

## **Jean-Claude Trichet: Interview with L'Espresso**

An interview with Mr Jean-Claude Trichet, President of the European Central Bank, conducted by Mr Claudio Lindner, published 15 September 2006.

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### **Mr Trichet, let us begin our examination of Europe with the message that the figures are giving us: are we in fact seeing a recovery?**

As early as the second half of 2005 our diagnosis was that the euro area was experiencing a gradual recovery and approaching the level of its growth potential. This diagnosis has now been confirmed by the very good data for the second quarter of 2006 which allow us to record good – and better than forecast – progress in the first half of this year. However, a word of caution: this does not mean that we are changing our diagnosis for trend growth. When we had a rather disappointing figure for growth in the fourth quarter of last year we said it did not change our sentiment that trend growth was around potential. I would say the same today after those flattering hard figures. We have to view everything from a medium-term perspective. And we should not discount the level of uncertainty that exists in the world today.

### **Not least because the United States, by contrast, seems to be experiencing a slowdown.**

What counts for us right now is the overall economic situation, on a global level, and therefore not just in the United States. The leading economic institutions and private research institutes state that we will probably continue to see a rather dynamic growth rate at a global level.

### **However, you seem to be very concerned with inflation, to the point that many people are betting on a further rate rise before the end of the year, to 3.5%.**

The primary mandate assigned to us is to guarantee price stability, and we have to be credible in order to be able to anchor inflation expectations. This is extremely important not only for our credibility, but also because it enables a favourable level of medium and long term market interest rates to be maintained. I am convinced that this is also the sentiment of the 313 million European citizens (315 if we include the Slovenians, who will be the next to join the euro area), who are asking us to safeguard their purchasing power by maintaining price stability. Therefore, this is not only what the Treaty commands us to do but also what our European fellow citizens are emphatically asking us to do.

### **Could inflation trends lead you to adjust rates again?**

After our last meeting in Frankfurt, I said, on behalf of the Governing Council, that strong vigilance remains of the essence so as to ensure that upside risks to price stability are contained.

### **Do you regard the 2% inflation limit as being absolutely inviolable or is there some degree of flexibility?**

What has to be kept in mind is that we take a medium-term perspective. Our definition of price stability is that, in the medium term, prices have to grow less than but close to 2%. Inflationary expectations seen by various panels tell us that, over the next five years, inflation is seen at around 1.9%. I believe it is essential that citizens, savers and investors can trust in the fact that we will take all decisions necessary to ensure that inflation remains at these levels in the medium term. For three reasons: because it is our primary mandate; it is what citizens are asking us to do, and because it is a major contribution to sustainable growth and job creation in Europe.

### **Where do you see risks of price increases?**

Further increases in oil and commodity prices and in goods and services prices due to past oil price increases. Also additional unexpected increases in administrative prices and indirect taxes. Then, more fundamentally, there are the so-called second-round effects, that is the risk of increases in wages and salaries that would derive from a loss of credibility regarding our capability in countering price increases. It is essential to intervene before these effects materialise.

### **Do your concerns include the increase in VAT to be implemented in Germany in January?**

The increase in VAT in Germany, which was decided upon some time ago by the government, had already been incorporated in our analysis.

**You were in Cernobbio, Italy, in early September. What was the mood among Italian entrepreneurs, politicians and economists?**

I saw further confirmation of the great potential of Italy and of the Italian corporate sector, but I also found unanimous agreement that one of the most important problems facing Italy is the insufficient labour productivity and consequently the rise of unit labour costs. It is a European problem, and not only an Italian problem, but in Italy it is particularly visible: we have to do all that we can to implement the Lisbon agenda aiming at accelerating productivity growth.

**But the Italian industrial structure is weak nowadays. What should be done?**

Research carried out in Italy and in Europe, more generally, has concluded that we are not benefiting sufficiently from productivity gains in sectors that use new technology (and not only in the sectors that produce the technology themselves) and this seems to be due to overly rigid labour, goods and services and financial markets. Structural reforms that would allow the economy to be made more flexible are the primary tools for achieving a leap in productivity. In the United States this was made possible in the mid-1990s.

**And, consequently?**

One should never underestimate the importance of investment in research and development, which are today insufficient both in Italy and in the euro area as a whole.

