

## **Jean-Claude Trichet: Interview with Le Monde**

Interview by Mr Jean-Claude Trichet, President of the European Central Bank, conducted by Mr Pierre-Antoine Delhommais and Mr Arnaud Leparmentier, 17 November 2009.

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### **The euro area economy grew by 0.4% in the third quarter. Is the crisis over?**

After the second quarter figures, which were still slightly negative, this positive growth confirms that we have indeed come out of the period of free fall which characterised the six months following the collapse of Lehman Brothers. The figures confirm our baseline scenario, that of a progressive and gradual revival of the economy. What we are now observing is more favourable than we projected some months ago. That said, we must remain cautious. There is still a lot of uncertainty, as much at the global level as at the level of the euro area, particularly concerning next year's growth. We cannot yet claim victory.

### **Is there a risk of a relapse, like in 1937 after Roosevelt's first stimulus plan?**

Uncertainty, as I said, is an important characteristic of the period that we find ourselves in. We have observed, in recent past, the eruption of events which were unforeseen in terms of their severity.

We observed also during the six-month period of global economic free fall that the decision-makers could not rely on reliable analytical instruments. In particular the central bankers noted during this period that economic reality was rendering obsolete, week after week, the analyses and projections of the most tried and tested models. Throughout this period we had to rely mainly on the wisdom and experience of our collegiate decision-making authorities. Today we have regained a reasonable level of confidence in our analytical tools. But a great deal of uncertainty remains.

### **We are seeing differences in growth between the different countries of the euro area, for example between France and Germany, which is recovering more quickly. Is this not worrying?**

For the Governing Council of the ECB, what matters is the euro area as a whole. It is for this area that the Governing Council has responsibility for issuing the single currency; an area made up of sixteen countries inhabited by 330 million European citizens. What matters is the interest of an entire continent, in the same way as the US Federal Reserve disregards the differences between Massachusetts, California or Missouri, which are nonetheless significant. The quantitative divergences in the euro area are no different in nature from those observed among the different states in the US. Furthermore, one should not read too much into the differences in quarterly growth, but rather place them in a medium-term context.

### **If growth is back, shouldn't the exceptional measures taken during the crisis be withdrawn?**

We need to acknowledge that the speed, scope and boldness of the decisions taken by the central banks, on the one hand, and by the governments and parliaments, on the other, have allowed us to avoid a formidable depression. In particular, without this bold and swift reaction by central banks, and notably by the ECB as early as 9 August 2007, the systemic liquidity crisis would have spread across the industrialised countries, and then across the globe, and it would have been grave. I can say the same thing about the actions taken by the public authorities.

The budgetary positions are much more diverse than one may think. Some countries are in a relatively favourable position because their past management was wise and prudent, while others are already very close to losing their credibility. However, all countries must have a

budgetary strategy that is seen as being credible in the medium term by households, businesses and investors. The success of the recovery in Europe rests on the confidence of households and businesses. If they do not have confidence in the sustainability of public finances in the medium to long term, they will consume less and invest less. The success of the recovery in Europe depends on the confidence of investors in the creditworthiness of sovereign issuers. If this confidence is lacking, investors will require higher market interest rates, which would penalise both the public and private sectors of the country concerned.

**Is the Stability and Growth Pact still meaningful, with deficits that are approaching 10% of GDP?**

I have always said that in a single currency area which is not a political federation, the Stability and Growth Pact is essential for the stability of Monetary Union. We are living in difficult times. It has been necessary to take bold measures to avoid a depression. It is essential to get on a credible path towards fiscal consolidation in 2011 at the latest, as has already been decided by the European governments. We say loud and clear to all the countries concerned: "Follow the Stability and Growth Pact to the letter. Be aware that if you are not credible in consolidating public finances in the medium term, you will hamper your recovery already from today."

**You advocate policies of budgetary consolidation, but at the same time France is choosing to issue a large bond...**

The government deficit problem is not exclusive to France. It is a crucial topic for almost all countries. It is, of course, essential that the "Grand emprunt"/"special national bond" does not result in new public spending in the sense of the Stability and Growth Pact, because the situation is already extraordinarily difficult.

