

Jean-Claude Trichet: Interview in *Frankfurter Allgemeine Zeitung (FAZ)*

Interview with Mr Jean-Claude Trichet, President of the European Central Bank, in *Frankfurter Allgemeine Zeitung*, Germany, conducted by Messrs Gerald Braunberger and Stefan Ruhkamp on 19 May 2010 and published on 21 May 2010.

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FAZ: Mr President, many Germans are asking themselves whether our money is still safe. What do you have to say to them?

Trichet: The European Central Bank has a track record of successfully meeting its objective of keeping inflation below, but close to, 2% over the medium term. For over 11 years since its establishment – including the current period – the ECB has succeeded in doing just that. Over this entire period, we have achieved an average annual inflation rate of less than 2%, but close to 2%, in the euro area. And in Germany it is even significantly lower. The facts speak for themselves. No central bank in Europe – not even the Deutsche Bundesbank – has achieved such a low rate of inflation over such a long period of time.

FAZ: But the fear is that the ECB is getting itself into a situation where it no longer has complete freedom to act.

Trichet: We have full freedom to act, and we will never shy away from our responsibility for delivering medium-term price stability, also in difficult circumstances. In France I was at times called the “Ayatollah of Franc fort” (a play on words on “strong franc”) or a “clone” of the President of the Deutsche Bundesbank at the time, Hans Tietmeyer. In 2004 the German and French governments tried to pressure us into cutting interest rates. I said on behalf of the Governing Council that the ECB refused to do this. In December 2005 we increased rates against the publicly expressed sentiment of ten governments! In 2008 we did not hesitate to raise interest rates, even in a period of financial turbulence. We don’t allow ourselves to be influenced by any government, any social partner or any kind of pressure group. We act always fully in line with our own responsibilities. And that is the reason why we have delivered price stability.

FAZ: But by purchasing government bonds, you’ve crossed a red line. Has the credibility of the ECB suffered as a result?

Trichet: There has been no crossing of any line. Our line is price stability, and our credibility is derived from achieving this objective over the medium term. The Governing Council of the ECB observed that the effectiveness of the transmission mechanism for our monetary policy was being severely hampered. We are not increasing the money supply. By contrast with what other major central banks have done, we are not purchasing government bonds in order to inject liquidity into the markets. What we are doing is fundamentally different: we sterilise. We ensure an unchanged stance of monetary policy. This is why the liquidity supplied is immediately being absorbed again in its entirety. We have to do whatever we consider appropriate in order to ensure price stability. If we always listened to the criticism directed at us by politicians, social partners and financial pressure groups, we would be unable to fulfil our mandate.

FAZ: What does the functioning of the market for Greek government bonds have to do with the functioning of monetary policy?

Trichet: Markets are strongly correlated with one another. A failure in the bond market would have raised doubts everywhere else. Moreover, government bond yields are benchmarks for the financing conditions in the real economy – i.e. for firms and households. The crisis that we’ve been facing since 2007 has been the worst since the Second World War. And had we not acted, it could have been the worst since the First World War. There are doubts regarding the industrialised world’s ability to put its public finances in order. That being said,

the euro area as a whole is on a solid footing within the industrialised world. Unfortunately, however, the same cannot be said of all individual euro area countries at present. That is the problem, and it had to be – and is being – addressed.

FAZ: The ECB is buying bonds that banks and investors want to get rid of. Do you risk taking on the role of a European “bad bank”?

Trichet: No. We are only aiming to stabilise those markets that stopped functioning normally. But the first – and absolutely necessary – condition for success is that governments accelerate fiscal consolidation and are unwavering in their implementation of the tough measures that are indispensable.

FAZ: What will happen if the market failure that you observed continues and the ECB is forced to purchase more and more bonds? Will it not then become increasingly difficult to stop the process?

Trichet: We don't want to create an artificial situation. We just want the markets to function more normally, to allow our monetary policy to be effective throughout the euro area. Otherwise, there would be instability, and that would have a negative effect on all member countries. All governments have committed themselves to being ready to accelerate fiscal consolidation. We are following this very closely in liaison with the Commission.

FAZ: What happens if, for example, the Greek people refuse and the government breaks its austerity promise? Do you not need a Plan B?

Trichet: Let us look back. Since the euro was launched, the ECB has been preaching that the Stability and Growth Pact is a cornerstone of EMU. I repeat this at least once a month. The governments of Germany and France in particular wanted to get rid of its rigour in 2004 and 2005. We rigorously defended the Pact and avoided its de jure dismantling, against the wishes of the Heads of State and Government of large euro area countries. Now, the ECB has demanded a very serious adjustment programme from Greece, an adjustment programme that is very much in the country's own interests.

FAZ: However, there is a risk that one of the countries whose bonds you are buying will not be able to service its debts. What then?

Trichet: We are in the field of governments. There are three levels of government responsibility. First, accelerate the necessary and indispensable fiscal consolidation. Second, exert strict surveillance of peers within the Eurogroup – i.e. euro area governments. Third, if tensions emerge despite the first two levels of responsibility, stand ready to intervene through the Financial Stability Mechanism.

