Jean-Claude Trichet: Interview in *The Wall Street Journal*

Interview with Mr Jean-Claude Trichet, President of the European Central Bank, in *The Wall Street Journal*, conducted by Messrs Brian Blackstone and Marcus Walker on 19 January 2011.

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WSJ: If 2008 and 2009 were years of crisis, and 2010 was a year of stabilization and recovery. How do you see 2011? What should Davos participants be focused on this year?

TRICHET: Since the start of the recovery, in the third quarter of 2009, the real economy has surprised up on the upside. This is encouraging. I see 2011 as a year of continuous hard work, to make the financial sector more resilient and to improve the soundness of fiscal policies. The crisis, which started in 2007 and intensified in September 2008 revealed the fragility of the financial sector first and then the relative vulnerability of public finances in the advanced economies.

WSJ: What worries you most?

Trichet: To consider that because we managed to avoid a depression and are now experiencing the recovery, we could lose momentum in the reforms that are still urgently needed. That is the main danger.

WSJ: This year austerity becomes pan-European. But a recent United Nations report said austerity risks a renewed economic downturn. Do you agree?

TRICHET: No, we do not. I do not buy the very simple reasoning that would suggest that pursuing sounder fiscal policy would hamper growth. On the contrary, I think that appropriate fiscal retrenchment in countries that need it is part of growth enhancement, because sustainable public finances makes a difference in terms of improving confidence of households, enterprises, investors and savers, which is decisive to foster growth and job creation.

WSJ: Does the U.S. have it wrong? It is engaging in even more fiscal stimulus.

TRICHET: It’s not for me to give a lecture to other advanced economies. We have our own responsibilities. In our own case we strongly believe that fiscal soundness is confidence-enhancing and therefore part of a growth-enhancing strategy.

WSJ: In your recent ECB press conference you made repeated references to the July 2008 rate hike and said the ECB is never pre-committed not to move interest rates. Were your remarks over-interpreted as hawkish?

TRICHET: I have nothing to add to what I have said last Thursday (ECB press conference on 13 January). You have to place my remarks in the context of the first 12 years of the euro, during which we delivered price stability in line with our definition: less than 2%, close to 2%. When you look at the yearly average since the setting up of the euro it is 1.97%, better than had been done in any such period of time in the previous 50 years. You don’t get this result by chance. We are profoundly attached to our mandate. And that explains the solid the anchoring of our inflation expectations, which we see as one of our major assets because it helps avoiding second round effects when we have oil price increases in particular. Clearly, in particular on the side of energy and commodity prices we have a number of developments that we will continue to monitor closely.

WSJ: Tighter monetary policy would have the biggest impact on countries like Spain, Greece and Ireland where private debt is linked to Euribor. Can you understand why those peripheral countries are concerned about this hawkish shift?

TRICHET: I also said in my last press conference that the present interest rates were appropriate. In any case all countries in the euro area have an immense stake in the solid anchoring of inflation expectations because medium and long-term interest rates incorporate future inflation expectations.

WSJ: Inflation is being driven by energy and commodity prices and higher value-added taxes in some countries. Is the ECB's focus on headline inflation misplaced? Does the Fed have it right by focusing more on core inflation?

TRICHET: In the U.S. the Fed considers that core inflation is a good predictor for future headline inflation. In our case we consider that core inflation is not necessarily a good predictor for future headline inflation. That being said all central banks, in periods like this where you have inflationary threats that are coming from commodities, have to go through the hump and be very careful that there are no second-round effects. This is what we are doing.

WSJ: When you hiked rates in 2008 there were signs of those second-round effects. Do you see evidence they are starting to take hold in Germany or elsewhere?

TRICHET: At this stage, we do not see this. And everybody knows we would not let second-round effects materialize. We will continue to deliver price stability.

WSJ: Could the ECB raise interest rates while still maintaining nonstandard measures including unlimited loans to banks?

TRICHET: It is our doctrine since the beginning of the turbulence that interest rates on the one hand and non-standard measures on the other hand are decoupled. We design the monetary policy stance; we decide interest rates to deliver price stability in the medium term. Non-standard measures are there to help restoring a better functioning of monetary policy transmission. We are disconnecting both measures. We can move interest rates on the one hand, and we can move non-standard measures on the other hand independently.

WSJ: Euro member states are working on comprehensive measures to address the debt crisis. What elements should be in that package?

TRICHET: These decisions are the responsibility of governments. We have in particular a very strong message, which is that we need a "quantum leap" in the strengthening of governance of economic and fiscal policies.

WSJ: When you spoke of a quantum leap last year, you referred to quasi-automatic sanctions on excessive deficits. Governments so far haven't come along. What makes you optimistic that you can still get your point of view adopted by governments?

TRICHET: There are a number of elements that are important: the reinforcement of sanctions; the reinforcement of the independent diagnosis that would be made by Commission. It's a set of quantum leaps, including the quasi-automaticity of the start of the corrective procedures and of the sanctions, which in our view is extremely important. Governance is now discussed by the European Council and the European Parliament. The Parliament has in the past always demonstrated a remarkable capacity to capture what is essential for Europe. So, the involvement of the Parliament is very important.

WSJ: Last year, governments made a watery compromise on sanctions, weaker than the European Commission's proposals. Should governments rethink that compromise?

TRICHET: Even the initial proposals from the Commission seemed to us too timid. Our position has not changed.

