Jean-Claude Trichet: Interview with *L'Agefi Hebdo*

Interview with Mr Jean-Claude Trichet, President of the European Central Bank, conducted on 20 April 2011 by Mr Philippe Mudry and published on 18 May 2011.

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Agefi: A survey of our readers on the future of finance reveals deep scepticism about the nature of the benefits resulting from regulation and also about its possible contradictions. What do you think?

Jean-Claude TRICHET: Considering the gravity of the situation which the international community has had to face, the lingering scepticism in some areas is understandable. It is important to understand that we had to cope with a crisis of extraordinary severity in 2007 and in 2008 which intensified following the collapse of Lehman Brothers. Without the unwavering determination of the central banks on the one hand, and of governments on the other, and without significant exposure to budgetary risk, on both sides of the Atlantic and in all the developed countries, we would have faced a very deep depression and the worst financial crisis since the First World War! Our calculations at the European Central Bank and throughout the European System of Central Banks tell us that, in total, some 27 % of gross domestic product, in terms of risk to the taxpayer, had to be mobilised on both sides of the Atlantic in order to avoid the worst. Fortunately, of course, this risk was not converted into losses in the majority of cases, and many such cases have yielded profits; nonetheless, without this risk-taking we would have been facing a terrible disaster. The central banks as well as all the governments of the developed and the emerging countries have been very determined. Inasmuch as disaster has been averted, a number of partners, in the private sector essentially, feel that there is no point after all in making sweeping improvements to the rules and regulations governing the financial sector, in particular the prudential rules. This is not our view at all. The central banks all consider that it is absolutely essential to remain aware of the fragility of the financial system and to implement the reforms we need. We would be unable to address a situation as severe as the one in September 2008 a second time.

When you look at the path followed since 2007 in terms of financial regulation, what strikes you as being the main benefits, but also current limits, of the process prompted by the G20?

– The G20's action follows two major pillars: financial regulation and the coordination of economic policies aimed primarily at reducing major imbalances. On financial regulation itself, we are halfway down that road. We managed to reach a global agreement in record time, not just between the industrialised countries, but also now with the systemically important emerging countries on new prudential regulations and fresh requirements in terms of own funds for all banks, with decisions that have far-reaching repercussions. Moreover, the decisions required a great deal of goodwill from all European and American partners, but also from those in China, India, Brazil, Mexico, Russia and all the other major emerging countries. I regard this as a notable success. It must not be called into question. Here and there I hear market participants, who are members of private financial institutions, saying that some decisions are too stringent and too demanding. The decisions taken must of course be implemented. In addition, there are still a lot of things to do, particularly as regards the so-called systemically important financial institutions. Equally, there is the "shadow banking" issue which is related to those financial institutions that do no fall under the scope of the regulatory framework for banks. Of course, there is also the issue of effectively implementing the prudential rules on liquidity. These are all examples of work in progress, and they are being examined by the G20, the Basel Committee and the Financial Stability Board.

Do you regard the convergence of national laws as satisfactory today?

– The rigorous implementation of the rules defined at the global level by each of the countries affected is absolutely essential. If there is uneven implementation, we immediately create extremely dangerous distortions in the functioning of the global financial system; we open the way for what is known as "regulatory arbitrage", the aim of which is to attract to one's own country the most financial activities possible by having more lenient and more limited regulation. All the conditions for a fresh disaster would then be in place. The same rules must be implemented by countries worldwide. This is especially true on both sides of the Atlantic. That's why it is vital for the so-called "Basel III" framework to be implemented rigorously, particularly by all the European countries of course as well as by the United States. We must not repeat the bad experiences of previous years, notably with "Basel II", which was not implemented uniformly, particularly on the other side of the Atlantic. As central bankers, we continue to stress this fundamental aspect. If we fail to adhere to it, we will then have all the ingredients for further crises.

A number of the criticisms directed at re-regulation concern its contradictions, real or assumed. For example, some feel that the tightening of capital and liquidity ratios is too severe and risks adversely affecting the financing of economies. Does this criticism strike you as justified?

Jean-Claude TRICHET: In our view, the rules which have been defined for capital requirements are optimal. We reflected long and hard on them. Of course, there are arguments in both directions, but considering the drama resulting from a crisis in terms of lost growth and job creation, we gain a lot more by being reasonably demanding in terms of capital. Preventing further crises from occurring is a benefit that far outstrips the potential losses, if certain analyses are anything to go by. Let's be clear one more time: these decisions, debated at length by those primarily responsible, have been evaluated at governor and ministerial level and adopted at the global level by heads of state and government. They must be implemented.

Another criticism: this tightening of the rules runs the risk of producing a concentration in the financial sector, and on the financial markets as well, which is even stronger than it is today.

Jean-Claude TRICHET: I do not believe so. We must be constantly and closely vigilant with regard to the structural changes to international finance. There are permanent risks that we must continue assessing, but I do not think the rules we have just defined, or those still being worked out, will lead to this hyper-concentration. On the contrary, I have to say that one of the main lessons of the present crisis is that there were very high risks associated with what I would call the "financial mammoths".

Is too little attention being paid to the much-discussed area of "shadow finance"?

