of our monetary policy strategy in 2003, that we were considering the monetary pillar as giving very important information permitting the cross-checking of the economic analysis within a medium to longer term perspective. We also said that we were working a lot to broaden and deepen our analysis. And I would say that it is what we are doing. We consider that we have to continue working to understand better the dynamics of the components of M3, particularly in periods where the yield curve is flat, in a period where we have a lot of observations that M1 on the one hand and M3 minus M1 have different dynamics. Equally important are the dynamics of the counterparts. Each month when I mention the monetary analysis, on behalf of the Governing Council, I often mention explicitly some of the counterparts of M3, for instance the non-financial corporate increase in outstanding credit, the private sector credit, the outstanding loans to finance housing etc. And this deep and broad analysis of components, counterparts, and sectorial breakdown of M3 is fully part of the monetary pillar analysis – not in a mechanistic approach, but in an approach that has served us very well. Myself and my colleagues of the Executive Board including Jürgen Stark and Lucas Papademos we all underline these points. I can tell you that myself, I consider the monetary pillar has been probably decisive when we decided to increase rates in December 2005, against the advice of the OECD, of the IMF and a number of observers. That decision was due to the fact that we had our two pillars and were incorporating and assessing the binocular vision that we had of our situation. Today absolutely everybody is vindicating what we had done at the time. But everybody has forgotten that a number of international institutions were against that move as well as ten executive branches out of 12 [then eurozone members]. So all this just to mention that we are very much attached to the monetary pillar. Let me finally add that Banque de France had a monetary pillar which served it very well in the run-up to the euro. Christian Noyer underlined himself the success of eliminating any remaining risk premia with the best other currencies that were in the exchange rate mechanism no.1, the Deutschmark or the Guilder or others thanks to the monetary policy concept of Banque de France. The judgement of the market is probably a very good judge.

FT: It's interesting you use this word "decisive" – that the monetary analysis was decisive in December 2005. Could the monetary pillar be decisive in the coming months? When we have a look at the other pillar, it seems to suggest everything's perfect – you have inflation exactly within range; the economy's growing at or around potential. The only alarm signal we have is the monetary pillar. Could the monetary pillar be decisive in the coming months when it comes to interest rate setting?

JCT: As I said in Dublin on behalf of the Governing Council, we are in a mode of strong vigilance. As you know, I did not want to elaborate in advance what we could do after June in the second half of the year. I was very clear on that. As I said what is clear is that we will do what will be necessary to ensure price stability in line with our definition. The monetary analysis, which, as I said, is permanently enriched, will continue to play the same role in the future in our cross checking exercise. Note also that we are never mechanistic in our decision-making process. As far as the economic analysis is concerned we, for instance, do not underwrite our projections at the level of the Governing Council. We consider that staff projections, whether ECB staff or Eurosystem staff, as an important input in our decision-making process, but we also consider that we have to make our own judgement on the basis of all information and analysis that are available and which we judge pertinent. And I am very happy to

see that a lot of colleagues are going closer to our own views on, I would say, a concept of judgements and decisions enlightened by experience, and coming out of a collegial meditation as comprehensive as possible as regards the inputs including money and credit. The governor of Bank of England looking very carefully at some of the counterparts of the monetary aggregates and at credit in particular is to be noted.

FT: You said that you're not mechanistic. Is there any chance of formally getting rid of [M3] reference value, which of course is some kind of a mechanistic way to judge the figures?

JCT: At this stage we consider that it has served us very well, and we consider that what we have said since the very beginning and in 2003 suffices, taking into account what I have said on the permanent deepening and broadening of our analysis.

FT: As you know, the market expectations are for an interest rate increase in June, and maybe another one by the end of the year. But the question in a lot of people's minds is, if we are approaching a peak, and we might be at a period where rates are likely to stay at the same rate for some period of time, would you ever give any indication that we were entering that sort of a pause or have reached some sort of a plateau?

