Christian Noyer: Inflation, Europe's response to the debt crisis, emerging-market economies and priorities for the G-20 – interview in *The Wall Street Journal*

Interview with Mr Christian Noyer, Governor of the Bank of France and Chairman of the Board of Directors of the Bank for International Settlements, in *The Wall Street Journal*, Paris, conducted by Mr Brian Blackstone and Ms Nathalie Boschat on 24 January 2011 and published on 26 January 2011.

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WSJ: The European Central Bank recently toughened its stance on inflation. How **concerned are you about the risks of inflation taking hold in the euro zone?**

Noyer: The uptick in inflation is mostly due to the rise in oil and commodity prices. Core inflation has remained relatively subdued. By nature, that [the rise in inflation] should be temporary. Our projections show that the inflation rate should come back to a zone perfectly in line with our definition of price stability during the course of 2011.

As a central bank, we are very attentive to the only risks that exist in such a situation, which is that there might be second-round effects – an acceleration of inflation due to other causes – wages and other dynamics of internal costs.

This is why we are vigilant about all those evolutions. I am quite confident that we will be able to keep inflation at bay. That includes sending the message that we will never tolerate that inflation could become entrenched. We are determined not to let inflation become entrenched through second-round effects. It is this determination that would permit us to keep expectations where they are.

WSJ: Since the current rise in inflation is due in large part to the buoyancy of emerging countries, are you worried that controlling inflation is to some extent out of your control?

Noyer: It's true that there are factors beyond our direct control. But there are also structural answers to these factors, such as development of production, in order to limit the rise in agricultural prices. There are possibilities, and the level of prices helps a lot to develop production and alleviate the pressure.

When we look at the global picture of economy, there are emerging countries which have suffered less from the economic crisis and advanced economies which had to recover from a much lower growth and even recession. That in turn creates problems for emerging economies, including the fact that some of them have hesitated to run the fiscal and monetary policy that would have been absolutely appropriate given the state of their economies.

That calls for a better understanding of each other's state of economic development and economic policies. That's what the G-20 wants to do through the framework for strong and sustainable growth initiative.

WSJ: The G-20 is looking at various factors to assess the nature of global imbalances, and the debate often focuses on the part that foreign exchange rates should play in this assessment. What role do you think currencies, including the yuan, should play in the global rebalancing?

Noyer: It is up to [China] to assess exactly what part the exchange rate can play in the rebalancing. But appreciation of the yuan can help [China] enhance domestic consumption and dampen some of the effects of the rise in commodity prices.

WSJ: In order to address currency misalignments, shouldn't the G-20 call more strongly for increased currency flexibility across the board?

Noyer: The G-7 has been monitoring excessive currency fluctuations. But the world having changed and G-7 economies no longer being the dominant ones, should we adopt the same rules as we did during the '70s? We need to find out how to manage the system.

How can we monitor capital flows, and how can we avoid the risk of capital controls hampering global trade? We need to give a clear mandate to the IMF to monitor the capital account. It would be useful to have a clear set of rules. The IMF can be an independent assessor of policies and give advice on the best course of action.

WSJ: What lessons have you learned from the crisis?

Noyer: There was probably during the period of time that preceded the crisis an excessive belief that the combination of the growing importance of emerging economies, which brought a disinflationary force in the manufacturing sector, and the credibility attained by central banks globally had created a world where inflation could be kept at bay quite easily.

There was insufficient focus on some of the effects of low interest rates for a long period, like the fact that it facilitated asset bubbles and asset bubbles may lead to burst bubbles and economic and financial crisis or the transmission into pressure on inflation. We'll probably be more attentive in the future.

WSJ: The ECB has upped its vigilance on inflation in the euro zone, but if interest rates were to b e raised earlier than expected, it could be a problem for countries in the periphery that depend on the ECB's support through its bond-buying program. Would it be possible for the ECB to raise rates to address rising inflation in core countries while keeping nonstandard measures in place to prop up peripheral states?

Noyer: Generally speaking, it is technically feasible. I am not signaling that we are going to raise interest rates. As a matter of fact we have done a lot to start unwinding nonstandard measures. Excess liquidity in the euro-system has decreased dramatically and the situation has normalized. Now the market is working much better.

People know that we never have hesitated to do whatever was necessary to restore the proper functioning of the monetary market and the effectiveness of monetary policy transmission. We have been sometimes criticized but the results are there.

WSJ: Do you think the euro zone's bailout fund – the European Financial Stability Facility – should be expanded?

Noyer: The European response has been an ambitious response to the present crisis and the fund has been a remarkable success. We would clearly favor the fund to be enhanced both quantitatively and qualitatively. I think increasing it quantitatively is probably the intention of governments. The fund's firepower is limited by a number of technical constraints to get a triple-A rating. How to move closer to the original intention in terms of firepower is clearly up to the reflection of governments. It is appropriate to think about [enlarging the size of the fund] even if there is no immediate need.

As far as the qualitative aspect of the fund is concerned, it seems to me that having the capacity for instance to intervene in secondary markets could probably be an interesting feature in some cases, if only to facilitate access to the market. This of course raises for governments the question of conditionality of the support … but probably they can find answers to that.

Another possibility would be that of precautionary programs [such as credit lines], like what the IMF is doing.

It's useful that governments look into that and look at the various tools that could be effective and which could correspond to the various goals that they want to pursue, including making sure that the policies followed by member states receiving EFSF support are aimed at restoring a sound fiscal and the appropriate competitiveness.