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# ECONOMIC AND MONETARY COMMITTEE
# MONETARY DIALOGUE WITH MR JEAN-CLAUDE TRICHET, PRESIDENT OF THE ECB
# (pursuant to Article 113(3) of the EC Treaty)

## WEDNESDAY, 26 MARCH 2008

3-003

**IN THE CHAIR: MRS PERVENCHE BERÈS**

*(The meeting was opened at 10.30 a.m.)*

3-004

**President. –** Mr President of the European Central Bank, you will remember that our last exchange of views took place on 23 January, at the time when the Fed was reducing its interest rate by 0.75%, on the occasion of a meeting with the national parliaments. At the time, I believe you were still telling us that we were in a situation in which major adjustments were being operated on the markets. Would you still use the same term today? And we are relying on you to answer two questions to which we wanted to give priority in today's meeting, namely how it is that the Central Bank can separate the activities associated with maintaining price stability from its responsibility as a lender of last resort, on the one hand, and, on the other, how it is that the Central Bank may possibly specify a strategy in terms of inflation. These are the two questions that we see as a priority for today's exchanges.

3-005

**Jean-Claude Trichet,** *President of the European Central Bank***. –** *(FR)* Madam President, Members of the Economic and Monetary Committee, I am delighted to be speaking to your committee today, and to be continuing our regular dialogue.

As always, I shall begin my speech by evaluating the economic and monetary situation, explaining the reasons underlying our decisions in respect of rates. I shall then give you fuller details of the distinction the European Central Bank operates between specifying our monetary policy on the one hand and, on the other, keeping the monetary market in good working order.

3-006

*(DE)* I should then like to end by drawing some preliminary conclusions on the regulation, prospects and stability of the financial markets.

3-007

First, the economic and monetary developments. Since my previous appearance before the European Parliament, inflation has remained at relatively high levels of above 3%. The incoming information has confirmed our assessment of prevailing upside risks to price stability over the medium term, in a context of continued vigorous money and credit growth. Strong upward pressure on inflation in the short term mainly stems from the recent increases in energy and food prices. Looking ahead, the inflation rate is expected to remain significantly above 2% for most of the year; hence, the period of relatively high inflation rates will be more protracted than previously expected.

The March 2008 ECB staff macroeconomic projections foresee that HICP inflation will range between 2.6% and 3.2% in 2008, and between 1.5% and 2.7% in 2009. These projected ranges have shifted upwards, mainly as a result of higher food and energy prices. I should stress that the staff projections are based on a number of purely technical assumptions which are unrelated to policy intentions, such as the use of market expectations in the assumptions for short-term interest rates.

In the view of the Governing Council, risks to the medium-term outlook for inflation are on the upside. These risks include further rises in oil and agricultural prices. Furthermore, taking into account high-capacity utilisation and tight labour market conditions, wage growth may be stronger than currently expected, as well as the pricing power of firms – notably in market segments with low competition. Moreover, administered prices and indirect taxes may increase beyond what is foreseen.

At this juncture, it is therefore imperative that all parties concerned meet their responsibilities and that second-round effects on price and wage-setting stemming from current inflation rates are prevented. To that end, schemes in which nominal wages are indexed to consumer prices must be avoided. This is key to preserving price stability in the medium term and thereby the purchasing power of all euro-area citizens.

Turning to economic activity, in the fourth quarter of 2007, real GDP grew by 0.4% quarter-on-quarter, following a rise of 0.8% in the third quarter. Incoming information confirms the picture of moderating growth. Looking forward, ongoing growth is expected. The euro-area economy has sound fundamentals and does not suffer from major imbalances. Investment growth – while dampened by the global slowdown – should provide ongoing support. At the same time, employment and labour force participation have increased significantly, and unemployment rates have fallen to levels not seen in 25 years. Accordingly, consumption growth should continue to contribute to economic expansion.

This assessment is reflected in the latest ECB staff projections, which foresee annual real GDP growth in the range of 1.3% to 2.1% in 2008 and of 1.3% to 2.3% in 2009. These ranges have been revised downwards,

reflecting weaker global demand, stronger pressure from commodity prices and less favourable financing conditions than foreseen in December.

In the view of the Governing Council, uncertainty about the prospects for economic growth remains unusually high. Downside risks relate to a potentially broader than currently expected impact of financial market developments. Further downside risks stem from the scope for additional increases in commodity prices, protectionist pressures and the possibility of disorderly developments owing to global imbalances.

The monetary analysis confirms the prevailing upside risk to price stability at medium- to longer-term horizons. On the basis of data available up to January, the underlying money and credit expansion remains strong, even taking temporary factors into account, such as the relatively flat yield curve. There is little evidence that the financial market turbulence since August 2007 strongly influenced the overall dynamics of broad money and credit aggregates. Bank loans to the domestic private sector have grown at annual rates of around 11% for the past two years. While the growth of household borrowing has moderated over recent months, loan growth to non-financial corporations remains very strong.

In line with its mandate, the ECB's Governing Council remains strongly committed to preventing second-round effects and the materialisation of upside risks to price stability over the medium term. Against this background, on 6 March, we decided to leave the key ECB interest rates unchanged. The current monetary policy stance will contribute to achieving our price stability objective. Indeed, the firm anchoring of medium- to longer-term inflation expectations is of the highest priority. The Governing Council will continue to monitor very closely all developments.

Let me now address the issue of the separation between the determination of the monetary policy stance, on the one hand, and its actual implementation, on the other hand, that is, keeping short-term rates close to the level chosen by the Governing Council. In accordance with the Treaty provisions, the primary objective of the ECB is to maintain price stability in the euro area. To that end, the Governing Council determines, on the basis of its economic and monetary analysis, the appropriate monetary policy stance by setting the key ECB interest rates at a level that ensures the maintenance of price stability over the medium term. In view of safeguarding its credibility and firmly anchoring long-term inflation expectations, it is crucial that the Governing Council sets the appropriate monetary policy stance on the basis of no other considerations than the delivery of price stability in the medium term.

Once the appropriate level of the key ECB interest rates has been set, the Executive Board of the ECB implements monetary policy so that the level of the key interest rates decided by the Governing Council actually prevails in the money market. For this purpose, the ECB steers – primarily by means of open market operations – the liquidity which is lent to euro-area credit institutions against adequate and sound collateral and for a given and short period of time. By so doing, the ECB also fosters a smooth functioning of the euro-area money market.

The steering of liquidity has been an important element of the Eurosystem's framework for monetary policy implementation since the launch of the euro. By these means, market participants get, loud and clear, the signal about the orientation of the monetary policy stance, and this fosters the predictability and credibility of the Governing Council's monetary policy decisions. The fact that these decisions are firmly based on the objective of price stability, and the concomitant fact that the steering of liquidity is in turn dependent on these decisions, but in no way influences them, ensures that price stability is maintained over the medium term.

