Jean-Claude Trichet: Hearing before the Economic and Monetary Affairs Committee of the European Parliament

Introductory statement by Mr Jean-Claude Trichet, President of the European Central Bank, at a hearing before the Economic and Monetary Affairs Committee of the European Parliament, Brussels, 4 October 2011.

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Dear Madam Chair,

Dear Honourable Members,

It is always a great pleasure to be here as President of the European Central Bank (ECB), before the directly elected representatives of the European people. This interaction is a cornerstone of our Economic and Monetary Union.

Today, I appear before your committee with particular emotion. This is the last of my 35 immensely fruitful dialogues with you.

Members of the European Parliament, you are the heart of the living democracy in Europe. We at the ECB are the guardians of the currency of our fellow citizens. And we are fully independent in our actions to protect the currency whilst you ask us to report to you.

Indépendance et responsabilité sont indissociables. Afin de conserver sa légitimité, une banque centrale indépendante doit être prête à rendre des comptes au Parlement et au public. Tout au long de mon mandat, j'ai attaché autant d'importance à l'une qu'à l'autre. La BCE est farouchement indépendante. En même temps, elle ne peut pas se passer d'une interaction régulière et étroite avec le Parlement européen: c'est cela même qui lui permet d'accomplir ses missions en toute transparence et responsabilité. C'est pourquoi j'ai toujours répondu présent lorsque vous m'avez convié à venir échanger ici, que ce soit en session plénière ou en Commission, et plus fréquemment que d'habitude lorsque des circonstances exceptionnelles l'exigeaient.

Ich möchte in meiner Einleitung mit dem vereinbarten Thema beginnen, nämlich den Prinzipien der Geldpolitik der EZB seit ihrer Gründung. Danach werde ich eingehen auf die Beziehungen zwischen der EZB und dem Europäischen Parlament in den letzten acht Jahren, und den Beitrag unserer beiden Institutionen zur europäischen Integration. Mit einigen Überlegungen zur Zukunft der EU, und insbesondere der Wirtschafts- und Währungsunion, werde ich dann schließen.

1) The ECB's actions since its creation: permanent alertness, resolute action and fierce independence

Let me first reflect on the ECB's actions since its creation. With current discussions sharply focused on how to deal with the financial and sovereign debt crisis, it is sometimes forgotten that our primary objective is to maintain price stability in the euro area.

More precisely, we aim to maintain inflation rates in the euro area below, but close to, 2% over the medium term.

This is what the Treaty demands from us. This is what the citizens of the euro area expect from us. And this is what we have delivered.

Price stability is a necessary condition to foster sustainable economic growth, job creation and to ensure the well-being of Europe's citizens.

One fundamental indicator is medium and long term inflation expectations. Inflation expectations that are in line with our definition of price stability help employers and employees in the euro area to agree fair wages. They help businesses small and large to make longer-term investments. They ensure, all things being equal, a more favourable financial environment because market medium and long term interest rates incorporate stable price expectations. And they help governments to play their role in macroeconomic stabilisation.

Preserving inflation expectations in line with price stability has been far from easy. Let me remind you of a few of the many shocks to the economy since 1999.

The early 2000s saw the bursting of the "dot-com" bubble. Medium and long term inflation expectations remained stable. Then came the terrorist attacks of 9/11. Inflation expectations remained stable. We saw dramatic surges in oil prices. Once again, medium and long term inflation expectations remained stable.

Then, in 2007, there were the first signs of an unprecedented financial crisis, the repercussions of which continue to this day. What happened in late 2008 in particular could have resulted in an economic catastrophe not seen since 1929. Authorities across the world took action to avoid another Great Depression. We at the ECB responded by lowering interest rates and introducing our non-standard measures. We experienced a very short period of negative inflation, with some commentators expecting a long period of deflation. Yet medium and long term inflation expectations remained stable.

As you know, 2010 and 2011 have been extraordinary years for the economy, with parts of the euro area confronting serious problems in sovereign debt markets. But I can say once again: inflation expectations remain stable.

Dealing with these diverse shocks has required constant alertness, resolute action and fierce independence.

Permanent and credible alertness in 2004, when the ECB kept interest rates at 2% while governments and international institutions were calling for more cuts.

Fierce independence in 2005 when the ECB started increasing its policy rates despite, again, the strong opposition of many governments and against the advice of international financial organisations. The ECB was criticised for that decision; with hindsight, that criticism turned into respect.

