

Jean-Claude Trichet: Interview with Ta Nea, Der Tagesspiegel and Luxemburger Wort

Interview of Mr Jean-Claude Trichet, President of the European Central Bank, conducted on 11 December 2006 by Ms Irini Chrysolora (Ta Nea), Mr Moritz Döbler (Der Tagesspiegel) and Mr Pierre Leyers (Luxemburger Wort), published on 18 December 2006.

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Can you please describe the current risks of inflation in Europe?

We have, in the eyes of the Governing Council, as I expressed on 7 December in my press conference, several risks. One is the pass-through of past increases in the price of oil and raw commodities that have not yet materialised in the consumer prices. We have also the risk of further increases in oil and commodity prices which we have to take into account. We have the risk of administered prices and indirect taxes being augmented on top of what has already been decided. And, more fundamentally, we have also risks that are associated with the so called “second round effects”, namely the spiraling of the wages and unit labour cost reflecting inflation fears and feeding inflation. Until now the last risk did not materialise. It is very important that it does not materialise because when it does, it is too late and very hard to get back to price stability.

How close are we to the second round effects that you have mentioned?

There are signs that some risks might augment in this respect. It is one of the reasons why in the last meeting of the Governing Council special attention was given to this. It’s important that we keep unit labour cost, wages and salaries in good order so as not to give rise to these “second round effects”.

You appeal to the responsibility of social partners. What would you consider to be a reasonable wage increase?

Social partners should not forget that we have unemployment at too high levels in Europe and that we also have different levels of productivity and of cost competitiveness in the various economies of the euro area member states. If we want sustainable growth and job creation a high level of responsibility is of the essence.

Most analysts interpreted your latest decision as implying that there are going to be more interest rate hikes next year, in particular two more, so that the euro interest rate reaches the level of 4 percent. Why do you believe they have come to this conclusion?

We have to be faithful to our mandate to ensure price stability. I said during my press conference that acting in a firm and timely manner to ensure price stability is warranted. Everybody knows that we will do what is necessary to deliver price stability. We are like a crew on a ship. We know where we have to go, there is no doubt about our objective: price stability. What one does not know is whether and when there will be a tempest, whether and when the sea will be calm, whether we will have headwind or tailwind. On this everybody can make up his own mind. And if there are different views in the market, it is because there are different assumptions on what will be necessary for us in order to deliver price stability. But everybody knows that the crew of the ship will take all necessary decisions to arrive at its destination.

Your comments after the last Governing Council were interpreted differently by different people. Is that something that you actually aim for, that there is no clear signal?

What the market has perfectly understood is that we will do whatever is necessary, without tying our hands ex ante. The proof is that inflation expectations are well anchored. Opinions might differ on the overall environment, on what will happen exactly in this vast European economy of 315 million people, what will happen in the rest of the world, what are the new chances, opportunities and risks that might appear. Acting in a firm and timely manner to ensure price stability is warranted. The ship knows where it goes.

Sometimes you have to adjust the course of the ship...

That’s the reason why we do not pre-commit in the medium term.

The members of the Governing Council are often described as belonging to different fractions. Some are “doves” others are “hawks”. To which fraction do you belong?

As President of the ECB I am speaking on behalf of the Governing Council of the ECB. It is an oversimplification to sum up the positions of the various members of the Governing Council in that fashion. We have a profoundly united Governing Council, the decision making entity in the ECB is the Governing Council itself and not any fraction of it. Each of us is working as responsible for the stability of the complete euro area, none of us represents any particular interest, any particular economy or nation. Moreover, I consider that the collegial wisdom is fundamental, namely each of us is incorporating the wisdom and the views of all the others and reserve the right to change his or her own approach depending on this interaction. As President I am the warrantor that the Governing Council is up to its Treaty mandate: price stability.

What can the ECB do to have a better control of the money supply?

The monetary pillar in our strategy is important. As you know we cross check results of the economic analysis and of the monetary analysis. We have ample liquidity in the euro area. As an example, the rate of growth of the outstanding loans to the non-financial corporations was 12.9 percent over the last 12 months. This shows that credit is presently abundant in Europe.

