Jean-Claude Trichet: Hearing before the Economic and Monetary Affairs Committee of the European Parliament

Introductory statement by Mr Jean-Claude Trichet, President of the European Central Bank, at a hearing before the Economic and Monetary Affairs Committee of the European Parliament, Brussels, 21 March 2011.

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Dear Madam Chair,

Dear Honourable Members,

As on a number of occasions before, our regular meeting takes place in extraordinary times. The tragic developments in Japan with the deplorable loss of human lives, but also their potential global economic and financial implications have galvanised the international community into action.

Here in Europe, our hearing today comes at a time between two meetings at the level of Heads of State or Government. And it comes at a time when the very important decisions on the economic governance reform in this Parliament are coming closer. Before focusing on the economic outlook and topics for today, let me therefore say a few words on the economic governance reform.

Comme vous le savez, le conseil Ecofin a adopté la semaine dernière une « approche générale » sur ce dossier. Cette approche contient diverses améliorations. Pourtant, plusieurs des propositions très importantes pour renforcer suffisamment le cadre de gouvernance ne sont pas encore prises en compte. Ceci est nécessaire pour tirer toutes les leçons de la crise. Nos concitoyens européens, qui ont le souci de notre avenir à long terme, demandent aux autorités de faire tout ce qui est nécessaire pour empêcher une répétition des développements que nous avons vécus ces dernières années. Ainsi, selon un «Eurobaromètre» récent, presque 80% des citoyens dans les pays de la zone euro considèrent qu'une plus grande coordination des politiques économiques entre les Etats membres – c'est-à-dire une gouvernance effective et efficace – serait nécessaire pour combattre la crise financière et économique.[1]

Vor zehn Tagen haben die Mitgliedsstaaten eine Erklärung zur verstärkten Abstimmung der Wirtschaftspolitik im Eurogebiet gegeben. Diese Erklärung berührt inhaltlich viele Punkte der vorliegenden sechs Gesetzesvorschläge. Besser noch als diese Erklärung parallel stehen zu lassen, wäre es, ihre Kernpunkte in das gegenwärtige Gesetzgebungsverfahren einzubringen. Dies würde der Absichtserklärung ihre volle Glaubwürdigkeit zukommen lassen.

I. Economic and monetary developments

Let me turn to the euro area economic and monetary developments since our previous meeting last November. I will concentrate on the analysis of the Governing Council on the occasion of its meeting of 3 March.

Incoming data have confirmed our view that the underlying momentum of economic activity remains positive. Looking ahead, we expect the economy to further benefit from the ongoing

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1 *Eurobarometer* vol. 74 on Economic Governance in the European Union (published 12 January 2011). It shows that on average (unweighted) close to 80% of respondents in euro countries consider "a stronger coordination of economic and financial policies between Member States to be effective in combating the financial crisis."

recovery in the world economy, the very accommodative monetary policy stance and the measures adopted to improve the functioning of the financial system.

As regards price developments, inflation in the euro area is on the rise. In February HICP inflation stood at 2.4%, after 2.3% in January. This increase largely reflects higher commodity prices. In particular, sharp increases in energy prices have led to upward price pressures in the earlier stages of the production process. It is crucial at this stage to avoid that the recent rise in inflation translates into broad-based second-round effects, for instance via price-setting or higher wages. Such effects would give rise to broad-based inflationary pressures over the medium term.

In the view of the Governing Council, as expressed on 3 March, risks to the price outlook are on the upside. Commodity prices could increase more than expected. Also, indirect taxes and administered prices could turn out higher given the need for fiscal consolidation in the coming years. Finally, the ongoing recovery in activity could result in stronger than expected domestic price pressures.

As regards our future monetary policy stance, I have nothing to add to what I said, on behalf of the Governing Council, on the occasion of our last monetary policy decision meeting earlier this month.

As regards liquidity-providing operations, the Governing Council decided to conduct them in the second quarter of 2011 on the same conditions as in the first quarter of 2011. This means that we will continue to apply fixed-rate tender procedures with full allotment in all our refinancing operations at least until mid-July.

II. Interaction between banks and sovereign debt

Let me now turn to the specific topics you have asked me to address and start with sovereign debt. I should like to emphasise once again that the right way to avoid the risk of sovereign debt crises in an economic and monetary union is through sound national macroeconomic policies and strengthened economic governance.