Alertness in August 2007, at the very start of global money market turbulences, when the ECB was the first central bank to take non standard measures to ensure the smooth transmission of monetary policy.

At the very beginning of the financial crisis the ECB decided to stick to a strict *separation principle* between the "standard measures" and the "non-standard measures". The "standard measures" are designed to deliver price stability in the medium term: they are the interest rate decisions. The "non-standard measures" are designed to help restore a better transmission of our "standard" monetary policy decisions at times when the crisis is disrupting markets or segments of markets: the "non-standard measures" include the supply of liquidity at full allotment and fixed rates and the interventions in private and public securities markets.

This *separation principle* permits us to preserve, including in the present deep crisis, a strong sense of our direction in the medium term – price stability – whilst taking into account the reality of the disruption of markets due to the crisis.

Like actions, numbers speak louder than words. Let me mention one number: 2.01%, the average inflation rate in the euro area since 1999 until today, over a period of almost 13 years during which oil prices have soared.

This number has become so deeply embedded in our society that people have almost forgotten it.

But this number reflects the lowest annual average change in prices that any large euro area country has experienced since the beginning of the European project, over 50 years ago. Price stability is now so self-evident to the citizens of Europe, and so much expected from their central bank, that achieving it is taken for granted.

Even our regular exchanges of views have sometimes dealt less with the "M" than with the "E" of EMU!

2) Economic and monetary developments

Achieving price stability through alertness and fierce independence sets the framework for our day-to-day actions. In this context, let me report on recent economic and monetary developments. Note that as we have entered the Purdah-period, nothing I say has any bearing on upcoming monetary policy decisions.

We expect real GDP growth in the euro area to be very moderate in the second half of this year. Growth is dampened by a slowing pace of global growth, by declines in equity prices and business confidence, and by continuing tensions in segments of financial markets as well as in some sovereign debt markets. The more moderate economic outlook is confirmed in the ECB's September projections. The risks to the economic outlook, which previously were balanced, are now on the downside, mainly relating to tensions in some financial markets.

Turning to prices, inflation was 2.5% in August, and rose to 3% in September according to the Eurostat flash estimate, almost exclusively as a result of oil price developments. We expect inflation to stay above 2% over the coming months. Next year, it should fall below that level, depending on commodity price and wage developments. This pattern is also reflected in the latest ECB projections of inflation ranging between 1.2% and 2.2% next year. The risks to the medium-term outlook for inflation were broadly balanced in the eyes of the Governing Council in its last meeting, whereas before they were seen as being on the upside.

Our monetary analysis indicates that the underlying pace of monetary expansion remains moderate. Liquidity accumulated prior to the period of financial market tensions continues to be ample but recent data indicate that part of it may be held more for precautionary reasons than for spending.

Finally, in the context of our continuing analysis of the euro area economy, let me draw your attention to today's release of the 2011 Structural Issues Report. This deals with structural features of distributive wholesale and retail trade and their impact on prices in the euro area. The distributive trade sectors are not only economically important in their own right, but also relevant to monetary policy. Ultimately, it is retailers who set the prices of most consumer goods and they are a key interface between producers and consumers. I very much ask you to take note of the report. It suggests ample scope for further improving effective competition and removal of unwarranted barriers to cross-border trade.

3) The European Parliament and the ECB – a constructive relationship to the benefit of Europe

Let me turn to the relationship between our two institutions. The ECB's fierce independence and its accountability to the Parliament are two sides of the same coin. In this endeavour, and especially throughout the recent turbulent times, our two institutions have interacted very constructively. The quality of our relations has been instrumental to the exercise of our tasks and, I believe, more generally to the process of European integration.

The hearings in your Committee are naturally the cornerstone of the ECB's Treaty-based accountability obligations. But they are more than that: beyond monetary policy *stricto sensu*, they have allowed two genuine European institutions – two institutions that only have the whole in mind and not just the parts – to have a continuous dialogue on a number of issues of great relevance for the smooth functioning of the single market of the European Union and of EMU.

This holds in particular for legislative dossiers on which you decide, together with the Council, and to which the ECB has contributed. I feel reassured when I see the numerous occasions when you have used your powers to bring Europe forward rather than settling for the lowest common denominator. I am confident that this will continue.

The latest example is of course the economic governance package. Long before the crisis, our two institutions had sent similar messages to governments, in our own ways and through different fora.