This also ensures that the liquidity provision aimed at promoting the smooth functioning and resilience of money markets is also fully in line with the primary objective of price stability.

Particularly after the onset of financial tensions in August 2007, the principle that the steering of liquidity is subservient to the monetary policy stance, and does not affect it, appeared of the essence.

In this period of acute turbulence – and I had the opportunity briefly to explain this in front of you – the ECB has succeeded in containing deviations of very short-term interest rates from the official interest rate set by the Governing Council. As a result, the ECB has ensured a continued effective implementation of monetary policy in line with the stance, thereby also contributing to safeguarding overall financial stability.

Since the last hearing, tensions have continued. During this period, the Eurosystem remained, as usual, in close contact with other major central banks. In this context, on 11 March the Governing Council of the ECB decided, in conjunction with the Federal Reserve, to offer US dollar funding to Eurosystem counterparties as it did in December 2007 and in January 2008. Through the operations currently being undertaken, liquidity for an overall amount of up to USD 30 billion is provided. The Swiss National Bank is following an analogous course of action.

Overall, given its flexible design, the Eurosystem's operational framework, with its broad range of instruments, has thus far proved to be resilient and effective. Even in the course of the ongoing financial turbulence, there has been no need to adjust or extend the existing framework, for example by introducing new innovative instruments or a broader range of collateral. We have not changed our concept since the start of the turbulence. We have not changed our concept since the start of the euro.

Let me now turn to recent developments regarding financial stability and supervision. I would like to share with you the ECB's assessment of the current financial stability situation. Perhaps you will also permit me briefly to touch on the possible policy measures which are being prepared at European and international level in response to the financial turmoil.

With the global financial system undergoing a process of de-leveraging, the euro-area financial stability outlook continues to be clouded by considerable uncertainty. Since my last hearing before your Committee, it has been argued that the total valuation and income losses facing the global financial system are clearer. Yet considerable uncertainty still remains about the reliability of total cost estimates and about how the costs will eventually be spread. There is also uncertainty about the possibility of feedback effects on the financial system, including questions about what the ultimate impact on the intermediation of credit – both for financial institutions and markets – will be. Moreover, until conditions on the US housing markets show signs of improvement, the possibility of continuing tensions in structured credit markets cannot be excluded.

In the period ahead, large euro-area banks are likely to face pressure on their revenues on account of lower activity levels in the structured credit markets as well as from a general retrenchment from risk-taking across many business lines. At the same time, the banks are facing increased funding costs. Consistent with this, a number of financial market indicators – including bank equity prices and credit default swap spreads – have generally been reflecting expectations of weaker profitability as well as concerns about credit and counterparty risks. On the positive side, several years of strengthening profitability had, by mid-2007, left the euro-area banking sector in a strong financial position to face the possibility of a credit-cycle downturn.

All in all, given the heightened uncertainties, and in an environment where balance sheet conditions could unexpectedly change, vigilance is, more than ever, of the essence. Financial institutions will need to step up their efforts to effectively manage the risks that may lie ahead. From the central banks' perspective, restoring confidence among economic agents and market participants is crucial in the current environment of great uncertainty and high market volatility. One very important contribution the ECB makes to preserving confidence is to continue firmly anchoring medium- to long-term inflation expectations for the euro area, while at the same time ensuring the smooth functioning of the short-term money market.

At the current juncture, priority has been given to comprehensively draw lessons and formulate policy responses to address the challenges raised by the financial market turbulence. The key areas have been identified and, since my last hearing before you, work has been progressing intensively both internationally and in the EU. The Financial Stability Forum and the ECOFIN have developed preliminary assessments warranting further policy action. In that context, let me mention some areas where I see that a timely response is necessary.

First, with regard to improving disclosure and valuations of structured finance products, financial institutions are called upon to promptly and fully disclose on- and off-balance-sheet risk exposures. Moreover, guidance is warranted by auditors and supervisors with the aim of enhancing the clarity and robustness of structured product valuations, particularly in relation to illiquid assets.

Second, credit rating agencies, whilst eliminating conflicts of interest, should take measures to expand the scope of information provided to investors – thus facilitating their exercise of due diligence, while improving governance and rating methodologies. If their endeavours do not prove to be adequate, public policy action would need to be considered.

Third, supervisors should ensure that banks retain adequate capital and liquidity buffers. In this context, work is under way to refine certain aspects of the capital adequacy framework, especially in relation to the treatment of securitisation and off-balance-sheet exposures. Moreover, further supervisory guidance needs to be developed for liquidity risk, incorporating the lessons from the turmoil and focusing on liquidity stress-testing and contingency funding plans.

These are three examples of areas where very significant progress should be made. More generally, I would call for a further significant change of culture at national, European and global level. I would sum up this cultural change in two words: transparency and anti-cyclicality. 'Transparency' because enhanced public information on financial instruments, on markets and on institutions is not only necessary to permit market participants to take optimal economic decisions, but is also the only way we have of avoiding contagion, herd behaviour and, therefore, the propagation of turbulence in times of difficulty, and 'anti-cyclicality' because a large number of rules, regulations and procedures have a tendency to foster behaviour that is largely procyclical, amplifying the booms as well as the busts in the cycle. We must look at all parts of global finance with a view to diminishing progressively their procyclical components, which implies, in particular but certainly not exclusively, eliminating to the greatest possible extent asymmetry in the treatment of booms and busts and, where necessary, extending as far as possible the time horizon adopted by all the institutions concerned.

I am now at your disposal for questions.

*(Applause)*

3-008
**Alexander Radwan (PPE-DE).** – *(DE)* Madam President, Mr President, thank you very much also for the very clear words of a central banker on the financial market situation. People worldwide are preoccupied with

the imponderables, as are people in Europe with regard to countries like Ireland and Spain (perhaps you can say a few words about this), since it is regularly rumoured that similar property problems may arise there. At the moment no one can judge how things will proceed.

We have a situation in which those who have hitherto been the most fervent advocates of free market operations are now calling most loudly on the state to allow central banks to take the consequences of the bungling in New York, London, Frankfurt and Paris and, ultimately, to remove those who were responsible for the bungling. So I thank you for what you said about the short-term needs. Unfortunately we in the European Parliament are very aware of the European Commission's lethargy here, but to some extent this also applies to finance ministers, who are not responding to the situation as strongly as they should be doing. I hope that the European Central Bank will continue to be a driving force in this context.

However, I found what you said about the behaviour culture even more fascinating. You spoke of 'anti-cyclical' behaviour. You spoke of herd behaviour and transparency – at least, that is how it was translated. One can sign anything. The question is who can make it happen? Are we to believe that all this – transparency, 'anti-cyclical' behaviour – can be brought about by bank managers who, when they have short-term profit in mind, may all run off together in a different direction? Is there not instead a need for policy to provide a framework for a while? Not actual regulation, but a framework for change? I am concerned about the extent of the crises, starting with the Internet crisis, and now the subprime crisis. The profit and loss swings are becoming ever larger. Accordingly it is all the more necessary for the central banks to take action. This is the question – how can we impose this code of behaviour if necessary, or do you believe that the market itself can do this?