At the same time, the governments have considered that a permanent crisis management mechanism would be useful. From the side of the European Central Bank, the design of such a mechanism is essential for it to provide a positive contribution to financial stability in the euro area as a whole. I would like to highlight two aspects: first, the mechanism may in no way weaken the incentives for sound fiscal and macroeconomic policies pursued in all member states. It must in particular not weaken incentives for preemptive fiscal and macroeconomic adjustment by countries concerned, thereby avoiding moral hazard. Second, given that the euro area is characterised by an exceptionally high degree of economic and financial integration among countries, the mechanism should be able to employ a range of instruments to be effective in stemming against contagion in situations of acute market instability. If indispensable, supporting countries while still keeping some market access, may be an appropriate way and would imply a prudent use of funds. In this context, I continue to consider secondary market interventions as a helpful tool in this context.

Regarding the institutional method to set up the ESM, the ECB, like the Parliament, supports the largest possible recourse to the Union method. It would welcome that, on the basis of the experience gained, the ESM could become a Union mechanism at the appropriate point in time. In the meantime, the ECB encourages that the assessment of circumstances leading to the activation of the ESM and the conditions on financial assistance entail an appropriate involvement of Union institutions, thus benefiting from their expertise and their Union-wide perspective.

Turning to the issue of bank resolution, the presence of sound bank resolution mechanisms, limiting the costs associated to a bank failure in the case of a cross-border group, is likely to facilitate the negotiations to share the public costs incurred if and when required. Therefore, we support the overriding policy objective of the new EU framework for bank recovery and resolution proposed by the Commission.

Although the implementation of the new resolution regime in the EU could already reduce the fiscal costs of bank failures, I believe that explicit arrangements should also be put in place to ensure that in the future the financial sector bears the burden of possible crises to come. As part of a credible resolution framework, bank levies (possibly accumulated in resolution funds) could possibly be considered.

However, a levy on banks should be seen as a complementary tool in the set of instruments aiming at increasing the loss absorbency of systematically important banks – notably capital and liquidity surcharges, and contingent capital. The Financial Stability Board is currently exploring several options, in particular on contingent convertible capital and bail-in debt instruments.

To this end, I welcome the fact that the European Commission is considering bank levies and bail-in in its plans for the future EU crisis management framework. The ECB stands ready to further contribute to the challenging work that is still ahead of us in the development of this framework.

I would like to take the opportunity of today's meeting to address another topical issue: the finalisation of the proposed EU Regulation for OTC derivatives, central counterparties and trade repositories. We would welcome if the draft report of your Committee on this significant legislative initiative took account of the important role that central banks play for ensuring the stability and efficiency of market infrastructures. Central banks have proven their relevant role during the financial crisis and we would thus welcome that their contribution to financial stability be fully reflected in the new Regulation.

This means that the central banks would be adequately involved in the new EU framework for central counterparties (CCPs) and trade repositories. They would cooperate with supervisors in the authorisation and the ongoing risk assessment of infrastructures, technical standard-setting and decisions regarding the recognitions of third country central counterparties and repositories. Regarding the arrangements for cooperation and information-sharing among authorities, the Commission's proposal of colleges provides, in our view, a set-up that is preferable to bilateral contacts between those authorities and ESMA.

III. Eurobonds

Let me now say a few words on the other subject you suggested: so-called "Eurobonds". The ECB is not in favour of introducing such "Eurobonds", understood as guaranteed government bonds on a joint and several basis, in the present circumstances. We note that the aim is to support the development of euro area bond markets, as well as at providing a possible mechanism to alleviate or resolve the ongoing sovereign debt crisis.

With respect to supporting the euro area bond market, the main advantage could be cost savings from reducing the liquidity premium in the bond markets. This could arise particularly if Eurobonds gained benchmark status, comparable for instance to US Treasury bonds. As regards the impact on sovereign debt developments, moving to Eurobonds would remove the financial market pressure in the short term but, if not replaced by new mechanisms, fundamentally reduce incentives for sound fiscal policies.

In our institutional set-up, fiscal discipline is induced via existing domestic provisions; the fundamental institutional framework of governance (the Treaty and the Stability and Growth Pact) and the assessment by savers and investors.

Jointly guaranteed bonds would not permit savers and investors to assess fiscal policies of individual countries. As long as we do not have a political federation with a federal budget, this would create an incentive problem. It would impair the incentives for fiscal prudence at the domestic level.

Consequently, Eurobonds would be the natural counterpart if national fiscal competences were clearly at the level of a union which would be a federation. In the present institutional framework we need to make very important progress in the collegial governance and surveillance of fiscal policies which remain national.

Dear Honourable Members, I thank you for your attention and am at your disposal for questions.