COMMITTEE ON ECONOMIC AND MONETARY AFFAIRS
MONETARY DIALOGUE WITH JEAN-CLAUDE TRICHET, PRESIDENT OF THE ECB
(pursuant to Article 113(3) of the EC Treaty)
BRUSSELS, TUESDAY, 10 OCTOBER 2006

2-002

IN THE CHAIR : MRS PERVENCHE BERÈS

(The meeting was opened at 5.15 p.m.)

2-002-500

Chairman. – Ladies and gentlemen, we shall proceed with our third monetary dialogue with the European Central Bank and an exchange of views with its President, Mr Jean-Claude Trichet, whom I welcome most warmly to this Committee.

We have just voted for the 2005 Annual Report on the work of the European Central Bank and we shall meet again for the debate in plenary on this report on 26 November, which will give you a further opportunity for discussion with us during this quarter.

Mr Trichet, as usual, I shall first of all give you the floor concerning the two points which the members of this Committee felt should be included in your introductory remarks. We asked you to examine the diverging tendencies in terms of competitiveness within the euro area and the question of hedge funds linked to financial stability. I believe you would prefer to keep this second point for questions, but to do otherwise would be perfectly in keeping with the expectations of the members of this Committee.

2-003

Jean-Claude Trichet, *ECB***. –** *(FR)* Madam Chairman, ladies and gentlemen, I am delighted to appear before the members of the Committee on Economic and Monetary Affairs today and to continue our regular dialogue. These quarterly meetings are very important for the European Central Bank, as you know, and I shall begin, as usual, with an assessment of the economic and monetary situation.

2-004

(DE) I should like to go on to devote particular attention to the need for comprehensive structural reforms in the euro area. I should also like to go into more detail on divergent developments in the competitiveness of individual euro area Member States in terms of prices and costs.

2-005

I shall begin with economic and monetary issues. On the occasion of my previous appearance before the European Parliament in June, I described how the new data at that time confirmed our assessment that economic growth in the euro area was broadening and becoming more sustained. In addition, the cross-checking of our economic and monetary analyses underlined the prevalence of upside risks to price stability over the medium to longer term. In order to contain upside risks to price stability and preserve the firm anchoring of inflation expectations, the Governing Council of the ECB has continued to progressively withdraw monetary accommodation, increasing key ECB interest rates by 25 basis points on 3 August and again earlier this month. Let me explain in more detail the assessment underlying these decisions and the outlook for the economy and risks to price stability.

Starting with the economic analysis, all the main indicators of economic activity that have become available over the past few months confirm that the economic recovery has become more broadly based and is mainly supported by domestic demand. All in all, the recovery appears to be somewhat stronger than on the basis of earlier data. Notably, the strong data on real GDP growth in the euro area has confirmed that a significant acceleration in economic expansion has taken place over the past few quarters. The incoming information on activity in the third quarter further supports the assessment that economic activity will continue to grow robustly, while possibly moderating somewhat.

Looking ahead to the remainder of 2006 and 2007, the conditions remain in place for the euro area economy to grow at solid rates around potential, with some volatility in the quarterly growth rates likely to emerge around the turn of the year.

In the view of the Governing Council, risks to the outlook for economic growth are broadly balanced over the shorter term, although the recent fall in oil prices – if it were to prove lasting – has the potential to lead to somewhat stronger demand and output growth than embodied in the Governing Council's baseline scenario for activity in the coming quarters. Over the longer term, risks to growth lie on balance on the downside, and relate mainly to the possibility of renewed oil price increases, further protectionist pressures and disorderly developments owing to global imbalances.

Turning to price developments, annual HICP inflation rates have declined somewhat over the last few months, standing at below 2% in September and mainly reflecting favourable base effects combined with the recent significant fall in oil prices. However, although the outlook for energy prices is uncertain, also taking into account current energy prices and the higher quotations on futures markets, headline inflation rates are likely to increase again towards the end of the year and in early 2007.

In the view of the Governing Council, risks to the outlook for price developments remain clearly on the upside. They include a stronger pass-through of past oil price rises into consumer prices than currently anticipated, additional increases in administered prices and indirect taxes beyond those announced thus far, and the possibility of renewed increases in oil prices. More fundamentally, given the favourable momentum of real GDP growth observed over the past few quarters and the positive signs from labour markets, stronger than currently expected wage developments pose substantial upward risks to price stability. Against this background, it is crucial that the social partners continue to meet their responsibilities, in particular in the context of a more favourable environment for economic activity and employment.

As regards medium to longer term prospects for price developments, the monetary analysis continues to point to upside risks to price stability. The rate of monetary and credit expansion remains rapid, reflecting the still low level of interest rates in the euro area. In particular, loans to the private sector continue to grow at double-digit rates on an annual basis. Given the implied upside risks to price stability over the medium to longer term, monetary developments require careful monitoring, particularly against the background of improved economic conditions and strong property market developments in many parts of the euro area.

To sum up, annual HICP inflation rates are projected to remain elevated in 2006 and 2007, with risks to this outlook remaining clearly on the upside. Given the ongoing dynamism of monetary and credit growth in an environment of ample liquidity, cross-checking our monetary and economic analyses supports the assessment that upside risks to price stability prevail over the medium term.

It is against this background that the Governing Council of the ECB decided to further raise key ECB interest rates in two quarter-percentage increments on 3 August and 5 October to establish the minimum bid rate of the main refinancing operations of the Eurosystem at 3.25%. These actions have helped to keep inflation expectations solidly anchored at levels consistent with price stability. Such anchoring is a prerequisite for monetary policy to make an ongoing contribution towards supporting sustainable economic growth and job creation in the euro area. Notwithstanding recent increases in key ECB interest rates, our monetary policy in the euro area remains accommodative. If the Governing Council's assumptions and baseline scenario are confirmed, it will remain warranted to further withdraw monetary accommodation. The Governing Council will therefore continue to monitor very closely all developments so as to ensure price stability over the medium and longer term.

Fiscal consolidation – which is absolutely of the essence in the euro area – is likely to be most successful when coupled with comprehensive structural reforms. These are urgently needed not only to cope with the challenges posed by technological change and accelerating globalisation, but in particular also to help to cushion the adverse economic effects of the projected demographic change in the euro area.

For Europe's future in the face of these challenges, and for the prosperity of its citizens, it is essential to ensure that a fully operational internal market is up and running. This necessitates the fully free flow of labour and capital and free trade in goods and services. It also calls for continuing to fully implement the single market and removing the remaining barriers to it within the EU; this will provide a powerful means to promoting the efficient allocation of factors of production as well as deeper economic and financial integration. It will also allow Europe to better realise its potential for stronger output and employment growth and increase its resilience to shocks.