In November 2003, three weeks into my mandate, the ECB lambasted the fateful decision of the Council that effectively watered down the Stability and Growth Pact. Let me quote what I said eight years ago during my first regular hearing before your Committee: *"The failure to respect the rules and procedures foreseen in the Stability and Growth Pact risks, in our view, undermining the credibility of the institutional framework and confidence in the sustainability of public finances across the euro area."*

In 2005, six years ago, in the name of the Governing Council I both expressed our "grave concerns" as regards the conclusion of the negotiations on the new text of the Stability and Growth Pact, and I raised alarm bells as regards the evolution of the competitive indicators of the various countries member of the Euro area.

Well before some sovereigns run into trouble in 2008, the Parliament also *"requested that Member States in the euro area strengthen the effective coordination of economic and financial policy"*[1].

When the time came to transform these messages into ambitious legislation, the Parliament immediately seized the opportunity. You were fully supported by the ECB.

A second telling example of the fruitful interaction of our institutions is the new architecture of financial supervision. Throughout the 2000s, the Parliament regularly called for the reinforcement of a true level playing field at the European level, while pointing out significant failures in the supervision of ever more integrated financial markets.[2] When the Commission put forward the financial supervisory package, the Parliament did its utmost to strengthen the powers of the new supervisory authorities. Here again, you could also count on the support of the ECB.

4) Visions for Europe from 2011

Honourable Members,

In the middle of the deepest financial crisis since World War II, it is important to remind ourselves that Europeans can take pride in what our continent has achieved over the last 66 years. The unprecedented level of prosperity, peace and stability that the European Union and the Economic and Monetary Union have provided for their citizens is something we need to cherish.

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1 European Parliament resolution of 18 November 2008 on the EMU@10: The first ten years of Economic and Monetary Union and future challenges (2008/2156(INI)).

2 See e.g. García-Margallo y Marfil Report on the Commission communication on implementing the framework for financial markets: Action Plan (2000), Van den Burg Report on prudential supervision rules in the European Union (2002), Van den Burg Report on financial services policy (2005–2010) – White Paper (2007) and Van den Burg & Daianu Report with recommendations to the Commission on Lamfalussy follow-up: future structure of supervision (2008).

An important debate is underway on *how* to ensure that Europe continues to deliver well into the future. Important and much needed reforms have been adopted over the past few months. But this is not the end of the road. On the contrary: further steps must be taken on our way to an ever closer economic union. In the short to medium term, it is essential to implement and enhance the newly agreed legislation as far as possible. Here, this Parliament has a pivotal role.

On economic governance, there is no doubt that you will make extensive use of tools such as the "economic dialogue" to support economic integration with the required legitimacy. This will open up the process of fiscal and macroeconomic surveillance and, by enhancing transparency, it should encourage Member States to abide by the new rules as strictly as possible.

I am also confident that, both in the financial supervisory and governance package, you will seize the opportunity of the review clause to go one step further. In 2013 and 2014, you will have a *rendez-vous* with the Council to take stock and explore possible improvements. This will once again be an occasion to bring forward European integration in key policy areas.

You have always pushed the frontiers of what is impossible by putting forward new ideas which have eventually become political reality. As a citizen of Europe, I very much hope that the Parliament will maintain this track record.

When I received the Karlspreis a few months ago, I was reflecting on the future of the European Union and of the Economic and Monetary Union "tomorrow" and the "day after tomorrow". As a citizen of Europe I see the necessity of deepening the institutional framework of the European Union. In my personal view, Europe will need to make significant progress towards political unity with an executive branch and a Parliament, both with extended responsibilities as in any democracy. Part of this executive branch would be a European finance ministry which will be responsible, not necessarily for a large federal budget, but certainly for a strong economic and fiscal surveillance and governance, for the handling of the financial sector and for the external representation of the Economic and Monetary Union.

Such a strengthening of the EU executive will not be possible without one absolutely necessary condition: democratic legitimacy. This Parliament is the only institution that can ensure this for Europe as a whole. Collective responsibility for the destiny of EU and EMU and strong democratic control by the Parliament are two complementary and necessary dimensions. The future belongs largely to this Chamber; the future depends very much on this Chamber.

Mrs Chair, honourable members of the Economic and Monetary Affairs Committee of the European Parliament: let me convey to all of you my most sincere thanks for our very fruitful cooperation over the past eight years. I have very much enjoyed working with you in such a constructive spirit. I wish you, as well as my successor, Mario Draghi, the Executive Board and the Governing Council of the ECB great success with the challenges, as well as the opportunities, that lie ahead.

I can assure you that from its side, the ECB will continue to guard our currency, the euro, and deliver price stability to Europe's citizens.