JCT: I have already said what I want to say as regards the second part of the year. As regards our own past of course similar questions have been asked several times, for instance: "You are at the level of 2 per cent. Will you remain at the level of 2% for a long period of time, a considerable period of time, a short period of time, and so forth?" As you know we refused to respond to those questions. We said, "We will do what will be deemed necessary to ensure price stability" and as a matter of fact we remained at that level for around two years. But we always said that the market should be fully aware of the fact that we could change our interest rates at any time. I called this posture "credible alertness", and this was our constant mode. Other central banks could have at the time a different conception of their medium term pre-commitment, saying that "we will stay at this level for a considerable period of time", which was interpreted by the market as meaning something like more than six months, perhaps one year. You also had some central banks embarking on some more or less automatic instrumentation of their monetary policy, with periodic regular increases. We always refused to do that because we trusted it was not appropriate in our case. We always said: we will do what is necessary and we trust that we are sufficiently candid and transparent as regards our primary mandate, our definition of price stability and our monetary policy concept, for this to function correctly. And the fact is that we could function correctly with a correct understanding of the observers of the market.

FT: Are you concerned about the Spanish property market?

JCT: The Spanish property market, Irish property market...

FT: You were going to say the London property market, but we're not in the euro yet.

JCT: When you are in. [laughs] It's clearly an area where we have elements of buoyancy. It's an area that my colleagues of the Executive Board and of the Governing Council and I have mentioned regularly as calling for close monitoring. It's also an area where we have seen, and I said this in Ireland, some signs of cooling down in terms of prices and in terms of outstanding credit, that are observed in the household credit for financing housing. So, clearly, it is something which is important, it is something which we have to look at very carefully. We mention it as one of the elements which had been taken into account to justify our previous decisions, and we will continue to monitor very, very carefully this "cooling down" which is starting to be observed in Spain in Ireland in particular, at a moderate pace. On the other hand, never forget that we are looking at a vast continental economy of 318 million people. As I said, in Dublin, from Dublin to Ljubljana and from Lisbon to Helsinki, it's an impressive economy by its dimension and size. And what we expect as a likely evolution is that as you have a cooling down in a number of economies, which would be a normal evolution, in the whole real estate cycle, we could have some picking up from a very low level, in particular in Germany, corresponding to the expansion of the German economy. And there we would have somewhat of a balancing effect.

FT: Maybe just come back to France, actually, on that point. We talked about Mr Sarkozy and possibly a confrontation, but do you also see, perhaps, a chance that France might now follow in Germany's footsteps in implementing the sorts of reforms that are necessary to restore international competitiveness?

JCT: I think that the ECB has always called all partners, whatever their sensitivity, to go along the way which had been decided by Europe, by the European Council, unanimously, namely the Lisbon

agenda for reform and we have always said that we were fully supporting reform – all over Europe, all over the euro area, as part of what was necessary to elevate our growth potential and I am supporting, and all my colleagues on the Governing Council are supporting, the reformist drive anywhere in Europe, and of course, in this particular moment, in France, certainly.

FT: But in a way, France hasn't paid a heavy price for not reforming as fast, say, as Germany. There's been a general recovery and French growth has been a bit uninspiring, but it's been okay. But there's been no price paid. So why reform if you can just sort of get along? It's a free ride then.

JCT: First of all, I will not assess myself a hit parade of who is reforming the most rapidly. Again, what Germany has done is to work very effectively on its unit labour costs, on regaining cost competitiveness. Both in France and Germany and Italy, and a number of other countries, a lot of homework remains to be done in the structural reforms. The price that the full body of Europe has had to pay, and of course France in particular, is a growth potential too low, and unemployment too high even if significant progress were made as I have said. In France, eight years after the euro, around two million jobs were created. Eight years before the euro, around 500,000. So, progress was made but the level of unemployment remains much too high all over Europe, and certainly also, of course, in France. So a price was paid. If you would increase the rapidity with which you are reforming yourself, you would be better off. Everybody would be better off and there would be more growth and more job creation, and less unemployment. This is the reason why we support the reforms.

FT: Surely this is a new chance for France. You have a new political leader, who has talked about a culture, maybe shifted back a bit, but he has talked the language of reform.

JCT: We support the language of reform, and we support the implementation of reform because we trust it gives more growth and more job creation. That's absolutely clear. It's not new, but I repeat it.

FT: But just for a moment, if you could just be a Frenchman, rather than a European...

JCT: I am proud to be a Frenchman and proud to be a European...

FT: ...just for a few moments. Sarkozy has been described even as a possible Thatcherite; too strong, perhaps, but do you expect some real changes in the first three, four months?

JCT: The French people have chosen. As I said this Institution issues the currency for 318 million people of all sensitivities and my colleagues and I fully respect all of them. But I would say all that goes in the direction of active reform, elevated growth potential, and in line with the drive that has been decided in Lisbon is good and we fully support it.

