Jean-Claude Trichet: Ensuring price stability and confidence - five ideas

English translation of a contribution by Mr Jean-Claude Trichet, President of the European Central Bank, published in Le Monde, in the edition dated 16 June 2005.

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Europe is experiencing a significant and demanding episode in our profoundly original historic undertaking, namely a voluntary Union of peoples and nations, which began 55 years ago with the launch of the Schuman Plan. More than half a century of economic and democratic construction, with its highs and lows, its latent periods and its periods of acceleration. This is not the first time that a new idea or project has been put aside for some time or rejected. The rejection by France of the European Defence Community in August 1954 was initially regarded as signalling the end of European construction. However, Europe then set itself new objectives, objectives which have proved to be historically successful. Did Jean Monnet not write in his memoirs that "those who never want to do anything because they have no guarantee that things will happen as planned are condemning themselves to immobility"?

The historical evolution of Europe progresses at its own pace, which can be assessed only in the long term. I have confidence in the ability of Europe to overcome its present difficulties and I share the sentiment of confidence and resolve expressed in the joint statement issued by Josep Borrell Fontelles, Jean-Claude Juncker and José Manuel Barroso, the Presidents of the European Parliament, the European Council and the European Commission respectively.

The European Central Bank is, in its domain, a totally executive body. Together with the national central banks of the euro area, i.e. the other members of the Eurosystem, it has been tasked with ensuring price stability for our 307 million fellow euro area citizens. I feel it is important today to highlight five ideas.

First, there is the issue of responsibility. An independent monetary institution is ultimately responsible to public opinion. It implies that the bank regularly answers questions put to it by the European Parliament. Indeed, at an average of six times per year, I am invited to appear before the European Parliament, more often than my American counterpart appears before the US Congress. And the ECB Vice-President and I are, within the G7, unique among central bank representatives in holding a press conference immediately after every monetary policy decision by the Governing Council, 11 times per year, tirelessly explaining the Eurosystem's analysis of the situation and the reasons why the Governing Council has taken the decision it has.

The **second idea** is the importance of being faithful to our mandate – price stability – in the eyes of the citizens of the euro area. I am not just thinking of the Germans, who coined the term "Teuro" to express concern about the "expensive euro", or the Italians, who consider that price rises remain excessive. I am thinking about all consumers, the 307 million in the euro area, and particularly the least fortunate, who are in all European opinion polls sending us a clear message, asking us to be vigilant. That is the reason why we say to everyone: "If you are hesitant in your decisions as a consumer because you fear the future erosion of your purchasing power, hesitate no longer, as you can count on us to guarantee the purchasing power of your money."

The **third idea** is that our faithfulness to our mandate also allows us to offer the most favourable financial environment possible for growth and job creation. As all savers and investors in Europe and throughout the world are convinced of our credibility, they are incorporating in their expectations future inflation in line with our definition of price stability, i.e. "below and close to 2%". This remarkable result is due entirely to the very high level of confidence in the Eurosystem. This result explains in particular why the euro is today recording the lowest rates ever observed and the growth rate of outstanding loans to the private sector is (at 7.4%) twice that of nominal GDP. As I write, ten-year rates on the best ratings have settled at 3.1%. Who would have dared envisage that before the creation of the euro? This is why we are saying to businesses: "Investment is your decision, a decision based on a number of criteria. One of those criteria is the level of interest rates. Is this not the moment to invest?"

The **fourth idea** is that, contrary to a wrongly-held but widespread belief, the euro area has the same characteristics as the United States in terms of interregional differences relating to growth and inflation. In the United States, as in Europe, there are considerable differences from State to State and from region to region, and the growth and inflation differentials are of the same magnitude in the two economies. On both sides of the Atlantic the central bank looks at the relevant area’s economy as a whole, for all States or member countries together. I would also like to mention that for each European economy, belonging to the euro area is a "win-win" situation: not only in terms of achieving the concept of the internal market and enjoying the lowest interest rates because all risk premia by comparison with the best-performing currencies are eliminated, which is of particular benefit for those countries which had high market interest rates; but also because all risks associated with exchange rates are eliminated within one vast integrated economy, which is good for all countries, including those whose market rates were already low.

Turning to the **fifth idea**, on the question of whether we can contribute further to growth and job creation while fulfilling the requirements of our mandate, some say: “You should be less demanding in your definition of price stability. 2% is too low. Make it 3%. You could then reduce your intervention rates!” But such advice would backfire: by opting for 3% we would not only lose the confidence of households but also push all rates up, not down, with those rates incorporating the increase of 1% in expectations of future inflation. And that would be totally counterproductive… Others make a more admissible remark and say: “Your definition of price stability is in line with a good anchoring of inflation expectations. This is good for growth. But are you not doing too much? Perhaps you could achieve the same result with lower intervention rates!” Yet this is not what the information we currently have available suggests: if we had been too cautious not only would our fellow citizens share that view (and then they would find the price rises reasonable) but also this would have had an impact on the observed price rises (which would then be significantly lower than our definition of price stability) and above all on inflation expectations, which would then be significantly less than 2%. This is not the case at present. Regarding inflation expectations in particular, all of the public and private surveys and market indicators converge to 1.9% or 2%. We cannot be arithmetically closer to 2%! These objective surveys show that we are doing what it necessary to ensure stability and credibility, no less…no more. And that is why the Governing Council considers our interest rates to be appropriate. We are not biased – I have said that I was not preparing the markets for a rate cut. Nor am I preparing them for a rise in interest rates. We remain vigilant, realistic and pragmatic.

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A good monetary policy is necessary but not sufficient alone – it cannot achieve everything. European citizens know that the Eurosystem is doing and will do all it can, thanks to and by being faithful to its mandate. A sound budgetary policy which complies with the Stability and Growth Pact is also essential. Structural reforms also have a decisive role to play in strengthening competitiveness, raising the potential growth rate and stimulating job creation.

Behind all this is a key word in today's Europe: **confidence**. Confidence on the part of households and firms, which must be nurtured and strengthened. We are fortunate to have a European Central Bank which inspires such a level of confidence among Europeans and the rest of the world such that our market rates are at exceptionally favourable levels. Let us maintain this precious confidence which has been entrusted to Europe.