3-009
**Jean-Claude Trichet,** *President of the European Central Bank***. –** Thank you very much for your question. It is a very comprehensive one, and I will comment on the various aspects that you have addressed.

First of all, I have mentioned on a number of occasions that, in our own monetary policy decisions, we have for a long period of time been taking into account the signals that we have been getting from the monetary pillar, in particular as regards the counterparts of the monetary pillar, we have seen signals coming from credit for housing. These were concentrated on a number of economies – not on all the economies in the euro area. But the interest rate decisions that have been taken since December 2005 were motivated partly by these observations. What we have observed since then is a slowing-down of the rhythm of credit allocation in this domain.

I would say that in this domain of real estate in Europe – as in many others – alertness is certainly of the essence, but I have no particular information that would be interesting at this stage. But let us continue to be very alert.

As regards the remarks I made, and which you made, on herd behaviour and the necessity for transparency, this is a general remark. I think that transparency is really of the essence – and this is not a new observation stemming from what we are observing at this present, very significant episode of turbulence, with a big and very significant market correction.

This was also the case on the occasion of the Asian crisis. In the Asian crisis, transparency appeared to be absolutely necessary to avoid contagion by one emerging country in Asia of the other emerging economies in Asia, and we observe exactly the same in the present episode, where we see that all the elements where there is an absence of transparency – whether it is markets, instruments or institutions – are conducive to the hectic behaviour of markets, herd behaviour and turbulence. I think that this is really something which is very broadly shared now, and I am confident that we will introduce transparency everywhere.

As regards who should take the lead, I think we have to be as holistic as possible. All institutions are at stake, all public authorities are at stake – without any exception, in my opinion – in driving this transparency and anti-cyclical move, and we have to create the environment which would be conducive for private institutions to behave as properly as possible. The present situation is not correct, is not appropriate, and we have to learn all the lessons from the present situation.

3-010
**John Purvis (PPE-DE). –** Mr President, I wonder whether you could clear up something for me. This is on the price stability issue, because you have repeatedly said it was your only concern – and you said it again today – yet up to June 2007 you were very rigid on your interest rate increases, even though there was a slight nudging of the 2% level, but since then rates have been frozen. There has not been any movement in interest rates, and yet inflation has been well above your target and again today you tell us it is going to stay above that target, certainly this year and probably into 2009.

I thought that you were perhaps going to tell us that your forecasts were coming down and inflation was going to be moving down, or that commodities and food prices were going to come off the top, but in fact you have told us today that you do not see that happening. So is it the state of the EU economy or perhaps solidarity with other jurisdictions? Maybe the Americans are beginning to take control of your policy on inflation and price stability?

3-011
**Jean-Claude Trichet,** *President of the European Central Bank***. –** I would say firmly 'no'. If we have maintained our interest rates at the present level, it is

because we believe that this is necessary to deliver price stability in the medium term.

As I said in the last introductory remarks – and I have to repeat that here – we believe that the current monetary policy stance will contribute to achieving this objective. Again, we have only one needle in our compass. We have a very comprehensive analysis of all the risks for inflation in the medium term, and we draw conclusions on the basis of this analysis. As I explained, we make a clear separation from this monetary policy stance which is guided by one needle in our compass. Once it has been decided, we consider our duty to keep the actual short-term interest rates in the money market as close as possible to the monetary policy decision.

We have done that – I trust with success – from the first day. You will remember that I had to explain to you what we had been doing on 9 August. From the first day we were adamant that we must demonstrate that we were able to maintain the interest rates in the shorter term on the money market fully in line with what we had decided.

3-012
**John Purvis (PPE-DE). –** What is the medium term, if it is not 2009? Is it way beyond that?

3-013
**Jean-Claude Trichet,** *President of the European Central Bank***. –** In the constituency of central banks we generally consider the medium term to be between 18 and 24 months.

3-014
**José Manuel García-Margallo y Marfil (PPE-DE). –** *(ES)* Madam President, Mr President of the European Central Bank, in your concern to demonstrate the separation between the Bank's two areas of responsibility as regards price stability and functioning of the market you have drawn a number of conclusions from the recent turbulence.

I shall focus only on two: banks' capital requirements and, secondly, procyclical behaviour on the part of certain financial institutions. Does this mean that the provisions we have adopted in respect of banking capital are insufficient? Do they need to be supplemented?

Does this mean that certain financial institutions which have displayed more pronounced procyclical behaviour – I am thinking of hedge funds and private equity – need to be reviewed?

The second question, on quite another matter. You have not mentioned growth in the external sector, you have not referred to exports. I would like to know how you think exports are going to grow and what margins for the exchange rate with the dollar and other currencies the European Central Bank has in mind when determining those growth forecasts.

3-015
**Jean-Claude Trichet,** *President of the European Central Bank***. –** As regards the relationship between rules and self-regulation, I would say the following – I say this in relation to the credit rating agencies, but it seems to me that this might apply to a large number of sectors and institutions, including investment banks – if it appears that self-regulation, codes of conduct, sets of principles that are considered benchmark principles for appropriate behaviour can be worked out and appear convincing in terms of attaining the goals of financial stability, then I consider that we should take that option.

If it appears that they are insufficient or there is no capacity for the private sector to work out agreed benchmark principles, then regulation is necessary, and we should be clear on that. In the various areas at stake, we give the private sector a chance to work out a possible set of benchmark principles. If they are not sufficient or it appears that the private sector is incapable of doing that, then regulation might be necessary

On the other issues that you mentioned – export growth and the environment – as regards export growth, we consider that one of our risks is the possible slowing-down of the global economy, and from that standpoint we have to be alert. I mentioned that risks were on the downside from that standpoint, but there is nothing new there. I have already said that to you many times on previous occasions.

As regards the situation of our own economy, I said that the fundamentals were sound and that we were not heavily imbalanced, which is clearly demonstrated when you look at the external accounts of the euro area. As always, we have to be as pragmatic and as close to the facts and the figures as possible.

I mentioned the staff projections. They are very much in line with a number of other projections which have been published recently – even if you have some differences, for instance between the OECD projections and the IMF projections – which are more or less optimistic.

The latest figure, which I had at 10.00 before appearing here this morning, was an Ifo Institute figure, which was better than expected. We had other figures from various economies in Europe that were either better than expected or lower than expected. We have to take these figures as the reality that we have to judge and analyse. Again we have to be very pragmatic and keep close to the reality.

I have said a number of times that, even if we are all interdependent, particularly on both sides of the Atlantic, we are not in the same economy; we do not have same shocks to cope with. We are in a different universe and we have to take our decisions in the light of the reality of the European economy.

