Jean-Claude Trichet: Interview with the Wall Street Journal

Interview of Mr Jean-Claude Trichet, President of the European Central Bank, with the Wall Street Journal, published on 23 March 2009.

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WSJ: You've shown a bit of optimism recently, saying we could see a moderate recovery in 2010. Where will recovery come from?

Mr. Trichet: I have not been alone in mentioning that in Europe 2009 will be a very, very difficult year. As regards 2010, I always mentioned not only our own diagnosis, but the fact that an overwhelming majority of observers, economists and international institutions would say that in the course of next year there will be a progressive gradual recovery. It's neither an optimistic vision nor a pessimistic vision. It's the present, realistic vision.

WSJ: Federal Reserve Chairman Ben Bernanke spoke recently about "green shoots" in the U.S. economy. Do you see similar green shoots in the euro-zone economy?

Mr. Trichet: Again, we have to accept that in Europe as in the world 2009 is a difficult year and you have, in the present situation, elements that you could see as very negative. You have some that are a little bit reassuring on both sides of the Atlantic. But all taken into account, we are still in a situation where the trend is downward.

WSJ: What will turn the downward trend around?

Mr. Trichet: I see four main possible factors behind a progressive gradual recovery in 2010: first the expansionary effect of the fall in the price of oil and commodities; second the activation of the economies through discretionary fiscal policies and automatic stabilizers which are very substantial; third the extraordinary measures that have been taken to put the financial sector back on its feet: on this side of the Atlantic the commitments of the executive branches in the form of recapitalization, guarantees and other options represent around 23% of the GDP; fourth the policies of the central banks: as an example for the ECB and the Eurosystem the size of the balance sheet represents now 16% of the GDP when it was 10% before the crisis, namely an increase of 600 billon euros (approximately 800 billon dollars).

A number of other factors are also very important in the perspective of a medium-term recovery: the continued surge of technology, the considerable growth potential of the emerging economies. But as regards a relatively prompt recovery what is decisive is the confidence factor. What we are experiencing is a very sharp and abrupt disappearance of confidence. So it depends very much on us that 2010 could be, or not, a year of progressive gradual recovery. It depends on the capacity of authorities and private sector together, to re-inject in the economy of the world these elements of confidence that have disappeared mid September 2008.

WSJ: Do you think the criticism that European governments have not done enough, in terms of fiscal stimulus, is justified?

Mr. Trichet: I think it's not. After the recent meeting of ministers and governors of the Group of 20 in London, I had the conviction that both sides of the Atlantic had understood much better each others' situations. There is a mutual understanding that when you take all into account, you see that on both sides of the Atlantic, what has been done on the fiscal side corresponds to the gravity of the situation.

To speak more directly of the euro area, you must take into account the combination of discretionary decisions that have been taken by all governments, plus the automatic stabilizers that are much more important on this side of the Atlantic; the level of public spending as a proportion of GDP, which is much higher on this side of the Atlantic; and the room for maneuver for each particular economy that existed before the crisis and exists today.

To be efficient in rebuilding confidence, you have to demonstrate that you are doing, immediately and audaciously, what is necessary today. But at the same time, you have also to reassure your own people that you have an exit strategy, to reassure households that we are not putting in jeopardy the situation of the children, and to reassure businesses that what is done today is not done to the detriment of their own taxation in the years to come. Activation of the economy depends crucially on confidence. And confidence today needs that we can prove to our own people that we have the right balance between the short-term and the medium- and long-term perspective.

WSJ: What do you think are the most urgent requirements for enacting global policy now? There are a number of measures that have been announced and not enacted. Are you, for example, concerned at the pace at which the U.S. financial restructuring is going?

Mr. Trichet: What I would recommend for us as for the US is to, now, as efficiently and rapidly as possible, do what has been decided. Nothing will really work until the financial sector is back on track and ready to lend on a sustainable basis. I would say exactly the same with the budget. Decisions have been taken; they are very important. Let's do it! Quick implementation, quick disbursement is what is needed. Not embarking on useless and counterproductive quarrels which fortunately are over now.