FT: Within the eurozone there are divergencies. You've alluded to the hot periphery, you have a laggard Italy, yes, things have looked a little better in the last 12 months or so, but how, from your position as president, and your colleagues at the European Central Bank, how are you managing these divergencies? And how concerned should we be about them?

JCT: Several observations. The first observation, we are running a 318 million people area. It's very vast. It's the order of magnitude of the US. So we can compare diversity in the US and diversity in Europe. We compare diversity in terms of growth and diversity in terms of inflation, only to give you two examples. And I have to say we were impressed by the fact that the figures that you have when you compute the standard deviations on a cross state or a cross country basis are more or less the same. So it seems that it is a normal characteristic of a vast continental economy of the dimension of 300 million people to have on a state-to-state basis, or country-to-country basis the same magnitude of diversity. I have had a number of occasions to elaborate on that.

FT: Yes....

JCT: And we all have a number of anecdotes on both sides of the Atlantic. You're in the US, the unit labour costs, the levels of productivity are not the same in Massachusetts, South Carolina or California. It's normal we find, in a very vast economy. Even in the UK diversity is present. If you are in London or Edinburgh, you are not necessarily in exactly the same economic environment. So it's normal. What is very important is that we central bankers, all call for as much cohesion as possible. For us, it's important to have the various executive branches as lucid as possible, and as aware as possible of what's going on, including, in terms of unit labour costs. The Commission has played, and is playing an important role in making everybody aware of the various evolutions, for instance of unit labour costs, in the various countries.

FT: It's benchmarking...

JCT: It's clear that we have the same diversity as is observed in the United States. We have also perhaps more persistence in our diversity. So there is an element of transparency and lucidity at the level of the eurogroup, the executive branches, which is certainly important. Another observation I would like to make is that when looking at the United States, we are discovering, and that has been done by research, in a very convincing way, that financial integration, and namely the credit channel and the risk-sharing channel, are playing a very important role in absorbing asymmetric shocks. Namely around 60 per cent of the asymmetric shocks would be absorbed by the financial integration channel while perhaps, and that was a surprise, only an order of magnitude 15 per cent would be absorbed by the fiscal channel through the mechanism of the federal budget. For us, the conclusion is that financial integration is not only very important in terms of appropriate functioning of a single currency area with a single monetary policy, not only important because a single market with a single currency is part of the way you are getting higher growth potential, it is also important for the cohesion of this area when you have asymmetric shocks. You have through financial integration an efficient way to weather those asymmetric shocks. By the way, what is also pleasing is to see is that when our research concentrates on better explaining the diversity in growth, on what is the business cycle component, and what is the long term trend component, we see that the convergence of the business cycles is more and more visible in the euro area.

FT: It's very interesting; you talked about financial integration down the credit channel. Does it present any problems that the City of London, which obviously plays a very important part in the clearing system, is actually outside the Euro Zone?

JCT: It's a very disputed question, of course. We would call ourselves – as you know, we don't hide our position – for UK, to join in. We trust that the UK does not see the advantage of joining in because it is benefiting from the reforms that have been implemented in the UK, have been accepted by both the left and the right, the New Labour, if I may, and...

FT: That's Old Labour now!

JCT: I don't know what the appropriate name is!

FT: It's the end of New Labour...

JCT: Well, you will tell me exactly how I should call that! But I am mentioning this sensitivity on the left as well as on the right, which has accepted that a flexible economy is paying off in terms of growth and job creation. The fact is that previous reforms are giving the UK a competitive edge. But if you look at the figures, Ireland is growing faster than the UK. Ireland has a GDP per capita, which is higher. Fancy, Ireland in the euro area with a GDP per capita over and above the UK one? I mean are you so sure that the UK made the best choice! But again, it's entirely up to the UK, to the UK government and to the UK people.

FT: But it was a Frenchman – it wasn't you – who once said, ten years ago, without the UK, the Euro Zone would be like someone without a right arm.

JCT: I don't know which Frenchman told you that. He would certainly express a view, which is unanimous: we all call for the UK to get in. And the UK knows that. So it's a very simple situation. We all call for the UK to get in. It's up to the UK. That said, even without the UK, we are 318 million people. So even without the UK we are of the order of magnitude of the US. And on top of that, out of the 27 EU member states, 25 have no opting-out clause. So 25 have already committed themselves to enter when time comes, meaning when the Maastricht criteria are met. And on top of that, out of the two that have an opting out clause, one, Denmark, is already de facto in the euro area, and considers that the belonging de facto to the euro area is serving its national interest very well, on a bipartisan basis.