FAZ: If that is the case, why is the ECB propping up the bond markets? Would it not be better for an institution to be created which the governments finance and are responsible for?

Trichet: We are not propping up the bond markets. That is not our objective. We are ensuring the effectiveness of monetary policy. On 6 and 7 May, the days immediately prior to the decision to purchase bonds, the markets were massively disrupted, and market participants all over the euro area and the rest of the world observed this situation, which was deteriorating extremely rapidly. This was a very serious situation, in which we had to intervene in order to preserve, as I said, the integrity of the monetary policy transmission mechanism.

FAZ: So why has the President of the Bundesbank, Axel Weber, distanced himself from the purchase programme and voted with other members of the Governing Council against it?

Trichet: I never comment on the statements of other members of the ECB's Governing Council. I will only say this much: an overwhelming majority were convinced that the decision was right under the circumstances.

FAZ: In comparison with almost every other major currency, the euro has fallen sharply this year. Is this a risk for price stability?

Trichet: The euro is a credible currency. The fact that it is a currency whose rate of inflation has been below 2% for over 11 years demonstrates its trustworthiness. Price stability is a key feature of the euro and a major asset for domestic and international investors.

FAZ: So there is no need for intervention?

Trichet: I never comment on interventions.

FAZ: The crisis stems from excessive debts. We are now fighting the crisis with even more credit and even more money. How do we get out of this spiral?

Trichet: We have a number of ways of providing the banks with additional liquidity support, which will automatically be discontinued when the situation improves. Owing to the serious tensions observed very recently in the markets, we have now reintroduced some of these support measures. But you can be sure that we will exit those measures in a timely fashion in line with improvements in the functioning of the markets. We will never lose sight of our primary mandate of ensuring price stability over the medium term, with the right monetary policy stance. There is a clear separation here. By the way, note that the growth of the monetary aggregate “M3” is currently negative. I have been committed to price stability all my life. For me, inflation is a tax that would mainly hit the poorest and weakest in our society.

FAZ: The purchase programme seems like a second major bailout. Are we rescuing the banks again?

Trichet: We are constantly urging the banks to live up to their responsibilities. All our support for the banking sector is geared to stabilising the real economy in the financial crisis in order for price stability to be ensured and, by way of consequence, for jobs to be retained. We are therefore calling on the banks to strengthen their balance sheets and lend. They should not use their profits for huge bonus payments or excessive remuneration packages, which are a disgrace in the current environment, nor to massively distribute their profits. Instead, the banks should do everything they can to strengthen their capital base in order to be able to better provide credit to businesses.

FAZ: The fact that you keep repeating this gives me the impression that banks are not sticking to it. Do we therefore need new and stricter rules for banks and the markets?

Trichet: We need better regulations for banks. We also have important financial institutions that are not banks, for example highly leveraged institutions such as hedge funds, and they can also potentially be problematic in some circumstances. In the financial sector in general, not only in banks, certain types of behaviour have developed which are a long way from the values of our democratic societies. We need to change the dominant values in the financial sector. Greed, which is too often the dominant value, must be replaced by a sense of responsibility vis-à-vis the real economy. That is one of the lessons learned from the financial crisis and is something that the ECB is taking to international fora.

FAZ: Is it only a question of morals, or is it also a task for regulation?

Trichet: It is a question of values and also a question of rules. The Financial Stability Board has developed principles for guiding recommendations, for instance. In any case, we cannot afford to save the financial system a second time at taxpayers' expense. The system must become much more resilient.

FAZ: It is being claimed that the speculation on the markets is also responsible for the weakness of the euro. Is that right?

Trichet: Let us be clear, it is not the euro that is in danger, but the fiscal policies of some countries, which have to be – and are being – addressed, and, by way of consequence, the financial stability of the euro area, which has to be – and is being – consolidated. In any case, market developments are always a combination of the mood of investors and the influence of speculative investors, such as hedge funds.

FAZ: In the ECB, there is talk of reducing the influence of rating agencies. Why do you think that a credit assessment by the ECB would lead to better results?

Trichet: That must be discussed globally. The functioning of the credit assessment system is currently highly pro-cyclical. It is certainly not necessarily optimal that we only have three major rating agencies for the entire world. But we have still not concluded our analyses.

FAZ: Is there any chance of a stable financial system as long as the economy and the Member States are so heavily dependent on credit?

Trichet: We must improve very significantly the functioning of the entire financial system. We definitely cannot afford to find ourselves in a situation like 2008 again. With your question, you seem to doubt that there is the political will. It is the task of independent institutions, such as the ECB, to tell politicians that they have to adopt a responsible financial policy. I do not underestimate the difficulties that democracies face in taking painful decisions. But it is obvious that several industrialised countries have been living on credit. The richest countries in the world have made the less rich and poorer ones finance them, which is not sustainable and, in the end, will not be sustained! That applies to a number of industrialised countries on both sides of the Atlantic.