WSJ: If recovery does not take hold gradually in 2010, does the Stability and Growth Pact give European governments room to do more?

Mr. Trichet: The Stability and Growth Pact has been revised to cope with exceptional circumstances. It is our way to maintain appropriate cohesion in a single market with a single currency and with no single federal budget. Respect of the procedures and provisions of the Stability and Growth Pact is of the essence.

WSJ: Ireland expects an 6.5% decline in GDP this year. Their deficit is projected to be 10% of GDP and they'll soon introduce a budget that will raise taxes. Is that really the appropriate response in the teeth of a deep recession?

Mr. Trichet: I am not speaking of one country in particular. In each case you have to see what your own room for maneuvering is. If the additional deficits are costing you both, a strong increase of the cost of your own refinancing and a loss of confidence of your people, you're not better off! If your people have the sentiment that they will be not better off in an endless spiraling of deficits, they will not spend any money that you give them today!

WSJ: There are a number of countries that, absent the euro zone, would have made an adjustment in real wages through devaluation. How do you see adjustments in real wages now being made in the euro zone's less-competitive economies? Isn't the inevitable consequence in certain countries falls in real wages and deflation, even if that doesn't occur in the euro zone as a whole?

Mr. Trichet: The euro zone is a single market with a single currency and the various countries have to be considered exactly as the various States of the U.S.A. It goes without saying that the situation of the various States in the U.S.A. is not all alike. In a small number of euro-zone cases – this has nothing to do with the present crisis – there is a necessity to progressively catch up with a level of competitiveness which had been deteriorating over the past years. Germany is a good example of such adjustments: it entered the euro area with a level of relative competitiveness which was insufficient. It regained, in a very efficient fashion, competitiveness to offset its insufficient level in the entry.

WSJ: A number of other central banks, in words and in deeds, have suggested the risk of deflation is rising. You have maintained the risk of deflation in the euro zone overall is low. Why would the euro zone be different than other major developed economies of the world?

Mr. Trichet: All the international institutions that are looking at the situation say there is no substantiation of a significant deflationary risk in the euro area at the moment. That being said, we have to be alert and look at the risks permanently. We are certainly helped by our very clear definition of price stability, which is annual inflation at less than 2%, but close to 2%.

Surveys of medium-term euro-zone inflation expectations have oscillated between 1.7% and 2%. When you look at what has been extracted from financial markets and compare with the U.S., you see we are benefiting from more solid anchoring of inflation expectations. I have also to take into account a number of figures that are till now, significantly over the zero level: for instance compensation per employee over 12 months is +3%, negotiated wages +3.5%, M3 +5.9%, M1 +5.2%. But as I said, we remain permanently alert.

WSJ: If you saw the risk of deflation rising, would you still see difficulties with a policy rate near zero?

Mr. Trichet: There are a number of drawbacks associated with policy rates deliberately put at a zero level by the decision of the central banks. That's the reason we do not think it would be appropriate. But what counts are the interest rates that are in the market and that the public gets. I will surprise you! Taking into account our unlimited supply of liquidity at our main policy rate and the fact that we have the deposit rate at 0.5%, we have, at the moment I am speaking, our six-month rates on the money market that are a little bit below U.S. six-month rates, and our one-year rates that are 13 basis points below the U.S. money market one-year rate.

WSJ: You've highlighted recently the differences in the euro-zone financial system that underlie the differences between the non-standard steps the ECB has taken and those of other central banks.

Mr. Trichet: Yes indeed. We have 70% of the financing of the euro area which goes through commercial banks and 30% through securities other than stocks. And on the other side of the Atlantic, it's exactly the contrary; it's 30% or a little less for commercial bank financing and 70 percent for securities other than stocks. That is the reason why we have concentrated our bold non-standard measures – eligibility of collateral, unlimited supply of liquidity at fixed rates – on the commercial bank channel.

