

## Jean-Claude Trichet: Interview with China Finance

Interview by Mr Jean-Claude Trichet, President of the ECB Interview with China Finance, 16 February 2009.

\* \* \*

**China Finance:** At ten years, how would you assess the successfulness of Euro both in terms of bringing about benefits to the Eurozone economy and as an international currency?

**Mr Trichet:** Since the introduction of the euro, fellow Europeans have enjoyed a level of price stability which previously had been achieved in only a few of the euro area countries. This price stability is a direct benefit to all citizens. It protects incomes and savings, and helps to bring down borrowing costs, thus promoting investment, job creation and prosperity over the medium and long term. The single currency has been a factor of dynamism for the European economy.

In recent months we have seen another benefit of the euro: the financial crisis is demonstrating that in turbulent financial waters it is better to be on a large, solid and steady ship rather than on a small vessel.

However, the euro was not created to either compete with any other international currency. We are not campaigning for the international use of the euro. The euro was created in order to achieve the single European market. 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, we have fulfilled this promise effectively.

**China Finance:** What needs to be done to meet the challenges to the credibility of Euro posed by persistent dispersions of inflation, current account deficit and public finance among the member economies?

**Trichet:** The first 10 years of the euro has brought low levels of inflation overall in the euro area, lower than the levels in the individual countries before. The existing differences are no bigger than if you compare differences in price levels, for example, between various states in the United States, which is as you know similar in size to the euro area. The single currency also enhanced price transparency, increased trade, and promoted economic and financial integration within the euro area and with the rest of the world.

As for public finances, the Stability and Growth Pact was created precisely to substitute for a more uniform fiscal arm of the euro area. As you are aware, there was an agreement reached in the EU late last year to provide fiscal stimulus corresponding to the current economic slowdown, however, on behalf of the Governing Council I reiterated several times that these packages should be provided by countries only if they have the leeway granted in the SGP.

**China Finance:** In view of the increasing interests of adopting Euro from non-member countries in times of financial turmoils, how do you see the need to balance between the expansion of the Eurozone and maintaining its stability?

**Trichet:** As said before, the financial crisis certainly reemphasised the value of belonging to a large, single currency area. However, I do not see this as a matter of balancing – expansion can only take place while maintaining stability. The Maastricht criteria will not change and this is in the interest of both the euro area as a whole and the individual candidate countries. Let me only add that 2009 January did not only see the 10th anniversary of the euro, but also the joining of the 16th member state, namely Slovakia, to the euro zone. If you consider that we started with 11 countries in 1999, this certainly demonstrates that the euro area is open to newcomers.

**China Finance:** How effective is monetary easing measures by the ECB in mitigating the economic recession in Europe? Do you see more room to maneuver in case the economic prospects continue to get worse?

**Trichet:** 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%”. Secondly, 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 a non standard measure. The extension of eligibility in our collateral framework is also another non standard measure, particularly as it was already very broad and flexible. In particular, as a result of these decisions 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. Experience has demonstrated that we have to prepare for exceptional situations, and I would not exclude anything, and equally I will not pre-commit to anything ex ante. We'll always look at the situation on the basis of our own analysis, taking everything into account.

**China Finance:** The EU member countries have endorsed somewhat coordinated fiscal stimulating packages. What's your view on the impact of large scale fiscal stimulus on the short and medium term growth and on the soundness of government finance in view of the Stability and Growth Pact? Indeed some Euro members sovereign debts have been downgraded recently as they are seen as overindebted. How serious negative impacts could this have on the credibility of the monetary union, given that the ECB has no fiscal power?

**Trichet:** The most recent forecast of the European Commission shows that this year the budget deficit in the euro area countries will reach an average of 4%, with 7 countries out of the 16 above the 3% threshold. Its important to emphasise that this situation should be temporary and reversed as soon as possible.

