Mario Draghi: Restoring confidence with more transparency

Interview by Mr Mario Draghi, Governor of the Bank of Italy, with the Wall Street Journal, at the World Economic Forum, Davos, 2 February 2009.

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WSJ: Are there any signs markets are stabilizing or improving and if so, how much should we read into it?

Mr. Draghi: There are markets that have started to function again, though at a reduced level. Spreads on the interbank market have narrowed considerably, and the corporate-bond market has shown signs of being alive. There has been a flurry of new issuances in the first few weeks of January. We will get little bits of good news and we can enjoy them. But we shouldn't make too much out of it.

WSJ: What is the priority for regulators at the moment?

Mr. Draghi: Credit circuits have been clogged now for more than a year. The very first thing to do is restore confidence in the banking sector, because it's clear that until that is done there will be no significant flow of private capital to the banking sector.

WSJ: How do you restore that confidence when the market has become so skeptical and skittish?

Mr. Draghi: The only thing we can do to help restart the market is to tell the world that there are certain kinds of real products that are simple to understand, easy to price and satisfy certain legal conditions.

WSJ: How do you do that beyond emergency measures and into the medium and long term?

Mr. Draghi: There needs to be significant progress in developing greater transparency so we can understand what's on banks' balance sheets and what valuations are.

WSJ: More specifically?

Mr. Draghi: In the future, there is going to be an unavoidable move toward standardization. With standardization, regardless of whether you have regulation, you will have a powerful push toward transparency, because people would understand and price products with full knowledge of them. It is also of primary importance that we create a centralized clearing and settlement process.

WSJ: Aren't you afraid that the push for more regulation will put a brake on financial innovation?

Mr. Draghi: We want to create a system which doesn't destroy the prospectives of the banking industry. Standardization may well hamper growth of financial innovation, but this growth will be more sustainable through time.

WSJ: All things considered, what do you think the banking landscape will look like in the future?

Mr. Draghi: What we want is a financial industry, and banking sector especially, where you have more capital, less debt, more rules and much stronger supervision. You can have that only if there is a level playing field and broad endorsement by political leaders. It has to be done in a way that you keep the market alive. That's the art of doing it.

WSJ: You talk about engaging political leaders. The G-20 is looking at a variety of changes to the global financial regulatory system. What do you hope will come out of it?

Mr. Draghi: I am confident that this group will not only endorse a global response but also contribute to shaping it.

WSJ: Is there a sense that we could see political leaders make a coordinated statement about their goals – for instance, increasing transparency – and then leave it to each nation's discretion on how to implement the shared goal?

Mr. Draghi: Yes. I think that is exactly the process. There is a great need for political endorsement at the global level. Then implementation is going to be, unavoidably, national. There is a shared sense that one of the great benefits for the financial-services industry was that over the last, say, 20 years, it has became global. Nobody denies this benefit now. We will lose all this if we become protectionist again by taking up initiatives purely at a national level.

WSJ: If you achieve all these goals, is the end result a world in which crises become less likely?

Mr. Draghi: No. I think crises are part and parcel of the market functioning. Our aim is to make sure you don't amplify normal market oscillations, either by regulation or by individual behavior. That's the ideal regulatory action plan.