For those Member States that have fulfilled the convergence criteria laid down by the Treaty and participate in the euro area, the considerable benefits of the internal market are further enhanced by the single currency. I welcome the enlargement of the euro area on 1 January 2007 with the entry of Slovenia. In order to fully reap the advantages of the euro and to allow adjustment mechanisms to operate efficiently within the enlarged currency area, it will be necessary to fully integrate Slovenia into Economic and Monetary Union, including the free circulation of labour inside the euro area.

I shall now move on to the issue of diverging competitiveness developments in the euro area. While pursuing the aforementioned structural reforms is essential to maintain the competitiveness of the euro area as a whole and to translate the opportunities brought about by globalisation into achievements, there is also a need to address deviating trends in competitiveness within the euro area.

Competitiveness is commonly understood as the ability of a country to compete in international markets. This ability is usually assessed on the basis of various measures of cost and price competitiveness and complemented by accounting for 'non-price' factors, such as the quality and the technology content of the goods produced, the ability to diversify and

innovate quickly, the reliability of the servicing network, and a number of other points that are not price factors. Ideally, one should look at all these measures to fully understand the direction in which a country is moving. However, I will limit my considerations to relative developments in cost and price developments across euro area countries.

The analysis of cost and price competitiveness across a wide range of indicators suggests that euro area countries have experienced rather diverse competitiveness trends since the start of the EMU.

Persistent losses in cost and price competitiveness – if those are not offset by corresponding improvements in non-price competitiveness – are sooner or later paid in terms of output losses, rising unemployment and increasing current account deficits. These losses in competitiveness mainly originate from a lack of flexibility in labour and product markets and in our view reflect the need to improve the adjustment capacity of the economies concerned. Indeed, structural rigidities – and in particular distortions in the wage and price formation mechanism – hinder a proper working of the competitiveness adjustment mechanism across the euro area countries.

Let me stress this point further. By looking behind unit labour costs developments in the countries where they have been rising persistently, it appears that these losses mainly reflect a slowdown in labour productivity growth and a failure to keep wage growth in line with productivity developments. Clearly, this suggests that the process of wage determination in some euro area countries should allow for sufficient differentiation in order to give greater regard to the situation in individual firms, industries, sectors or regions and take account of the various labour market conditions. In other words, when deciding on how to compensate productive factors, and in particular employees, the social partners involved need to take into account the efficiency in producing output and also they need to internalise the repercussions of wage settlements on the competitiveness of the firm, industry, sector or region. Indeed, experience shows that in countries where social partners have taken into account the implications of their wage settlement decisions on competitiveness, the European and global market shares of their exports have been more resilient and job creation more dynamic.

This is why structural reforms are crucial in the areas of tax and benefit systems, wage-setting mechanisms, including wage indexation, and labour legislation. In general, policies to foster a sufficient degree of competition in the labour, goods, services and capital markets, to create a business-friendly environment for investment and innovation and a high degree of wage and price flexibility need to be given priority in the agenda of national policy-makers. These reforms would help to encourage better allocation of resources, improving the efficiency of investment decisions as well as increasing productivity and real GDP growth.

Let me stress, in conclusion, that the European Central Bank backs the drive towards reforms that is in motion in Europe. The European Central Bank backs the governments of Europe that are embarking courageously on those structural reforms. We do not underestimate the difficulties of the task and the necessity to explain tirelessly that the people of Europe will be better off – including in terms of growth and job creation – thanks to these reforms.

Thank you for your attention.

2-006
Chairman. – As is customary, I should like to proceed to the first round of questions. I give the floor first to the Group of the European People's Party (Christian Democrats) and European Democrats for three interventions, the first of which is that of Mr Radwan.

2-007
Alexander Radwan (PPE-DE). – *(DE)* Madam Chairman, we are pleased to see the President of the ECB back in the European Parliament, and indeed the first comment I should like to make goes back to discussions relating to this that have been taking place over the last week. We discussed SWIFT with the President, and clearing and settlement with his colleague. I should have liked to see things happening the other way round, with the ECB taking the initiative on SWIFT instead of tackling clearing and settlement with such vigour.

We have, of course, just voted on a report on the ECB by the Committee Chairman. Although the Group of the European People's Party (Christian Democrats) and European Democrats is the group campaigning vigorously for the independence of the European Central Bank, particularly with regard to monetary policy, we do hope that our definition of its self-determination and independence is not overstretched. In our view, the ECB is currently taking too vigorous an approach. Groups that do not otherwise support the autonomy of the ECB as we do see things differently, and welcome the fact that the European Central Bank is now pressing ahead with this.

I would be pleased if outstanding issues, for example that of the supervisory rules and that of the legal framework, were resolved more quickly and the European Parliament did not need to learn about it via the press. We have already said this to Mrs Tumpel-Gugerell, and we shall say it again. I shall not allow myself to be annoyed by the market's attitude to this, either; those market operators currently enthusing about this questionnaire were the first to level severe criticism at the cooperation between the ECB and CESR a few years ago.

The ECB President before last, Mr Lamfalussy, visited this House some time ago and said that it is actually very difficult to impose an appropriate system or control on the statistics – Greece and Hungary spring to mind. As we know, Hungary's state that it is in deficit, and Greece suddenly has a 25% growth rate. I should be interested to hear the President's views on the data situation and data control, and in particular on transatlantic relations from the point of view of the USA's failure up to now to accept Basel II.

2-008
Jean-Claude Trichet, *ECB***. –** There is a large number of issues at stake. Firstly, as regards the transatlantic relationship, one of the main issues, as you very wisely said, is the implementation of Basel II. Monitoring of the banking industry in the United States is quite complex because there are three entities with various responsibilities. One of these is the Federal Reserve, which is our sister institution.

At this stage I would remain very cautious because there is ongoing domestic discussion in the United States. I can only say that my understanding is that the Federal Reserve Board is very much in line with our own understanding of this global consensus on Basel II that has been worked out. I am hopeful that they will convince the United States that it is appropriate to follow that course, possibly with delays in some areas, but not deviating from the overall concept that has been agreed upon by the Basel Committee. Again I remain cautious, because it is for United States to devise its final position within its very complex framework. But I would remain reasonably optimistic.

I do not know whether you want to address a number of other points that are associated with this question of how to assess and help financial stability. I can only mention, and these are interconnected issues, that we have backed the Commission initiative to launch a code of conduct in the area of clearing and settlement. We are of the opinion that the work we have been doing with the ESCB CESR standards should now be worked out because the Commission has said that it will not embark on a directive and that it prefers a code of conduct. I see a complementarity between the code of conduct of the Commission and the work that you know pretty well, because we had a number of opportunities to explain what we were doing. We really trust that we must be sufficiently cautious in this respect.

2-009
Gay Mitchell (PPE-DE). – I have asked the President of the Central Bank in the past about asset inflation in certain Member States and his concerns about that. Low interest rates have fuelled this, and in Ireland – the country I know best – we now have mortgage companies and banks offering 40-year interest, 40-year mortgages, interest-only loans and all sorts of things. The result has been huge asset inflation. Do you remain concerned about this, Mr Trichet? Has the European Central Bank taken steps to talk to the Member State central banks about this issue? What impact can this have on the eurozone in the medium term?

