Jean-Claude Trichet: Interview with Dnevik, Expansión, Irish Independent and La Repubblica

Interview with Jean-Claude Trichet, President of the European Central Bank, conducted on 27 March 2007 by Ms Elena Polidori (La Repubblica), Mr Javier Blas (Expansión), Mr Bojan Glavic (Dnevik) and Mr Brendan Keenan (Irish Independent), Frankfurt am Main, published on 2 April 2007.

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One recent survey over the first 5 years since the euro introduction finds a deep disappointment among European citizens, especially over price rises since the euro launch. How do you evaluate those five years?

People of Europe are telling us to ensure price stability and saying: We support you in ensuring price stability. And they add: We are not sure that we have perfect price stability. That is true, but it cannot be interpreted in a negative way. It means: We back your mandate.

To give you one striking survey result – 73% of citizens in the euro area back ECB independence in order to ensure price stability.

The enthusiasm of some new EU members for membership of the euro also seems to be fading, and their target dates are less and less ambitious. Is the ECB considering some exhortations to bring those dates forward?

We have always said that entering the euro area is an important decision which is based on the criteria as laid down by the Maastricht Treaty. So I really think the way things are being done is the right and proper one. We are not a closed shop. We already have one former communist country – Slovenia – in the euro area. That is a remarkable demonstration of the fact that we are not a closed shop. I am confident that the new EU members, to the extent that they are converging according to the criteria of the Treaty, on a sustainable basis, will progressively join the euro area.

You have signalled your concerns that wage increases are the main risk to price stability in 2007. But so far wages are increasing at a slow rate. Why are you still concerned?

We think that wage increases must be worked out by the social partners, taking into account three main parameters. First – the level of unemployment. With some countries still having mass unemployment, it's important that they have moderate increases in wages in order to permit as active as possible job creation. Second, the level of unit labour costs is very important. If it points to competitiveness problems in a country – for instance a loss of market share inside the euro area – then it calls for wage moderation to re-establish competitiveness. Third, the level of labour productivity must be taken into consideration in order to preserve competitiveness.

So there is no single recipe, as the situation of the individual countries differs. But taking all this into account, we believe wage moderation is of the essence at the level of the euro area as a whole.

Would you say that inflation risks for the medium term, i.e. 2008, have increased in the last three months or decreased?

In the opinion of the ECB Governing Council the outlook for price developments in the medium term remains characterised by upside risks.

Is the ECB happy with its current target for inflation, or is still there room to revise the definition of price stability?

It is extraordinarily important to anchor inflation expectations, not just on a medium term basis, but also in the long-term, and even the very long-term. The remarkable success of the ECB Governing Council is that it has anchored expectations from the very beginning in line with our definition of price stability: less than 2%, close to 2% inflation. This created the financial environment favourable for growth and jobs creation. There is absolutely no case for changing our definition of price stability.

According to the OECD both the ECB and the Fed should avoid a rise of interest rates because the inflation situation does not justify an increase. In particular, the OECD chief economist said recently that eurozone inflation is "well under control". Is this expert right or wrong?

Each institution does its own analysis. Let me tell you that the OECD is today fully supporting all the monetary policy decisions of the ECB since December 2005 – when we started increasing interest rates. I don't think you can interpret the recent OECD analysis as in any way contradicting our decisions.

Financial markets are not fully pricing in a further rate increase, in particular for June. In that context, would you say that market expectations are different from the ones of the ECB Governing Council? How far in advance does the Council have to decide on giving guidance to the markets about a change?

I certainly do not comment on a day to day basis on market probabilities that go up and down. I fully confirm on behalf of the Governing Council, as I did before the European Parliament, that our analysis shows that monetary policy continues to be on the accommodative side, with ECB interest rates moderate, money and credit growth vigorous. Therefore acting in a firm and timely manner to ensure price stability in the medium term is warranted.

