

Jean-Claude Trichet: Interview with Corriere della Sera

Interview by Mr Jean-Claude Trichet, President of the European Central Bank, conducted on 23 September 2009 by Ms Marika de Feo, Corriere della Sera.

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Is the improvement in the financial markets in line with the new data coming out of the economy?

“There is a significant improvement in the functioning of the financial markets in comparison with a year ago. This was what we were aiming at, when we had to take very bold decisions after mid-September 08 (when Lehman collapsed), in order to permit the markets to function again. Back then, there was a systemic solvency issue, not only a systemic liquidity issue. And it is not surprising, taking into account what has been done by the central banks as well as by the Governments, that now we observe this improvement in the markets. There are other factors as well that are playing a positive role. In any case we monitor with great attention at this stage the interaction between the financial sphere and the real economy.”

Will growth be positive again earlier than in mid of 2010?

“Our staff told us this month that the real economy could be a little bit better, in average, in 2009 and 2010 than what had been projected three months ago – 0.5% higher for each year. But it means that 2009 will remain very negative and 2010 perhaps only very slightly positive, as an average. I don't exclude that we could observe positive growth, quarter on quarter, at the level of the euro area as a whole, before mid 2010. But this doesn't change our main message. Namely, that we have a bumpy road ahead and that the level of uncertainty remains exceptionally high and therefore that prudence and caution are of essence. Now much depend on us, on our capacity to reintroduce confidence in the financial and real economy decision making processes, in the households as well as in the corporate sector. It is what the ECB and the Eurosystem want to do: preserve confidence, inspire confidence, remain a solid anchor of confidence.”

Can we conclude that you still fear a double-dip?

“I said that we have to be prepared for a bumpy road ahead. We are in a situation where uncertainty remains: we could have, quarter on quarter, at times, positive figures, without excluding at times negative figures”.

Now the G20 will replace the G8. Which is your opinion?

“I think it is important that we have a progressive improvement in the global governance. The G20 should be given credit for being the place where global governance could be effective. The G20 is called to be essential, appropriately enlightened by the IMF, because we need to have both as good analytical presentations and diagnosis and the peer pressure of the G20. The G20 has to address the issues of the domestic large imbalances between savings and investments, and of the set of unsustainable external imbalances. We know that these imbalances have been at the roots of the present difficulties. If we don't correct them, we'll have the recipe for the next major crisis. And this of course would be totally unacceptable.”

Could it be dangerous for the recovery, if governments would withdraw their support to the economy?

“One thing is sure. When time comes, systemic economies are not credible in going back to sustainable fiscal policy in the mid to long run. We won't have the recovery which we are hoping for. Because Governments would not inspire confidence to households and corporate business. It is the evaporation of confidence that created this dramatic turmoil. Now we have to do everything to rebuild confidence.”

When is the timing for a fiscal exit strategy?

“The position of the Governing Council of the ECB is that the fiscal adjustment process should start, in any case, not later than the economic recovery and that the consolidated effort should be stepped up in 2011. This is the position for the euro area as a whole. Naturally some countries have more problems than others and they have to take into account their particular situation.”

In Germany and Italy there is a debate for cutting taxes – would it be a right way to support growth?

“The rule which is the best in terms of running a fiscal policy is: first, to be careful that the level of deficits in the mid-long term is in line with the Stability and Growth Pact; that the fiscal strategy is sustainable and inspire confidence. Second: to go to this position you need to reduce public expenditure. And third, if it is not enough, you have to increase taxes. Only in the case your reduction of spending is big enough to give you additional room you can embark on tax reductions. There is no other way to proceed. I’m not responding for Italy, or for a particular country, it is simple arithmetic.”

How can a high ratio of debt be reduced, especially in countries with low growth, like Italy?

“Italy is not the only country with a high ratio. The reduction of the debt is a matter of appropriate decisions. It is true that, when global growth is relatively low, it make things more complicated. But a high level of national debt is hampering growth. So, regaining control of the debt dynamics and reducing the debt outstanding as a proportion of GDP is good for growth and foster medium- and long-term prosperity.”

The Governing Council will be in Venice in ten days. Can you suggest how Italy can regain its diminished competitiveness?

“My responsibility – the responsibility of the Executive Board together with Lorenzo Bini Smaghi and Governing Council together with Mario Draghi - is for the euro area as a whole, for our 330 million fellow citizens. For the Italian diagnosis I rely very much on the analysis of Banca d’Italia and of Mario Draghi. I will say that for all countries permanent monitoring of the competitiveness indicators is absolutely of the essence. And that includes in particular a close monitoring of the unit labour costs and all appropriate efforts to develop and reinforce creativity, innovation and entrepreneurial spirit in the economy as a whole.”

Which assets does Italy have?

“I think that the potential of Italy is considerable, because it possesses a human resource which is of exceptional quality. The country has an entrepreneurial spirit which is quasi unique in the euro area, together with a capacity – including at very small enterprise level - to innovate which you don’t see in all countries. I trust that Italy as an economy has a lot of assets, which suggest, that its growth potential should be higher than what has been observed in the past years.”

And which are the priorities?

“Amongst many others an attentive monitoring of the unit labour costs is essential which suggests taking into account the productivity progress when you are augmenting salaries. Italy has in particular to regain competitiveness in comparison with the average of the euro area. This is very important.”

Why was the banking system in some European countries, like Italy and France, more resilient than in others?