As regards the euro-dollar question, excessive volatility and disorderly movements in exchange rates are undesirable for economic growth. In the present circumstances we are concerned about excessive exchange-rate moves. I have already had occasion to say to you that I have noted with great attention that the US

authorities have reaffirmed that the strong dollar is in the interest of the United States economy.

3-016
**President. –** Indeed, you had already said this.

3-017
**Elisa Ferreira (PSE). –** Thank you for coming here, Mr President. Clearly I welcome your message that we should learn from the present situation as well as from the regulatory and the governance issues that you addressed and pinpointed.

Having said that, it is true that there seems to be some sort of contradiction between past messages and what the ECB can do today; with the inflation rate so high – 3.3% – and interest rates unchanged, I think it is the only thing that can be done. But, on the other hand, it is true that inflation comes down to 2.5% if you exclude energy costs, and, if you exclude food costs, it is 1.8%.

This brings us to another type of issue, relating to a more in-depth appraisal of the ECB. I think the forthcoming 10th anniversary of EMU is probably the right moment to make a more in-depth analysis of how we evaluate the performance. So could you please tell us – share with the Parliament – some of these more structural approaches that you will probably be putting forward formally in the months to come, including in particular the external dimension of the euro – this international relationship that we have got to address – and the internal growth and asymmetric impacts, as well as the increasing presence inside the European Union of non-members of the euro area? Could you please go a bit further on this proposed (and welcomed, from my point of view) learning as much as possible from the present moment, and also from our past history, because that has changed so much?

3-018
**Jean-Claude Trichet,** *President of the European Central Bank***. –** I would like to draw your attention to the following thought experiment. Imagine we are in front of Parliament two years before the euro is set up – say at the beginning of 1997 – and somebody says that nine and a half years after the setting-up of the euro we will have a currency which has a very solid anchoring of inflation expectations – in line with the better anchoring of inflation expectations in Europe at present – that currency will be used by 320 million people and 15 economies, and that currency will be as solid and as confidence-inspiring as the 'best' currencies available in Europe today.

What would the Commission's reaction have been at that time? Probably to say that it was a dream. What we have done is something really extraordinary – extraordinary in comparison with the expectations 12 years ago but which seems totally natural for all of us because it is what we can observe.

So the challenges that we have to cope with are to maintain and preserve this in circumstances that are always demanding. The present circumstances are demanding, but we have had very demanding times in the past. They are forgotten because time elapses. However, we had to cope with the start of the oil shock, which was a very great shock. We had to cope with the explosion of the tech bubble. We have had to cope with a very large number of very demanding shocks and times. It will be the same in the future.

I will conclude with enlargement. It is extraordinarily heartening to think that we are now 15 with Malta and Cyprus. The inclusion of Malta and Cyprus in the euro area went very well. For enlargement we have to prepare in the best fashion possible, with full respect for the Treaty and the criteria. I stress that because it is our duty to preserve the integrity, prosperity and credibility of the euro area in this enlargement period. It is our duty.

We will continue to live up to this responsibility and we are very conscious of this in the Governing Council and the Executive Board of the institution. We are aware, and this applies to all the staff of the institution, that your confidence places an enormous degree of responsibility on us and we try to live up to this responsibility.

3-019
**Robert Goebbels (PSE). –** *(FR)* Mr President, you used the terms 'fight against inflation' and 'monetary stability' some 20 times. Everybody knows that price stability is your primary objective. Nevertheless, in the United States, despite inflation that is higher than that in the European Union, or at any event higher than that in the Eurosystem, the Federal Reserve has reduced its rates by 300 points since the subprime crisis broke out.

You have just been preaching moderation in incomes policy to us; you have done so again, but at the same time you go to the rescue of banks and their shareholders by supplying them with virtually unlimited funds. Is this policy not an incitement to speculation, a perverse invitation to banks to get into debt, which enables them to increase the return on their own funds? Does not the fact that banks and speculators can rely on help from the central banks increase what is known as the moral hazard?

With your permission, Madam President, I reserve the right to speak again following the President's response.

3-020
**Jean-Claude Trichet,** *President of the European Central Bank***. –** *(FR)* Mr Goebbels, I shall say three things. First, with regard to the United States and the Federal Reserve, the European economy and the European Central Bank, we are each in a different environment with, as I have said, different crises, and economies whose structures are different and which find themselves in different circumstances. That is why I am not focusing my evaluation on what has been done on the other side of the Atlantic. I am simply saying that naturally what we, for our part, are doing accords with our mandate – which you gave us, which European democracies gave us –, it accords with what people, our fellow citizens, 320 million fellow citizens are strongly

urging us to do. Naturally they are not content with the current inflation, and it also accords, I must emphasise, with what is needed in a difficult period. If expectations of inflation were not fixed, if we had both an increase in expectations of inflation and an increase in their volatility, all this would create unrest in all the markets, because it would immediately be incorporated into interest rates, particularly medium- and long-term interest rates. And yet we would not be contributing to financial stability. On the contrary, we would be adding to financial instability. That is very important.

With regard to our messages to the social partners, and to all those in a position to play a part in price formation – you have noticed that I mentioned price formation as well as wages and salaries –, it is obvious, and experience has consistently shown, that if, in periods of temporary crisis such as the oil crisis or the crisis in agri-foodstuff materials and products, we fail to take account of lessons learned in the past, we shall find ourselves back facing the same problems as those we had in the years of the first oil crisis, which you will remember.

Finally, with regard to our attitude to the banks, I would remind you that we have not changed our rules in respect of refinancing of banks since the euro was created. What has happened is that they have been adapted to the situation we have been having to deal with since last August. I have already had occasion to explain, to you yourself Mr Goebbels and to the whole committee, that when we intervened on 9 August we lent for 24 hours, in other words for a day, a single day, and that after that day we were repaid, that naturally we charged interest on the loan, that we lent on the basis of guarantees that were the guarantees laid down from the very start of the euro's creation. On that point, I stress that our policy interventions do not involve implementation of the monetary policy of liquid assets on the market, elements that would accord with your opinion, which I would share if that were the case.

3-021
**Robert Goebbels (PSE).** – *(FR)* Madam President, I note that President Trichet has not answered my question on the moral hazard, which ensued from a speech consistently in favour of bank liquidity. Would the Central Bank not have achieved the same effect by reducing the interest rate, which would have enabled the banks to refinance themselves more easily while also offering the real economy the possibility of benefiting from a lower interest rate?

3-022
**Jean-Claude Trichet,** *President of the European Central Bank***.** – *(FR)* I have just told you that there was no moral hazard in our money market interventions, contrary to what some people had said, which is why I completely refute the moral hazard argument. Moreover, if we had reduced interest rates, without having a reason as far as the fight against inflation was concerned, in that case the moral hazard would have been as follows: if I am understanding your reasoning correctly, we would have been asking our fellow citizens to pay for the banks. In effect, they would have had more inflation, and consequently they would have been paying for the banks. As it happens, that is where I see a considerable moral hazard.

