

Jean-Claude Trichet: Interview in *Expresso*

Interview with Mr Jean-Claude Trichet, President of the European Central Bank, in *Expresso*, Portugal, conducted by Mr João Silvestre, 24 April 2010.

* * *

Are we really leaving the crisis behind or are there still some risks ahead? Is there a risk of a double dip?

As regards the conjuncture in the real economy, what it is clear is that on the global level we are in a recovery mode. That is particularly visible in the emerging countries, in emerging Asia especially but also in Brazil and in Latin America. The emerging world is picking up now very clearly and that is excellent for global growth. As regards the financial sector and financial aspects of the global economy, I would say that there is still of course very hard work for drawing all the lessons from the crisis. We have to be sure that we have a global financial system which would be much more resilient than it was before the crisis. It is work in progress. It is the work we have started in the auspices of the G20, the work that we are doing with the Financial Stability Board, with the Basel Committee, with all the workshops that have been established at a global level. For the banks, we will have decisions by the end of the year on the capital requirements, new rules and regulations at a global level. We are bound to learn the appropriate lessons and to pave the way for a global financial system which should be much more solid. We cannot afford to have twice the same acute degree of instability. For several reasons, I think people would not tolerate that. Our democracies have accepted a level of taxpayer risk that has been extremely elevated to avoid the collapse of financial sector. I do not think they will accept that twice.

What are the main risks in your opinion? Still the financial system?

We always have risks in a market economy. There was no risk in the Soviet economy, but this absence of risk led the economy to a total collapse. In a market economy, you have to permanently identify and analyse risks, you must have the best risk management possible to be sure that you prevent the materialization of risks both at the level of individual institutions and at the systemic level itself.

In the present moment, we still have all the risks associated with the fact that we have not yet achieved the work that we started at the end of 2008 and have not yet drawn all the lessons from the crisis. We still have to make very significant progress to improve transparency and to combat short-termism. We have to counter pro-cyclicality, which is one of the features of global finance today, amplifying the booms and the busts of global economy. Promoting and improving transparency, countering short-termism and eliminating as much as possible pro-cyclicality are three of the most important avenues we have to take.

One of the problems of pro-cyclicality is that banks, despite the huge amount of liquidity, are not conceding enough credit to the economy.

I confirm that, of course. We did by means of so called “non-conventional measures” all what we could to permit the commercial banks to continue to finance the real economy as well as possible despite the crisis. We did that in a manner which has been prompt and decisive in terms of quantity and quality of the measures taken. Now we are progressively unwinding these measures. This unwinding is fully in line with the fact that the markets are progressively functioning better. As regards the banks our message is: do not forget that what we are doing ourselves is to permit you to finance the real economy and do your job.

Are they frightened about this financial crisis or still have lots of toxic assets on their balance sheets?

After every recession – we avoided a depression but we had a sharp recession – we observe that there was a period of decreasing outstanding credit to the

private sector. As a rule, recovery of credit has always been more rapid for the households than for the corporate business.

Do you expect new problems in the future in some of the euro area banks? I am thinking, for instance, in Irish banks where the government created recently a bad bank.

I would call all responsible authorities, private or public, to be very alert. The cleaning up of bank balance sheets is in line with what we recommend. We have a very simple message for all banks in euro area: to do their job financing the real economy; to do all they can to restructure their balance sheets to be able to finance the economy including taking advantage of the market possibilities to issue new capital, utilizing their retained earnings to reinforce their own funds and have moderate remuneration. In a small number of cases we are also telling them to utilize the options offered by governments to restructure their balance sheets.

What is, in your opinion, the appropriate capital requirement for a bank?

We will see. We have opened up the discussion with the private sector. The Basel Committee is gathering all the responses from the industry that were due by the end of April. We will work intensively, at the level of the international community, on the appropriate calibration of the new Basel rules.

You think that the exit strategies of the fiscal policy, namely in some countries higher deficits like Ireland, Portugal or Greece, are in themselves threats to the economic recovery?

We in the ECB Governing Council have always defended fiercely the Stability and Growth Pact (SGP). We have always drawn the attention of the governments to the fact that the SGP was essential and crucial for the Economic and Monetary Union (EMU). For all governments, the sound management of fiscal policies is essential, not only because they are part of the EMU, not only because it is both moral and common sense behaviour to protect the children and the grandchildren and not to impose on them an abnormal burden, but also because it is a crucial element in of the confidence of the households, entrepreneurs and market participants. That is the reason why we see no contradiction between the objective to permit the economic recovery to expand and be active as possible, and the sound management of fiscal policies.

But governments should be careful on the pace of fiscal tightening to avoid risks?

Governments should be aware of the fact that if they do not do what is necessary to be credible in having a sustainable fiscal position in the medium term, they will not create confidence. If they do not create confidence in their capacity to run sustainable fiscal policies they will not help the recovery today. Because the recovery today depends crucially on the confidence of households, of fellow citizens and of enterprises.

Do you think Portugal could experience in the future a situation similar to Greece if the government fails to accomplish Stability and Growth Program and bring the deficit to a level below 3% of GDP?

The countries are all in very different situations. That being said all governments of the euro area, without exception, have the task to be credible in the sustainability of their fiscal policies. It is our permanent message.