FT: Could you just rehearse very briefly, for the British people, what the benefits would be of joining the Euro, say, tomorrow or in a years' time? If we did join, what would be the benefits?

JCT: I would say the UK has been absolutely instrumental in joining in on the very bold endeavour of the single act and the single market in the mid eighties. It was really something that had been decided upon by all Europeans at the time, of course, but I would say the UK had been very active, and rightly so. It was the start of the rebirth of the European drive. It was something, which has been absolutely fundamental in my understanding of the historical evolution of Europe. Then I would tell the UK: "that a single market to which you are so profoundly attached is not achieved without a single currency." Make the thought experiment for one second that you are in the US, and that currencies are different in Massachusetts, in California, in Florida, and Alaska, and tell me what would be exactly in your eyes,

the single market of the United States of America? At this stage my argument would be as simple as that. I stop there.

FT: But we are in a single market?

JCT: We are not in an achieved single market, because you still have, of course, between parts of the market this difference of exchange areas, this barrier, which remains.

FT: But just to make this point clear, again, back in 1992, when Britain was in effect forced out of the ERM [European exchange rate mechanism], many people...

JCT: By the market.

FT: By the market, not by you, yes exactly, and we know that this was a terrible experience. It destroyed the Conservative government, but many people said, Britain would not be able to maintain a stable currency... Or Britain would be tempted into competitive devaluations, which would undermine a single market. None of this has happened.

JCT: Britain has made extraordinary, impressive structural reforms that have, in my understanding, very profoundly transformed over the last 25 years the British economy for the better. That of course has nothing to do with the response to the currency question, but again, it's up to the British people. It's totally open, we all know that.

FT: It's an interesting moment, this is the end of the Blair decade; Gordon Brown has finally got his hands on the top prize. You've seen him for many years in Ecofin [EU finance ministers meetings]. What do you think his leadership will bring in terms of the contribution to the economic discussion? Might he be a bit more amenable on the euro?

JCT: No, I will not embark into guessing what he will do on the euro. He certainly knows better than anybody that the UK is fully welcome.

FT: What about enlargement of the Euro Zone? What does that mean for the workability of the ECB and the governing council?

JCT: Firstly it is fantastic to experience this historical transformation. I have known a world where you have the north and the south, and the east and the west. We are in a different universe, conceptually. We [once] relied upon the balance of terror. I was once, as chairman of the Paris Club, in Moscow with colleagues of the G7, discussing the potential rescheduling of the Soviet Union debt. We still had a Soviet Union. We went to the Kremlin, and we were discussing with the master of the Soviet Union, with Mr Gorbachev. Fancy that we would be in a universe where we have now one previous communist country, Slovenia, which is part of the euro area. It is something, which is extraordinary. We are very positive ourselves on the enlargement. We consider it is a chance for Europe, it's helping Europe, it's helping the development of the European Union. It's a major contribution to our future growth and prosperity. You know that we have already settled in advance what will happen when we enlarge the euro area. We were called by the Nice treaty with an enabling clause to reflect on that and to propose an appropriate solution, when we are more numerous. We found out a unanimous solution. It's one of the great successes of the ECB; being able to work out a solution and propose that solution unanimously. We were criticised by all institutions and partners. The parliament said, "it will not fly; it's no good". The commission was not on board. A number of economists were not happy with that, a number of governments as well. But finally nobody found out a better way, and we have been vindicated, it's been adopted, and we know now how we will proceed in our decision making, even when we are much more numerous. I see now our work in this domain as reminding everybody that it's very serious to enter into the euro area, that you have to converge correctly as required by the Maastricht Treaty, in your own interests, that you have to be in line with the criteria, not only in the moment that you take a snapshot, but also on a sustainable basis. We said that. I think it's accepted and well understood by all partners as being a condition for the national success of the country concerned. We have also to protect the credibility of the euro area, so there is a joint interest in being as efficient and as professional as possible in organising this enlargement. We are not a closed shop. We have proved that with the entry of Slovenia. And again, historically, what's happening is very profoundly heartening.

FT: Aren't you concerned a little bit about one or two examples, where some of the countries have clearly politicised the central bank – and interfered, or removed, or put pressure on the central bank governor to go?

