

Jean-Claude Trichet: Interview with Der Standard, De Standaard, La Tribune, Süddeutsche Zeitung and L'Echo

An interview with Mr Jean-Claude Trichet, President of the European Central Bank, conducted by Ms Birgit Baumann (Der Standard), Mr Luc Coppens (De Standaard), Ms Isabelle Croizard (La Tribune), Ms Helga Einecke (Süddeutsche Zeitung) and Ms Catherine Mommaerts (L'Echo), published on 15 March 2006.

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After the second ECB rate hike, you repeated that monetary policy was still accommodating. At what level do interest rates become neutral, i.e. when they neither stimulate nor brake economic activity.

When I reported on the decision of the ECB's Governing Council to raise the interest rates I said that our decision reflected our assessment at that time. It is still our assessment. Our assessment is clear. We did not decide ex ante a series of monthly increases of rates as has been done by other central banks. The Governing Council assesses the risks to price stability and does what is necessary to counter these risks when they increase. We do not refer to the notion of a theoretical "neutral rate". We refer to our mandate, which is to deliver price stability and be credible in delivering price stability over time. It is what the Treaty calls on us to do and what the people of Europe are very clearly asking us to do. By doing so, we are also contributing to a financial environment which is very favourable to growth and job creation in the euro area. When I say that our monetary policy stance is accommodating, it can be confirmed by a number of observations: we have real short-term interest rates which are very close to zero; nominal short-term interest rates are the lowest in the euro area since the Second World War, for example the German Bundesbank never went lower than 2.5%; there is abundant liquidity in the euro area with monetary aggregates growing twice as fast as the growth in GDP.

Businessmen complain that the ECB's rate hikes came too early and might put the economic recovery of the euro area at risk. How can the ECB cope with that criticism?

What we are doing is what our mandate commands us to do. But our mandate is not at all in contradiction with growth and job creation. I will tell you why: in order to preserve a level of medium and long-term market interest rates that is exceptionally favourable to growth and job creation, we have to solidly anchor inflation expectations at a level that is fully in line with our definition of price stability. We do that precisely by demonstrating to observers, investors, savers and our 313 million fellow citizens of the euro area that we do whatever is necessary to deliver price stability. If we were not credible in doing so, all our medium and long-term market interest rates would be much higher. This is well understood by European and global observers. By delivering price stability we also contribute to reinforcing consumer confidence. We are telling consumers: "look, we are protecting and preserving your present and future purchasing power". To sum up, what we are doing, i.e. being faithful to our mandate, allows the present euro area recovery to be sustainable in the medium and long run.

The growth rate of Europe now seems unable to reach its potential. Should the ECB therefore become more than a financial watchdog?

Our present assessment is that the current trend in the growth rate in the euro area is around its potential growth rate, taking into account some volatility in the quarterly figures. We will see whether economic growth will accelerate, or whether we will have to cope with other, new shocks. We are constantly assessing the situation in a pragmatic way, based on the facts and the new information that we receive. Let me add something which is important: a good monetary policy is a necessary condition for growth and job creation, but is not sufficient in itself. We also need a sound fiscal policy, bold structural reforms and appropriate monitoring of competitive indicators. This is the responsibility of all the other stakeholders which have a part in the overall result.

The political leaders gave a very sharp reaction to your first rate hike in December, but not to the second in March. Did you convince them in the meantime or how do you explain that?

The ECB is totally and fiercely independent, as you can read in the Treaty on European Union. Its credibility is based upon this independence. That credibility is our most precious asset and permits us

today to have exceptionally favourable medium and long-term interest rates. I trust that this is increasingly well understood by all our partners in the euro area.

Did the recovery in Germany help the ECB Governing Council to decide on the last rate hike?

As you know, we look at the situation of the euro area as a whole. The significantly positive signals in various German surveys are important, because Germany is the largest national economy of the euro area. We will see how the present period of recovery develops. We have quite a number of good signals. These signals are encouraging for the euro area and confirm a trend for the recovery that is likely to be around our growth potential. That said, we are very pragmatic. We look at all the facts, figures and data, and stand ready to incorporate them in our future assessment.

What risks to price stability do you see, with the exception of oil prices?

We see a number of risks. Some of them are associated with the increasing prices of oil and commodities. These increases are progressively incorporated in the prices of other goods and services that are energy intensive. We have another set of risks, which are associated with indirect taxes and increases in administered prices. Furthermore, we have the risk of “second round” effects. This means that economic agents may incorporate in their price setting the wrong assumption that the higher headline inflation due to oil price increases will last in the medium and long run. These risks of “second round” effects are particularly significant as regards wages and salaries. We are there precisely to ensure price stability in the medium term. To date, we have not seen these risks materialise, but we have to prevent them. Once the second round effects materialise, it is too late. Signals for risks in the medium to long term can be deducted from our monetary analysis. For example, loans to the private sector are growing quite rapidly.