2-010
Jean-Claude Trichet, *ECB***. –** I think it is a very important question. I would like to mention two or three things.

Firstly, we are monitoring this situation very closely. We have mentioned this buoyant activity and, at the level of the EU area as a whole, including the counterpart of M3, which is the outstanding lending for house purchases, to give you the most recent figure, we had a rate of growth of 11.1% for lending for house purchases. This is a very dynamic rate of growth, taking into account the fact that Germany is not included because it has its own real estate cycle and is therefore not part of this buoyant activity. So, leaving Germany aside, there is on average very buoyant activity in the rest of Europe.

Within our two pillars we have looked permanently at monetary developments. I can mention that M3 in August had a growth rate of 8.2%, which was over and above the rate of growth that we had in July, which was 7.8%. So after two months of relative drops in the rate of growth of M3, we are seeing a pick-up. Of course the lending for house purchases is part of this explanation, as a counterpart. Our monetary policy decisions take into account all the pertinent information that we have, and this is part of the pertinent information that we take into account when we make our decision. Of course, a number of other actions, signals or messages can be conveyed at national level, and I know that it is the case in your own countries through the national central banks in particular, and the surveillance authorities. But again, at our level it is something that we look at very carefully and which has been taken into account in our decisions over the last month.

2-011
Karsten Friedrich Hoppenstedt (PPE-DE). – *(DE)* Madam Chairman, I did have a question about Europe, but I should like to put it to one side for a moment. As we know, the IMF has recently held its meetings in Singapore. The USA has proposed increasing the percentage of voting rights held by newly industrialised countries such as China at the expense of European participants. Does the President see a possible connection in the valuation here, namely that those with the highest external deficits are proposing those with the largest foreign-reserve assets?

I should like to expand on the question. In this connection, as we know, a key issue at the moment is the EU anti-dumping measures in the footwear industry. The argument is that China's taxes on shoes – we are talking about approximately 120 million pairs here – are too low and its currency is undervalued, and this is supporting exports. Can you see that this is a self-defeating argument?

We have always said that, if China wants to revalue its currency – make an adjustment – it should do so in a restrained manner and in very small steps. Does the President believe that the measures against China represent a wrong turn, particularly from a European point of view? What will be their effect on market operation?

2-012
Jean-Claude Trichet, *ECB***. –** There are two questions, one on the exchange rate of the Chinese currency and the other on the ongoing process of reform of the IMF and the international financial institutions.

Taking your second question first, for a number of years we have mentioned in successive G7 communiqués – and I would of course stick to the G7 position – an orderly and smooth progressive appreciation of currencies, not only in China alone but in emerging Asia in general. This would be in line with the interests of the countries and economies concerned and in line with a global interest. So I stick to what I have been a signatory to over three years.

On the other hand, these issues are extremely delicate. When you speak of exchange rates, you are necessarily speaking of market interest and market developments. I would say that we will certainly remain, as was the case after the last international meetings, relatively cautious in the matter, but there is no doubt that it would be in the interests of all parties concerned. It seems to me that it is well understood by all parties concerned.

As regards the rebalancing or reviewing of the IMF positions of various countries, as you know in Singapore it has been decided to increase in an ad hoc operation the position of a number of economies. They had been identified by the managing director as being clearly under-assessed in their own position vis-à-vis the IMF, and as you know there has been an overwhelming majority to follow on. So I would separate that from other considerations. I would say that it was a first step which had been considered by the international community as a whole – because it was an overwhelming majority – as an appropriate way of better representing the small number of countries concerned, including the country you have mentioned.

2-013
Ieke van den Burg (PSE). – I would like to concentrate on three issues on which I would like you to provide us with more precise analysis and data. Two are directly linked to the arguments that you put forward for having this increase in interest rates. One is wage developments. I am a little surprised that the developments are stronger than you expected because, from the figures I have seen, they remain relatively flat compared to what could be expected in a situation of higher employment figures.

The second element is M3. You have already mentioned the part played in the M3 increase, which I agree is increasing very steeply as a result of loans in the mortgage sector. But what part do private equity buy-outs and loans on companies also in mergers and acquisitions play in this M3 figure? Because we are seeing a big increase there as well. I hope that you will be able to provide more precise figures about where these M3 increases are coming from.

The third element is more linked with the risks that exist. You have noted the SEC, FSA and New York Fed initiative on credit derivatives and the lack of information on data, particularly for the unconfirmed trades and their volume, which may pose systemic risks. Is the ECB also participating in this and do you also have tools to provide more information on this?

2-014
Jean-Claude Trichet, *ECB***. –** As regards the risk to price stability, I have mentioned in the economic analysis that these were upside risks. I am speaking of risks, not of materialisation of risks, which would be too late in our own understanding. But I have mentioned the stronger pass-through of past oil prices and commodity prices, because there is a lot of past augmentation in the pipeline which has not necessarily been totally reflected in consumer prices. Of course that would be a stronger pass-through than previously anticipated and that would be the risk.

I would also say that we always have higher administered price increases and indirect taxes than previously expected. Past experience has shown that this was a risk which materialised regularly. We will see what happens, but this is a risk. I would also mention the fact that fortunately we are in an environment in which we have higher growth and more dynamic job creation. That of course creates additional elements which could result in wage and salary increases and unit labour cost increases which would be higher than expected at present. I do not think this is very original. We are making exactly the same analysis as the analysis made by economists and observers in general. So I mention all those risks again. We considered that if we were already seeing the materialisation of the risks, and particularly of the last one, it would be too late and we would of course have enormous difficulties in regaining the capacity to continue anchoring inflationary expectations solidly.

As regards the monetary analysis, we do not only have the loans for house purchases that I already mentioned. Just to complement your information, the loans to the non-financial corporate are going at a pace of 12%. The rate of growth plus inflation are only a small fraction of 12%.

There is something which has to be noted there, and this is good in some respects, namely that investment is now clearly more dynamic. To give you an illustration, over the last four quarters, the rate of growth has been at around 2.6% in the euro area. Out of this 2.6%, the contribution of investment is around 0.9%. So it is quite a substantial contribution to growth in the present situation. This is of course positive. We have also a lot of credit that goes to finance mergers and acquisitions and that is something which also contributes to this 12% dynamism. So, in general, I would say that the whole set of outstanding growth in credit in general is growing very rapidly.

With regard to the last point, I would only mention that it is understandable that a lot of work has been done in New York and in London because the bulk of the derivatives markets are there. But it is part of a global effort to analyse the situation and, when the time comes, take appropriate positions and decisions, again at a global level because there is no solution which would not be at a global level in such matters.

2-015
Robert Goebbels (PSE). – *(FR)* Madam Chairman, Mr Trichet, it is the external shock caused by the increase in energy prices that is mainly responsible for a rise in inflation in Europe and elsewhere. You have reacted by increasing interest rates while at the same time arguing, each time you come before this Committee, in favour of wage restraint.