– The issue of the "non-banks", of shadow finance, and of all the institutions or market participants not under the oversight of the banking supervisors, is very important. Over the last two decades we have witnessed a tremendous explosion in new financial institutions. I myself lived through a period during which all the institutions with high leverage, by the end of the 1980s, were managing capital worth something in the region of USD 100 billion. 17 years later, in 2007, the figure was USD 3,000 billion! Very significant financial services have been, and are being, rendered by these market participants, but the systemic risk which can be associated with them must be considered from every angle. Obviously it would be counterproductive if tighter regulations had the effect of pushing regulated finance into the unregulated area. This is a major topic which is being examined right now at the request of the entire international community, particularly at the level of the Financial Stability Board. I think I am expressing the feelings of all central bankers when I consider that there are crucial issues here in terms of transparency and appropriate regulation. We must be sure that these financial market participants do not create new systemic risks.

Are you satisfied with the rise of the organised markets compared with over-the-counter (OTC) transactions, with specific reference to centralised compensation?

– Here again, we are dealing with another core issue on which the entire international community is reflecting. The act of pushing activities which are very broadly disorganised towards clearing houses, towards organised markets, is a formidable undertaking. Of course, there will always be OTC contracts, but we have a major interest, in terms of regulation, financial stability and the removal of as much systemic risk as possible, in ensuring that these contracts, these derivative instruments, become as standardised as possible and can be traded through organised markets.

In more macroeconomic terms, how do you judge the actions of the G20 aimed at reducing global imbalances?

– The reasons for the crisis and the responsibilities are manifold, because there were multiple failures. It is unnecessary to dwell on finding a single scapegoat. However, one of the causes was certainly the prevailing complacency over a long period about very large international imbalances. One of the main lessons from the crisis is the need to have the right kind of coordination of macroeconomic policies, which is the international community's responsibility. We have created integrated global finance and a globalised economy: there is a need to strengthen very considerably the governance of these. The International Monetary Fund is playing a leading role here by providing significant conceptual support for this strategy of the G20 and the entire international community. We have a lot of progress to make in this area as well. Everyone is well aware of the dangers associated with these major imbalances – surpluses on the one hand, deficits on the other – in a full-blown crisis. Then, as we emerge from it, as is the case, with a perceptible upturn that is getting stronger, some then start to question things. I'm rather shocked by the number of voices being raised to explain how we can, after all, easily live with major imbalances and that they can be economically justified. I do not believe this to be the case at all. I think we have to resolutely carry on and bolster the efforts being made in this area. From that viewpoint, the euro area as a whole does not have an external imbalance since our current account balance is broadly in equilibrium.

What importance do you ascribe to the debate on the international monetary system?

– I think that the points identified by the G20, from a long-term standpoint, particularly the issue of capital flows, special drawing rights and other topics associated with the international monetary system, are interesting. It is good to discuss them. Ultimately, though, we have two questions for the short to medium term. One of these involves the relationships between the major convertible currencies: the dollar, the euro, the yen, the pound Sterling, the Canadian dollar. For over 30 years we have had a system in which these important relationships have been monitored by the G7. From that viewpoint, these relationships have not been destabilised in the course of the crisis. We should congratulate ourselves on this, even though it calls for constant vigilance of course. Then there is a topic on which it seems to me that the international community also agrees, i.e. the ties between the currencies of the major emerging countries, which themselves have very large surpluses, and all the other currencies, including the major convertible currencies. The currencies of these major emerging countries with large surpluses must progressively become more flexible, i.e. appreciate in an orderly and progressive manner.

In Europe there are genuine concerns about the Union's capacity to overcome the debt crisis facing the peripheral countries. The markets are highly sceptical. What can they be told in order to convince them of the relevance of the measures undertaken at the European level?

– On the issue of fiscal policies, I believe that the European Central Bank, through me, can reiterate certain points. Firstly, we always said that when there was a single currency but no political federation, there was a clear need for budgetary supervision. This was hotly disputed. I can remind you how in 2004 and 2005 major countries, notably France but also Germany and Italy, were telling us that we did not need this surveillance framework for fiscal policies. We had to fight very hard to preserve it. Today, this episode obviously seems totally outlandish, bearing in mind what has happened since. Some, moreover, said that the Stability and Growth Pact itself was “stupid”. We always said that the careful monitoring of fiscal policies was essential, as were healthy policies. This remains true today. However, one should add another pillar of governance, particularly within the euro area, in the form of monitoring competitiveness indicators, and unit production costs especially; the changes to these must also be tracked extremely carefully. For six years at least, we have been telling all European governments to monitor very closely changes to competitiveness indicators and imbalances within the euro area. We emphasise the three pillars necessary for European governance, all three of which must be improved substantially: supervision of fiscal policies, supervision of competitiveness indicators, and structural reforms. The central banks across the whole of the Eurosystem – the ECB and the national central banks, i.e. the Banque de France in France’s case, for instance – have a very clear message for governments: Europe’s governance must be improved decisively, and governments are not going far enough. We expect a great deal from the dialogue with Parliament in order to push governments towards taking a decisive step.