WSJ: Would that difference guide any future non-standard steps you might take?

Mr. Trichet: We will certainly continue to do whatever we think optimizes our own situation. In the next decisions that we could take, it's pretty possible that we would continue to be non-conventional through the channel of bank financing. This channel remains for us essential.

WSJ: What is your assessment of the adequacy of bank lending in the euro-zone?

Mr. Trichet: I will continue to tell our banks that we expect them to pass on to the real economy what we have been doing ourselves in terms of reduction of interest rates and of supply of liquidity. It's up to them, being the main channel of financing of the European economy, to pass along the decisions we have been taking. If I am shipping this message, it is because we trust that this is not yet entirely done. We do not scapegoat at all our banks; we rely upon them. We are encouraging them as much as possible to do their job, and their job is to lend.

WSJ: There's been a concern in other economies about banks that are so weakened that they're zombie institutions that exist but are unable or unwilling to lend. Is that a phenomenon reflected in Europe?

Mr. Trichet: No. You have a large number of institutions in the euro area, which fortunately did not embark into massive toxic-assets investment, which were reasonably cautious and prudent and are continuing to be creditworthy without extraordinary help from authorities. We might have some quasi passive institutions, but it is not at all the generalized case. Again, in any case, putting the financial sector back on its feet and lending is the first priority.

WSJ: There remains a sentiment among some that the ECB is not as willing as other central banks to be as responsive to the economic downturn with its policy rate.

Mr. Trichet: At times, I see some observes looking at central banks as if they were participating in a race. Who is the first to do this or that? It is true that the ECB was the first central bank to act decisively at the start of the crisis on 9th of August 2007. We had our own good reasons, it was not a race! Today it is true that the size of the balance sheet (16% of GDP) is bigger in proportion than the size of the FED balance sheet. It might change after last week decisions. But it is not a race! Today our six-month and one year money market interest rates are lower than in the dollar or sterling money market because of our lower risk premia and liquidity premia. But it is not a race! We are all doing what we judge optimal taking into account the different characteristics of our economies and our common will to solidly anchor inflationary expectations and, in so doing, improve confidence. As regards the future rate of our main refinancing operations, presently at 1.5%, I said clearly that we could decrease it again. I also said that at 0.5% our deposit facility interest rate was already at a very, very low level.

WSJ: Are there any obstacles to the ECB purchasing government assets, which is now a policy of central banks including the Fed and the Bank of England?

Mr. Trichet: Two remarks: As regards the private papers, our collateral framework has been very supportive since the beginning of the crisis: I have also noted that our corporate securities markets behaved properly in terms of volume since January. As regards possible outright purchases of securities in general I said that we are not pre-committed for any new decisions. One element which has to be taken into account is that the risks of the central banks and the risks of the governments are, in the euro area, clearly separated without combination of risks or blending of responsibilities.

WSJ: Are you suggesting that by buying government assets, there would be a blurring of responsibility where there is so far a clear division, and that blurring would be undesirable?

Mr. Trichet: It is an element which has to be taken into account.

WSJ: There is also a debate about whether, with the house still burning down, as it were, longer-term questions about the new global financial architecture can wait. What is your view?

Mr. Trichet: Confidence is of essence! If we want to succeed right now in this very grave crisis we have to take bold decisions now and be equally determined in reassuring our fellow citizens in the medium and long run. We have to fight against short-termism. We have to improve transparency. And we have to eliminate pro-cyclicality. Fluctuations are normal in a market economy. We have to accept fluctuations, otherwise we would have no market economy – we would be in the Soviet Union. On the other hand, it is extremely clumsy to amplify those booms and busts. We have to concentrate on augmenting the resilience of global finance. And finally we have also to improve surveillance of the macro policies of systemic economies in order to prevent the piling up of domestic and external imbalances. The Financial Stability Forum and the IMF have a decisive role to play in these respects.