At present, inflation is somewhat lower, growth is rather satisfactory and businesses are raking in record profits. Still, you come here and tell us that the social partners – that is, in fact, the employees, must practise wage restraint. Is this the way that the ECB sees the world, that there is an opportune moment when employees can aspire to greater purchasing power?

2-016
Jean-Claude Trichet, *ECB***.** – *(FR)* Mr Goebbels, firstly, I should like to say that, in our opinion, what counts are the unit production costs, that is, costs calculated after taking into account nominal wage and salary increases and improvements in productivity. If improvements in productivity are very rapid, as has been the case and is the case in certain countries in the world and in Europe, one can then have the same increase in unit production costs with nominal increases that are higher.

As you know, one of the problems of the euro area is that until now – and some statistics apparently show that there have been signs of recovery at the beginning of this year – and for a long period over the last ten years, it has seen an average level of improvement in productivity that was lower than the average level of improvement in the productivity of the most advanced industrialised countries, one of which is the United States, but also certain Scandinavian countries. It is not, therefore, a privilege reserved for the Americans. It is a privilege reserved for those countries which, in fact, are more eager, for very complex reasons, apparently, to take advantage of new technologies and new processes of production and globalisation.

Second observation: as long as there is an environment marked by high unemployment – and we are still in an environment where unemployment is high in comparison with the best industrialised countries - it is clear that a more rapid or too rapid increase in wages can only prolong the existence of an abnormal level of mass unemployment. These two considerations must always be present. These are economic considerations.

So, if wages increase more rapidly than we ourselves want, what happens? There is more inflation, purchasing power is eroded by inflation, fundamental disequilibria set in and that is the reason why we call for good sense, in the conditions that I have outlined and taking account of productivity.

2-017
Robert Goebbels (PSE). – *(FR)* Mr Trichet, would these appeals by the ECB for wage restraint not be more convincing if sometimes you also addressed the people in charge of businesses, the upper management, who continue to pay themselves sometimes astronomical salaries, bonuses, stock options and all the rest? As a matter of fact, the wages of employees are not allowed to be index-linked, while company directors continue to index their own incomes according to the market capitalisation of their company.

2-018
Jean-Claude Trichet, *ECB***.** – *(FR)* As far as the employees of a company as a whole are concerned, we make no distinction between them and we appeal to everybody for good sense, without discrimination, even the directors.

2-019
Chairman. – Even the holders of stocks options! We come now to the question from the Group of the Alliance of Liberals and Democrats for Europe, Mr Klinz, then it will be the turn of the Group of the Greens/ European Free Alliance.

2-020
Wolf Klinz (ALDE). – *(DE)* Madam Chairman, Mr President of the ECB, looking at EMU, we can see that the monetary aspect has been functioning much better in recent years than many had expected. The economic aspect is a different story, however. In principle, the coordination and harmonisation of the economic policies of the individual Member States has been failing for years to make any real progress, and that, in particular, has of course led to the Member States growing apart rather than together in terms of their competitiveness.

Two years ago, Mr Juncker was appointed President of the Eurogroup, with the aim of improving the process of coordinating economic policies. In fact, no great progress has been made. I should be interested to hear what ideas the President has to help the progress of the economic aspect on this equal to that of the monetary aspect?

My second question is as follows. The European Central Bank was one of the first of the large institutions to point out, as it did this summer, that hedge funds represent at least a potential risk to the stability of the capital markets, because they do now carry considerable weight in individual segments. It is clear that any kind of regulation or supervision can only have a hope of success if it is carried out globally, which means not just in the EU, but also in close coordination with the United States and the large, important Asian countries. In this regard, I should also be interested to hear whether the President considers this simply unworkable and will therefore shelve it, or whether he has any ideas on how we can actually make some progress?

2-021

Jean-Claude Trichet, *ECB***. –** On the first point, when I look at the diversity of unit labour cost developments or diversity of inflationary developments country by country in the euro area, I have already told you on previous occasions that when we take a snapshot of the situation, we do not see a significant difference with the United States of America. The standard deviation of unit labour cost developments state by state in the US – or at the level of statistical areas – and the standard deviation of inflation are at the same order of magnitude. Therefore it seems that the diversity we are observing is a characteristic of a vast continental economy.

We are a vast continental economy of 313 million people. What characterises the euro area is the persistence of this differential. We consider it important to think about the medium- and long-term persistence of differentials in terms of cost competitiveness, for instance.

When we make our calculations at the end of this year, we will see that one country in the euro area has had unit labour costs moving extraordinary slowly. That country is Germany. Germany had to catch up. It had a level of competitiveness which was not satisfactory at all at the beginning of the euro. So, year after year after year, there has been a catching-up process. That is normal. Those differences are normal because there was a good reason to catch up. Some went in the other direction and one can consider that perhaps it was also economically justified. However, there are other economies that might observe cost competitiveness that is deteriorating year after year, because unit labour costs would go over and above the average year after year. If we are in the case where one particular economy is, first, displaying large current account deficits; second, sees that it has accumulated since the beginning of the euro a large gap in terms of competitiveness vis-à-vis the average of the euro area; and third, continues to deteriorate its own position, then there is a case for changing that situation. For those economies in particular, of course, Mr Goebbels, our recommendations are *very* strong, because it is extremely important for those economies in particular to have a good handling of the unit labour costs. This is considered within the euro group framework, and this is an avenue that is certainly important.

As regards hedge funds, you are absolutely right to mention the fact that in our last publication on financial stability, we insisted particularly on the hedge funds risk. We had a full box on the hedge fund risk, and I would say that recent events have showed that the risks were for real. I have to say that they also showed that the resilience of the market has been strong, because it has been absorbed by the market quite rapidly. However, this is no time for complacency in any respect. We have to understand much better the interaction between this immense outstanding of all kinds of derivatives, in particular of credit derivatives. The hedge funds industry is exploding and we have to draw the appropriate consequences as to whether we can be satisfied with the present system, which is an indirect monitoring of the hedge funds through their own counterparts, supervised by us, or whether we should go further, as some are suggesting. I am inclined to think that provided we give a global solution, and that global solution understands the market, perhaps we should proceed.

2-022

Alain Lipietz (Verts/ALE). – *(FR)* Mr Trichet, you note in your report that the growth rate has stabilised at 0.7% per quarter, which one may consider as 'around potential'. Therefore you fix the potential European economic growth rate at some 2.8%.

My first question is as follows: in your opinion, is this rate sufficient, taking into account the adjustments that we have to make in our development model, for all the reasons that you have indicated? Do you not think that an increase in interest rates slows down investment and blocks increase in the potential growth rate?

My second question concerns hedge funds. We already control a whole range of funds, the links between master and feeder funds. We already have, therefore, some experience in managing this type of fund. Is there really any point in waiting for unity on a global scale to intervene in the regulation of these funds? Is not the critical size of the European Union sufficient to maintain, by means of example, a distinction between, for example, the use of these funds in investments and the safer use of these funds, for example, in the case of pensions?