3-023
**Wolf Klinz (ALDE).** – *(DE)* Madam President, Mr President, Alan Greenspan, the former Chairman of the American Federal Reserve Bank, defended himself against the criticism that it was not least the policy of low interest of 1% that he maintained for too long which played a part in the bubble by saying that ultimately the crisis had been caused by globalisation. He said that globalisation had led to the crisis and, if it had not broken out in the property sector, it would have broken out somewhere else, such as the credit card sector or automotive financing.

I should like to know your opinion on this, and whether you share Mr Greenspan's view that globalisation was to blame, or whether you do not primarily see other reasons for the crisis.

Secondly, you have made it clear that you expect banks to be more transparent, and you have left open the question of whether this will take place on a voluntary basis or on the basis of criteria, guidelines, statutory provisions and so on. At this point, nine months after the crisis began, is it not time to have a firm opinion on this? Do we really still need another six, nine or 12 months to come to the conclusion that on- and off-balance-sheet exposure must be revealed? Can we not already be sure of this, nine months after the crisis?

Do you also believe that the worst is already behind us? That is what business commentators sometimes say. Do you agree with this view, or do you see this as still being a time of major uncertainty?

There is increasingly an enormously speculative element throughout the financial markets. Over 90% of currency movements are speculative, over 90% of commodities contracts are speculative. Is this acceptable, or do you not think, rather, that in times of crisis like the present this causes additional risks?

3-024
**Jean-Claude Trichet,** *President of the European Central Bank***.** – Thank you for your questions. On the first question, I shall not comment on Mr Greenspan's remark: this forms part of a public debate which is always observed when you experience market correction of this amplitude. I will just say that my colleagues in the central bank constituency and I, when looking at the situation of global finance in 2006 – around one year before the start of the turbulence – were all thinking (and we said so publicly, on various occasions – myself included – after the global economy meetings, or the G10 meeting in Basle) that we were experiencing a level of risk pricing in global finance that seemed to correspond to an under-pricing of the risks at stake. This was visible in the level of spread, in the level of risk premiums, and in the level of volatility that was observed in a large number of markets.

That was a fact. We said publicly that we had that feeling – I myself remember saying that we had to be prepared (the message was for the private sector in particular) for market correction, which should be as orderly and smooth as possible. So, again, what happens – to the extent that it is a very significant market correction – is not abnormal, corresponds to a diagnosis which was made before, and is accompanied by episodes of turbulence, of very high levels of volatility and of overshooting that are very plain to see.

On the second question, I share your view that we now have a number of provisional lessons that, one would say, should be implemented as soon as possible. On the other hand, we should also take into account that there is no quick fix for any particular part of the world which does not correspond to a consensus at global level, and for this reason we have decided to launch a methodology which goes, in particular, through the Financial Stability Forum, which is the place where the international community asks for the forging of the appropriate lessons to be drawn and implemented. The Financial Stability Forum itself is monitoring a very large number of workshops, in particular the Basle Committee, which is working hard, precisely on all those elements that are specifically dealing with the financial institutions.

I can reassure you that we have at global level a methodology and work in progress, and the report of the Financial Stability Forum will be delivered on the occasion of the next Washington meetings of the IMF, involving the international community and all the 'G's concerned. I expect that we will then be able to start the implementation for which you are, in my opinion, very rightly calling.

Three other questions were asked. I shall be extremely brief. Again, to qualify the present situation, I would say it is an ongoing process of very significant market corrections, with episodes of turbulence, high levels of volatility, hectic behaviour and overshooting. I would not say that the worst is behind us, but it is an ongoing, very significant market correction.

As regards speculation, we have to look very carefully at this. Free markets in a way are markets where you have institutions and individuals that are making their own decisions on the basis of their judgement on the market. A lot of so-called speculators are only trying to avoid losing money in some way, so we have to be very cautious. That said, it is clear that very highly leveraged institutions that are non-regulated and non-transparent are creating a problem, and we identified that problem very clearly.

It seems to me that we have to continue exerting appropriate action in order, as I said before, to give a chance for the set of appropriate benchmark principles to be worked out, and if they are not convincing, or if they are not worked out, then it will perhaps be necessary to engage in regulation.

3-025

**Guntars Krasts (UEN).** – Mr President, about six months ago the world realised that the credit party was over. During this period, the ECB kept interest rates unchanged. At the same time, the Bank was very decisive in providing liquidity to the markets and interest rates at the same time. It is very important for those who are suffering from liquidity to gain ground, and the liquidity interest rate is a means of regaining their liquidity. I have a question concerning this. Was this one of the reasons why the ECB kept rates unchanged during this period – just to provide rather cheap money to solve the liquidity crisis, in spite of the growing danger of inflation?

My second question is: what is your view on the issue of the possible transformation of this credit crisis into a solvency crisis, for which interest rates, at least in the short term, are irrelevant? What would it mean for the Bank's future interest rate policy?

The Chief Executive of Deutsche Bank, Mr Ackermann, has announced that he is no longer a believer in the self-healing powers of the market. What are your ideas in this regard? Has something gone wrong with the ability of the market to self-regulate? Was it a mistake on the part of the institutions to allow the market too much room? Was there too much reliance on the market's powers of self-regulation?

3-026

**Jean-Claude Trichet,** *President of the European Central Bank***.** – Regarding the first part of your question, I would again confirm that our interest rates have been decided on the basis of our mandate to deliver price stability in the medium term in a period which is very complex and very difficult, particularly because we have to cope with a number of shocks. I will state very clearly: interest rates are there to deliver price stability in the medium term. We have to take care to fix interest rates at an appropriate level that we have decided should be observed in the money market in the shorter term. As you know, we have been very active since the very beginning of the turbulent episode. Everyone has noted this.

Secondly, concerning liquidity tensions versus the solvency problem, as far as the central banks are concerned, they are there to deliver price stability, to solidly anchor inflationary expectations, which also contributes to financial stability, and to deal with the liquidity issues when they occur – which has been the case. The solvency issue is of a different nature. It might involve – or necessarily involves – taxpayers' money if there is a will to intervene. This is a different universe, where the central bank itself has no risk to take because taxpayers' money is involved.

As regards the overall philosophical attitude vis-à-vis what we are presently observing, we in the central bank constituency know better than anybody that the solid presence of public institutions like central banks is decisive in times of turbulence, very hectic behaviour and a high level of volatility. We are there to provide

two anchors for the market – one solidly anchors inflationary expectations and the other anchor is whatever we decide in terms of interest rates.

We are the masters of our own interest rates. In the shorter term on the money market you can be assured that we will do what is necessary for the market to function at the level we have fixed. It is a way of telling the market that this can be relied on because we are a public institution. I believe that it has played a very important role – I would say a decisive role – since August last year when we observed the start of the turbulent episode.