We are totally transparent in our definition of price stability. Not all central banks are as transparent as we are. We have a very clear mandate and a very clear monetary policy concept. So every observer, investor, every saver, in Europe and the rest of the world, knows that we will do what is necessary to ensure price stability. By the way, they trust us. Otherwise, their inflation expectations would not be in line with our definition of price stability.

They also know that our policy is not to pre-commit in any respect to future action. We will do what is necessary, but we never unconditionally pre-commit.

The markets interpreted your last press conference and the ECB monetary policy statement, in particular the change from "low" to "moderate" as the description for the interest rates, as meaning that a peak on the current tightening cycle is very near. Would you say they are reflecting the thinking of the ECB Council?

A number of observers have taken notice of a change in the wording, from "low" to "moderate" and also from "accommodative" to "continues to be on the accommodative side". It was the intention of the Governing Council to make these slight changes. On future decisions let me repeat: we will do what is necessary to ensure price stability.

How much weight does the ECB give to measures of the output gap? Does the ECB it have a target for trend growth in the eurozone?

Our monetary policy concept calls on us to counter inflationary risks in the medium term, and be credible in delivering price stability over time. Our policy is neither commanded by calculations of an output gap, nor of a NAIRU [Non-Accelerating-Inflation-Rate-of-Unemployment], or of the computation of a theoretical neutral rate. We are guided by our own judgement of the risks to price stability based on our two-pillar strategy: our economic analysis and our monetary analysis. In doing so we are not the prisoner of any kind of model, but rather we are keen on having as comprehensive as possible analysis in order to take the best decision in situations that are always very complex.

At this stage the Council does not think that it is the time to consider increasing the previous estimate for potential growth of around 2-2.25%. That being said, we are looking very carefully at the evolution of productivity, which is one of the most important parameters.

What is behind the current strong growth in Europe? Are structural reforms beginning to pay off? Do ECB demands that governments do more to cut budget deficits not put the renewed growth at risk?

I have to say that the currently encouraging growth in Europe is certainly largely cyclical and it is important to see that we are currently in an environment of strong global growth, which is very encouraging. But it is also true that some structural reforms are paying off, in particular those which have been made in order to stimulate labour participation and job creation, especially in the unskilled labour market.

Since the setting up of the euro on the 1st January 1999, we have created more than 12 million new jobs. This compares with less than 3 million in the eight years before the euro. It is worth noting that these 12 million new jobs are more than the number of new jobs created in the United States during the same eight years period. This is an undeniable success in job creation. But it is not time for complacency because we still have mass unemployment. We think that all the structural reforms that are necessary would allow us not only to create jobs but also to have a jump in labour productivity that would permit a significant increase in our medium- and long-term growth potential.

We do not see yet this phenomenon, but we are analysing very carefully the recent evolution in labour productivity.

Let me add that one of the main lessons we can draw from the past is that in a encouraging period of growth – last year was one and we expect that this year and next year will also be years of encouraging growth – it is very important to pave the way for the best possible future by practising fiscal soundness. That is our permanent message to governments and on this point we are in full agreement with the Commission.

What lessons do you draw from recent sharp corrections on stock exchanges all over the world. Is it a sign of dangers on financial markets? If so, where do the main dangers lie?

We should not forget that: First, these corrections took place within the framework of very encouraging global growth. Second, the recent correction on the financial markets is a useful reminder of the fact that an appropriate pricing of risks in the global economy is very important. All investors certainly have this in mind. Third, it is not surprising that we have seen the most significant corrections in markets which had registered substantial capital gains in recent months and weeks. Fourth, the ECB, with all other central banks, will continue to monitor the situation very closely: smooth and orderly changes are always preferable to sharp and abrupt corrections, which are never welcome.

There is a strong sense that political pressure to limit ECB independence is rising in some countries (especially France). Does this worry you or is it just an empty threat?

A majority of the people of Europe says that it is good that the central bank is independent to ensure price stability. The percentage in France is exactly the same as in the euro area as a whole, at 73% - three citizens out of four! We have been made independent by the will of the people. All our democracies had multi-national and multi-party consensus to give the ECB independence. We are the child of a multi-party consensus for independence, which is again fully vindicated by the people of Europe. So I am not worried.