2-023

Jean-Claude Trichet, *ECB***. –** *(FR)* In reply to your first question, Mr Lipietz, I will not give you the potential growth as the European Central Bank would sign it, because we are prudent. We look at the opinions of experts, of economists from international institutions and private economists. When, therefore, I summarise all that I read in the literature, the figure we would be given would be from 2 to 2.5 and, according to most analyses, closer to 2 than to 2.5. That is the level of potential growth, as is quite understandable. I have said to you that, over the last ten years, there have been labour productivity improvements that are less than half the labour productivity improvements of the United States. Since this is one of the essential elements of growth potential, one can well see how our potential growth may be more modest than we would wish and one can well see also why we consider it vital to make significant progress, particularly in the field of labour productivity growth.

The rate increases that we have set are aimed at preserving price stability, which is what the 313 million of our citizens in the euro area are demanding. All the surveys, all the opinion polls show that price stability is very important to them and indeed that is what the Treaty expects of us. It is, however, absolutely essential also to ensure price stability in the medium term and to remain credible, because that is what enables us, in all of our market interest rates in the medium and long term, to anticipate inflation in accordance with our definition of price stability, that is, less than 2 but close to 2.

If, at the time of speaking, we have long-term rates, at ten years, which, on the best European market signature, are at 3.80%, that is because, with this 3.80%, the markets as a whole are convinced that the European Central Bank will actually ensure, over the next ten years on average, price stability in keeping with our definition, that is less than 2, close to 2. One can see, therefore, that there is no contradiction in our remaining faithful to our mandate, price stability, and our creating conditions that foster growth and job creation. It is by remaining faithful to our mandate that we can create conditions for lasting growth and for the creation of lasting employment.

On the second point, I think one needs to have some idea of how these famous hedge funds are divided up globally. There are not very many in the euro area, and personally I regret this, while there are a lot outside of the euro area, especially in the United States and in England. One may indeed wonder what is needed at the level of the continental financial system and in Ireland for us to gain any real benefit from activity that is just as dynamic as it is elsewhere. That is one of the reasons why it is vital to have a global agreement, because it would hardly be useful, in my opinion, for one of the authorities to legislate without there having been consultation at global level. Furthermore, I believe that it is important to differentiate between pension funds, which are very important institutions, and the speculative funds, called hedge funds, which are of a different nature. The fact remains that your question is very important and that it must be carefully considered both at European and at global level.

2-024

Sahra Wagenknecht (GUE/NGL). – *(DE)* Madam Chairman, my first question relates to current trends in interest rates on the capital markets. Looking at long-term interest rates in particular, we have a strong feeling that these clearly do not share the European Central Bank's optimistic expectations where economic growth is concerned – or, consequently, its expectations as regards inflation. What I would like to ask is whether this gives the President of the ECB food for thought, or whether he is assuming that the operators in that field are simply acting on the basis of false expectations.

For my second question, I will return to a subject that has already been raised, namely wages. The President specified just now, in response to Mrs van den Burg's question, that he does not in fact see current wage developments as constituting an inflationary risk at all – although, I, too, do not know where he gets that from – but only the somewhat improved labour-market statistics. Is he really serious when he says that, in view of the mass unemployment still existing in Europe – which cannot be denied – any slight improvement in the labour-market statistics must be understood as an inflationary risk and consequently met with interest-rate increases?

My third question concerns asset inflation, to which reference has already been made in another question. After all, wages in Europe have basically been falling for 25 years, and it is well known that the ratio of savings to income from capital is of course significantly higher than the ratio of savings to wage income. Does the President not see a possible connection between this massive redistribution in favour of income from capital on the one hand, and asset inflation on the other? If that is the case, and if he continues to demand reforms favouring this very redistribution, would the problem of asset inflation not just become worse, with the internal market, on the other hand, increasingly at sixes and sevens?

2-025

Jean-Claude Trichet, *ECB***. –** On the first question on long-term rates, I am not sure I caught your remark exactly. We have low long-term rates. This is due in part to the fact that we are solidly anchoring inflationary expectations. I already said that. That of course is absolutely essential for, all things being equal, paving the way for sustainable growth and sustainable job creation. That, to my knowledge, is a good thing and you should be happy with that.

There is another element which is that real rates are low. But that is an element which is global. At a global level, real rates are low. There is a lot of discussion with a view to trying to better understand why we have this low level of real rates. Some are arguing, and they perhaps are partly right, that the addition of the savings that are accumulated by the Asian emerging countries plus the fact that we have the savings of the oil-exporting countries, is piling up a level of global

savings looking for investment. That might explain why we see this very low level of real rates and part of the asset inflation that you are mentioning at a global level. However, I do not see how we could criticise our own monetary policy on the basis of these observations.

As regards asset inflation, you know that the best way to foster asset inflation is of course to have very low rates. So when we are responsible and when we do what is necessary to deliver price stability and remain credible in the delivery of price stability over the medium to long term ,we do our job and we go in the direction that implicitly you are suggesting.

On wages, I am not saying that as I speak we have abnormal developments in the euro area as a whole, but we have abnormal developments in some economies that are part of the euro area, and they have to be aware of that. But at the level of the euro area as a whole, I mentioned a risk which fortunately has not materialised and which I hope will not materialise. You know the metaphor of the toothpaste: it is easy to get out, but it is very difficult to put it back in the tube. So again it is something which we have to avoid, because if we do not avoid it, it will be too late.

2-026

Eoin Ryan (UEN). – I have three questions for you, Mr Trichet. After your press conference on 5 October, the markets took a very positive interpretation of what you said. They felt that you would be looking at a ceiling of interest rates at 3.5%. Would you say that the markets misinterpreted your words or your body language on that, or would you agree with their positive interpretation of what you said?

My second question has been touched upon today. Your mandate involves price stability and keeping inflation low. In other parts of the world, for example in the US, they do more balancing when it comes to economic growth and keeping inflation low. How do you balance those two things? For example, in your predictions as to how Europe will grow and develop economically, have you taken into consideration the fact that there may be a slowdown in the US economy?

Thirdly, how do you see the difference between the previous phase of interest rate rises – when they reached 4.7% – and now? What is the background or the environment? How does it differ? For example, globalisation is keeping prices down to a certain extent now, and it probably was not then. What are the differences between then and now?

2-027

Jean-Claude Trichet, *ECB***. –** In answer to the first question on what I said on behalf of the Governing Council at the last press conference, I will, of course, stick to what I said at that conference. The Governing Council has not changed its mind. I would say and I repeat that our monetary policy continues to be accommodating. If our assumptions and baseline scenario are confirmed, it will remain warranted – and I have also said that today – to further withdraw monetary accommodation. I will continue to monitor all developments very closely so as to ensure price stability over the medium term.