JCT: We have permanently told them, we and the European institutions, including the Commission and the Council that the independence of the central bank was integral part of our rules. I was myself public on that. At several moments we had to express our views because you know that in procedure, when you change your legislation on any kind of legislation that has to deal with monetary or financial matters, we have a say. So we have had several occasions to defend central banks independence. It is clear. It is in the Treaty.

FT: There are some countries, particularly in the Baltic States, for example, which, while they've experienced very impressive growth rates, inflation has been perhaps higher there than would be tolerable in Europe. Do you make any specific allowances for their stage of economic development before assessing whether they're eligible to come in, or does it have to be the Maastricht Treaty and nothing else?

JCT: What we consider essential is: stick to the Maastricht criteria. Slovenia has proved that we could stick to the Maastricht criteria and be an open shop. And before, you also had some countries that were with a standard of living that was only a fraction of the European Union at the time, and entered the European Union, and became a great success. So we are totally sticking to the Maastricht Treaty and we will continue to apply those rules

FT: In Davos, in the beginning of the year, you were quite prescient in your comments on under-pricing of risk, and during February and March we had quite a lot of turbulence in the financial markets. Markets have recovered since then; we're back to where we were before. I notice you've been talking again about risks being under priced. What are the lessons you draw from the experience so far, and is there more of a correction to come? Is that a risk that financial markets should be taking into consideration at the moment?

JCT: Let me first say that I would not make a prognosis or projections. Obviously we are not in a market that would be immobile; you have moves in spreads, you have moves in insurance premiums. You have moves also in the volatility that is observed, and we have seen corrections, we have seen tensions and corrections during the past months. So the market functions well. That being said, the appreciation of risks in general that we presently see on the market might be interpreted as signalling that perhaps all the risks are not fully appreciated, fully priced. Again, I'm cautious and prudent, because this is something that market participants have, themselves, to judge. But we call on all responsible entities not to be complacent and to improve as much as possible their risk management and to be aware that there are a number of characteristics that might explain the risk assessment in the present episode of global finance, but that they might not be sustainable in the long run. I'm thinking in particular at the level of current account surpluses that you are observing in a number of economies in the emerging world, and which might contribute to the ex-ante savings being higher than ex-ante investment. Amongst other factors you have also, and perhaps more importantly, the creeping oil shock, which has created an additional pot of "forced savings" that is coming from the price of oil and commodities, and at the level of global finance, this contributes to create a global environment where ex-ante savings are superior to ex-ante investments. And then, perhaps this might contribute to explain this sentiment that you have when you discuss with market participants or financial institutions in general that they are observing a lot of capital everywhere, a lot of capital "chasing investment". My experience is that the episodes in the global economy where you have "capital chasing investment" are not necessarily sustainable in the very long run. You have normally more investment chasing capital to be financed! So, again, let us look at the full picture. We have the chance of experiencing a remarkable growth at the level of the global economy. This is extremely rejoicing. In a large part of the world, particularly of course in emerging Asia, or in the emerging world in general, even in Africa, we see sustainable growth in the real economy, which is higher and more durable than what we have seen in the last 30 years. So this is good. This is a matter for rejoicing. And it is our duty to do all what we can for this situation to be as sustainable and lasting as possible. This is why we have to be cautious, encourage appropriate risk management and call for avoiding complacency.

FT: This situation of excess capital, as you described it, what is the reason for this, and does loose monetary policy by central banks play a role? And should one pay more attention to global effects of national decisions?

JCT: As you might have seen, the call of central bank governors for no complacency goes in all directions, financial institutions, managers, in the private sector as well as in the public sector. As regards the central banks, I really trust that we are doing what we judge necessary, to be up to our responsibilities on both sides of the Atlantic, and both sides of the channel, of course, and everywhere in the world. The major reasons for observing what we are observing today? I mentioned two of them.

I mentioned the way the number of emerging countries are prudent and cautious. At the moment I'm speaking in terms of posting current account surpluses. I have mentioned the fact that we had the oil shock of the addition forced savings. I could certainly [also] mention the sophistication in the financial markets, which has permitted, obviously, to engage in a remarkable dissemination of risks through sophisticated derivatives which perhaps explains also why you have an appreciation of risk, which is different now from what it was before. I would say all this has to be taken into account. Note that I don't pretend to be exhaustive.

FT: Let me ask about hedge funds, seeing as we're in Germany, where a political class seems to have an allergy to hedge funds. Do you think they should be regulated?

