

Jean-Claude Trichet: Interview with De Tijd and L'Echo

Interview by Mr Jean-Claude Trichet, President of the European Central Bank, with De Tijd and L'Echo, Belgium, conducted by Messrs Wouter Vervenne, Wouter VanDriessche, Marc Lambrechts, Luc Charlier and Serge Quoidbach on 4 December 2009 and published on 10 December 2009.

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Is the euro area now definitely out of recession? If so, will the expected recovery be sufficiently strong to create jobs?

Jean-Claude Trichet: The second quarter of this year saw the end of the period of free fall in terms of growth. This very difficult period lasted two full quarters following the intensification of the crisis in mid-September 2008 (editor's note: following the collapse of Lehman Brothers).

As of the third quarter of 2009 we have been experiencing positive growth again. This will be the case in the fourth quarter, too. According to the projections of the Eurosystem staff, average growth next year should also be positive, albeit still modest. And with a level of uncertainty – and I should like to stress this point – that remains very high. This is related to a number of factors, primarily international.

As regards employment, taking into account the “lags” usually observed after periods of recession, we could see an increase in unemployment even with growth rates returning to positive territory. We must therefore act with determination to strengthen confidence. Indeed, it was confidence that was so dramatically lacking following the events of September 2008. All of our actions today within the Governing Council of the ECB are aimed at strengthening the confidence of households and firms in the medium term.

Were you aware that this confidence would be so difficult to re establish?

In a cycle such as this, the decline is often much steeper than the recovery, which is slower. Hence the importance, for us, of: (i) assuring our fellow citizens that we are able to ensure price stability and thereby defend their purchasing power; and (ii) convincing firms that the financial environment will continue to incorporate a low level of inflation in the years to come, which will be reflected in medium and long-term market interest rates.

Last Thursday the ECB announced the progressive phasing-out of its extraordinary measures. Does this mean that market conditions are now completely back to normal? Moreover, analysts view the details announced for the 12-month refinancing operation as a signal regarding interest rates.

We always said that our non-standard measures – i.e. the measures adopted in order to take account of the highly irregular situation in the markets – would unwind naturally as the situation improved. The measures announced last Thursday reflect the improvement observed in the markets.

On the question of signals regarding rates, I want to be extremely clear. The intention of the Governing Council was to give no signals at all on interest rates. We consider that the current level of interest rates is appropriate. It was therefore appropriate to index the rate on the 12-month operation. We considered that this was the best way of confirming that we had no intention of giving signals on interest rates today. I believe that the market has understood this message well.

Is the banking sector in sufficiently good health, in your view? Is the worst now behind us?

In this respect, too, we have experienced a dramatic period. I should first like to stress the fact that Europe as a whole – governments, national parliaments, European institutions, etc.

– has overcome unprecedented challenges since the Second World War. We have managed to avoid the kind of dramatic events experienced on the other side of the Atlantic. In an intense period of stress, the European apparatus, which is extremely complex, has proved resilient. This is very rarely acknowledged. And yet, it must be said that the European ship has succeeded in weathering the storm. This was in no way self-evident.

Saying that, we must not allow ourselves to become complacent. We still have much to do in order to strengthen the balance sheets of financial institutions – and commercial banks in particular. We encourage them to act with determination in strengthening their balance sheets. Those institutions can turn to the market. But they can also retain their profits as reserves instead of distributing them. I believe, moreover, that a very high degree of caution should be demonstrated with regard to remuneration and the awarding of bonuses – both for ethical reasons, to avoid excessive risk-taking, and for reasons related to the need for banks to have sound finances.

All of the considerable steps taken by central banks and governments – and thus by taxpayers – have had one single objective: to allow banks to continue to perform their function, which is to finance the real economy. The banks have to live up to their responsibilities.

Paradoxically, haven't some banks, such as BNP Paribas, become too big as a result of this crisis? Does that not pose a new threat?

The question of knowing whether or not certain institutions in Europe and in other parts of the world are so large or so interconnected that they represent additional systemic risks is an important question which is being considered at the international level. There are various ideas on this subject. But nobody can deny that if a financial institution finds itself in a situation where it poses high risks to the whole of the system, and here it is not necessarily a question of size, it is appropriate to take measures to limit these risks.

We also have to act in such a way that the financial system as a whole is less fragile. We are working towards this, in line with the guidance of the G20. From this point of view, I am quite reassured to see that there is a global consensus, including among the emerging economies such as China or India. It is a matter of increasing the resilience of the financial system without calling into question the market economy. We all want the market economy, which produces wealth, to be much less fragile and less subject to the formation and subsequent bursting of bubbles. So this consensus is reassuring. But we have to succeed also. We all have an obligation to obtain results. I do not think that taxpayers would again accept to take the major risks that they have now taken to rescue the system.