Are you disappointed that most of the attacks are coming from your home country, France?

In France, the decision to make the Banque de France independent was particularly solemn because it required a change of the constitution of the Fifth Republic – the constitution of General de Gaulle – by a majority of three-fifths in both Chambers of the Parliament. After this, the people of France voted in favour of central bank independence as enshrined in the Maastricht Treaty.

These critics often point to the fact that the Federal Reserve has a mandate partly for growth, and the ECB does not. Is there any room for some element of this to be placed in the ECB mandate?

The fact that our primary mandate is to ensure price stability has been approved by all the democracies of Europe and everybody expects us to respect the will expressed solemnly by all our democracies. But I will add that it is the view of all central banks in the world that price stability is a necessary condition for sustainable growth and job creation. That is the reason why so many countries in the industrial world and in the emerging economies have adopted a concept of direct inflation targeting. The overwhelming majority of central banks in the world are given a single mandate to ensure price stability. It is the case in London, in Stockholm, in Ottawa, in Mexico City, in Brasilia as well as in Frankfurt.

My US counterparts, Ben Bernanke today and Alan Greenspan yesterday, always say themselves in their speeches that “price stability is a pre-condition for sustainable growth and job creation”.

What is your secret in being able to keep smiling and never lose your good humour when journalists keep asking for clear, but forbidden answers about further ECB rate increases. When can we expect the next one?

I don’t know whether I keep smiling permanently! What is true is that I never lose my nerve. I’ll let you judge my good humour. But we are so clear in our mandate and in our strong will to live up to our mandate, that everybody knows we will do what is necessary.

What is your advice to the authorities in countries like Ireland or Spain, where the eurozone interest rate is likely to be most different from a suitable "Taylor rule" national rate, as these countries face higher inflation and stronger growth than average?

First of all, let me say that in a single currency area the decisions are taken by the central bank on the basis of the overall situation of the area itself – the 317 million people. It cannot be otherwise. Equally the Federal Reserve takes decisions on the basis of the 300 million US citizens, and not on the basis of California, South Carolina or Alaska, even though there is the same dispersion of growth rates as in Europe. That calls of course for national policies in the euro area that are as appropriate as possible for the domestic situation. That explains why we are calling for highly sound fiscal policies, which is particularly valid for Spain and Ireland and they are following that way. As responsible as possible wages and salaries increases are also crucial in order not to lose competitiveness in very buoyant episodes of the cycle. Finally we call for as active as possible structural reforms to have as flexible economies as possible to increases growth and keep down unit labour cost.

How big a risk to eurozone price stability are housing price booms, like the ones in Spain or Ireland? Are you concerned about housing valuations on those countries?

As you know, we look at the entire real estate market of the euro area, not particularly here or there, Spain or Ireland. At the level of the euro area as a whole we have a dynamic growth of loans to finance housing, namely 9.4% over the last twelve months. This dynamism was one of the elements the Governing Council took into consideration in our decision making process. On top of that, all that can be done at the national level to counter adverse developments is certainly to be encouraged. Let me note that we are beginning to see some slowing down in the national real estate markets, in particular in Ireland and Spain.

Spain has the second largest current account deficit (in dollar terms) after the US. Is the ECB worried that this is signalling a growth path that is not sustainable?

This calls for very cautious and attentive examination. You have to look at the level of savings as a percentage of GDP, which is not abnormal, and at the level of investment. It is clear that Spain has a very high level of investment, which is not necessarily sustainable in the long run, because of the extremely large volumes of domestic and external financing, coming in particular into the real estate market. One has to place the figures for the current account deficit in that context, and in the context of the very dynamic episode of the cycle. That being said, we call on all countries in the similar situation, not only Spain, to have the soundest possible fiscal policies with large surpluses, and the utmost responsibility of the social partners in setting wages and salaries, in order to counter what would be a tendency to imbalanced growth.

What would be your recommendation to the Spanish government?