3-027
**Zsolt László Becsey (PPE-DE). –** Mr President, I come from a new Member State and have two short, connected questions requiring brief replies. One concerns the enlargement of the euro zone and the evaluation of Slovakia: what is the situation in this regard? When we consider the ECB and the Commission evaluation, how do you think that, for these types of new, catching-up countries, the sustainability of inflation can be maintained? This is one concrete question for a concrete reply.

The second question concerns your relations with the Commission, about which Ms Lulling has already asked. You are fighting for low inflation and anti-inflation, and at the same time I have the feeling that the Commission is constantly fabricating inflation by means of excise duty issues, minimum taxes and this type of thing. If you are fighting so hard against inflation and you are in the EU machinery, what type of relations do you have with the Commission? If not on this question – the anti-inflation question of the Commission proposals – why not? What type of administrative or high-level connections do you have in that respect?

3-028
**Jean-Claude Trichet,** *President of the European Central Bank***. –** On the first question on Slovakia, we are at the stage where staff are actively preparing the convergence report. The decision of the Governing Council of the ECB has not been taken; the convergence report has not been forwarded to the Governing Council. I cannot say anything in advance because I have to fully respect the position of the Governing Council.

I can say that the main principle which we have always applied is to look at all the criteria that are required by the Treaty, knowing that the Treaty itself calls for criteria to be met, not only immediately but also on a sustainable basis. It is absolutely clear that one of the major issues at stake is making a judgement on the sustainability of the criteria, including inflation criteria.

Concerning the Commission, we are permanently calling on executive branches and parliaments all over the euro area to be very careful not to add to the risks of inflation by augmenting indirect taxes and excise and other duties that, as you said, have an impact on inflation. It is a general message that we have for all.

To the extent that the Commission has an influence, we have the same message for the Commission as for governments and parliaments in the euro area. When I look at the figures I do not think that the Commission is a major contributor; nevertheless we have a problem there and we have to be conscious of the fact that there is a tendency to augment permanently, year after year after year, these components of inflation.

3-029
**President. –** I do not think that this is the object of our exchange today, but it could be the subject of lengthy discussions designed to establish whether or not taxes have increased within the European Union in the past few years.

3-030
**Gay Mitchell (PPE-DE). –** Mr Trichet, we have international accounting standards – Basle II, Solvency I, and now Solvency II coming on. I wish you well when you say that you are confident we will introduce transparency everywhere, because certainly we need it. When you add to these rules the role of credit rating agencies, which you have rightly criticised yourself, I have to say I am aghast at the fraudulent behaviour of some of our senior business people.

I want to ask in particular what further lessons have been learned from recent reviews of the role of regulatory authorities. Is the ECB looking to enhance or formalise dialogue or reporting from regulators in the event of market abuse that undermines market confidence? Very recently the stock of Anglo Irish Bank in Ireland nosedived because of rumours. The stock was then bought up very quickly, and the Irish Financial Regulator is investigating what appears to be an abuse of the market.

What steps, in cooperation with the national central banks and the regulators, is the ECB taking to combat this potential abuse, which is all too possible in times of uncertainty? There is evidence that some people are talking down certain stocks and then buying up those stocks. What steps are you taking in that regard?

You also described an ongoing, very significant market correction. With improved disclosure on and off the balance sheet, which we hope will come about along with more transparency as you have explained, in your opinion over what timescale are we to continue to face the sort of uncertainties that are now prevalent?

3-031
**Jean-Claude Trichet,** *President of the European Central Bank***. –** Thank you for your question. As regards your remark on rumours and on activities on markets – all kinds of markets, including the liquidity market – making money out of the propagation of rumours and then buying and selling in line with the effect of those rumours are, I think, criminal activities. They are criminal activities in all countries of the world, and they have to be very firmly combated. This is a general remark. As you know, as the ECB, we do not have direct responsibility in terms of banking or market

surveillance. We have to facilitate the appropriate functioning of these responsibilities, but we do not have a direct responsibility. But again, I stress that legislation in all countries makes such activities criminal.

As regards improved transparency, it seems to me that it is a process that we are presently observing. I am absolutely convinced that the spontaneous attitude of a very large number of institutions is to respond to the clear demand of markets – whether those markets are equity markets, bond markets or whatever kind of market. All this is absolutely clear to see. The call for transparency is present everywhere. I expect that, in absolutely all domains that make up global finance – and of course European finance and national finances – we will see the appropriate reflection in rules, regulations and the attitudes of surveillance authorities – the attitude not only of the banking surveillance authorities, but also of the insurance surveillance authorities and the SECs everywhere, in calling again for appropriate behaviour in this respect. The Asian crisis demonstrates very clearly that, if you do the job, you are then protecting yourself from possible further difficulties. Again, as regards Basle II and all the workshops that are working very actively and are about to be synthesised by the Financial Stability Forum, I must tell you that my colleagues are working very actively, also at a global level, in those workshops.

3-032

**Theodor Dumitru Stolojan (PPE-DE). –** Mr Trichet, I would like to ask you if you believe that adjusting the European economy to the new level of commodity prices will take one year or two years. Based on your assumptions, perhaps that reference interest rate – which is below or very close to 2% per year and is in a way amended or assumed by your ECB – should be kept to 2% or increased to 2.5% or 3%, because even your assumptions for next year regarding inflation rates are around these figures of 2.5-3%.

3-033

**Jean-Claude Trichet,** *President of the European Central Bank***. –** On the adaptation of our own economy – the euro-area economy – and economies all over the world to the new level of commodity prices, I would say that it is an ongoing process. It is a process of the adaptation of every economic agent, every firm and every economy at a national level, and of course at a continental level in the case of the euro area. So, in the light of that, I would not say that we will have adapted after one or two years of annual adjustment.

There is no such concept behind this. We have to permanently adapt to changing prices. It is the way the market economy functions and it is the process that we see before us, even if in some respects there are elements that prove that some are adapting more rapidly than others. The big mistake we could make in this connection – one that we made at the time of the first oil shock – is to forget about the absolute necessity to take the prices for what they are. If we want to hide the price level, as some did after 1974 as you will remember, then we will be in a very bad situation. A high price had to be paid at that time.

On the second question, whether we will change our definition of price stability, I say absolutely not. Our definition of price stability is less than 2%, close to 2%. It is on this basis that the inflation expectations are anchored. We are absolutely and inflexibly determined to maintain that definition of price stability, which, as I have said, is the key for delivering price stability in the medium term and certainly for permitting and avoiding the disanchoring of inflation expectation, which would be extremely damaging when we consider our primary mandate – totally damaging in the eyes of the people of Europe, because they are telling us to deliver price stability. It would also add to the turbulence because it would be incorporated in all medium- and long-term interest rates.

3-034

**Donata Gottardi (PSE). –** *(IT)* Mr President, I would like to go back to one of the first parts of your speech when you referred to the need to prevent indexing of nominal wages to price trends. I believe that this is a position which merits our support: the need to prevent automatic mechanisms which may act as inflation multipliers.