What do you think of the so called housing bubble? Do you think there is one in Europe and if so what are the dangers for the European economy?

We have to look very carefully at the euro area as a whole. There is evidently no such bubble in Germany, whereas in a number of other countries there is an accumulation of price increases of the last years, suggesting that close and careful monitoring is warranted. I don't have a diagnosis of a bubble in the euro area as a whole, but what we see in some parts of the euro area calls for very close attention. So we have to be alert.

Are you concerned that by raising the interest rates you might stop the main source of growth, as many see it, which is housing?

By raising interest rates, as we did last week, we are contributing decisively to the sustainability of growth. If we don't ensure price stability then growth will not be sustainable. That has to be clearly understood. We are not hampering growth! Not at all. On the contrary, we are permitting growth to be sustainable in the medium and long run. The mandate to ensure price stability over time – which has been given to us by the Treaty – is there because it is a condition for sustainable growth and job creation.

Are you concerned that a number of households which have accumulated big debts in the past will face serious problems paying them back in the future because of the interest rate hikes that you have decided during the last year?

I would ask those households which feel that interest rates are too high at the moment to compare with the interest rates they had in the same economies before the introduction of the euro!

But households tend to forget what happened before the euro. And some of them have accumulated big debts during the last two to three years and now they may be facing difficulties in servicing them. Do you have a golden rule to suggest to the households, so that they are not exposed to too many dangers?

If we want growth and job creation to be sustainable, thanks to price stability, interest rates themselves have to move. Borrowers know that interest rates can go up as well as down.

Greek citizens are paying considerably higher interest rates than other euro countries citizens. Why do you think this is happening? Is competition not working in the banking system?

We in the Governing Council, including Lucas Papademos, our Vice-President, and Nicolas Garganas, the Governor of the Bank of Greece, are calling for financial integration to be as complete as possible. In certain domains we can be reasonably satisfied, in others progress has to be made. It is clear that in retail banking progress must be made. We see that, even with the same currency and monetary policy, there are differences in the level of interest rates. But you also have to take into consideration that these interest rates are incorporating the credit risks of the loans. So one can understand that there might be some remaining differences.

The competitiveness of the Greek economy is low. What measures would you suggest to improve it?

In many respects the whole of the euro area has exactly the same characteristics and can receive the same recommendation as Greece itself: structural reforms are necessary. We need reforms that

permit goods and services markets to be more flexible, to function better and to be more fully integrated in this vast continental economy which is the euro area.

Flexibility is also needed in the financial markets. Financial integration should be completed and it is very important for the efficient functioning of the euro area. Labour market improvements also have to be taken into account if we want the whole economy to be competitive. I would draw particular attention – and I am not talking particularly of Greece, but of the entire euro area - to fiscal policy which has to respect fully not only the letter but also the spirit of the Stability and Growth Pact. Meaning that in good times one should save money for the bad times. We also have to follow the unit labour cost carefully. Because unit labour cost is one of the important indicators to measure overall competitiveness.

What is your comment on the rapid decrease of the German deficit level?

It is very good that the German government has expressed its full commitment to strictly fulfil the Stability and Growth Pact. This resolute commitment is very positive for Germany and for Europe as a whole.

Has the new government made a difference?

As you know, we are issuing the currency and preserving price stability for all, for all sensitivities in a fully multi-partisan way. I would say it was very good that Germany embarked on such a fiscal commitment. The progress made in cost competitiveness during the last years was also good.

In Germany, VAT is about to rise by three percentage points. How harmful is such a tax hike to price stability in the euro zone?

It is a decision that was taken a long time ago and was incorporated in our projections since then. It is clear that it has an impact on growth in Germany and Europe – we will have to see how much exactly. There is a mainstream consideration that there will be a little hump in the present last quarter of this year and a little bit of a slump in the first quarter of next year. We will see. But those who think that it will affect the German economy – and therefore the economy of Europe – very profoundly are not very numerous anymore.

What structural reforms are necessary in Germany and Europe as a whole?

For Germany and Europe as a whole the message is the same: actively continue to implement structural reforms. The goal is to be flexible, to adapt to an environment that is changing very rapidly. It is important for Germany, the first economy in Europe. It is important for Europe as a whole. And those reforms are paying off when we look at Ireland or Denmark, for instance.