**Isn't there a danger that keeping interest rates very low for too long will foster the return of inflation and the creation of new bubbles, as seen after 11 September 2001?**

The Governing Council of the ECB – there are 22 of us, including Christian Noyer, Governor of the Banque de France – owes the citizens of the euro area price stability. This is what we have done throughout the almost 11 years of the euro. It is the mandate given to us by our political democracies. It is the promise made to our 330 million fellow citizens. In order to deliver this, we have stood firm in the face of pressure. There were very vehement calls for us to lower our key interest rate at the beginning of 2004, and we refused; there was also strong criticism when we increased rates at the end of 2005. In both cases, given what has happened since, no-one is criticising us anymore. I am proud of the credibility of the Governing Council of the ECB with regard to stability. It is this credibility which has enabled us to solidly anchor inflation expectations. This has helped us to avoid inflation and, at the same time, has also protected us from the materialisation of the risk of deflation during the recent crisis period.

At present, we consider our key rates to be appropriate for the euro area. Furthermore, we will progressively unwind what we call our non-standard measures: they were designed precisely to permit a progressive unwinding when the time comes.

**Is the strength of the euro a threat to the recovery? According to the United States, "a strong dollar is in the interests of the United States". We don't hear you saying that "a strong euro is in the interests of Europe". Does this asymmetry signify that you do not wish the euro to appreciate vis-à-vis the dollar?**

It is indeed important that the US authorities state that a strong dollar is in the interests of the United States. I totally agree with this analysis. I would add that I believe that the strength of the dollar within the set of convertible floating currencies is in the interests not just of the United States, but of the entire international community. I noted with great interest yesterday the comments of my colleague Ben Bernanke at the Economic Club of New York. I quote: "The Federal Reserve will continue to monitor these developments closely. We are attentive to the implications of changes in the value of the dollar and will continue to formulate policy

to guard against risks to our dual mandate to foster both maximum employment and price stability. Our commitment to our dual objectives, together with the underlying strengths of the US economy, will help ensure that the dollar is strong and a source of global financial stability". This is a very important statement from my colleague, with whom I have a very good relationship.

### **Is the euro set to replace the dollar as a reserve currency?**

The euro was not created to compete with the US dollar or to replace the dollar as international reserve currency. It was created in order to complete the single European market and to bring stability and prosperity to Europe. The success of the euro in deepening the single market for the past 11 years has been remarkable. Imagine what the single market of the United States would be like if there were different currencies in California, Florida and New York State. The ECB does not campaign for the international use of the euro. We let economic agents and investors make their own decisions.

### **Were the root causes of the crisis economic or financial?**

The trigger was clearly financial. The financial sphere had generally underestimated the risks. More than six months before the crisis erupted in August 2007, I myself, speaking on behalf of my colleagues, the central bank governors, warned of the probability of a major market correction owing to the fact that risk was being underestimated, in terms of both quantity and price. Given the extremely close links between the financial sphere and the real economy, the entire system was potentially unstable, as we have seen. The decision-makers at the global level have a fundamental responsibility: we must make the financial economy and the real economy at the global level much more resilient and much less vulnerable.

### **Is the G20 the starting point for the response?**

In historical terms, the current period is marked by a very profound change in global governance. The fact that the G20 has become the leading authority for governance at the international level is fundamental. Do not forget that the structure of the G20 was set up following the Asian financial crisis. At that time the industrialised countries considered that if a medium-sized emerging country in Asia were capable of triggering an extremely severe international crisis, it was essential that all countries that represent a systemic risk should be involved in some way in global governance and the reforms contemplated by the major industrialised countries. Now it was the industrialised countries that triggered a very severe international crisis. And the emerging countries are entitled to ensure that the industrialised nations are taking all measures to make the global system more robust, together with the emerging economies. There is a kind of reversal of the situation between the industrialised countries and the emerging countries.

### **The crisis has been accompanied by great ideological confusion. What is your stance?**

I have been struck to see at the global level some degree of convergence among economists, in particular concerning their analytical tools. We have seen the spread of new-Keynesian general equilibrium models which can be interpreted as incorporating part of the Keynesian "lesson" and neoclassical analyses. In any case, when one refers back to the seminal texts, it is very striking to see to what extent the major economists went into greater depth and were much more problematic than those who came after them! This is true of both Keynes and Friedman. And if I had to name two economists today who also provide keys to understanding the crisis, I would mention Minsky for his analyses of financial instability and Knight for his analyses of "risk" versus "uncertainty". In any case, during a crisis one must be as humble as possible in the face of the reality which is evolving before our eyes and which is therefore, by definition, new. We must try to understand as best we can. We must strive to carry out research in order to better comprehend these potentially very unstable situations, like the one that we have seen, and not only situations that rest on the dynamic equilibrium paradigm. We must better understand phenomena of phase transition in financial markets

and in the real economy – for example the transitions seen in August 2007 and September 2008.