JCT: I think that there is a large level of consensus now that a lot of progress, should continue to be made at the level of the prime brokers, in order for them to be as, I would say, aware as possible, of the risk that they are taking. And this, of course, is something, which can be checked by the banking surveillance authorities, so there is a way to improve the indirect approach, which would permit ensuring that through those financial entities that are regulated, we are dealing with appropriate behaviour of the hedge funds themselves. You have another area where, I trust a lot of progress was made, since the discussion took place, in particular of the G7/G8, which is that we would be able to embark on what I would call "principles" or "codes of appropriate behaviour or conduct", or "good practice" as has been done in a large number of other areas, which would be voluntary code, and which would, perhaps, permit to elaborate more on issues like: What do you expect as regards to the optimal risk management inside the hedge fund itself? What do you expect as the state of the art exchange of appropriate information with your own investors? And what would you expect as regards to your own, state of the art exchange of information with your prime brokers? So that in these different areas, namely the three areas I just mentioned, but not exclusively the industry itself would say what one should do when being an active participant in the industry it would behave properly, in a state of the art fashion. It seems to me that I trust that in a number of areas, we can proceed very much through the way of such voluntary codes. I, myself, was very happy, because in the domain of preventing and solving a financial crisis in the domain of sovereign risks, voluntary principles could be worked out by issuers and lenders. This has been very useful. I had launched this particular idea myself together with several friends. I was very happy to see that it could fly.

FT: When was that?

JCT: I launched it when I was Governor of the Banque de France, and it was at the time when the idea of having perhaps new legislation at a global level to run such a crisis was launched. It appeared that it didn't fly for a variety of reasons, and finally the voluntary principles were put into a real existence, thanks to very active work done by issuing countries and by the private sector all encouraged by the G20. But again in general the avenue of voluntary "principles" or "codes", seems to me promising.

FT: The British are a little bit reticent, but interestingly Hank Paulson [US Treasury secretary] seems a bit more amenable.

JCT: Again, I'm cautious and prudent, but it seems to me that there is an emerging consensus provided that we avoid regulatory and administrative measures but that we rely on a purely voluntary set of principles.

FT: More generally, about the role of the eurozone, on the international stage. We were talking a bit about the global imbalances. Do you think the Euro Zone pulls its weight in the international debate? Should there be more involvement in, for example on exchange rate policy, and these sorts of discussions? Are there structural weaknesses because of the way the eurozone is represented politically and numbers of different people who speak from various bits of the eurozone, and the EU and...?

JCT: Again, the eurozone is an entity that is of course new, on the other hand, in all informal groupings, it seems to me that the eurozone has found out its place. The President of Euro Group is in the G7. I am in the G7. In the IMF, of course the nations themselves legally are the "shareholders" of the IMF, but it seems to me that it's been progressively clear that the Euro area has its place, in the IFMC, for instance, as well as in other groupings. In the Executive Board, Lorenzo Bini Smaghi follows the domain carefully.

FT: A criticism made by Mr Sarkozy, for instance, was that the other regions, the United States or Asia, somehow managed to fix or arrange so that the macro economic conditions, the exchange rate, or whatever, are more favourable for the economic growth, where somehow Europe fails to create the right conditions on the international stage to boost growth.

JCT: As you now we are in a freely floating exchange system between major convertible currencies since a third of a century. From that standpoint the euro and the sterling are in the same situation together with, in particular the dollar and the yen. We meet regularly in what we call the G7. There you have the executive branches and the central banks. We discuss and we sign a communiqué in particular on exchange rates. Let me stick to the Washington communiqué which was signed by all seven ministers and central bank governors as well as by Jean-Claude Juncker and myself. Let me add what I said after the communiqué was published. In three short sentences:

Excess volatility and disorderly movements in exchange rates are undesirable for economic growth.

As the Japanese authorities have said, the Japanese economy is on a sustainable recovery path and the exchange rates should reflect these economic fundamentals whilst exchange markets should be aware that there are two-way risks in any bet.

And I noted with interest that the US Secretary of the Treasury has confirmed that a strong dollar was in the interest of the US.

FT: He's also suggested that a slightly stronger renminbi would also be a...

JCT: We, together, have called upon our Chinese partners to let their currency appreciate in an orderly fashion in their own interest. It is a message for, not only the Chinese, but for emerging Asia, since a long period of time, since our meeting of Boca Raton in Florida at the beginning of 2004. We have shaped that message together, European and American, and Japanese.

FT: Do you think the Chinese are a little bit more amenable now, to a...?