Continue with the best possible fiscal policy. This part of national policy is a very important way to moderate imbalances. Continue to look very carefully at the evolution of the unit labour costs and labour productivity. Fostering labour productivity through structural reforms is of the essence.

The Italian public deficit is going down towards 2.3% this year, according to the last official projections. But the ECB, in its latest report, is still suggesting the extra fiscal revenues be used to balance the budget and not to cut taxes. As you know, the Italian government has already decided to use part of this extra money to reduce taxes. How do you judge the government's choice?

As a general rule, we recommend to all countries, not just Italy, that in the most encouraging part of the cycle, the windfall revenues should be used to balance the budget. It's a general rule that the ECB, as well as the Commission, are recommending to all governments and parliaments in Europe.

In case of countries with a very high level of public debt as a percentage of GDP, which is the case of Italy, our constant recommendation is to do everything necessary to reduce as rapidly as possible the level of outstanding debt. This is in the interests of the country itself, because it will diminish the burden of the future budget on the economy as a whole, fully in line – of course – with the Stability and Growth Pact.

In the same documents, the ECB fears that the measures of the Italian budget for 2007, the so called Finanziaria, will not be realized. What in particular does not convince you?

I would say that we call for the full implementation of the measures that were decided by the government on the proposal of Tommaso Padoa-Schioppa. The ECB also shares the latest conclusions of the European Council on the update of the stability programme, which encourages Italy to use the additional revenues for a more rapid reduction of public debt.

It is one and a half year since Antonio Fazio left the Italian central bank. What are the main differences between the former and the current Bank of Italy?

The Banca d'Italia has always been a very active and important member of the monetary team of Europe, a remarkable player on the field. I have to say that Mario Draghi, whom I have known for 20 years, has an outstanding and wide experience, has done and is still doing a lot to continue modernising his institution and to permit it to be up-to-date in all respects.

The Governing Council meeting scheduled for Dublin in May could be days before the general election. Could this create political difficulties, especially if the ECB were announcing or signalling a change in interest rates?

We are an independent institution. Everybody understands that we take decisions totally independently of such national political considerations. We wouldn't be credible and we would not solidly anchor inflation expectations if anybody could think that we were could modify our policy because of political events in any of the thirteen member countries of the euro area. I am really looking forward to be in Dublin in May – when I'm in Dublin, I always think of James Joyce and Dubliners. Ireland is a remarkable economic success story.

What is your opinion about Slovenia's difficulties in naming a new central bank governor and what consequences could this have for the country and Slovenia's seat on the governing council? Do the ECB rules allow for a stand-in to take the seat in such circumstances?

I regret very much the difficulties which have happened in Slovenia in this decision-making process, just after the remarkable success of introducing the euro. Governor Gaspari has informed me who will represent the Banka Slovenije on the ECB Governing Council. Yes, the ECB rules allow for a substitute to participate in such circumstances.

Slovenia is the only member of the eurozone with limits on the free movement of labour. When might it change and what effects does it have on the economy and labour market?

As you know, we called for the full implementation of the single market as a major improvement of the EU economy as a whole – for all the 490 million people in the EU and 317 million in the euro area. We call also for as flexible and integrated as possible markets in Europe and the euro area. I said very, very clearly that it was abnormal that labour movement for Slovenia inside the euro area would be limited. It doesn't fit the integration of Slovenia into the euro. Slovenia's labour force should be free of any restriction inside the euro area. This is one example that I would give very strongly – to say that the economic underpinning of full freedom of movement in a single currency area is very strong.

Has the ECB any estimate of its own on the impact of the euro introduction on inflation in Slovenia? Is such an estimate more difficult in a country with a very long period of double pricing (16 months)?

All the information I have at the moment is that the euro introduction has been a great success in Slovenia and the preparation which has been done by the central bank and the government as well as the ECB and the European Commission, has been very careful. To my knowledge, the success includes efficiently limiting and avoiding abnormal price increases.

I don't think the long period of double pricing should make the estimate more difficult. I think it was a good idea to have a long period.