Does size matter? Is it easier for Denmark?

I don't think so. There are many other examples of bigger countries like Canada or Australia. Those flexible economies which have done well, which are prosperous and leading in job creation. I think it's the privilege of countries where public opinion sees more clearly that everybody is better off when the economy as a whole is more flexible.

You named countries that make progress. Could you also specify euro zone countries that have difficulties in adapting?

All countries in Europe, and amongst them the three big ones Germany, France and Italy have more or less difficulties to adapt.

But let me add something. We see what we lose by not having done all those reforms. We could be better off, we could have more prosperity, more growth, more jobs. But it would equally be a mistake to think that nothing has been achieved in the Euro area. I will give you a figure that shows what I mean: Since the euro has been set up, 11.5 million jobs were created in the euro area. Now, what would you say how many jobs were created in the United States during that same period of time?

No idea. Twice as much?

7.2 million jobs! We created since the setting up of the euro much more jobs than the US! We have to recognise that some characteristics of the euro area are better than they are sometimes perceived even if unemployment is still much too high. Don't misunderstand me: That is not to say that we did enough reforms. It is to say: We should not be discouraged. We have the capacity to implement reforms and they will pay off.

Germany has often been dubbed “the sick man of Europe”. How accurate is that description nowadays?

I always considered this description wrong and I think my sentiment is shared by my colleagues in the Governing Council, by Jürgen Stark and by Axel Weber. Germany was going through a long period of catching-up, of overcoming the loss of competitiveness, the difficulties it had after the reunification – for obvious reasons that were unavoidable at the time. The productive sector in Germany has done a very important job of improving its cost competitiveness over the last eight years. This provides the basis for being the number one exporter in the world. But Germany, like all Europe, still has a lot to do in terms of structural reforms.

This position is about to be challenged by China. Can Germany, can Europe even compete in terms of costs with China or India?

We are an economy of 315 million people. It is a vast economy, slightly larger in terms of population than the size of the United States. In order to preserve our high standard of living and employment we have to permanently adapt. Flexibility and creativity are key in a world that is changing extremely rapidly.

In your latest introductory statement, you said that the monetary policy remained „accommodative“. Some political commentators disagree and say you were hurting further recovery of the European economy. What do you say to those critics?

I insist that we defend the purchasing power of those who are in the weakest situation in our societies. It is those who are primarily hurt by inflation. Surveys are showing that our fellow citizens are strongly calling upon us to do our job. They are not asking for less alertness of their central bank as regards price stability. They are asking for more alertness. They are not entirely satisfied with the present level of inflation in Europe and they are encouraging us to deliver price stability. If we would let inflation emerge against the interests of younger people, against the interests of workers, against the interests of the least fortunate segment of society, we would also create an obstacle to sustainable growth and job creation. I feel very strongly about this. The Treaty was well written.

French presidential candidate Segolène Royal and other politicians of your home country have demanded the ECB should be subject to political decisions. What is your comment?

We are independent because it has been decided by our political democracies. As you know the ECB is an apolitical institution working for the sake of all 315 million fellow citizens whatever their sensitivities. The Treaty of Maastricht has created an independent institution that works for all sensitivities, without any exceptions. And we are proud of that. The people asked for us to do our job independently through a Treaty that has been signed by all governments and ratified by all parliaments by the people of Europe directly, which was the case in France. It is true that creating an independent institution was a very important decision. In France it called for a change of the Constitution of the fifth Republic, a change which was voted on 25th June 1992 with a qualified majority (3/5) by the Congress in Versailles.

In recent months, there have been several reports about corruption involving large European companies, for instance Siemens. How harmful are cases like that?

We pay great attention to the fight against money laundering as well as against terrorism financing. To the extent that criminal activity is involved, I am sure that the national authorities will do all what is necessary.

The German banking system may change fundamentally now that the Landesbank Berlin is on the market and can be purchased by any buyer. What do think of this potential change?

Amongst the structural reforms you have the financial integration and the completion of the single financial market in the single currency area. From that standpoint a number of features of the German banking system do not fit well yet. Full opening up of the public segment of the banking sector would be in the interest of Germany and in the interest of Europe as a whole.

