

Jean-Claude Trichet: Interview in *Les Echos*

Interview with Mr Jean-Claude Trichet, President of the European Central Bank, in *Les Echos*, France, conducted by Mr Henri Gibier, Mr Jean-Philippe Lacour and Ms Isabelle Couet on 10 February 2011 and published on 14 February 2011.

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You have recently expressed your concern about a return of inflation in the euro area. Which feeling is uppermost today? Between concern about growth and inflation, which one prevails?

The real economy has had some rather good surprises for us, quarter after quarter. The return of growth was observed in the third quarter of 2009 and since then we have seen that the euro area is doing a little better than expected. The latest indicators since the end of 2010 confirm this. I emphasise that this does not only relate to Germany but to the euro area as a whole. At the ECB, we have not shared the fears of a “double dip” recession, even if our talk was cautious. I am sure that because the central bank has been an anchor of stability and confidence throughout this very difficult period, it may have played a part in consolidating this pick-up.

So the recovery seems to you less “chaotic”, to take up the term you used on one occasion...

We must always be wary of quarterly figures, as they can be very volatile. We may have good news and bad news from one quarter to the next. In any case, the new medium-term economic projections of our staff will be released in early March.

The concern has now shifted to price stability...

Everyone knows that we are inflexible on inflation risks. We have always done what we had to do to maintain price stability over the medium term, which is our mission. We are proud to have had an average price increase of 1.97% per annum over the first 12 years of the single currency, which precisely matches our objective of an increase of close to, but below, 2%. Moreover, this result is better than that of all the larger economies of the euro area over the past fifty years. It has given us high credibility with regard to price stability over the next ten years. We note that inflation expectations are well anchored, and that’s essential. As I said during the last two press conferences, the Governing Council still considers the risks to future inflation as balanced, but that they could move upwards in the future.

Do you believe in the possibility of second-round effects resulting from wage increases, as we are now seeing in Germany?

It is up to each central bank to avoid second-round effects when we see a price shock affecting raw materials and energy sources, on which we cannot take action. That’s even our fundamental duty. What matters is to prevent other prices from matching those movements, which have to remain temporary. In particular, the various economic agents and the social partners must not imagine that the correct inflation rate to take into account is that which comes from the abrupt rise in energy prices. In the medium term, all economic agents must bear in mind that the correct reference is that of less than 2%, close to 2% in the medium term, which we’ve made completely credible. That medium-term price stability is our primary mandate, and we owe it to our fellow citizens. Let’s not forget that inflation affects in particular the poorest and least advantaged members of society.

The ECB has embarked on a series of non-standard measures to react to the crisis. What’s your initial assessment?

Alongside standard measures relating to the key interest rates, set solely in order to attain medium-term price stability, we have been using non-standard tools: they aim to help restore

the efficiency of the transmission of monetary policy to the economy in a context of certain dysfunctional markets. As it happens, we intervened as early as August 2007, providing unlimited liquidity at fixed rates, because the crisis had led to a dysfunctioning of the money market. Today, we are seeing that the interbank market is working better. There are however a small number of banks which are still too dependent on the ECB. To solve this problem gradually, it is important that they are not encouraged to resort to the central bank rather than to the markets, and that's why the Governing Council is insisting that they increase their capital and use all the facilities offered to them by the Member States.

Is your policy of buying the bonds of “peripheral” states on the markets efficient?

It's one of the non-standard measures that we have taken to restore the transmission of monetary policy. We make public every week the scale of our interventions, but not the specific market we are intervening in. In any case, we absorb each week the liquidity that was injected as a result of this programme. We do not carry out quantitative easing. But don't forget: our primary mandate is price stability in the euro area as a whole. Interest rates are set according to this medium-term objective. And the intervention programme is such as to allow the best possible transmission of our policy in the euro area as a whole.

Why did you say that you would prefer the European Financial Stability Facility (EFSF) to buy government bonds rather than the ECB, if what is at stake is restoring monetary policy transmission ?

It is because certain governments, individually, have behaved in an abnormal manner, and because all governments have fallen short in their collective supervisory duties that we are seeing anomalies in the behaviour of certain markets. The governments have to meet their responsibilities. It is for this reason, in particular, that I have asked for the EFSF to be enhanced, in quality and quantity. The possibility for the EFSF to purchase government bonds is part of this thinking.

The euro area has gone through a rocky period because of the sovereign debt crisis in certain countries, to the point of doubt being cast on the sustainability of the single currency. Do you believe the measures being taken concerning the EFSF are appropriate to avoid a similar situation arising again in the future?

The euro is a currency which inspires confidence. It is credible for the next ten years, and beyond. Moreover, the situation in the euro area as a whole is in many respects better than that in comparable economies. Our current account is in balance, which is far from being the case in all major industrial countries, and our consolidated annual government deficit for 2011, as a proportion of GDP, should be half those of the United States and Japan. The monetary union part of Economic and Monetary Union (EMU) is working well, thanks to the fact that we are constantly on our guard. On the other hand, there is still much to be done as regards economic union. This is because some countries have not had satisfactory budgetary policies, and because the supervisory system in place since the creation of the euro has not functioned correctly. Our message has always been that, in the context of a single currency without political federation, there has to be an extremely strong framework of budgetary stability. We signalled this again most forcefully when in 2005 a number of major member countries, including France, Germany and Italy, tried to weaken considerably the Stability and Growth Pact by denouncing what they said to be its excessive orthodoxy. Having lived through the recent challenges, both individual and collective, nobody is any longer suggesting that we should weaken the governance of Europe. The Governing Council for its part is in favour of a very considerable strengthening of economic governance in the euro area, as indeed it always has been.

