FONDATION ROBERT SCHUMAN European Interview n° 31

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Exclusive Interview with Jean-Claude Trichet, President of the European Central Bank

1. The single currency, the euro, has just celebrated its tenth anniversary. How would you assess its first decade in existence?

Today 329 million Europeans across 16 countries share a single currency, which is in line with what had been promised by the founding fathers of Economic and Monetary Union (EMU): a currency that retains its value, inspires confidence and enjoys the same level of stability and credibility as the most successful of the currencies that it replaced. Ten years ago many people believed that this promise could not be fulfilled and that the single currency was bound to fail.

Since the introduction of the euro on 1 January 1999, European citizens have enjoyed a level of price stability which had been achieved in only a few countries. This price stability directly benefits all European citizens, as it protects income and savings and helps to reduce borrowing costs, thereby promoting investment, job creation and lasting prosperity. The euro has been a factor in the dynamism of the European economy. It has enhanced price transparency, it has increased trade, and it has promoted economic and financial integration, not only within the euro area, but also globally.

In recent months we have seen another benefit of the euro: the financial crisis has already demonstrated that, in turbulent financial waters, it is better to be on a large, solid and steady ship than on a small vessel. Would Europe have been able to act as swiftly, decisively and coherently if we had not had the single currency uniting us? Would we have been able to protect many separate national currencies from the fallout of the financial crisis? European authorities, parliaments, governments and central banks have shown that Europe is capable of taking decisions, even in the most difficult circumstances.

The euro has been advantageous for those countries which have chosen to adopt it. Nevertheless, this is no time for complacency. The current challenges are pressing and new challenges and shocks will arise. The continued success of EMU and the benefits of the euro achieved so far need to be enhanced and consolidated. Euro area citizens can rely on the Eurosystem, which comprises the ECB and the 16 national central banks of the euro area,[1] to do whatever is necessary to guarantee monetary and financial stability.

2. It is often said that the euro triggered a rise in prices. Is this assertion justified? What have been the consequences of the introduction of the single currency on European citizens' purchasing power? Have workers benefited from the euro or not?

The first ten years of the euro have, overall, brought low levels of inflation in the euro area, lower than the previous levels in the individual countries. Over the past ten years we have managed to keep inflation stable in the euro area, with the average annual inflation rate in the vicinity of 2%. This is a good result, taking into account the sharp rise in raw material and energy prices recorded over this period, and this figure is significantly lower than the average inflation rate in the decade preceding the introduction of the euro.

However, it is true that a few sectors in some European countries tried to take advantage of the euro cash changeover on 1 January 2002 to increase certain prices. According to a Eurostat assessment, the euro changeover effects may have led to an average rise in the Harmonised Index of Consumer Prices of between 0.1% and 0.3% between December 2001 and January 2002. As this was a one-off phenomenon, it appears negligible when looking at the ten years of the euro.

With the benefit of hindsight, it has become clear that the Governing Council of the ECB, which comprises the members of the ECB's Executive Board and the governors of the national central banks of the euro area, took the correct decisions in order to guarantee price stability in the euro area in line with our mandate and as required by the Treaty establishing the European Community. Let me also point out that we will have very low levels of inflation for some months in the course of 2009 as a result of the fall in oil prices. This will have a positive impact on the purchasing power of our fellow euro area citizens.

Finally, I would also like to stress that the euro has not hindered job creation, as we sometimes hear and read. On the contrary, during the first ten years of the euro the number of people in work increased by approximately 16 million, significantly more than in the United States during the same period. And many more jobs have been created in the euro area in the last ten years than were created in the decade preceding the introduction of the euro.

[1] Nationale Bank van België/Banque Nationale de Belgique, Deutsche Bundesbank, Central Bank and Financial Services Authority of Ireland, Bank of Greece, Banco de España, Banque de France, Banca d'Italia, Central Bank of Cyprus, Banque centrale du Luxembourg, Central Bank of Malta, De Nederlandsche Bank, Oesterreichische Nationalbank, Banco de Portugal, Banka Slovenije, Národná banka Slovenska, Suomen Pankki – Finlands Bank.