You said you are not committed to a series of rate hikes, but two hikes do not make a cycle. Can we expect a scenario similar to that from 1999 to 2000, with seven rate hikes in a row?

We have not decided ex ante a series of rate hikes. It is important to convey this message, because otherwise observers might think that we have decided to raise rates at every meeting, as has been done by another important central bank. At the same time, I said that we never embark on any pre-commitment – we will do what is necessary to counter the risks that we identify. That is why we increased rates in December, why we did not in January and February, and why we did increase rates in March. I don't want to say anything else. One thing is for sure: all observers have understood that we did not decide a priori to increase rates and that we will do what is necessary to ensure price stability. And they trust us. This trust is perhaps our most precious asset.

Can we today speak of a housing market bubble in the euro area?

The development of loans for financing housing forms part of the information which we receive from the monetary analysis and which we monitor closely. If you take the full body of the whole euro area you have a level of outstanding credit for housing which is very dynamic, exceeding 11% growth on a yearly basis. That figure is posted despite the fact that the German real estate market remains depressed. That means that, in part of the euro area, there is an even more rapid development of the situation. So it calls for very close monitoring. At this stage, I will sum up our present understanding of the situation: it is something that is important to monitor closely. It was naturally part of the information we took into account when we decided to increase rates during our last meeting. But I would also add that, at the level of the euro area as a whole, all economies taken into account, I wouldn't say that we are presently alarmed, diagnosing the immediate danger of a bubble. I would say that we have information that calls for very close monitoring and we will continue to follow these developments very carefully.

But you have some differences between countries. How can you cope with that?

Again, at the level of the Governing Council of the ECB we have only one instrument, which is the single monetary policy. If there are situations that are different from country to country, as is the case, other instruments, in particular at national levels, are in the hands of the governments, the parliaments and, in some cases, the national central banks of the countries concerned. However, it is clear that, as far as we are concerned, in that domain, as well as in others, we only have the single monetary policy as an instrument.

What is your appraisal of the seven years since the euro was launched? When do you think it best played its role as a monetary shield?

The euro has been an incredible success. Human nature is such that when you have a big success, you tend to forget it. The success has been such that we have been able to deliver to 313 million people the level of monetary confidence, of monetary credibility, of low medium and long-term market interest rates that previously were the privilege of only part of the euro area. All that was considered by many impossible "ex ante". I have participated in the run up to the euro and I have a very vivid memory of what many observers believed even in 1997 or 1998: the fact that we could succeed in benchmarking the euro on the most credible currencies of the euro area was considered as a quasi impossible endeavour. We succeeded and we met the promise which was made by all the authorities, including central banks, to the people that the euro could be as good, as solid and as credible a currency as their previous national currencies. I am proud, as was my predecessor Wim Duisenberg, to be able to go to all the countries in the euro area and tell people: "you have a currency which has fulfilled the promise that was made".

The launch of the euro was supposed to accelerate the process of economic union and fiscal harmonisation. How do you explain the lack of progress and, worse, the apparent rejection of the euro by many of the larger new Member States of the European Union?

Let me remind you of some figures. Today, 25 countries are members of the EU and, quite soon, there will be 27. Of these 25 countries, only two have an "opt out" clause as regards the euro. In the future, 25 out of the 27 countries will not have an "opt out" clause. And out of the two economies that have an opt out clause – the UK and Denmark – Denmark follows very closely the monetary policy of the euro area. Now let me give you some figures on the Exchange Rate Mechanism 2. When I first arrived at the head of the ECB, there was just one participating currency, the Danish krone. Now, the number of participating currencies is eight. I do not observe a frozen situation, quite the contrary. The euro has facilitated the completion of the single market and is also pushing in the direction of structural reforms that are a major endeavour for Europeans in general. It does not mean that we are fully satisfied with the present situation. It is clear that in the domain of structural reforms, we have to do more, much more. We gave our strong backing to the initiatives taken recently by the European Commission, under the leadership of Mr Barroso, to re-launch the Lisbon Agenda.

If you look at those countries that have implemented well and fully their structural reforms, you see that they are success stories. Ireland, in particular, is a remarkable success story, as regards full employment and GDP per capita. Denmark, which is de facto in the euro area, has made structural reforms in the labour market, which have proved very efficient. We are fully backing this trend of reforms. It is very important to communicate as efficiently as possible and to convince public opinion that this is a successful way to fight unemployment and promote growth.

Part of the needed structural reforms are sector-based and imply cross-border mergers and acquisitions. Are you completely discouraged, for example, by the French government's recent attitude in the Suez-Gaz de France case and Dominique de Villepin's call for economic patriotism?