JCT: I fully respect their responsibilities and it is their decision. They know that we consider that it would be in their interest and in the interest of all partners at a global level that we would go in this direction.

FT: Do you think the World Bank is suffering a crisis of leadership at the moment?

JCT: I have no comment.

FT: You're now nearly half way through your tenure as President...

JCT: I have had the honour of this responsibility together with colleagues of the executive board and of the governing council for 3 years and a half.

FT: But if one was to use a motoring metaphor, you've hit cruising speed. So what would you like to do as you plan ahead? What things do you have in mind for improving institution, and things you'd really like to contribute?

JCT: First of all, when you have the chance of participating in a historical endeavour of such magnitude, it is difficult to speak of cruising speed. What is absolutely extraordinary is when I compare where we are now, after eight years and several months, with what was anticipated nine or ten years ago. I negotiated the Maastricht Treaty, together with Horst Köhler [German president]. I was explaining in New York and London what we were doing and the reasons we were doing it in, I would say, circles that ten years ago were quite sceptical. Even nine years ago! New York convinced itself that we would really set up the euro only at the end of the first quarter of 1998. From time to time I think that what we are doing is remarkable and that it is not very often in history that something of that dimension would be really done, surrounded by such scepticism at the very start of it. So what I would say, first of all, we should continue to preserve credibility and to run as well as possible this set up – of the same order of magnitude of say, the United States – in a universe where, I have to say, the challenges are impressive. The Fed has its own challenges but we have the same. We have to run our monetary policy in a world that is changing so rapidly – India, China growing so fast, the full body of emerging Asia taking off equally brilliantly, science and technology multiplying discoveries. I myself was first trained as a mathematician and a specialist in physics in the French education system. From time to time I pinch myself because I have a difficulty in realizing that the progress of science and technology is so rapid and so overwhelming; it's amazing.

So are the challenges of globalisation, the take-off of emerging countries, and all the other structural changes that are at stake – change in science and technology, the ageing of our population in our own industrialised society. All these are the shared challenge of Mervyn King, and Bank of England, of Ben Bernanke, and the US Fed, of the ECB and all my colleagues in the various committees, here in the ECB's Executive Board, and in the Governing Council. But on top of that in our case we have two

other challenges. And it's really on top. We have the structural transformation of Europe – to achieve the single market with a single currency. And we are far, of course, from having achieved a single market with a single currency, particularly in the area of the services industry. And to enlarge. And we know that the European Union has not finished enlarging. We will see what comes, what happens then, but it's really a historical endeavour, which is striking. And we have to be up to all those challenges simultaneously. I would say we have five challenges when other Institutions have three. And the three are already fantastic and call upon you to adapt to change rapidly, to explain tirelessly to our European fellow citizens that we can make the best out of the new world if we change sufficiently rapidly. It is true that it is not that easy to change as rapidly as India and China are changing themselves...

FT: Do you see the ECB having a specific role on some of those? Obviously price stability and credibility is your main goal but when you talk about the creation of a single market, and also of eurozone enlargement, does the ECB have a role itself it can actually play as a catalyst?

JCT: Again, we must be up to those challenges. Clearly we must help achieve the single market. We must help achieve the structural reforms. I already said that we support structural reforms that all governments in Europe are implementing including the future government of President Sarkozy in France. It's clear that the role of the ECB, the role of the national central banks members of the Eurosystem, in this domain, is more of a catalyst nature. Again the Eurosystem has a responsibility to explain to 318 million fellow citizens why we would be better off with reform.

On financial integration, I would say we go further, of course, as you know. We trust that we have a catalyst role to play and we have several examples of the role being played. STEP [the short term European paper initiative], for instance, is a good example, where we helped the private sector crystallising its own progress and improvement. Eonia [the European overnight index average – a measure of the overnight euro interbank interest rate] is of course is something that we foster ourselves. But we not only play a catalyst role. You know to what extent, of course, Target2 [a new generation payments system] has been very important. We will have Target2 running at the end of the year and it's also something that is very striking because it will be a single infrastructure at the level of the euro area. At the very beginning we were connecting the various national infrastructures, then the second generation is a unique infrastructure. We have the endeavour of Target2Securities [a planned eurozone securities settlement system] – a lot of areas where we push, we say that we are at the disposal of the private sector. We have of course the SEPA [Single European payments area] project, which is also a very ambitious one, and where we have played a role as a catalyst, crystallising positions. In all these domains the Eurosystem is very active. In the Executive Board Gertrude Tumpel-Gugerell and José Manuel González-Páramo are devoting a lot of time to foster financial integration together with the Vice-President.