Isn't it risky to announce already a gradual withdrawal of the exceptional liquidity measures?

The Governing Council – made up of twenty-two members including myself and Guy Quaden, Governor of the Nationale Bank van België/Banque Nationale de Belgique – must at all times carefully assess the risks of the situation. There are risks associated with unwinding too quickly the non-standard measures that we have taken, and there are risks involved with unwinding them too slowly. I could say the same thing about monetary policy itself or about fiscal policy. In any event, you have to very carefully assess all of the risks that you are taking without having an a priori bias in one direction or another. Experience has shown us how dangerous it can be to focus on short-term concerns to the detriment of economic stability and prosperity in the medium to long term. This is why central banks are independent. In this regard, at the beginning of 2004, in the same week, three Heads of State or Government asked the ECB to lower its interest rates: the German Chancellor, the President of the French Republic and the Italian Prime Minister. The Governing Council of the ECB refused to do this, clarifying that it was not warranted to reduce further interest rates, which were at the level of 2%, without putting at risk price stability in the medium term. Similarly, ten out of the twelve euro area governments publicly criticised our interest rate rise at the end of 2005. Today, there is no longer anybody suggesting that we were wrong in

taking the decisions that we took. This shows how strong the tendency around us is to concentrate on the short term. At last Thursday's Governing Council meeting, we confirmed that the level of interest rates was appropriate, and we took measures to initiate gradually our strategy to exit from the crisis, while continuing to provide liquidity support to the euro area banking system for a prolonged period. We will continue to be very vigilant and to carefully assess risks of all kinds without having an a priori bias. One should never lose sight of the medium and long-term objectives and concerns.

Weren't you expecting the banks to support the economy more?

Everything that we have done, and are continuing to do, to facilitate the refinancing of banks, we are of course doing so that the banks can perform in the best possible way their function of financing the real economy. Our message to them is very clear: there must not be any significant financing difficulties resulting from the supply of credit by financial institutions. This said, the demand for credit is sluggish at the moment, which is always the case after a serious recession. Overall, we are seeing a decline in the outstanding amount of loans to non-financial corporations, owing in particular to decreasing credit demand from firms. With regard to households, outstanding credit has once again risen during the most recent months.

Aren't you concerned to see that, on the one hand, the banks are hurrying back to the markets, once again fuelling what some people consider to be financial bubbles, and, on the other hand, are being strongly urged to lend more?

One should beware of making overly simplistic judgements. The sector that we are looking at is not homogenous. Some market players seem to have completely forgotten that only a few months ago, the entire financial system was in the process of collapsing, and it was the speed and scope of the decisions of central banks, as well as governments and parliaments, which allowed us to avoid a catastrophe. These players are fortunately in the minority. The financial system as a whole understands that it is essential to do everything possible to increase the robustness of the global financial system.

Are you pleased with the agreement among finance ministers on strengthening bank, insurance and market supervision at the supranational level? Some say that too much power still rests at the national level.

I would like to pay tribute to the Swedish Presidency for its remarkably active, clear and very professional handling of this extremely difficult issue. Achieving a consensus among the governments of 27 countries on subjects as complex as the European Systemic Risk Board, on the one hand, and the three European micro-prudential supervisory authorities, on the other hand, is a successful outcome for the Swedish Presidency, acting on the basis of the relevant proposals by the European Commission. As is well-known, the proposed solution was not necessarily the best in the eyes of all the parties involved. It is not precisely what we ourselves suggested initially. However, it has the advantage of representing a consensus of the governments themselves. The European Parliament will now consider this matter and I have every confidence in the efficacy of its efforts.

Will you indeed be the President of the Systemic Risk Board, as has been suggested?

As you know, the President of the European Systemic Risk Board will be elected by the members of the Board once it has been set up. The question is a little premature.

In the United States, there is a great deal of debate concerning the Federal Reserve Act. There is talk of ending the Federal Reserve System's supervision of large banks. Are you concerned by this?

Well before the eruption of the crisis in 2008 the Governing Council of the European Central Bank said that it was important to establish a close link between the central bank and prudential banking supervision. I think that the events of the past two years have confirmed the accuracy of this position. Generally speaking, I note that there is a fairly widely held belief in Europe and worldwide that it is better to have quite a close association between the

central bank and prudential supervision. I have found this to be particularly evident in Belgium – and this shows the confidence placed in the Nationale Bank van België/Banque Nationale de Belgique and its governor – but also in a great many other countries.

I would be amazed if the current debate in the United States were to lead to a Federal Reserve System that no longer had a close link with micro-prudential supervision, since this does not appear to me to be the lesson that should be drawn from the crisis at all. I would add that the ECB has very close and confident relations with the Federal Reserve System.

The IMF has warned that there are still many toxic assets on banks' balance sheets. Is this a problem that will re-emerge at some point?

