

## Jean-Claude Trichet: Interview with The Wall Street Journal

Interview by Mr Jean-Claude Trichet, President of the European Central Bank, with The Wall Street Journal, conducted by Messrs Brian Blackstone and Matthew Karnitschnig, published on 27 January 2010.

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**Question:** As Davos approaches, what are your thoughts on where the global economy has come in the last year, what risks have receded and if there are any new risks that you see?

**Mr. Trichet:** To me Davos is 2007, 2008, 2009 and now 2010.

In early 2007 it was before the start of the financial turbulences I said publicly that my colleagues and I were warning against an under-assessment of the quantity of risks and an under-pricing on the unit of risk in global finance.

In early 2008 we were in a situation which was obviously very demanding because we were experiencing the turbulences which had started since August 2007 and we had to take already some unconventional measures. We had not yet to cope with the dramatic intensification of the crisis, namely the post-Lehman situation.

In early 2009, in Davos last year, we were coping with the most demanding situation since more than 60 years. The financial crisis had turned into an economic free fall with the grave and immediate threat of having a depression which could have been as grave as 1929. This free fall lasted two full quarters: Q4 of 2008 and Q1 of 2009. We have avoided, thanks to the measures we took, the materialization of the depression.

At this Davos meeting, we have a unique occasion to compare notes because you have here the private sector, both financial and non-financial, as well as the public authorities, the executive branches, members of parliaments, central banks, coming from both, the industrialized and the emerging world. Comparing notes to better understand why the system the financial system was unacceptably fragile and to see together how to make the global economy much more resilient.

**Question:** When you look at the current situation, where are the greatest risks in Europe and globally?

**Mr. Trichet:** We are now experiencing a modest recovery in Europe. And, we all have to make the financial system much more resilient in the medium- and long-term with a management of the transition that would permit not to hamper the present recovery. In any case we cannot afford to be twice in such a dramatic situation at the global level. I trust profoundly that our democracies will not accept twice to put between 25% and 30% of GDP of taxpayer risk on the table to sustain the financial sector. We have an absolute obligation to make the system much more solid.

This is sometimes challenged by some financial institutions and market participants that see that the market is fortunately functioning again and have forgotten that governments put over 25% of GDP of taxpayer risks on the table and that major central banks have engaged in non-conventional measures, which have been absolutely extraordinary. Those miss the point that if things are progressively back to a normal functioning this is not thanks to the spontaneous behavior of the system itself, but very largely of the incredible engagement and commitment of public authorities which normally should not do that.

**Question:** Do you see any evidence out there that there is excessive risk taking in the financial system again?

**Mr. Trichet:** One of the major lessons we have to draw from the crisis was that risk management by financial institutions had been unacceptably poor and a major improvement of risk management by private institutions is of the essence. This calls for not confusing very

short-term apparent profits, with the medium-term, real contribution to sustainable profits that should be the pertinent criterion for the remunerations: That being said the main message we have for our banks is loud and clear: “Reinforce your balance sheets by the appropriate means, including issuance of new shares when and where possible, putting aside a significant proportion of your profits instead of distributing it and being highly responsible when fixing up remuneration packages.” All what central banks decided to do as regards non-conventional measures was done with the sole goal of permitting the financial sector to do its job, which is financing appropriately the real economy. Our message is crystal clear.

**Question:** Do you think that the banks in Europe have been forthcoming enough about their potential losses?

**Mr. Trichet:** The theory according to which the European banks would be less transparent than other banks in the industrialized world is not confirmed by what we know. We call upon our banks as well as all other banks to be as transparent as possible. That being said I think that the analysis of the IMF and our own analysis published in our last Financial Stability Review, stress that the loan provisioning is now the main issue for most institutions more than the so-called toxic assets.

**Question:** What kind of a grade would you give banks at this point? They have had several months since the economy has stabilized. Are you happy with their progress in taking these steps? Or do you think they have a lot left to do?

**Mr. Trichet:** There have been many measures taken by financial institutions in the various market places, including the issuance of new stocks, which we consider good for the resilience of the banks and encouraging because it proves that the market is recovering. But a lot remains to be done to be sure that our banks as I said are fully able to do their job, which is to finance the real economy. Credit demand is obviously still very weak because of the sharp recession which ended only a few months ago. So it is not surprising to see the outstanding loans to the non-financial corporate decreasing somewhat. But we must eliminate, as soon as possible, all remaining abnormal supply of credit constraints.