How can we resolve the growing gap within the euro area between those industrial countries which have been able to keep their finances on an even keel and those which are not very competitive and are sinking into debt?

I am not sure that the euro area really can be split in two like that. To be sure, when you have a vast single market to manage, there are bound to be significant differences from state to state or from country to country. But you have to remember that the differences you see today are the opposite of those that existed five years ago. When the euro was introduced Germany was described as the “sick man” of Europe. It has made a remarkable effort, by itself, and has since become competitive again. Germany’s return to growth benefits the whole of the euro area. Other countries have in the past experienced excessive nominal growth and now have to adjust. The important thing is that the countries of the euro area, taken as a whole, should remain around the average in the long term. The same phenomenon of disparity can also be seen in the United States, where the differences between states in terms of growth or indeed unemployment levels are comparable to those we see in the euro area. It is a feature of major continental economies of this size.

If we look at a specific case, do you think that the issue of Greek solvency has been resolved or do new ways need to be found for Greece to reduce its debt?

A plan has been put in place by the Greek government. This plan was approved by the international community and by Europe. It is currently being implemented and it is this that is very important. It is rigorous implementation of the plan which will allow Greece to regain a credible level of creditworthiness.

What do you think of the competitiveness pact proposed by Germany and France to avoid further crises of this kind?

We are in the middle of a process, led by Herman Van Rompuy, President of the European Council, and are waiting to see what will come of it. As far as the ECB is concerned, anything which serves to strengthen economic governance is not only good but also absolutely essential. I would add the hope that the European governments will be minded to strengthen the proposals which are currently being scrutinised by the European Parliament because in our view they are very insufficient.

In wanting to strengthen competitiveness and budgetary orthodoxy, are we not condemning Europe to sluggish growth for some time to come?

Competitiveness is at the root of everything. The euro area is more open to the rest of the world than Japan or the United States. We accept global competition. When one member of EMU achieves a good level of competitiveness, as Germany currently has, this benefits the euro area as a whole. If we wish to improve standards of living and create employment in the EMU the only way is through competitiveness.

A new round of “stress tests” is going to be launched in order to assess banks’ risk. What can we expect from this new exercise, the credibility of which has been diminished by what happened in Ireland? Should a State’s risk of default be taken into account, something which wasn’t done in the last round of tests?

These stress tests are currently being very carefully prepared by the relevant institutions. I have every faith that they will be rigorous in their preparation. As you know, a State’s risk of default as measured by the market is taken into account in the “trading book”. In the “banking book”, where instruments are held until maturity, default is not an envisaged possibility.

Is the ECB better equipped to prevent/anticipate a country’s risk of default now that it is at the helm of the new European Systemic Risk Board (ESRB)?

The ESRB’s objective is certainly not to be a giant rating agency for European countries. Our working hypothesis is of course that no default of any country of the euro area should be envisaged.

The French presidency of the G20 is pursuing two very ambitious objectives: international monetary system reform and the development of measures to curb the volatility of the prices of raw materials. Do you think that it will be possible to achieve tangible results in these two areas?

These are areas of great importance, which merit a substantial degree of attention on the part of the G20 countries. On the subject of exchange rates, the major emerging market economies that are growing very rapidly and exhibiting considerable current account surpluses should gradually introduce more flexibility into the management of their exchange rates. This has already been made public by previous G20 statements. In due course, there is the question of these major new currencies becoming fully convertible and freely floating, which would lead to a very significant structural change.

As for raw materials, the issue of the optimal management of rare natural resources has long been ongoing. Some of them are not renewable, and we must therefore ensure the long-term preservation of our common heritage, in the best possible conditions. The demand for agricultural products will increase, owing to the rising standards of living in the major emerging market countries. It is important that we do everything we can to ensure the supply of these products increases substantially, both in the medium and long term.

How much importance should be attached to speculation causing the prices of basic foodstuffs to rise?

We mustn't confuse very short-term speculation, which probably doesn't have a significant and lasting impact on the medium-term price level, with the phenomenon of change in the portfolio allocations of global fund managers who for a long time didn't invest in raw materials at all. Now that raw materials are gradually playing a more important role in asset allocation, this could generate a lasting upward pressure on prices. It is a phenomenon that we must watch very closely.

A potential favourite for your successor, the President of the Bundesbank Axel Weber, has taken himself out of the running, citing a lack political support from certain governments. Does this mean that the European debate on the subject is still far from being settled?

This is a decision that Axel Weber has taken for personal reasons. I respect that decision. The appointment of the President of the ECB is a very important decision, which is in the hands of the heads of state and government.

Would you be prepared to stay on if necessary?

The question does not arise! I have a clear mandate, with a time limit.