Fifteen years ago now my country, Italy, managed to put an end to the vicious circle which had grown up between automatic wage rises and price rises. Admittedly, as the most recent data show, cuts over the last five years have proved greater than anticipated and the problems they have brought about in terms of increasing the numbers of the 'working poor' are a matter of concern. In view of the situation, what instruments do you think you may need to protect wages and pensions and at the same time safeguard purchasing power and sustain internal demand?

As far as wages are concerned, the only model to which we have referred recently is the link with productivity and trends in productivity, increases in productivity and the decisions reached through collective bargaining. Although that is the case where wages are concerned, what about people who do not fall within the scope of collective bargaining? I am thinking of pensioners or people on the minimum wage, what mechanism for adjustment is there which can allow the best point of balance to be found while at the same time providing a solution which will not increase inflation?

3-035

**Jean-Claude Trichet,** *President of the European Central Bank***. –** These questions are very important. In brief, I would say that, in normal times, it is absolutely clear that the key for wage and salary increases that would be significant is labour productivity, as you said. Labour productivity, if at a high level, permits wages and salaries to increase without placing the unit labour cost for the firm or for the economy as a whole in a situation which would be non-competitive and therefore would create unemployment. This is clear, and in the case of some countries – in particular in the euro area –

we see high levels of labour productivity and a high level of progress in this domain, whilst there are other economies where we have a low level of labour productivity. Our understanding, therefore, is that structural reforms are of the essence, to permit those economies that have much too low a level of labour-productivity increases to catch up and achieve a much better level, which would be very important for the economy as a whole and for all individuals in the economy and would enable more increases in wages and salaries.

In times of external shocks, as I said, we are then in a situation where the economy as a whole has to transfer more to the external suppliers, whether it is a supplier of a commodity or supplier of oil. Of course, this is not at all agreeable; of course, we can try to fight against this very high level of prices at global level using appropriate means. But once the price is there, if you do not accept the price as it is, you are paving the way for spiralling inflation and increased unemployment. It is as simple as that. We could see what happened after the first oil shock at the end of 1973 and the beginning of 1974, and, even after the second oil shock in 1980, we could see all the difficulties and all the unemployment.

Never forget, mass unemployment in Europe started with the very bad reaction after the first oil shock. We had no mass unemployment in Europe before the first oil shock. We were at full employment in practically all the economies in Europe.

3-036

**Mia De Vits (PSE).** – *(NL)* Mr Trichet, following on from what the previous speaker said, you talk about price stability. I want to talk about people's purchasing power. Inflation is rising, wage and salary earners have been facing pay restraint for years, and we have determined that the share of wages and salaries in gross national product has fallen.

So my question is how can we maintain people's purchasing power? You also say that systems of automatic indexation must be restricted. You have repeated this, and so I am also going to repeat what I said during your last visit, when you made the same statement. Your statements about this lead to unnecessary polemic, certainly in my own country, Belgium.

We have no automatic indexing system. A large number of corrections have been applied to the system. And so I do not believe that there is still a country today that really applies full wage indexation. But it is necessary in order to maintain people's purchasing power. And I have not heard you talking about this.

A second point. You talk about monetary stability. I want to talk about jobs for people. If the single monetary policy cannot operate to the advantage of all Europeans, we are doing the wrong thing. And if there is a problem with demand, I think we must support that demand, by buying dollars, by reducing interest rates, so that we can make money available for productive investments.

And finally my third point, on regulation and control of financial markets. I do not think that, after all that we have been through until now, we can again rely only on self-regulation or on benchmarking; no, I think regulation is required. Three quarters of the volume on the financial markets is made up of hedge funds. They go to the Cayman Islands and do not want transparency. Large parts of the activities of the American banks are off- balance-sheet, and nothing has been done about this. So I believe that no more time should be lost, that we should take preventive action, that the ECB and its American counterpart must both come to the table, and that measures must be agreed.

3-037

**Jean-Claude Trichet,** *ECB***.** – On the first question, I will again repeat the position of the Governing Council: we are concerned about the existence of schemes in which nominal wages are indexed to consumer prices. My understanding of what you are telling me is that in your own case they are not indexed to consumer prices but they have a link with part of the prices, if I understand correctly what you have said.

We are concerned about the existence of schemes that link nominal wages to the consumer price index (CPI). We take a strong line on that because it is a recipe for being trapped into what was observed after the first and second oil shock.

This leads me to the second question. One of the most striking successes of the euro-area economy is job creation. Since the setting up of the euro on 1 January 1999, according to the figures that I have, we have created 15.7 million new jobs over nine years. In the nine years before the euro, we created 4.5 million new jobs. 15.7 million is significantly more than in the United States of America for an economy which is approximately the same size as regards the number of citizens in both economies on both sides of the Atlantic. It is very important that this impressive success in job creation should continue.

Structural reforms are of the essence; the continuing pace of structural reforms is of the essence. It is also clear that the recommendations that we are making are needed to ensure that abundant job creation will continue because, despite this job creation, it is clear that the level of unemployment remains much too high.

As regards your last question, I would certainly echo what you said on the need to embark on rules and regulations without hesitation. In any case we judge that self-regulation does not work because either there is no self-regulation or it appears to be insufficient. However, I believe that it is always important to give an opportunity for the views of the private sector.

As regards our cooperation with the United States of America, it is absolutely critical that decisions are taken

at the level of the international community as a whole, because we are in a universe where if some are regulated and others are not or some are subject to an appropriate set of principles and others are not we are all faced with great difficulties. We have to work out the lessons at global level and the methodology that we have introduced is designed to cope with that.

3-038
**Mariela Velichkova Baeva (ALDE).** – Some economists advise that a sure cure for inflation might be to send the economy into a deep recession. Monetary policy, interest rates, inflow of capital in regions with soaring interest rates and far-reaching changes taking place all over the world are only a few of the factors that influence the state of nervous tension in economies. The anti-inflationary viewpoint of some of the economic policymakers has become an obsession and is shared by central bankers across the world. Against this background, which weapon might be used to hit back at inflationary expectations?

3-039
**Jean-Claude Trichet,** *President of the European Central Bank***.** – I would say that price stability is, of course, the responsibility of central banks all over the world. We all know this, and a number of factors reveal this very strongly. It is also what our fellow citizens are calling for. What we ourselves are observing is that they are asking us – and when I say us, I mean not only the ECB but all central banks – to deliver in that respect.

One of the major tools we have in delivering price stability in the medium term is precisely the credibility of the central banks, the fact that inflation expectations are anchored and, therefore, that all decision-makers can take into account that, after the hump, due to a particular external shock – whether it be the commodity shock, the oil shock or the food shock that started significantly in the last quarter of last year – despite those shocks, their confidence that the hand of the central banks will deliver price stability over the medium term permits everybody to make the working assumption, when fixing prices, wages and salaries, that this is the precise future inflation to be taken into account. That is the reason why all central banks, and of course the Governing Council of the ECB, are so inflexibly attached to their mandate and to their credibility.