3. The world is currently experiencing a major financial crisis. According to the European Commission's most recent forecasts, euro area GDP could fall by 1.9% in 2009 and recovery will only be weak in 2010, and this despite revival plans and falling interest rates. In your opinion, what are the key elements for economic recovery in the Union?

Based on our most recent information, we continue to foresee persistent weakness in economic activity in the euro area over the coming quarters. According to the ECB staff macroeconomic projections published on 5 March 2009, annual real GDP growth in the euro area is projected to be between -3.2% and -2.2% in 2009, and between -0.7% and +0.7% in 2010.

The world is undergoing an abrupt downturn, as the adverse impact of the financial turmoil on real economic activity has been aggravated by a strong contraction in international trade. In this context, the euro area is expected to face a protracted period of severe economic weakness: the contraction of external demand will adversely affect exports and investment, while the deterioration in labour market conditions and low confidence can be expected to dampen consumption. Taking into account these elements, the recovery in the course of 2010 will probably be moderate as the international environment gradually improves and financial market tensions fade.

I would like to stress that the current situation is particularly challenging, owing also to the exceptionally high degree of uncertainty. But, over time, I am convinced that the euro area shall reap the benefits of different factors. In particular, we should not forget the very substantial fall in commodity prices seen since the middle of 2008, which will continue to provide not inconsiderable support to real disposable income, and thus consumption, in the period ahead. Moreover, the significant policy measures that have been decided upon in recent months to deal with the financial turmoil should help to restore trust in the financial system and ease constraints on the supply of credit to companies and households.

Finally, improving confidence is a key ingredient in overcoming the present economic situation. Governments and central banks in the European Union are doing everything possible to preserve, enhance and strengthen confidence. As far as the ECB is concerned, our institution must, more than ever, be an anchor of stability and confidence.

4. What role can the ECB play in the battle against economic recession? Will it adopt a zero-rate policy? Is it conceivable that the prohibition on the ECB monetising Member State and company debt will be reversed, a way out which the Fed appears to be seriously considering? Failing that, what solutions do you recommend to enable, in the future, Member State debt to be reduced, a satisfactory level of bank capital to be restored and companies to have access to financing? To avoid just substituting private debt with public debt, can we consider converting part of struggling banks' debt into equity capital as some economists have suggested?

Since the outbreak of the financial turbulence in August 2007, the Governing Council of the ECB has taken unprecedented action in a timely and decisive manner. A significant number of exceptional measures aimed at supporting the functioning of the euro area money market have been implemented. We have engaged in the unlimited provision of liquidity with maturities from one week to six months. We have reduced our key ECB interest rates by 275 basis points since October 2008. In terms of their nature, magnitude and timing, these steps were unique in the ECB's ten-year history. Let me stress that the ECB's unprecedented monetary policy decisions remained fully in line with our mandate to maintain price stability, i.e. to keep inflation rates below, but close to, 2% over the medium term. With regard to a zero interest rate policy, and as I have said when I have reported on the Governing Council's deliberations, we feel that there are a number of disadvantages associated with zero rates.

Going forward, I want to stress again that the Governing Council of the ECB will take the measures necessary to remain true to its mandate in the present very demanding environment. We are committed to continuing to keep inflation expectations firmly anchored in line with our medium-term definition of price stability, which supports sustainable growth and employment and contributes to financial stability. European citizens can be assured that the ECB has the capacity and willingness to do what is necessary to deliver price stability and maintain confidence.

5. What are your views on the financial crisis in central Europe? What can be done to help these countries through this difficult period?