It should not be forgotten that the rules of the SGP are very important for the cohesion of the euro area. These rules are also underpinned by strong financial and economic principles. Governments have to take into account the fact that if their citizens consider that the fiscal policy of their government would not be sustainable in the long term, confidence would drain away. And in such a case, when confidence is lacking, additional public expenditure will not have a positive effect on growth.

On the second question, following an episode in which the pricing of risks was, in general, too low, markets now have a tendency to overvalue risks. But it does not affect the euro as a currency. Rather, it is clear that the single currency has proved to be an anchor of confidence and stability during this crisis. If you think back to the European currency turbulence and its consequences in 1992 and 1993, you can imagine what consequences the crisis of recent months would have had for the euro area without the euro – both on the interest rate markets and on the exchange markets.

**China Finance:** What challenges do the US quantitative easing policy pose for the Euro area? What's your assessment on the need for coordination on economic and monetary policies between the major economies in bringing about an early recovery of the global economy?

**Trichet:** I believe that all central banks are doing what is necessary for the economic area they are responsible for and responding to the requirements of the specific conditions. I do not see the point in comparing one central bank's actions with the other. As I said before, the ECB's open market operations and collateral framework of today are already in a “non-standard” mode and its measures can be interpreted as a way of additional “non standard risk taking”.

At the same time, we have a very close co-operation with our colleagues on the other side of the Atlantic, which proved to be useful precisely in the times we are living. The international meetings, in particular the global economy meeting of central bank governors and the G20, provide regular forum for a thorough and open discussion between the participating

Governors, particularly with Governor Zhou, who plays a very important role in these meetings.

**China Finance:** To what extent do you see the need to reform the international monetary system and the global financial regulatory system in the light of lessons learned so far from the ongoing financial crisis?

**Trichet:** The current crisis stands out because it affects the heart of the global financial system. Its root cause was a wide-spread underassessment of the quantity of risks and marked an undervaluation of the price of risks in the global financial system, especially in the most advanced economies. One of the reasons why this could happen was the widely held view that regulation should not stifle financial innovation and that markets knew best and could – for the most part – regulate themselves adequately. The turmoil has shown that this attitude was deeply misleading. When the turmoil set in, many financial institutions realised that their risk management systems were not as reliable and robust as they had believed them to be and, indeed, should have been.

We have always been in favour of a very close relationship between the central bank and the banking surveillance authorities. We said that long before any new problems, any new difficulties. We had a Governing Council position close to the start of the ECB, which we made public. We also strongly believe that better coordination for big cross-border institutions is absolutely necessary.

Some avenues have already been suggested by Ecofin, the Council of Finance Ministers in the EU. The European Parliament has also carried out several works. The European Commission set up the De Larosi re group, a high level working group, to make recommendations. One of the European Parliament's suggestions is that the ECB could play a particular role in this domain for the coordination of surveillance for cross-border institutions. In the US the Federal Reserve has a surveillance responsibility which concentrates very much on the big cross-border institutions. I see similar suggestions coming from the private sector and from the industry. As President of the ECB's Governing Council I have no position of the Governing Council, but I am impressed by the mark of confidence in the ECB, demonstrated by the previous suggestions.

In any case, the fragility, not only of global finance but of the international economy itself, is something that we should not accept as a normal feature of the globalized market economy. A new concept of strong resilience at a global level is of the essence.

**China Finance:** The recent revised GDP data indicates that China has become the third largest economy in the world. What opportunities and challenges do you see posed by the increased role of China in the world?"

**Trichet:** The progress of the Chinese economy is absolutely striking. I have myself the memory of the city of Peking at the beginning of the 80's. And I can measure how difficult it is for today's visitors to imagine what Peking or any other Chinese big city looked like only 25 years ago. This remarkable success of the Chinese society and the Chinese economy is profoundly changing China as well as it contributes to a profound change of the world. China is called to take all the global responsibilities which are the counterpart of its economic and financial global influence.