**Question:** Do you worry that the global economy has become bubble dependent for growth, leading to crises?

**Mr. Trichet:** I have been myself involved personally in numerous financial crises since the beginning of the 1980s: in particular the sovereign debt crisis in Latin America, in Africa, in the Middle East and in the Soviet Union. As Paris Club president at some point in the time in the 80's I had to deal with around 55 countries that were in bankruptcy. The perception in the West was that it was not dramatic because the industrialized countries were not directly touched, but, as you can see entire continents were very heavily financially hampered. In the 1990s we had the burst of the Mexican, the Asian, the Russian crisis, – again in the emerging countries – and in the industrialized world the LTCM crisis and the tech bubble explosion. Then after this succession of very demanding episodes we have the present financial crisis, which started at the heart of the financial markets of the West. This was the first real test for two new entities, which are the integrated global financial system and the integrated global economy. Those entities are in particular the product of the conversion to market economies of all economies in the world and of the remarkable advances of technology, in particular Information Technology (IT), but not only IT. The least we can say that this first real stress test of global finance has demonstrated a fragility that is absolutely unacceptable. We have to correct it.

**Question:** When central banks recognize that a bubble is developing should they take corrective action to pop it before it becomes a big problem by raising rates?

**Mr. Trichet:** No central bank today will say that central banks should remain passive when a significant financial bubble is developing. But that does not mean that this issue is not very complex. As regards the European Central Bank, we feel today vindicated in our monetary policy concept, which attaches importance to our monetary analysis and explores information

that can be drawn from the dynamics of the components and the counterparts of monetary aggregates. With the benefit of hindsight this monetary analysis, which is part of our two pillar monetary policy strategy, proved very helpful in a period of growing financial imbalances. When we increased rates at the end of 2005, 10 governments out of 12 were asking us not to increase rates. The IMF was telling us not to increase rates. The OECD was at the time also telling us not to increase rates. We had evidence coming from the monetary analysis that it was appropriate to increase rates. We increased rates. Today there is not the slightest criticism on what we did at the time. This is no time for complacency in any respect today. But we feel encouraged to continue to work very actively to broaden and to deepen our monetary analysis.

**Question:** Are you worried about signs of political pressure on other central banks?

**Mr. Trichet:** I don't trust this is serious. We are in a world where if households, market participants and enterprises would lose confidence in the capacity of central banks of the world to be solid anchors of price stability and, therefore of financial stability, in the medium- and long-term, the economy as a whole would not function correctly. It seems to me that more than ever we have a need of independent institutions having the capacity to take fully into account longer-term horizon considerations.

**Question:** What lessons have you learned from past crises as you deal with the fallout of the current one?

**Mr. Trichet:** Lesson number one: We have to considerably reinforce the resilience of the financial system. I understand the infuriation of our public opinion because the global financial system was much too fragile. That being said I would guard against scapegoating. As a matter of fact the full system has to be improved and redressed and not only some parts and parcel of it. To fix a systemic failure, you have to fix the whole system.

Another lesson of those crises is the necessity of rapid decisions when and where needed. The ECB proved a capacity to decide rapidly when the crisis started and I have to say that the central banks all over the world avoided the depression because we, together did not lose time. It was a matter of weeks and, at certain moments a question of days.

A third lesson valid for all crises and particularly for the present one is that institutions and individuals have to remain calm and never to lose sang-froid. Keeping composure in very demanding circumstances is always necessary to handle correctly the unfolding of a crisis.

**Question:** Do you think that it might make sense to have some kind of mechanism within in euro zone to allow the ECB or some other body in the EU to take more control of a country's budget as a way of giving the markets more confidence and helping guide that country, such as the case of Greece?

**Mr. Trichet:** The Governing Council of the ECB has always been very vocal, very strong in defending the Stability and Growth Pact at a time where some governments were opposing the Pact and wanted to dismantle it. We call for a rigorous implementation of the Stability and Growth Pact by all countries. We also call for all data, facts and figures to be audited appropriately at national and, when judged necessary, at the European level by Eurostat. I expect the European Commission to take very soon a number of proposals in that sense.

As an example at the moment we see one government – the Irish government – is looking energetically at what it has to do. Ireland was in a situation that was difficult and a number of courageous and convincing decisions have been taken.

I expect and I am confident that in the demanding situation in which Greece is, its government will also take the right and necessary decisions to implement the goal which has been fixed, namely to have a public deficit below 3% (deficit as a share of GDP) as early as 2012.