As regards central and eastern Europe, we are following the situation very closely. We have already taken a number of decisions, in particular repo agreements with a number of central banks in the region. I also welcome the initiatives taken by other international and European organisations in the light of the difficult economic and financial situation in central and eastern European countries. Going forward, the ECB will continue to monitor the situation in the region very closely.

6. Some concerns have been expressed about the solidity of the euro area, apparently weakened by the indebtedness of certain Member States. Is this true?

The euro area is extremely solid. And my response to questions of the type "What would happen if…?" is that I never comment on absurd hypotheses. I have confidence that the Member States will face up to their responsibilities, including with regard to fiscal policy.

Let me reiterate some facts and figures. In response to the financial crisis, governments have committed some 3.5% of euro area GDP to capital injections and other government debt-increasing support measures for the financial sector, less than half of which has been used thus far. In addition, the announced ceiling for guarantees on bonds issued by banks or loans between financial institutions corresponds to approximately 20% of GDP, some 8% of which has been used. At its meeting on 11 and 12 December 2008 the European Council approved the European Economic Recovery Plan. According to this plan, the Member States will contribute €170 billion (1.2% of GDP) to a total EU fiscal stimulus of €200 billion (1.5% of GDP), the remainder coming from the EU budget and the European Investment Bank. This coordinated effort is intended to support economic recovery by strengthening aggregate demand and increasing efforts to implement the structural reforms envisaged in the Lisbon strategy. At the same time, the European Council reaffirmed its full commitment to the implementation of the Stability and Growth Pact and to sustainable public finances in the medium term.

As has been stressed by the European Commission and by the ECB, stimulus measures need to be timely, targeted and temporary in order to be effective. While some stimulus measures expire automatically, the reversibility of many others is not guaranteed and may prove to be very difficult.

In this context, a credible commitment to a path of consolidation is necessary in order to maintain the public's trust in the sustainability of public finances, which is important for the economy to recover and for supporting medium and long-term growth.

7. Others have called for an improvement in the economic governance of the euro area. What do you think about this debate? If any, what would be the steps towards an amelioration of European economic governance?

The ongoing financial crisis has once again underlined the importance of sound economic governance at the national, European and global level. On the one hand, monetary policy in the euro area is defined by the Governing Council of the ECB and implemented by the Eurosystem central banks, fully respecting the principle of independence enshrined in both the Treaty establishing the European Community and the Statute of the European System of Central Banks. Economic policies, on the other hand, fall under the remit of Member States. These national policies are embedded within a European framework which takes into account the increased economic and financial interdependencies within the Single Market and EMU, notably through the Stability and Growth Pact (for fiscal policy) and the Lisbon strategy (for structural policy).

As regards economic policies, the first ten years of EMU demonstrate that the agreed European framework lays down the founding principles of sound macroeconomic management and requires political commitment, in particular as far as fiscal and structural policies are concerned.

The Stability and Growth Pact stipulates that the Member States should set their fiscal house in order during "good times". Those countries that have failed to do so over the past few years are now particularly limited in their room for manoeuvre in terms of fiscal policy when dealing with current economic developments. Even during exceptional times such as the current crisis, the need for sound and sustainable fiscal policies in the medium term should not be forgotten. It is therefore essential at this time to define a strategy to return to safe medium-term budgetary positions in order to avoid undermining public confidence in the sustainability of public finances.

Current economic developments also underline the need to strengthen the growth potential, resilience and adjustment capacities of European economies. The Lisbon strategy called upon the Member States to undertake the necessary structural reforms. Also in this regard, the ECB strongly supports the steps taken over the past few years and encourages executive branches to accelerate the path to reform. The financial crisis has strengthened the case for Europe's reform agenda.

As regards fiscal policies, structural reform policies, and also the monitoring of developments in competitive indicators, including unit labour costs, "peer surveillance" by governments is of the essence. The ECB strongly supports all efforts to improve the effectiveness and efficiency of this peer surveillance, which is decisive for the stability and prosperity of the euro area.

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