I said also in the question-and-answer session – and I will repeat it in front of you – that I would not like to say anything that would change the expectations of the market until the end of the year, and I will not say anything about next year, apart from the fact that we will do, as we have always done in the past, all that is needed to ensure price stability and be sure that the inflation expectations are solidly anchored. I never committed myself not to increase rates, or to increase rates. We all have our freedom, but we are totally – and inflexibly – attached to our mandate. Everybody knows our mandate. Everybody knows our definition of price stability. Everybody can extract the inflation expectations from various markets, panels or surveys. We are totally transparent, so you can draw yourselves the appropriate conclusion from what I said, but we will always do all that is necessary to be up to our mandate.

As regards the global economy and the interaction with the European economy, I felt at Singapore that our global diagnosis was that we were still experiencing a period which is exceptionally favourable, with a rate of growth in real terms at global level of around 5% – which started in 2004 an continued in 2005 and 2006 and will probably go on into 2007. It is very dynamic.

At the same time, the uncertainties and the risks were on the upside. We have to take that into account. I would say in a way it has its repercussions in our own domain as regards the risks for growth. In the short term they are balanced, perhaps even on the upside because of the recent decrease in the price of oil. We will see what happens. It is very volatile.

In the longer term, we see downside risks. I could mention, of course, the risks that are embedded at a global level as part of it. As regards the impact of globalisation on disinflation – if it is part of your question – I would say that the disinflationary drive that is associated with globalisation has been extraordinarily strong in the past, and is probably diminishing when I look, for instance, at the prices of imported manufactured goods. I see the average prices of imported manufactured goods have a tendency to be less disinflationary today than one or two years ago. However, all this calls for further analysis.

2-028

Antonis Samaras (PPE-DE). – Mr Trichet, you increased interest rates for the fifth time despite the fact that inflation in September was only 1.8%. You seem to believe that annual growth of 2.5% is too much for the eurozone, and 8% unemployment too little. However, we represent people here, Mr Trichet: middle-class debt-holders, for instance. For them, this is hard to buy.

The ECB is also preoccupied with eliminating excess liquidity, but as Mr Lamfalussy pointed out here last week, excess liquidity was exactly what stopped isolated financial failures in the past from developing into systemic crises. Mr Lamfalussy also stated that price stability means fighting not only inflation, but deflation as well. Deflation may come about if authorities trying to bring inflation down burst a bubble in the assets market. Since I am not sure you take this as seriously as we think you should, what some of us are saying here is: should you not pay at least some attention to Mr Lamfalussy?

2-029

Jean-Claude Trichet, *ECB***. –** I have the greatest respect for Alexandre Lamfalussy. He was our predecessor. He is a founding father, I hope for all of us.

Could you remind me of the level of the interest rates in your own economy before the euro? At present it is 3.25% for short term, and 3.8% on a ten-year basis. So we are creating an environment, as I said, which is still accommodating. If you compare it with the past, clearly the difference is striking. We are not devising a monetary policy according to what we are observing today. We are called upon to deliver price stability in the medium term. In the case of successive oil shocks – that have unfortunately been a feature of the last few years – we would have increased rates much more. We are reasoning in medium term. By the way, wait a little bit until the end of the year, and you will see what the level of inflation is. Then you will detect an incredible degree of volatility, because it is less than 2% today. At the end of the year it might be substantially more than 2%. So you cannot run monetary policy on this basis. We run monetary policy on the basis of medium-term price stability, and it is in the medium term that all observers, economists, market participants, are expecting that we will deliver. They are right to expect that we will deliver, because we are entirely devoted to that.

Speaking of deflation, the last figure I have for M3 is 8.2%, private sector loans are 11.3%, lending for house purchases is at 11.1% and loans to non-financial corporations are at 12%. It has no meaning. We are in a universe which is not at all a universe of deflation. I suggest that you ask your own people. They will tell you that inflation is too high. It is as simple as that. So again, we are doing our job. We are called upon to do our job and we try to do it in the best way possible with absolute conviction. This has been confirmed even today with the Nobel Prize, which has been given to an economist who said that there was no long-term trade off between the inflation and employment. He has won the Nobel Prize because he discovered something which was very important, and we are paving the way for growth and job creation to be sustainable. That is what we do.

2-030

Astrid Lulling (PPE-DE). – *(FR)* Mr Trichet, since you have on several occasions expressed your concern about the rate of inflation and the upside risks and you have spoken a great deal about price stability, I should like to ask you the following question, because the Commission has just put to us a proposal to increase to 31% the excise duty on alcoholic drinks: as things stand, do you not think that the Commission should have other concerns than to submit such proposals to us, and indeed without any need, for example in relation to the functioning of the single market, since it will not operate better after a linear increase in these rates of almost a third? Moreover, many of the new Member States already have problems implementing the current minimum rates and the largest Member State intends to raise the VAT rate by 3%, to which the increase in excise duty will be added. What is your opinion? You are at great pains to counter inflation, but if the Commission has nothing else to do than to propose to us, without proper consideration, an increase in indirect taxation, I am afraid I do not hold out much hope for your aim to control inflation. What do you think?

2-031

Jean-Claude Trichet, *ECB***. –** *(FR)* Mrs Lulling, your question comes at precisely the right moment. I said just now that, among the risks that we have to take into account, there was the prospect, so to speak, of past rises in the prices of oil and other raw materials being passed on to consumer prices as well as additional increases in administered prices and indirect taxes – I should have said excise duties – in addition to what has been announced up until now. I did not yet know about this idea. It demonstrates that the risks that we are talking about, regarding the consumer price index, are not fictitious risks. Having said that, I have no opinion on this particular point as I have had no time to analyse it.

2-032

Astrid Lulling (PPE-DE). – *(FR)* Mr Trichet, I hope that you do have an opinion on this matter because you have just said that one must keep in touch. Thank you, you have given me some good arguments. I am the rapporteur for this committee.

2-033

Kurt Joachim Lauk (PPE-DE). – *(DE)* Madam Chairman, I have three short questions for the President of the ECB. The first is as follows. Is he in favour of the ECB becoming a market operator with regard to clearing and settlement? If so, what timetable are we looking at and how does he intend to deal with corporate governance?

Secondly, the President has already touched on hedge funds and the fact that most of them are outside Europe. Does the President envisage the need for greater regulation of hedge funds?

Thirdly, the President has rightly pointed out the structural shortcomings in competitiveness. Europe still has an unacceptably high level of unemployment. It is always difficult to put together a package. If the President could concentrate on one measure, which measure would he prioritise to reduce unemployment?

2-034
Jean-Claude Trichet, *ECB***. –** As regards the first point, I would like to mention the fact that we are currently working with the market on the settlement question. There is a good concept called 'target to securities'. That would allow for settlement to be made in Central Bank money at the level of the euro area, but it would be open to the whole of Europe. That system seems to be in line with our feeling that we have to be involved as long as the Central Bank money is in question. It could deliver services that would be appreciated by the users. We are working on that, and when we have finished this work and interacted with market participants and users, I could get back to you and all those involved with a fully-fledged proposal. That is how things are.