I think that there are two issues. First, there is the question of the toxic assets that were revealed when the crisis erupted – the “sub-prime mortgages” in particular – and that still remain on balance sheets. This is a serious issue, although it is not perhaps the most important question facing us today. Second, there is the problem of the provisions that must be set up for loans granted by banks to their customers which are not repaid when due, owing to the crisis. I am confident that the European commercial banks will be equal to the new challenge thanks to their profits and also thanks to the reserves and provisions that they have already accumulated. But this is one of the reasons why we urge them to take every opportunity to strengthen their balance sheets, because the period ahead will also be very difficult.

For some financial assets, such as gold, we are seeing a return to risk-taking on the part of investors. Is this a parameter that the ECB takes into account in its strategy?

I will not make any specific comments regarding gold.

Generally speaking, one of the fundamental lessons of the crisis is that when we underestimate financial risks and focus only on the short term, we set the stage for a future catastrophe. The new principles for bank remuneration, which the international community have agreed within the framework of the Financial Stability Board, were established precisely in order to ensure that there is no incentive for operators and traders in particular to favour the most risky attitudes and decisions, leading to illusory profits in the short term at the expense of the long-term interests of the financial enterprises concerned and the stability of the financial system as a whole.

We know how much banks' balance sheets have been affected by the provisions for bad debts linked to toxic assets. Since the market for these structured products is still in difficulty, should the banks fear further write-downs on structured products?

That is a good question, but I do not believe that this is the most important problem facing European commercial banks today.

With regard to toxic assets, it should be borne in mind that the accounting rules play a major role in how they are entered on balance sheets. The rules differ on each side of the Atlantic. The question of harmonising the accounting rules in Europe and the United States is an important one that must also be addressed from the perspective of a fully harmonised global market for financial services.

The Dubai crisis has caused large disparities in terms of country risk in the euro area. Greece and Ireland are currently facing long-term rates which are markedly higher than in countries with European core investors. Are you concerned about the situation in these countries?

The Dubai crisis is an illustration of the extent to which the global financial markets are nervous because you only need one crisis, relatively modest, to cause them to worry again. This makes me all the more convinced that we must continue to work together to increase the robustness and resilience of the international financial system. Those who believe that such efforts are futile and that we have returned to a scenario whereby it is “business as usual” are seriously mistaken.

That said, I am pleased about the decisions taken by the governments in the context of the ECOFIN Council with regard to the proposal by the European Commission to remedy the situation regarding their public finances. It is essential that European governments fully restore confidence in their ability to manage their public finances in a sound and sustainable manner in the long term. This confidence is a very important factor in the recovery. As regards Greece, which you mentioned, I shall simply reiterate what I said before the European Parliament: "Given the severity of the situation, I am confident that the Greek government will take the necessary and courageous measures in the near future."

The euro has remained relatively robust against the US dollar despite the fact that the US authorities say they are in favour of a strong dollar. Are you happy with the US behaviour on the currency markets?

As regard the euro, and particularly with regard to the relationship with the US dollar, I repeat what I said at the press conference following the last meeting of the Governing Council of the European Central Bank. I think it is very important that the US authorities, the Secretary of the Treasury, as well as the chairman of the Federal Reserve have made it clear that a strong dollar is in the interest of the United States. A strong dollar vis-à-vis the large floating currencies is also in the interest of the stability and prosperity of the global economy.

Finally, what has helped you the most in managing the crisis? What has been your goal?

I believe that above all, for the ECB and the entire Eurosystem, it has been our team spirit. The Governing Council, the Executive Board, the ECB staff and all the national central banks have proven their solidarity and unity under exceptionally difficult circumstances. It is because of this that we have been able, since the beginning of the period of financial turmoil, to make a prognosis which has turned out to be right and to take the appropriate decisions for the challenges we have faced. We took those decisions very quickly because we had to, without ever losing our course: that is to say price stability in the medium term, which is our primary goal. I believe that it is the ability of the Governing Council to strictly maintain its medium and long-term price stability strategy, whilst taking quick and, where necessary, unconventional decisions, which best summarises our management of the crisis. But we cannot afford to be complacent. We are still in a difficult situation which means we must always be on our guard. I have been in such situations myself many times, and it is very important to strictly maintain a long-term strategy at the same time as managing a crisis. For example, in my country in 1992 and 1993, as Secretary of the Treasury and Governor of the Banque de France, I had to pursue a long-term strategy of competitive disinflation at the same time as being faced with monetary crises in the European exchange rate mechanism. Also, as President of the Club de Paris in the 80's and early 90's, we pursued a strategy of long-term debt whilst managing financial crises in the sovereign countries of Latin America and Africa, in particular. At the moment, my colleagues and I believe that one of the most important goals is to be an anchor of stability and confidence for our 330 million citizens in what is an extremely difficult period.