**You have mentioned structural reforms, which are currently at the heart of the Italian political debate on developments in the finance laws. Let us begin with the deficit-to-GDP ratio, which is well above the 3% limit. Is the situation in Italy a cause for concern for you?**

Our message to Italy, as to all euro area countries, is the following: the benefits that higher than expected economic growth is bringing, in particular in terms of higher tax revenues, should be allocated entirely to reducing the public deficit and preventing the growth of debt.

**That is a kind of recommendation.**

Yes. The position of the Governing Council is very well known. We are recommending rigorous compliance with the Stability and Growth Pact. And as a general rule we would suggest first that public spending be reduced, and only after as much as possible has been done in this area, that taxes be increased if necessary in order to comply with the Stability and Growth pact.

**You know Tommaso Padoa-Schioppa well after having worked with him for so many years here in Frankfurt. Will he do this to improve Italy's accounts?**

Tommaso Padoa-Schioppa is one of the most experienced persons, not only within Italy and Europe, but also in the world. He has personal influence, and personal prestige in all fields of money and finance, which I regard as being very important. Of course, it is clear that the challenges and risks that he faces are enormous."

**Being a minister is not like being a banker, the tasks and responsibilities are quite different.**

"Tommaso has been a marvellous banker, but he has also held a large number of other responsibilities. These are different tasks, but they both require clear judgement, decision-making ability, strength of character and determination. Let me add that I do not forget myself that central bankers, by definition, have a multipartisan responsibility.

**Why?**

Price stability is a common benefit for all citizens, regardless of their political sensitivities and individual preferences.

**According to a Financial Times journalist, in the absence of structural reform Italy risks being expelled from the euro. Is that true?**

Italy is a very important economy in the euro area and is of course definitely not at risk of this. I have already said that I do not comment on absurd assumptions. Exactly like all other member countries, Italy does need to do its homework: improving productivity and its public accounts.

**One of the main stumbling blocks in the negotiations ongoing within the government is the issue of pensions.**

That of pensions is a European problem, due to the ageing population and the resulting pressure on public funds. Without further reforms to pension systems, the contribution rates would need to be doubled in some countries, up to as much as 40% of salaries in some cases, in order to keep a balance in the system's accounts.

### **But what should be done in these cases?**

In order to tackle the consequences of ageing populations, we need comprehensive reforms. Even if there are no unequivocal solutions, some measures are valid for several countries: raising the retirement age, eliminating early retirement incentives, reduction in replacement rates, integrating public pensions within a system which allows future payments to be financed so that the ageing of the population does not create imbalances between generations.

### **Should men and women retire at the same age?**

This is a sensitive and important issue triggering a whole host of reactions and different points of view. Apparently, in accordance with current jurisprudence, I would say they should retire at the same age, as the European Court of Justice maintains that there should be no discrimination or distinction between men and women in any area.

### **How urgent is pension reform?**

Extremely urgent, in all euro area countries. When we look at demographic trends, we tend to put it off as we are talking about long-term developments. It seems that the movement is slow and long, and that there is time. However, it is a complete illusion because it is an issue that has to be tackled as early as possible.

**The more radical left-wing and the unions are opposed to it and say that you are technocrats who only pay attention to numbers. As an important international leader, do you not believe that there are also social costs which need to be taken into consideration? We are, after all, talking about millions of people and all the weakest categories of the population.**

It is a crucial factor. Structural reforms of this sort have been decided upon by national governments within the framework of the agreements made in Lisbon and we should not forget that the ultimate objective is to increase the pace of economic growth in order to ensure more prosperity and provide more jobs for everyone, which is fundamental for the weakest and the poorest. Rather than finding a compromise between the various members of our society, between those that have costs and those that reap the benefits, I see it more as a compromise between the present and future. It is a forward-looking investment and a better future for the weakest part of the population which entails costs at the beginning. And in any case let us not forget that we cannot ask our children and grandchildren to pay our bills!

**In Europe, the population is shrinking to the point that by 2020, according to different studies, there will be 20 million people available for work. In the United States, it is on the rise. How is this?**

Perhaps this is because the United States is a population with entire generations of immigrants in which the birth rate is higher. And then there is the cultural aspect, they are more optimistic than us.

### **Why?**

This involves philosophical and cultural aspects and I am not convinced that they are structural. There have also been difficult periods in the United States, for example, at the end of the 1980s when Europe was more upbeat and had greater faith in the future, in building something together. These are cyclical phenomena and we at the ECB, together with Lorenzo Bini Smaghi, and the Governor of the Banca d'Italia, Mario Draghi, and the entire Governing Council, try our best to ensure that Europe regains confidence in itself. Credibility is a key word for the ECB.