“Several countries had resilient banking systems, it is not necessary to single out Italy and France. There are a number of combinations of factors, which might have played a role. The structure of the banking sector, the importance of retail banking are probably important factors in this resilience together with the quality of banking surveillance by the central banks.”

Some experts say that structural reforms cannot be introduced in this moment of the crisis. What do you think about that?

“I do not think it is true. Structural reforms are more important than ever. Part of the insufficient resilience of the various economies in the world as well as in the euro area is probably due to the insufficient structural reforms made in the past. It is also clear that the big challenges that we have for the future in term of fiscal policies will be solved only if we embark in structural reforms, because in a large number of domains it would be the only way to reduce public spending.”

Is the window of opportunity for introducing reforms of the financial system shrinking?

“With the improvement observed in the financial markets some institutions and market participants might think that there is no need for the reforms designed at global level. It would be plain wrong to think that. The improvements observed are observed in particular because there have been bold decisions taken by central banks and by governments. They could not be repeated several times! We have to be fully aware of that. More than ever it is extremely important to introduce the necessary reforms in the financial system, in order to strengthen its resilience and avoid excessive booms and busts.”

Is there a possibility, that increasing capital ratios of banks after the recovery could induce financial institutions to reduce lending in advance, slowing down growth?

“We have to find out at a global level the appropriate balance between two considerations: in the long run we need capital requirements that are fully taking into account the long-term risks that exist in the financial sphere. At the same time, today we have to cope with an exceptional crisis situation and we have to be careful not to aggravate this situation by encouraging a deleveraging process which is adverse from the stand point of the recovery.”

Did the Basel Committee and the FSB terms of reference found a balance between the long-term and the short-term consideration?

“Yes. I think we captured this correct balance when we said, after the meeting of the governance body of the Basel Committee, on September 7th that we were requiring banks to move expeditiously to raise the level and quality of their capital to the new standards (which will be calibrated by end 2010) but in a manner that promotes the stability of national banking systems and the broader economy. That being said there are today ways for banks in Europe that need more capital to get it. For instance the recapitalisation option that has been set up by Governments is only utilised at the level of 55 %. The Governing Council calls on banks to take appropriate measures, where necessary, to strengthen further their capital bases and take full advantage of Government measures to support the financial sector.”

Are you satisfied with the improvement going on?

“It is a process which goes on, but that we strongly encourage.”

“The ECB has financed the banks with around 600 billion euro. But they are not forwarding the funds to the real economy. What can be done to encourage lending?”

“We are practising, in particular, moral suasion with banks, telling them that what the ECB is doing is not for the sake of being kind, but because we need them to finance the real economy. It is also true, that the demand for new credit is more modest than before the crisis, because of the recession. So when we are asking the mid-sized enterprises whether they had a positive response from banks to their request for new finance, a large majority, 77%, are responding yes whilst a minority of 12 % said no.”

In which measure the present monetary policy, very expansionary on both sides of the Atlantic, is supporting the creation of a new bubble in the financial markets?

“You know to which extent we are, in the ECB, in the Eurosystem attentive to do what is necessary at any time to ensure price stability in the medium- and long-term, in line with our

definition - below 2 %, but close to 2% -. I trust that we are credible in this promise to be faithful to our mandate and that is the reason why we are solidly anchoring inflation expectations. And I take it that we are united in purpose – in delivering credibly price stability – on both sides of the Atlantic as well as on both sides of the Channel.”

Which risks do you see for the exit strategy, especially if it is not going to be coordinated between both sides of the Atlantic? Is there a risk that the dollar could suffer of this?

“As I just said we are united within the community of central banks: we want to deliver price stability. We don’t take the same decisions, because we are in different situations, dealing with different economies, facing different shocks, different levels of flexibility, different structures. As regards the floating currencies, I consider very important for the stability of the exchange rates and the prosperity of the global economy that Chairman Ben Bernanke, Treasury Secretary Tim Geithner and President Obama underline “that a strong dollar is in the interest of the US”. I trust that it is not only true but that it is also very important for the global economic stability.”

Which limitation to boni do you favour?

“I’m in agreement with the FSB terms of reference which seems to me very appropriate. Seen from a central bank perspective, what is decisive is that the boni should not create incentives for taking absurdly high levels of risks that would materialise in a crisis of the type we are experiencing. The main problem, seen from our perspective is to be sure that the structure of remunerations is conducting to sound and wise decisions justified in the medium and long-term.”

Are you satisfied with the Commission’s proposal for the European surveillance system?

“The Commission has now presented its proposals to the Council, which is under the Swedish Presidency. As regards the ECB and its General Council we stand ready to do all what we can for the European Systemic Risk Board to fulfil its very important systemic responsibilities in the best fashion possible to the service of the European financial stability.”

Are you satisfied with the outcome of the G20 meeting in Pittsburgh?

“As this stage I would only make three short observations:

First, we central banks appreciated that it is said that “a sense of normalcy should not lead to complacency.”

Second, I noted that it is also in the preamble that “we will prepare our exit strategies and, when the time is right, withdraw our extraordinary policy support (...), maintaining a commitment to fiscal responsibility.”

Third, it is particularly important that the G20 is designed to be the premier forum for international economic cooperation; that the IMF is asked to play a key role in the multilateral surveillance, that the Financial Stability Board includes major systemic economies, and that the communiqué welcomes the key measures agreed by the oversight body of the Basel Committee.”