The ECB's Governing Council didn't discuss any particular dossier relating to cross-border mergers and acquisitions. In the past, the Governing Council always referred to the full completion of the European single market. As a matter of principle, the Governing Council thinks that there is an opportunity cost associated with the non-completion of the single market. Let's not forget that it is not a new endeavour. The Single Act launched the endeavour for a single market in the mid-1980s. In 1958, when the Treaty of Rome was ratified, the idea was to produce a common market of the size of the USA to benefit from economies of scale. The ambition was already clear 50 years ago: free circulation of men and women, goods and services and capital in the European Union.

Austrian Finance Minister Karl-Heinz Grasser, who is chair of ECOFIN during the first half of 2006, claims that all EU Member States should achieve balanced budgets by 2010, what do you think about that?

It is a good goal. We have always called for the rigorous implementation of the Stability and Growth Pact. You will remember that there were calls to drastically change the rules in this domain, and even by some to abandon the pact. We have always said that the Pact is a crucial element in the EMU. The Stability and Growth Pact is very much the "E" in EMU. We have no federal government, we have no federal budget, but we have a single currency. In order to be coherent, the EMU needs a stability and growth pact. The three percent threshold, which I am proud of having introduced myself in the negotiations, is not only mentioned in the Stability and Growth Pact but is also referred to in the Treaty. I often have to answer the question, whether more than three percent would not be opportune in difficult situations where an economy could use that extra push. That would be the Keynesian

argument: the more you spend, the more you activate the economy. But besides that argument, there is what economists call the "Ricardian effect". David Ricardo rightly stated that the greater the deficit becomes, the more investors and consumers alike start to realise that such a deficit is not sustainable in the longer run. Somebody will have to pay for it, either through higher market interest rates or through tax increases. Entrepreneurs become nervous and slow down their investments, consumers start saving more and spending less. So the economy slows down and jobs are lost. The more the budget goes into the red, the stronger this Ricardian effect becomes, and the more it outweighs the Keynesian arguments for deficit spending. That is why the stability pact is also a growth pact.

Slovenia is the only new EU Member State that is ready for the euro. Do you think it can join in 2007 as expected?

We will see. I don't want to anticipate the result of the reports that the ECB and the Commission will publish in May. We have to check whether the criteria stipulated in the Maastricht Treaty are fulfilled on a sustainable basis.

After seven years, do you have any arguments left to convince the British to join the euro ?

It is up to the British people to decide. As you know, in the past, the British Prime Minister said very clearly that it is in the interest of Britain to join when the time comes. I'm also convinced of this. When you compare Britain and Ireland, you can see that there are good arguments. However, even without the UK, we number 313 million people in the euro area.

With Otmar Issing's departure, the last pioneer of the first ECB-Management is leaving. What has been done in your institution in the last eight years and what challenges lie ahead of you?

Otmar Issing has been and is a marvellous member of the Executive Board. Our institution, the ECB, has been designed to be credible over time irrespective of staff changes. The ECB is credible according to all the information we extract from observers, market participants and the financial sphere. The successive members of the Executive Board are themselves part of the continuity of the institution. I am confident that this trust is solidly based.

Do you think Lucas Papademos would be a marvellous successor to Otmar Issing as Chief Economist?

We will take together, the six of us, the decision for the responsibilities in the Executive Board, when time comes, with our new colleague.

The Federal Reserve System has a new Chairman, Ben Bernanke. What kind of man is he and do you expect to have the same relationship with him as you had with his predecessor, Alan Greenspan?

It is very important that we have a very close relationship with the Federal Reserve System. It has been the case consistently over the past years. At the time of the terrorist attacks in the United States on 11 September 2001, I mentioned several times that we had an exceptional and confident real-time dialogue with the Federal Reserve System, which permitted us to take the appropriate decisions as regards the potential liquidity risks that existed in both the euro and the dollar on our side of the Atlantic. That kind of immediate decision on the very afternoon of the terrorist attacks was possible only because the degree of mutual confidence and companionship between us is very high. I had a very good relationship with Alan Greenspan. We met very often because the various "G's" (G10, G7, G20) meet regularly. We have a special brotherhood of central banks which is important. I have myself the privilege of presently being Chairman of the G10 and I am the direct witness of this very close and confident relationship between central bankers. Ben Bernanke's appointment has been extraordinarily well received by the global community, all observers and market participants. I have full confidence that we'll continue to have the very same, very close and friendly relationship with the Federal Reserve System.

Do you think that the Federal Reserve System and Congress are ready to seriously discuss the opportunity of having an inflation target?

The fact that the question has been mentioned with the main argument that it could help to anchor inflation expectations is an idea that we like, as you know. But I don't want to comment in any respect on decisions that are of the responsibility of the Federal Reserve System's Open Market Committee and of its Chairman, Ben Bernanke.