As regards the other aspects of our discussions on financial stability in line with the functioning of the market, you know that together with CESR we have worked out a draft standard for the ESCB and CESR. We were waiting for the Commission to decide whether to embark upon a directive. It has plumped instead for a code of conduct. We hope the work we have already done, and which will be finalised soon, will complement this code of conduct.

As regards unemployment, which was the last question, I would say that we hope that the structural reforms we are calling for would considerably raise the level of job creation. We are encouraged to believe that, because the economies that have embarked on those reforms, particularly labour market reforms, have a much lower rate of unemployment. We think there is a major opportunity of improving the situation in the euro area.

2-035
Pervenche Berès (PSE). – *(FR)* For my part, I shall ask you two questions:

Airbus managers tell us now that, taking into account exchange rates between the euro and the dollar, Airbus production should relocate towards the dollar zone. I should like to know your reaction to these remarks.

As regards hedge funds, you already told us, at the time of our last discussion, that it was necessarily a matter requiring a global solution. Everyone agrees. The question is how to prepare for this global solution. Given our experience in matters of banking supervision and of this or that product on the financial markets, do we not have to clear the ground and try to explore what could be a lighter regulation, and then propose it? This morning we had a discussion with our monetary experts and the fact that, within the European Union, we shall be in an exemplary situation in the implementation of Basel 2, perhaps gives us the opportunity to be the ones who, in this field, are in a position to make proposals, since you have made a distinction between pension funds and hedge funds. We can see that banks are now able to be both judge and judged in their dealings in relation to hedge funds. When we are told that the banks are adequately regulated, do you think that, considering the motives for their behaviour and for their investment strategy in hedge funds, this information and indirect supervision are adequate and that more transparency and registration would not be necessary?

2-036
Jean-Claude Trichet, *ECB***. –** *(FR)* On the first point, I shall tell you that we have been in a floating exchange rate system for 35 years, that is, a third of a century, a very long time. Secondly, I shall tell you that I stand by the G7 communiqué which includes a paragraph about exchange rates which I signed with the European executive members of G7, with the President of the Eurogroup and with my colleague, Ben Bernanke, and the secretary, Mr Paulson. I stand by this text.

As regards hedge funds, I have already indicated that that is not the only question, that it was necessary to take into account the interaction between these funds and the other market participants as well as of the enormous explosion of the outstanding debts of credit derivatives overall, and not only credit derivatives. Financial markets are currently experiencing a quite extraordinary creative abundance, that we have observed for several years but which, it seems, is tending to accelerate and has some extraordinarily positive aspects.

If my former American colleague were here before you, he would tell you that if the bursting of the technological bubble has been so spectacularly absorbed by the financial sector, it is because the derivatives, and the credit derivatives in particular, had spread the risks extremely widely, and consequently they were absorbed by all the holders of these credit derivatives because they were not concentrated in a small number of financial institutions, large international commercial banks which, otherwise, would have been in an extremely difficult situation and this could have triggered a very serious financial crisis. That is what he would have said to you or perhaps what he would say. It is indisputable that these new and recent creations stem from a real need on the part of all the operators and that there has been a meeting between sellers of

derivatives and buyers of derivatives, between sellers of risks and buyers of risks and that all this has corresponded and corresponds to something which can be very positive in certain circumstances.

The problem for all of us is to have a better understanding of the potential risks. Be very aware of the fact that there are not only negative aspects. There are some very positive aspects too. The negative aspects have not yet been tested and that is what we must do at global level.

I do not yet have a conclusion myself. I exclude nothing, as I said to you just now, but I believe that one has to be very professional in these matters, to understand properly how the system works and to do mental stress tests in order to see the major difficulties that we may have to face without overestimating the dangers but without underestimating them either. There are some very significant market risks but, once again, they are not linked only to the hedge funds themselves.

2-037
Poul Nyrup Rasmussen (PSE). – Mr Trichet, thank you for your remarks on hedge funds, which I still find very interesting and relevant. You said that there are not that many, but those which are there are very big, and it is a huge and increasingly important development on our financial market. I would add some points.

Firstly, over the last three years in the European capital markets and in industry we have seen an increasing importance of these capital funds. I think we can expect an ever-increasing development of capital funds operations and hedge funds on the European markets. It is a simple fact that the business model for many hedge funds has changed over the last few years, because we have had very low interest rates and these have led hedge funds to invest in items other than normal interest-bearing items, i.e. stocks, first and foremost. When I look at the case studies on specific firms, I see an astonishing amount of specific cases in which hedge funds have led to a tripling or quadrupling of the internal debt of these firms, emptying their capital and a quick withdrawing of shareholders' values as a net effect of these operations. When I add to that the well-known herding and crowding effect of many hedge funds, we have a positive correlation between their actions. When I add to that the credit derivatives with over-the-counter dealings, I see some risks and dangers, which lead me to the following questions.

First, Mr Trichet, could you imagine some reporting requirements for hedge funds that could give us a better monitoring basis in the private and public sectors, including yours?

Second, could we imagine some well-structured requirements for information which would give us better transparency for hedge fund operations?

Lastly, when you said we need a worldwide agreement, I cannot help thinking that there is the New York Stock Exchange; there is a monitoring system in the US which is far-reaching and much more demanding than in most places in Europe. We have the City Code in London, but do you not see that this lack of balance in monitoring procedures, transparency and access is in itself having a lagging-behind effect on the European financial markets? This underlines that we have to do something more than we have done in the past.

2-038
Jean-Claude Trichet, *ECB***. –** First of all, I entirely agree with you on the fact that what we are observing are structural changes that are extraordinarily rapid. As a result of that, they are beyond our full understanding. They are new; we have no past data and experience to refer back to. On top of that, there is no stress test.

On the other hand, I know that risks are everywhere. Over the last 25 years I have been living with the crisis of sovereign debt. We had several continents that were bankrupt. I was Chairman of the Paris Club. We had Latin America, Africa, the Middle East and the Soviet Union out of order and bankrupt. Then we had the Mexican crisis, the Asian crisis – we have accumulated experience in that field. We are living in a world which is extraordinarily appealing in many aspects, but has risks. It is never time for complacency. At a global level we see both prosperity and uncertainty. It is no time for complacency.

As regards your questions, I would say that we have to have to reflect on the reporting regimes. We can even say that it could be voluntary, so that every counterpart would know which others did not wish to be open. They would be voluntarily adhering to these reporting regimes.

On the other hand, it could be compulsory. As you said, we could have a requirement that would be more or less demanding. It is clear that none of us currently seems to be fully satisfied with the current situation in which we rely on the major financial institutions that are under supervision to ensure that their counterparts are fit and proper and reliable.

