

## Jean-Claude Trichet: Interview with the *Börsen-Zeitung*

Interview with Mr Jean-Claude Trichet, President of the European Central Bank, and the *Börsen-Zeitung* conducted by Dr Jürgen Schaaf on 16 December 2008, published on 31 December 2008.

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**Question:** Do you believe that the citizens of the euro area will one day have a similarly strong relationship to the euro as the Germans used to have to the Deutsche Mark?

**Answer:** Confidence in the currency, in the central bank as an institution and in the independence of the central bank to deliver price stability is crucially important. When asked whether they considered the ECB's independence from politics to be an important condition for price stability, 78% of the 320 million fellow citizens of the euro area said "yes". And that was before the recent intensification of the financial crisis.

**Question:** And now?

**Answer:** All evidence suggests that, since then, the sentiment of our fellow citizens on the importance of the euro and of the ECB as an independent institution has even increased.

**Question:** Studies have shown from time to time that the support of the population for the stability of the currency is even more important than the institutional independence of the central bank. Has the euro already achieved this status?

**Answer:** As a symbol of European unity, the euro is already extremely successful. Since the outbreak of the financial crisis, the euro and the ECB have become, even more visibly, a central anchor for confidence. In this sense, I believe the emotional relationship of citizens to the euro has become stronger.

**Question:** What, in your view, is the greatest achievement of the first ten years of the euro?

**Answer:** For me, the greatest success is the fact that, after having promised the citizens that the euro would be equal, in terms of stability and the maintenance of value, to the previously most solid currencies, including the Deutsche Mark, we have fulfilled this promise effectively.

**Question:** And what is the greatest challenge for the next ten years?

**Answer:** There are a number of challenges that face us. The first is to maintain the level of credibility and confidence that the euro has gained during the first ten years. And in addition to all the other challenges that an important central bank in the industrialised world has to deal with, I would stress two challenges that are entirely specific to the ECB. First, the fact that we are ourselves actively contributing to achieving the single market with a single currency and, second, that we must prepare in the best possible fashion for a successful enlargement of the euro area.

**Question:** In addition to price stability, the stability of the financial markets has become the focus of attention in the context of the current crisis. Would it be sensible for the ECB to have an explicit mandate to safeguard the stability of the financial markets?

**Answer:** Our primary mandate, to ensure price stability, is a very important prerequisite for financial stability. Furthermore, our two-pillar strategy allows us to identify long-term risks to price stability and to financial stability at an early stage through our monetary analysis. In addition to our economic analysis, our monetary analysis examines not only the evolution of monetary aggregates, but also, in close detail, the dynamics of their components and of their counterparts, including the evolution of credit outstanding to categories of borrowers. This also brings potential risks to the stability of the euro area financial system to our attention.

**Question:** But is that enough?

**Answer:** All central banks make a contribution to financial stability in their respective economic areas. And I would say that in our case macro-prudential matters are certainly part of our responsibility.

**Question:** Is the same also true of banking supervision?

**Answer:** The position of the ECB's Governing Council has always been that a very close link between central banks and banking supervisory authorities is indispensable. One of the lessons of the first ten years of the euro, and of the recent financial market turbulence, is that if we can make an even greater contribution to the smooth functioning of banking supervision in general and in the euro area in particular – with regard to banking institutions with cross-border activities – this could be a sensible option. It has to be studied very carefully, and we will see afterwards what the position of the Governing Council will be.

**Question:** The spreads on government bonds have widened considerably in the euro area. Unsound fiscal policies are thus punished, but some countries face potential refinancing problems on the capital market. Is this a curse or a blessing?

**Answer:** The capital market is sending signals that need to be looked at attentively. Following a phase in which the pricing of risks was, in general, too low, the markets may now be showing a tendency to overvalue risks. In any event, developments need to be watched closely.

**Question:** But who will stand by the side of the countries with worse ratings if the capital market is practically blocked for these countries because of a continued flight to quality?

**Answer:** I am sure that these countries will take the appropriate steps to face up to these challenges themselves.

**Question:** That means that they shouldn't hope for external help?

**Answer:** The very fact of belonging to the single currency area is, in itself, a significant contribution to facing up to this situation.

**Question:** The financial crisis worsened considerably in the autumn. Would the world look different now if the US investment bank had been rescued?

**Answer:** I don't want to go into the major difficulties of individual institutions in September. It is clear to me that the financial crisis has worsened significantly since mid-September and has moved into a new phase. But even if all organisations that were in trouble had been rescued, it would have remained necessary for central banks and governments on both sides of the Atlantic to take extremely bold measures in order to be prepared for systemic liquidity and insolvency risks.