WSJ: You have called for maximum flexibility for the European Financial Stability Facility. There is discussion whether EFSF should take over all or part of the bond buying program from the ECB. If that were to happen, would you be relieved?

TRICHET: As I said, they have to improve the stabilization fund in both quality and quantity. By quality I mean having a tool that is as flexible as possible.

WSJ: You have said bond purchases are meant to ensure the transmission of monetary policy. If EFSF buys bonds, wouldn't that take a monetary function away from the ECB and give it to a fiscal authority?

TRICHET: As all our non-standard measures, the securities purchase is indeed meant to help restoring a better transmission mechanism of our monetary policy. It is clear that if markets are functioning better more generally then we have less problems in the transmission of monetary policy. In any case, the main tool to improve the situation is to restore the credibility of individual governments themselves.

WSJ: Should countries be able to borrow money from the EFSF for bank recapitalization without having to apply for a full bailout?

TRICHET: These are the responsibilities of the governments. We are asking to demonstrate full responsibility for economic and financial stability through a quantum leap as regards the economic governance in the euro area, a quantum leap in conditionality and greater flexibility in their utilization of the mechanism.

WSJ: You have said there is a sense of urgency to improve the EFSF. Governments appear to have put off any changes until March at the earliest. Do you think leaders are showing a sufficient sense of urgency?

TRICHET: Since the beginning of the turbulence, I have said we needed to demonstrate – all of us, all authorities – a solid sense of direction, a sense of responsibility and the awareness of the necessity to be ahead of the curve and not behind the curve. I maintain that.

WSJ: What do you think the risk is that this wrenching process will cause the breakup of the euro or its membership?

TRICHET: Of course the euro is there and will be there in the future. I do not comment on what I consider absurd hypotheses. I am used to such questions from the very beginning of the euro. The paradox is that, years ago, the question was about Germany supposed to be at that time the "sick man of Europe". I was responding that Germany was doing hard work that its economy was catching up on competitiveness. Now the same hard work has to be done by those that were growing rapidly over the past years but at the same time had lost their competitiveness. One has to accept that within a vast economy that has the size of the euro area, with 331 million people, there are economic differences. For instance when I look on both sides of the Atlantic I see that the differences between the fastest and slowest-growing U.S. states, it is more or less of the same order of magnitude as between countries in the euro area, for instance between Oklahoma and Nevada, 13 % differences in growth in 2009; between Slovakia and Ireland more than 9 % in growth in 2008.

WSJ: The U.S. copes with these differences through labor mobility and a federal budget. Does the euro zone ultimately need a big federal budget?

TRICHET: The quantum leap we are asking for in surveillance of fiscal policy has to be the equivalent, in our own institutional framework, of what a federation could do. And we should not overestimate labor mobility in the U.S. and underestimate it in Europe. If I take the U.S. state with the highest unemployment and the state with the lowest, I am not that far from what we observe in the euro area, for instance in 2009 between 18% and Spain, 3,7 % in Netherlands, and between 13,6 % in Michigan, and 4,3 % in North Dakota, 4.3%.

WSJ: Should senior bondholders of bank debt be forced to accept haircuts in the event of a bailout, as proposed by the European Commission?

TRICHET: This is not a European concept. This is a global concept, which is discussed in particular at the level of the Financial Stability Board and of the Basel Committee It is particularly important for so-called systemic financial institutions. Very careful analysis is required on the various possible options – additional capital buffers, contingent capital, bailing in financial instruments, etc. I would say for us it is still a work in progress. In any case I don't imagine we could have a different solution in Europe than in other advanced economies.

WSJ: What can be done to improve the euro zone's growth potential?

TRICHET: The growth potential of Europe and the euro area could be significantly higher if all European countries had implemented the structural reforms of the so-called Lisbon Agenda. Now the Europeans are again committed to bold structural reforms. Two avenues seem particularly decisive amongst many others. I would insist on the full opening of a real single market in services. When we created the single market we were an industrialized economy and services were not particularly dominant. Now we are an advanced economy and services are playing a dominant part, and we still have resistance to a real single market in services. This could give a boost to European growth potential. The second point is labor market reform where we need significantly more flexibility in a number of economies.

WSJ: This is your last year as ECB president. How important is it that the choosing of your successor by governments be a smooth process?

TRICHET: I have very hard work until the end of October and I expect to exert, with all my colleagues, my impressive, inspiring and profound responsibilities until the last day. As regards my succession I have full confidence in the heads of state and government. It is their responsibility.

WSJ: What has surprised you, both good and bad, over the last 12 years of the euro? What do you think the euro zone will look like in 2015?

TRICHET: I will not say that I was myself surprised because I have been deeply involved in the negotiation of the Maastricht Treaty and the setting up of the euro. But I guess that a number of external observers are very positively surprised to see that price stability with the euro has been, over 12 years, better than with the previous national currencies and that as many as 17 countries and 331 million peoples are in the euro area since the beginning of 2011. But this is not time for complacency. As all of the advanced economies we have to draw – without any complacency – all the lessons from the present global crisis, in particular in terms of governance.

WSJ: The Fed is doing more quantitative easing, while the ECB warns of inflation risks even though both regions are recovering in a broadly similar fashion. Are Fed and ECB policies diverging, and does it pose a risk to global financial stability?

TRICHET: On both sides of the Atlantic we have each of us our responsibilities that are very important. We are placed in different economies, particularly in terms of the financing of the economy, and of the nature of the shocks we have to cope with. But we are united in purpose: to deliver price stability in medium term and to solidly anchor inflation expectations.