But if you leave this one example out, the kind of reform process you are calling for is not making headway in Germany at all.

I know that it is fairly difficult. Again I cannot help mentioning the fact that it would be in the superior interest of everybody involved to achieve such a reform.

What kind of time span do you have in mind?

That is up to the responsible authorities. I am not going to mention a date. But as the ECB I can only say how important this step would be.

Growth in the US is slowing down. What needs to be done to achieve a soft landing instead of a hard landing?

We follow very carefully the situation. Our scenario is the scenario of the Federal Reserve System, a soft slowing down, which is presently observed.

How harmful is the current dollar-euro ratio? Do you see the value of the dollar on the rise again in the next few months?

On the euro-dollar relation I would confirm to you what I have already said: I signed myself, together with the other members of the G7, a communiqué in Singapore which said in particular: „Excess volatility and disorderly movements in exchange rates are undesirable for economic growth.“ I also noted the declarations of Secretary Paulson that “a strong dollar is clearly in the interest of the United States.”

How high will you allow the euro to go?

I will not say anything more. These sentences speak by themselves.

How is your relationship with M. Jean-Claude Juncker, the President of the Eurogroup?

It's good. The responsibility of Jean-Claude Juncker as President of the Eurogroup is extremely important. He has within the Eurogroup a huge domain with all Ministers of Finance where appropriate discussion and cooperation in particular in the fiscal policy and the structural policies are fundamental. He is an excellent President of the Eurogroup.

Europe has progressed as a political union not in a parallel way with monetary union.

We are not a full fledged federation. It is also clear that the constitutional treaty – which would be an important improvement in the functioning of the present European institutions – has not been approved, even if now, after the ratification by Finland, 16 countries have ratified the Constitution. That being said, we do have a combination of monetary union and economic union – EMU – which I strongly trust is viable and credible – including the Stability and Growth Pact and the will of governments to discuss and cooperate as regards fiscal and structural policies. As a citizen I would call for going forward in achieving political union. As President of the ECB I repeat that I consider EMU highly credible with its Stability and Growth Pact.

There is a lot of controversy about who should be able to join the EU. Do you see the same kind of controversy about who should be able to join the euro zone?

These are two completely different issues. The entry in the European Union is an important decision. Once you are in the European Union, the issue at stake is to meet the Maastricht criteria. As we are in favour of a strict implementation of the Stability and Growth Pact, we are in favour of a rigorous implementation of the Maastricht criteria. It's in the interest of all – of those who want to enter the euro area, and of the euro area itself. The decision which was recently taken by the European council on a proposal of the Commission – to approve Slovenia as a member of the euro area - has proven that the euro area is not a closed shop. I'm confident on the progressive enlargement of the euro area, - fully respecting the treaty provisions.

So, as long as they respect the Maastricht criteria, there is no limit to the number of euro member countries?

No. And as you know the decision making process inside the ECB is prepared and will be adapted to remain efficient, whatever the number of participants in the euro area is.

After eight, or rather – for the European citizens – after five years, would you say that the euro is accepted as THE European currency?

Undoubtedly, yes. The people of Europe ask us to do our job. They want prices to be stable. Achieving that, we also do the best for growth and job creation. The message is very clear and it comes from each and every country. We have to be faithful to the treaty, to our mandate, to the people of Europe. As an independent institution we are accountable to the people of Europe. It is true that in some countries there is still a sentiment that the prices are going up more than the inflation indicator is telling. We do not share that opinion. But in any case the message is crystal clear: continue to do your job with utmost dedication.

But common people do still doubt the accuracy of price statistics.

That perception has nothing to do with the euro, of course. We have full confidence that the price statistics that are produced at the national level and processed at the European level are correct. The methodology which is used is state of the art.

The ECB is still a young institution. In which areas do you see room for improvement?

The success of the euro is a success of this institution and of the Eurosystem - the team of central banks. On the first of January 2007 we will be fourteen in the team, the ECB and the thirteen national central banks. It is that team spirit which is our most precious asset. We will continue to improve our team spirit to the service of Europe and its 315 million fellow citizens of the euro area.