

Jean-Claude Trichet: Interview with Folha

Interview with Mr Jean-Claude Trichet, President of the European Central Bank, conducted by Denyse Godoy and Clovis Rossi, FOLHA, Sao Paulo, 8 November 2008.

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FOLHA – It is a (paradigm) dogma that central banks should only pay attention to inflation and not to other points of the economy like jobs or consumer spending. You have indicated that you are, now, more concerned about growth than about inflation. In times of a severe crisis like these in which we are, isn't that dogma correct anymore?

JEAN-CLAUDE TRICHET – I didn't say that. We are not changing the way we look at our monetary policy strategy. We consider that our primary mandate has been – it is today and will be tomorrow – to deliver price stability in the medium term. This is the mandate that we were asked to fulfil by the Treaty of Maastricht. In this perspective, we decided to decrease interest rates by 100 basis points in less than one month because we have observed a significant alleviation of inflationary pressures. We also took into account that we had regained control of medium term inflation expectations. That being said, I profoundly trust that by delivering price stability, we are contributing to sustainable growth, job creation and fostering financial stability. By being credible in delivering price stability over time, and by solidly anchoring inflation expectations, we are fostering, in very difficult times, the confidence of households. Our fellow citizens have to be reassured on the fact that their purchasing power will be preserved in the period to come. It is also very important for sustainable growth that all economic agents take appropriate decisions because they can rely on the credible delivery of price stability. A solid anchoring of inflation expectations also allows to have medium and long term market interest rates more favourable to growth and less volatile, which is essential in an episode of financial turbulences.

As regards these turbulences, we have been one of the first central banks in the world to react immediately, on August 9th, 2007, when we had the first tensions on the money markets. We decided to provide liquidity in order to put the market in a situation where it would function as normal as possible under the circumstances. But it is important to note that we apply a separation principle between our monetary policy stance, which is designed to deliver price stability in the medium term, and the implementation of this policy – at the level of interest rates decided to deliver price stability – which is managed with a view of appeasing the tensions in the money market.

FOLHA – But why aren't the financial markets as smooth as they should be after all these guarantees?

TRICHET – This is an important issue, despite the fact that central banks and government authorities have taken very important decisions. The central banks put in place a first line of defence against systemic liquidity threats, and then the governments came with a second line of defence against what I would call systemic solvency threats. At the moment I am speaking, there is a remaining level of tensions that doesn't take fully into account all the decisions that have been taken.

FOLHA – Does it mean that markets do not trust governments?

TRICHET – No. I think it is a question of time and I have called on commercial banks to speed up the process of fully taking into account the decisions that have already been made.

FOLHA – How much can emerging countries like China and Brazil help to avoid a worse global crisis?

TRICHET – I think that first of all we should recognize that, for the first time since World War II, we have seen a solid resilience of the emerging economies, which has been quite

impressive at a time when we could see the industrial economies heavily affected. And that is true, since the start of the turbulences, since the beginning of August, last year. During one year we observed that the emerging world was more resilient than the developed world. At the present moment, it is clear that even the emerging economies are affected by what has happened in the industrialized economies, and in particular since mid September. Of course, we are in a global economy where we are all interdependent. I myself never spoke of decoupling. So, we are all more or less touched by a phenomenon that comes here or there, but it is wrong to think that any of us could be out of the influence of the others. That doesn't prevent me from thinking that for the global economy to get out of this difficult period we have to count very much on Brazil, on Mexico, on China, on India, and on all other major emerging economies. That's absolutely clear. The potential for global growth is there. That's not to say that the industrialized world has not to put itself in order and contribute themselves to a steady and sustainable growth.

FOLHA – Is there a case for a stimulus package in Europe?

TRICHET – Various countries are in very different situations in the euro area. Some countries have fortunately exemplary fiscal policies and I would say that they have room for manoeuvring. But it is not the case for all. You have unfortunately countries that have already no room for manoeuvring. In those particular cases fiscal activism, instead of having a positive impact on the economy, could harm confidence, as economic agents would expect government authorities to address these imbalances, by increasing taxation a posteriori. On top of that, I would say also that you have to accept that when there is a very powerful oil and commodity shock it has necessarily an impact on the cycle, and to embark on excessively proactive policies to avoid these fluctuations in the business cycle could create future problems in the years to come. We experienced that on the occasion of the first and second oil shock in the 70's, when the authorities' response created mass unemployment in Europe for the first time since World War II. To sum up, a number of countries have the possibility to use their room for manoeuvring. Others have not. In all cases we have a framework which is the Stability and Growth Pact.

FOLHA – What about this idea France has launched of an European economic government?

TRICHET – There are some suggestions saying that the euro area needs an economic government. And I have to say that a large number of other voices would accept "economic governance" but not the expression "economic government", in particular because they fear it could mean exerting pressure on the independent central bank. As President of the ECB, I always make the point that the central bank is totally independent. Our own credibility relies on this independence, which has been granted to us by the European democracies. It is clear that the governments of the euro area themselves together with the European Commission have their governance which is being carried out. In particular, the Stability and Growth Pact, in the fiscal policy area which is a key element. You have also, certainly, to improve the implementation of the Lisbon agenda, in the domain of structural reforms. The Stability and Growth Pact, the implementation of the Lisbon agenda on structural reforms, and the peer surveillance by executive branches on unit labour cost evolution in each economy are three pillars that are very clearly under the responsibility of governments. Initiatives to foster the effective implementation of these elements are positive.

FOLHA – Have you felt in these recent months, in special in the past 60 days, a kind of pressure from the governments in order to be more focused on growth than on stability because of the recession that's coming?

TRICHET – I have to say that all the governments understand pretty well that they have to respect the rules of the Treaty and they know that our own credibility is essential to permit us to deliver price stability and, therefore, sustainable growth and job creation.

FOLHA – Are you in favour of reforming the IMF, which is an institution, dominated by the industrialized countries? Brazil is defending that the emerging countries must have more voice than they have today. How could it be reformed?

TRICHET – I think there is a general consensus to consider that it is normal that the emerging economies – taking into account their growing influence and the size of their GDP and the contribution of their growth to global prosperity – should become more influential in the IMF and at the level of the global economic institutions in general. So, I think nobody is disputing that, and nobody is, of course, disputing the fact that the G20 is taking more and more influence. There is also a call for the Financial Stability Forum to be itself more opened to the emerging countries and I think it is fully legitimate. The next question is of course how you speed up the process for all institutions to be more inclusive.

FOLHA – Do you think it would really be possible to regulate all these complex instruments, such as the hedge funds and the credit rating agencies?

TRICHET – I think we have to be clear that in market economies there are risks; otherwise you are not in a market economy. There are uncertainties and there are risks. If there are risks, from time to time there is also necessarily the materialization of some of these risks. The only country I know that had no risk and no materialisation of risks was the Soviet Union, and everybody knows the result of that: the final risk was that the full body of the economy collapsed. That being said, we have to improve very significantly the present functioning of the global financial system and the global economy. We have a large consensus to have much more transparency for financial instruments, for markets and for institutions. We need appropriate rules, standards and codes. And that is valid for all institutions, including the highly leveraged institutions. We must have an efficient and effective fight against procyclicality. We have to improve very significantly risk management in all pertinent institutions. And last but not least, we have to introduce much more discipline in the macro-economic policies, and that of course goes for fiscal policies, but also for appropriate discipline to prevent excessive domestic and external imbalances.