**Question:** Do you think that's realistic?

**Mr. Trichet:** It is what the Government has committed to do. I trust it is not only realistic but also necessary in the present demanding circumstances to take the right decisions to meet the goal. I approve the ambition. I approve the 2012 deficit target of below 3%.

**Question:** Are you satisfied that we're exiting this recession with global imbalances in better order?

**Mr. Trichet:** This is absolutely key! One of the main causes of the present crisis has been the accumulation of global imbalances. We have agreed in the G20 to organize a surveillance of the macro-policies of the systemic economies to reduce this constellation of global imbalances. But to be a success this surveillance exercise requires three conditions: First, that the IMF would produce lucid and courageous analysis. Second that peer surveillance would be executed fairly without any complacency. Those two first conditions, I trust, are reasonably likely to be met. But there is a third condition, that the countries and economies concerned would really change their domestic policies accordingly to pave the way for a better functioning of the global economy. There, I think, is the main issue. We have to convince our democracies that there are situations in which the superior interest of the stability and prosperity of the global economy calls for changes in domestic policies.

A great media like yours know better than anybody how difficult it is to convey to the public opinion of a great democracy that we all have a stake in the stability and prosperity in that entity which is the global economy itself. We all have a lot of hard work to do to improve explanations and pedagogy in this domain. Finally the most important in our democracies is the quality of information, the overall lucidity of the large public opinion. Again, this, I think, is the main issue. We have created an entity which is the global economy, and our own people are not yet necessarily fully aware of the fact that we all have an immense stake in the stability and prosperity of this global economy.

**Question:** What are your hopes for the Basel discussions, and in particular the US's willingness to sign on to that kind of accord?

**Mr. Trichet:** We are all engaged in working out the appropriate global rules. We have an agreement of all industrial and all systemic emerging countries. We are all committed to work out together these new prudentials and if one systemic country – I'm not speaking particularly of the US but of all of them – is not applying the new prudential rules, then the whole exercise of the G20 would appear futile. This is why I cannot imagine such a hypothesis. It is our collective duty to explain why there is a single entity which is the global economy and why it is essential for that entity that we apply the same rules globally and have a level playing field. I don't doubt for one second the sincerity of the US friends that are participating in the exercise.

**Question:** Your term expires in October 2011. You've talked about all the financial crises during your career. What would you like to see in terms of policies that might prevent your successor from having to follow the same path you have over the last 30 years?

**Mr. Trichet:** First let me reassure you: I will execute all my inspiring and heavy responsibilities until the 31 October 2011! My colleagues and I, we have to do the job. To deliver price stability in the medium and long-term and, by doing that, contributing to the financial stability in the long run! I insist on the long run! A central bank is an institution that has to be credible in the long run. Some Treasuries are issuing Treasuries for 50 years. The corresponding very long-term interest rates depend on the independence and the credibility of the central bank.

**Question:** A local question in Germany: the Landesbanken and the crisis they've gone through; do you feel that's been taken care of or do you think public sector banks in Germany and elsewhere need consolidation as some people are calling for? What needs to happen?

**Mr. Trichet:** We have always called all over Europe, in all countries, for getting rid of anomalies we were seeing in the market in this domain. It is not the case of Germany in particular, but we always said that there was an immense stake in having institutions that would not be abnormally behaving for reasons that were due their own structure. I said that publicly before the crisis so I have no hesitation in confirming it.

**Question:** What is your reaction to President's Obama bank reform plan, which would set new limits on the size of trading activities of the largest banks? Do you think it would help to solve the too-big-too-fail problem and curb global systemic risk and whether any aspects of the plan would be suitable for consideration in Europe such as limits on proprietary trading operations of banks?

**Mr. Trichet:** The reform proposals are relevant and interesting. We are examining them with great care. They go in the same direction of our own position, namely ensuring that the banking sector focuses on financing the real economy, which is its key role. There is naturally an international coordination mechanism at the level of the G20 and the Financial Stability Board, where proposals should be coordinated globally to ensure that there are no loopholes in our integrated global financial system. I expect therefore that the international community will work actively on such ideas to improve our collective effort against systemic risks.

**Question:** Ben Bernanke has faced a difficult confirmation process for another term as Fed Chairman that still hasn't been resolved. Can you talk about the actions he has taken in response to the financial crisis?

**Mr. Trichet:** I hold Ben Bernanke in very great esteem and very much appreciate the cooperation between the Fed and the ECB, which became particularly close as the crisis unfolded. I do hope and am confident that he will be confirmed by the US Senate.