**Question:** How do you explain the fact that, despite the ongoing banking crisis, the ECB's statistics do not yet indicate the existence of a credit crunch in the euro area?

**Answer:** What is true is that we see a certain weakening in the dynamics of loans to enterprises. But the rate of growth of outstanding loans to non-financial corporations has remained robust in double-digit figures. However, since bank lending standards have been tightening significantly for some time and the financial crisis entered a new phase only in mid-September, we must observe all developments very closely and remain attentive to new facts and figures.

**Question:** The major investor Warren Buffett once described credit derivatives as "financial weapons of mass destruction". Do you share this view?

**Answer:** I wouldn't necessarily use that formulation myself. But the level of complexity and lack of transparency reached in the production, marketing and selling of these financial market instruments indeed proved to be destructive and contributed substantially to the fragility of financial markets.

**Question:** The reputation of the ECB has been strengthened by the crisis. Has it also profited financially from the brisk demand for the greater amount of liquidity made available?

**Answer:** I will wait for all our accounts to be finalised.

**Question:** In October you considerably expanded the collateral framework for credit operations. Since then you have accepted more risky securities as collateral. How high is the ECB's exposure as a result?

**Answer:** Like all other central banks, we have been more forthcoming as regards our collateral framework in order to provide the banking sector with appropriate liquidity. Our balance sheet has grown by approximately 55% over the last 12 months. At the same time, we have to permanently ensure that our risk management is improved to take into account the increased volume of risks.

**Question:** The financial sector has been largely safeguarded through guarantees and equity capital aid. Now the car industry is asking for state support. Is this not understandable?

**Answer:** The decision on this falls first of all under the responsibility of the national governments and parliaments. As a central bank, we have emphasised the fact that the financial sector is of systemic importance because it affects all other sectors, all enterprises and their employees.

**Question:** Knowing what we do now, was the interest rate increase in July this year a mistake? And why is it generally so difficult for central bankers to admit to mistakes?

**Answer:** The modest interest rate increase in July was important taking into account the inflationary threats that were visible at the time.

**Question:** What were those threats?

**Answer:** Long-term inflation expectations threatened to become unanchored. In addition, wage and salary demands in some euro area countries caused us serious concern that there could be broad-based second-round effects. The interest rate decision enabled us to bring medium to long-term inflation expectations back under control in line with our definition of price stability. And this regained control of expectations was, by the way, the precondition which allowed us to cut rates strongly from October when the crisis worsened. Do not forget: our definition of price stability in the medium term is "less than, but close to, 2%". The interest rate increase in July must be related to the "less than 2%" part. Our recent decrease of rates after the intensification of the crisis in September must be related to "close to 2%".

**Question:** Since then rates have been cut drastically around the world. The US central bank, the Federal Reserve (Fed), has now de facto cut rates to zero. The conventional weapons of monetary policy are fast being exhausted. What unorthodox options does the ECB have at its disposal?

**Answer:** First, let me remind you that we have, in all circumstances, to deliver price stability in line with our definition "less than, but close to, 2%".

**Question:** And second?

**Answer:** Second, the present unlimited provision of liquidity at a fixed rate and with a one-week, one-month, three-month and six-month duration can certainly be described as an unusual measure. The extension of eligibility in our collateral framework is also an exceptional measure, particularly as it was already very broad and flexible. We have also expanded our balance sheet on a scale that would have been unthinkable before the crisis: around 55% in the last 12 months.

**Question :** The ECB expects that the economy will gradually start to recover again in 2010. Where are the impulses for growth likely to come from?

**Answer:** The growth and inflation projections you mention come from the staff of the Eurosystem central banks. They are not the forecasts of the Governing Council of the ECB.

We look closely at these projections, but we also consider other forecasts, such as those from the private sector.

**Question:** And what conclusion do you arrive at?

**Answer:** Taking into account the staff projections, we believe that the risks to growth in the euro area are on the downside. That being said, we are in an environment of great uncertainty and we must treat new data and figures with the greatest humility. But we also have to take into account the fact that some developments, such as the drastic reduction in the price of oil and other commodities, are simultaneously disinflationary and expansionary.

**Question:** Why is the Governing Council of the ECB so reluctant to give indications regarding the interest rate decision in January?

**Answer:** As I said at the last press conference when reporting on the position of the Governing Council, we are concentrating at present on the impact of our previous decisions. We have already cut rates by 175 basis points within a very short span of time. This impulse is, at the moment, far from having been fully transmitted to the economy. That being said, as I always stress, we are never pre-committed and we always do what is necessary to solidly anchor inflationary expectations in the medium term.