You know for some time our finance minister, Teixeira dos Santos. He was able to cut fiscal deficit between 2005 and 2008. Is he the right person to do it again right now?

It is not the responsibility of the ECB to give good marks and bad marks to finance ministers! All what goes resolutely and courageously in the direction of sound fiscal policies and improvements in the cost competitiveness of the economy has to be accelerated. It is essential.

Is it fair that some countries like Portugal or Ireland, with their own fiscal problems, could be called to participate in the solution for Greece financing its debt?

All the countries, without any exception, have to behave properly to have good management of their fiscal policy, good monitoring of their relative competitiveness, of their unit labour costs, of their structural reforms and overall competitive indicators. They all have to collectively exercise strong surveillance on the individual governments of the euro area, impose strong conditionality where needed and fully recognize that they are sharing a destiny in common.

Should the euro area and European Union create an institutional framework, like a European Monetary Fund, to solve this kind of problem?

Firstly, the SGP is there precisely to organize peer surveillance of the sixteen members. The close monitoring of the policies pursued by each of the sixteen and the good functioning of this peer surveillance is absolutely essential. If we have a reinforced surveillance on the members of the euro area themselves, we will not have problems in the future. Secondly, I think the task force presided over by Mr Van Rompuy, according to a decision taken by the heads of state and government, will concentrate on how we could improve surveillance and – when necessary – the conditionality that the euro area will impose on each of its members, in line with the Treaty.

You think that this solution to Greece is enough to calm down the financial markets?

I already said what I have to say on that.

Was this financial crisis your most difficult task in the ECB?

We have no “most difficult task”. We have to be permanently alert. As you know, the ECB has been very alert. Before the crisis, we warned against the possibility of a market correction of great magnitude. We said that, I said that myself, in 2006 and at the beginning of 2007. We were the first central bank in the world, in August 2007, to assess that a period of financial turbulences was starting and to take appropriate decisions. That was, of course, a very difficult decision to take based upon this new turbulent market environment we had to cope with at that time. We had a lot of difficult decisions to take, like all other major central banks of the world, after the intensification of the crisis, which took place mid-September 2008, when we decided to embark on a series of non-conventional measures. We have to be alert, all of us, permanently, to stand ready to respond to events that are very difficult to predict and in their nature are unique.

Was the financial sector, and banks in particular, too optimistic about the possibility of this kind of crisis?

It is unfortunately clear that the financial sector had very mediocre risk-management in the years preceding this crisis. There was a sentiment that risks could be taken and the eventuality of their materialization was not perceived by market participants and institutions. Furthermore, a number of financial instruments emerging were abnormally complex, and did not allow the final investor to be transparently informed. We were in an environment which proved to be simultaneously intransparent, complex and extremely risky. We have to be sure we are correcting all that and improving every part and parcel of global finance in the future.

Are bankers already prepared to be careful in the future or should the regulators impose on them that kind of behaviour?

We need both. We need, of the course, the private sector to be fully aware of the risks that might emerge. It is clear that, for the private sector as a whole the crisis was a tough lesson, so they have all changed their behaviour. They have all spontaneously, under the pressure of this intense crisis, improved their risk management. They learnt their lesson the hard way. The regulators themselves have to push them in the right direction and to impose on them what they do not do spontaneously. It is in a way a dramatic change of culture that we have

to process with the efforts of the authorities and public sector, as well as the private sector, in global finance and, therefore, the global economy.

Was there a threat of a new Great Depression?

What we had in 2008 and 2009 was a crisis which was graver than the worst crisis since World War II. If we had not been prompt and bold in the constituency of central banks and executive branches we would probably have had to cope with the worst crisis since World War I. We would probably have a depression, a very profound depression at global level. The threat was grave and immediate. That is one of the reasons why we have to be sure that we have much more solid and resilient global finance and global economy.

Is the euro area economy in worst shape than the US economy? Is the US recovering faster?

Each economy has its own features, its own characteristics, its own structures. When you compare figures you have also to take into consideration a significant difference which is due to difference in demographics that are much more dynamic in the US. You have also to consider that we have, in Europe, a connection to the rest of the global economy which is not the same in the US. All that being said, I think Europe has a lot to do to improve macro-policies, in particular fiscal policy, but also to be very active in the field of structural reforms. It is extremely important that the new 2020 project, which succeeded the Lisbon Agenda, will be done at utmost level of responsibility and determination. Because the big difference between Europe and the US is the flexibility of the economy. As a consolidated economic entity, whether at the level of the euro area or of the European Union as a whole, we are macroeconomically close to balance with no significant current account imbalances. We are financing our own investment with our own savings. Which is not necessarily the case in the US. But on the other hand, we have an economy that is not sufficiently flexible. We have to embark on bold, structural reforms and be very much active on that if we want again growth and prosperity.

In terms of structural reforms, is this an urgent need for Portugal?

I think that it is very urgent and very important for all European countries, and of course, amongst them, for Portugal.

Next June you will have a new vice-president, Vítor Constâncio. Was he a good choice for the job?

Vítor Constâncio has been a very active member of the team of the Eurosystem for a long period of time, a very active participant of the Governing Council and General Council of the ECB. The Governing Council was requested to give its own opinion which was positive. I am very happy to continue working with Vítor as of 1 June much more intensively.