FT: Is there is a danger, particularly on the structural reform, that you get this political backlash because... you hear it from politicians; the ECB lectures us about structural reform, but we're not allowed to talk about monetary policy, or exchange rate policy. And you are independent; you're not an elected...

JCT: Two or three remarks. Generally I'm told that more in the domain of fiscal position. We haven't spoken too much about fiscal policies. But I have to say that in the domain of structural reforms, what we do is to tirelessly explain. A large number of governments, if not all, are absolutely convinced that it will be the right direction, but are meeting resistance in their own public opinion or society. So what we are trying to do is to help convincing public opinion. I have observed, on the other hand, that in the domain of fiscal policies, there is a slight difference of culture, if I may very cautiously suggest, between the UK and continental Europe. It's always been state of the art in continental Europe that the central bank makes an assessment on the fiscal policies and calls for fiscal soundness. It was the case, even when the national central banks were not independent. Everybody was expecting the central bank to express publicly such opinions – whether it was in Germany, in Italy, in the Netherlands, in Belgium, in France etc. Perhaps in the UK it would be considered not exactly part of the division of labour but I'll let you judge. What is true is that as far as we are concerned, in the Eurosystem there is no new concept, we always have called for fiscal soundness.

FT: It didn't seem to have much influence over successive French governments, though. They haven't balanced the budget for how many years? 25?

JCT: I am speaking of continental Europe as a whole. In each country that depends. You have several episodes. At the moment I am speaking a lot of homework has to be done and is being done. And the commitment that was taken in Berlin under the chairmanship of Peer Steinbrück for euro area

countries, to achieve their medium term objective of sound budgetary positions as soon as possible and by 2010 at the latest, were praised by the Governing Council.

FT: Listening to you when you talk about being part of this historic endeavour, an extraordinary achievement and that Europe will be expand – you sound so much more comfortable about this than some of your compatriots.

JCT: I don't think that it is disputable, frankly speaking, that in terms of ideas, in terms of reference to political democracy and human rights on the one hand and of market economics on the other hand the handful of countries that have started European Union have won. And all the founding fathers of Europe, in particular my country and the five others which were so happy to see other nations joining them progressively and finally rapidly, including the UK, have proved remarkably lucid and visionary in historical terms. They were trying to promote peace, liberty and prosperity in their part of Europe, with a view to win against the values and the threats which were on the other side of the Iron Curtain.

I have already said that we ourselves in Europe had all the normal challenges of the industrialized countries plus two others: the deepening of the European construction and enlargement. Our main task is to face up with the implications of five major successes and paradoxically it is not easy. The countries that were the poorest of the world are now growing very fast. We called for that since World War Two. It's a first success. Science and technology are developing extremely rapidly – of course it's a second major success. Life expectancy is rapidly increasing. It's a third fantastic success associated with science and technology applied to human health. The European construction has proved effective and efficient in transforming Western Europe. It is a fourth success. And partially as a consequence of this economic and structural success the iron curtain fell, a major fifth success. But each and every of those successes are making as many new challenges. They call for changes in the international division of labour, for changes in the production process in the production sector, for dramatic reviewing of the financing of pensions and for particular structural transformation of our economies in Europe associated both with the integration of Europe and with enlargement. If we accept to adopt and engage in an appropriate pace of reforms the five successes/challenges, turn out of the real, effective chances. And then a virtuous circle can start. I don't say that it is easy and I think it would be very naïve to say that it is easy. I have the feeling that the lucidity of the large public opinion, the lucidity of our people is key for a successful future. As far as we are concerned we will continue to be an anchor of stability and to deliver price stability and the confidence with goes with it in our vast continental economy.

FT: That's very interesting: what you just said is, "we have won". If you're thinking about the battle in ideas, the idea is that, yes, the European Union should enlarge. Yes, that there should be an embrace of markets. Yes, that the battle in favour of price stability has also been won. Is that correct? Would that be a fair summation?

JCT: I mean, it's never definitely won. It is no time for complacency. And success in any domain can never be taken for granted. But we have won a lot of battles and it is a formidable encouragement for the future, in Europe, across the Atlantic and, for the first time since very long, really at a global level. But have we made a lot of progress, yes, in these domains – at a global level.