We clearly have to improve the situation. I remain of the opinion that when you are asking a global question, it is necessary to have a global answer. If you have an appropriate answer in one part of the world, then the hedge funds will go to another part of the world where they will not be under the appropriate regulations and they will create the same systemic

risk. We really have to get worldwide consensus. We are relatively close to that in my opinion. It is a question of maturing. We all agree on the fact that it has to be a collective response.

2-040
Margarita Starkevičiūtė (ALDE). – *(LT)* Mr President, my question is related to the recent regrets expressed by the European Central Bank over the decision of most of the new Member States to postpone the introduction of the euro. Does the President not now think that the position of the European Central Bank in respect of Lithuania, that Lithuania had intended to rapidly introduce the euro, has in a way induced most of the new Member States to postpone their plans for introduction of the euro, a situation which has provided the local populist forces with new arguments and eventually may undermine the fiscal situation in those countries? Does it not now occur to the President that a different approach should have been taken in the case of Lithuania?

2-041
John Purvis (PPE-DE). – A few months ago, Mr McCreevy said he saw no compelling case for legislation on hedge funds; he would keep a close eye on banks' exposure and try to understand issues such as prime brokers better and so on, but apparently he did not see any particular urgency. You say that we cannot be complacent, so I detect a slight difference of opinion there between the two institutions.

You say we are getting close to some arrangement with the international community on this; I would be very interested to know what exactly you have achieved on that score and where you expect it to end up. If you are really quite close to an agreement I think it is very important we should know. We do not want to destroy the goose that lays a golden egg, because as you say there are many positives in the hedge fund/alternative investment area. It would be interesting to know just where you have got to.

2-042
Piia-Noora Kauppi (PPE-DE). – Mr Trichet, you said in your introductory remarks that experience as regards competitiveness trends in eurozone Member States differs widely. It would have been very interesting for us to know your assessment of which Member States have been top of the class and which ones have not attained the average level of competitiveness. I understand that it is perhaps not politically correct for the President of the Central Bank to say that.

In relation to Mr Lamfalussy's visit to our committee last week, one of his initiatives was to speak about institutional arrangements, in particular the need for a longer-term secretariat for the Eurogroup. I would like to ask whether you see the need for such a permanent secretariat for the Eurogroup within the Council, with some institutional strengthening. In your view, would it help in attaining the fiscal policy targets which you mentioned in your remarks?

2-043
Dariusz Rosati (PSE). – Mr Trichet, you have said many times that the best contribution monetary policy can make as regards growth and employment is to provide price stability. You repeated that today, and I agree with you. However, in the Treaty we find that two different objectives are established for monetary policy: the overriding objective of price stability, and supporting the economic policy of the Community provided it does not jeopardise the objective of price stability.

Do you not think that if those who drafted the Treaty thought along the same lines as you, they would have restricted themselves simply to mentioning price stability as the overriding objective? If not, could you tell us an example of a hypothetical situation in which you would be prepared to support economic policies and somehow disregard price stability? The two concepts must have different meanings, because otherwise the Treaty would not make sense.

I should also like to ask you what the role of core inflation indicators is, and whether you take them into account in your policy mechanism.

2-044
Chairman. – Mr Trichet, thank you for answering these four questions. You will see from the diversity of the questions that we are tackling a whole range of problems, which reflect the many concerns of the Members and give them all an opportunity to speak.

2-045
Jean-Claude Trichet, *ECB***. –** Thank you very much indeed. It is very important for me to know what is important from your point of view.

As regards the first question I would say that, as far as we are concerned, we stick, as the Commission does, to the Treaty and we have clearly the implementation of the Treaty in mind. In the last round, we said, 'yes' for one economy to enter the euro area and we said 'no' to the other one. I consider that we are not a closed shop, we are an open shop and the proof of this will be given as soon as 1 January next year. On the other hand, we have to respect the Treaty and particularly the inflation criteria which have been discussed. However, for us it is absolutely clear, for the Commission it is absolutely clear, we have to apply the Treaty.

As I speak, the exchange rate mechanism comprises eight currencies, including the Slovenian currency and the Danish currency. That is quite a number of currencies. We will see what happens. But for those who are already in the system and who will enter the euro area, it is only a question of policies and meeting the criteria. Again, it is an open shop, not a closed shop, provided the criteria are met.

As regards complacency, I said that it is no time to be complacent, and that goes for the explosion of the derivatives market, the hedge fund industry, all other parts of the financial system and as far as financial stability in general is concerned. So I responded to the question on hedge funds. I could have responded to other questions as well. I would have been equally alert, if I may say, and equally emphatic on this non-complacency position. Again, it is not because I am particularly alarmed, but because the chances that we have in the present world are also offset by risks, as is the case in any market economy. The only economy I know of where there were no risks was in the Soviet economy. There were no risks. You could not go bankrupt, but everybody could see the results of this type of economy. So we live with risks and we have to cope permanently with those risks.

I would not qualify the degree of maturing where we are in this particular area to suggest that we could have a package very soon. We are working at a global level, at a transatlantic level and we will see when the time comes if we have a strong conviction. What is true is that none of us consider that we should be immobile. We could improve the present situation. Again, we have a concept at present. We are calling for the financial institutions which are under supervision to be extraordinarily alert and vigilant as regards their counterparts, particularly those counterparts that have the hedge funds. So we have a concept and that concept might also be improved, but other avenues are not excluded, certainly not in my mind, but again we do not have to deliver very soon as far as I know.

As regards the specific countries in that situation, I mentioned three criteria. Everybody can recognise the countries concerned: big current account deficit, accumulation of cost competitiveness losses over the last seven years, and continuing loss of cost competitiveness – the reverse case of Germany. Germany had very good reasons to catch up, it did so. Some have had good reasons to lose some of their over-competitiveness, it is OK. It is economically justified. Others had no particular reason to lose competitiveness. They have to care for their own overall economic strategy.

I have no opinion on how the Eurogroup should be organised. What I see is that the secretariat of the Council on the one hand and the Commission on the other hand are working very actively within the informal grouping that is the euro group, and it seems to me that their work is of good quality, so I do not see too many reasons to change that.

Mr Rossetti, when my US colleagues are in their own hearings, they say price stability is a necessary condition for growth and job creation. They have three goals in their legislation that are put the same footing. However, they say themselves – and here we come back to Mr Phelps, the Nobel Prize winner – that price stability is a necessary condition for sustainable growth and job creation. It is exactly the same in our case. I would say that it is because price stability is a necessary condition for growth and job creation in the eyes of Europeans, that the target price stability is considered the main mandate that we have and, as you said, without prejudice to price stability, you have the other elements. Amongst the other elements you have everything. You have the environment, you have cultural policies, linguistic policies and so forth, so it is the full set of European policies which we are supposed to contribute to. We do that. They are not only job creation and growth.

2-046

Chairman. – Thank you, Mr Trichet, for this monetary dialogue. We shall meet again in another setting in plenary on 26 October.

I thank the interpreters most warmly for staying with us until the completion of our work.

(The sitting was closed at 7.10 p.m.)