### **Is there a risk of further crises?**

It is highly likely that we will be faced with several major shocks over the next few decades, and, in any case, there will be a constant need for adaptation in the global economy. Two examples: we are living in a period in which considerable strides are being made in the fields of science and technology. These advances are unpredictable: there is no exact science when it comes to scientific progress, according to Karl Popper. It is inevitable that these new technologies will transform production processes themselves, as well as the international division of labour. Furthermore, it is a basic fact that the next 50 years will see the rapid economic development of the emerging countries – large and medium-sized, considering that apart from China and India, the number of Asian emerging economies in the ASEAN equals that of the entire European Union.

### **Is it a question of refounding capitalism?**

When I started my career in international economics, there was still an “East” and a “West”, and a “North” and a “South”. Today, however, there is a remarkable conceptual unification at the global level. Be it within the G20, with ministers and governments or with the central bankers in Basel, we work on the basis of one simple principle: namely, that a market economy is still the most appropriate means of generating wealth. The crisis has not only highlighted the importance of participating in a market economy, it has thrown it into stark relief. This is something that has not been challenged by the emerging countries, which comes as no particular surprise, for example, to those who, like me, knew emerging Asia 30 years ago and can see Asia today. The results of the introduction of the rules of the market economy in Asia are so evident that they are undeniable.

At the same time, however, these same countries and the entire international community are saying that it is unacceptable to have a global market economy that is so lacking in strength, soundness and resilience. We need to systematically draw all the lessons we can from the current crisis – without exception and without taboos. In essence, I do not believe that our democracies would again jump to the aid of the financial and the real economy in the same way that they have this time. We are compelled by our democracies to be successful in significantly improving the stability of the international economy.

### **The public is shocked by banks’ return to profits, a situation sometimes compounded by behaviour deemed irresponsible or arrogant...**

I would say that those, particularly in the financial sector, who believe that the economy has picked up where it left off, as though nothing has happened, are deeply mistaken. If the financial system is functioning again today, it is precisely because both central banks and governments provided a considerable amount of support. From both sides of the Atlantic, a total amounting to between 25% and 30% of GDP has been made available at the taxpayer’s risk. It is irresponsible to think that the recovery of the financial sector has happened naturally. Bankers in Europe and the world over must behave responsibly, do their job, which is to finance the real economy, and work resolutely to establish a financial system that is a lot more stable.

## **2009 looks like being a record year for bonus payouts ...**

What matters here is having sensible regulations that are the same throughout the world, otherwise we will witness a concurrent shifting of jobs and risk-taking activities to regions where there is less pressure. The regulations that were drafted by the Financial Stability Council and adopted by the G20 must be followed to the letter the world over, under the supervision of the prudential authorities. Moreover, I firmly believe that there is a problem of values in our societies. Some sectors of the economy and of society consider normal certain behaviours that do not fall within the limits of acceptability established by our political democracies. This is a serious flaw. Some things cannot depend solely on legislation, controls, regulation and supervision. In addition to the regulations, there has to be an ethical convergence of the values governing behaviours in the large democracies.

## **The number of tax havens identified by the OECD is falling every day, as Liechtenstein, Monaco and others are removed from its “grey list”. Is this a real success for the G20 or are we deluding ourselves?**

There is often a degree of confusion concerning the use of the term “tax haven”. Since national tax systems vary and levels of government expenditure vary, many countries have lower tax pressures than, for example, France. We are committed to combating those situations in which countries refuse to cooperate in the campaign against “illegal money” – this includes tax fraud, money from criminal activities and organised crime, drug money and money for financing terrorism. The OECD has undertaken considerable work in this area and much progress has been made.

## **What are your personal impressions after six years as President of the ECB?**

What I find most impressive is how the euro has gradually proved its worth. When I was negotiating the Maastricht Treaty, the international community was deeply sceptical; sceptical not only about whether it was possible to have a credible currency but even about the possibility of creating the single currency. Today, the credibility of the euro is undisputed. Equally remarkable has been the performance of the Executive Board, the Governing Council and Europe’s entire monetary team during these past years of crisis. We all kept our wits about us before and during the crisis. We made bold decisions swiftly, sometimes more swiftly than others, while maintaining our credibility in terms of medium-term price stability in line with our definition (less than, but close to, 2%) in the service of our 330 million fellow citizens. And I would say in the service of the confidence in the future that our fellow citizens can have. They know that they can count on us at all times.