3-040
**Astrid Lulling (PPE-DE).** – *(FR)* Madam President, Mr President, we too are concerned about inflation, and I have just heard this morning, on German television, that influential politicians from both governing parties are calling in Berlin for a reduced VAT rate of 7% to be applied to energy supply, particularly gas and electricity. Moreover, for once the European Commission is also recommending, in its proposed amendments to the 2006 VAT Directive, which we are currently discussing here, practical application of such a measure, for example to supplies of natural gas, electricity and district heating systems. Would you be willing to lend open support to proposals of this kind, following your own good example of always calling openly on the social partners to exercise moderation in pay issues? This would also be a strong signal in the face of the increasingly pressing appeals addressed to you to relax monetary policy, whereas theoretically inflation should push you in the opposite direction to such relaxation.

3-041
**Jean-Claude Trichet,** *President of the European Central Bank.* **–** *(FR)* Thank you very much, Mrs Lulling, for this information. I should say that I am going to study the proposal that has just been made by certain people. At this stage, I do not have any studies, or even information, which would enable me to have an opinion. So I am going to look at this very carefully. It is clear that, as I have already said, in all of the past few years we have tended to witness very substantial, highly significant increases in indirect rights in different forms in different countries, including Germany. The only disadvantage that I can see at first sight in a measure of this kind is that by definition it tones down the true price of oil and gas. And the problem is that we are also relying on the price to reduce consumption and make energy savings. Energy savings are absolutely essential, in my view, in all the economies that are major energy consumers. And that is still the case with us, even if we have made some progress. So I do not have an immediate response. I am going to examine the question that you have put to me. I believe that is the only question that you asked, Mrs Lulling?

3-042
**Astrid Lulling (PPE-DE).** – *(FR)* I also asked about relaxing monetary policy.

3-043
**Jean-Claude Trichet,** *President of the European Central Bank***.** – *(FR)* It seems to me that I have already answered this question very clearly.

3-044
**Werner Langen (PPE-DE).** – *(DE)* Madam President, Mr President, I should like to begin by saying that in the past few months the European Central Bank has done outstanding work. You have not tagged along behind the USA, but instead, irrespective of all the criticism that was expressed, you have followed your own independent path. The following questions arise:

First, in the USA the indebtedness of companies and the state is rapidly increasing further. In an election year, irrespective of the bank crisis, a policy of cheap money is in any case the order of the day. Do you see this excessive indebtedness in all sectors in the USA as involving risks for or effects on the euro area and the real economy in the world?

Secondly, what is your view of the huge divergences in exchange rates in recent months or for even longer? If I look at the statistics, they show that major divergences like those today also occurred in 1994/1995 and 2001/2002. At the time exchange rates subsequently converged again, so that a particular mechanism effected a reduction in the margin. Do you expect the relationship between the euro and the dollar in particular to come

back more into line again, or are there reasons for the two to continue to diverge?

My last question, which is highly esoteric, relates to the fact that we are discussing boycotting the Olympic Games. An alternative that has been mentioned is not to boycott the Olympic Games, but to put in place restrictions on trade with China. Can you think of anything in relation to China as a WTO member that would not massively disrupt the global economic structure?

3-045
**Jean-Claude Trichet,** *President of the European Central Bank.* **–** I have already said that each central bank has to cope with its own environment, its own economy, its own shocks and the structure and cycles of its economy, which vary between countries, so I will certainly not comment on what you said concerning the policy of the United States Federal Reserve. I trust that they have to do what they trust and judge to be appropriate in an environment which is very different from ours. One of the differences – as everybody knows – is that our external account is balanced, which means that, domestically, our savings are financing our investment and that there is an equilibrium between savings and investment in the domestic economy, which is reflected in the external accounts, and these are also balanced. In the United States of America there have been real imbalances in recent years, and the Federal Reserve, in particular, had called for savings to be increased in the United States. So that is a big difference, to which you alluded.

As regards the euro-dollar, again I said in response to a previous question that, in the present circumstances, we are concerned by excessive exchange-rate moves, and I will stick to that response for your second question.

On the third question, I would say that the ECB has, at this stage, no opinion on this. If I may say so, it is a question for governments and for Members of Parliament.

3-046
**Pervenche Berès (PSE).** – *(FR)* When I heard Mr Langen's question, I thought that if you answered it, you would be exceeding your mandate, but I see that we both interpret it in the same way.

Mr President, please allow me to ask you a question in my personal capacity. You have again spoken in favour of self-regulation, codes of conduct and the market's capacity to manage the present situation. Have we not reached a stage at which this strategy has, all the same, shown its limitations? I hear many voices being raised, whether it be Joseph Ackermann or Mr Giovannini, people who are not advocates of regulation at all costs, who are now saying that perhaps the time has come to rectify the market's failings somewhat.

And among these failings, I see one that is quite pressing, namely the issue of transparency. You have told us many times, and again this morning, that transparency is of the very essence of the market – I believe we share this premise of economic theory –, but in reality, the very way in which the markets operate does not produce transparency. When I look at the way in which we have legislated here, in connection with the financial markets, whether it be in legislation on market abuses or legislation on MiFI, the legislature's action was absolutely essential in order to ensure that the mechanisms of transparency work. So if we now want to re-establish market transparency, can we simply rely on the markets to regulate themselves? Do we not need to correct the rules, to see that these rules are not appropriate in terms of giving the players on the market the necessary level of transparency?

Obviously this leads me to raise the question of supervision. But before I do so, I want to recall with you the situation that prevails in the United States, where, obviously, the way in which JP Morgan is in the process of buying Bear Stearns shares for 10 dollars a share with the Fed's complicity is leading some people there to think that the Fed is rescuing Wall Street's big investment banks with public money, even if the actual supervisory mechanisms are in the ECC's hands.

When it comes to supervisory mechanisms, you have told us that this is a global issue, and that is the level at which questions need to be asked. So be it, but I am very afraid of two things. The first is that, in this wider debate, we always leave on one side the question of offshore markets, and I do not understand why the world's greatest powers are not capable of taking this offshore problem seriously. If people are serious when they say that we must, in transatlantic fashion, settle the issues in the forum of financial stability so that the financial markets work properly, this issue must be addressed.

And then, over and above the dialogues we have, it seems to me that each of us must upgrade or improve our own supervisory mechanisms, we must take them forward. And from this point of view, I am convinced that in Europe, whether it be from the perspective of the Council's capacity to take initiatives or even the Commission's wish to do so, we are below the necessary flotation level, and I think that even if this does not fall within the price stability mandate, the Central Bank has something to say about this. You have said so in the past. Today one sometimes has the impression that basically, you do not really dare to move forward clearly on this issue.

3-047
**Jean-Claude Trichet,** *President of the European Central Bank.* **–** *(FR)* Madam President, you have broached many questions.

On the very important question of the regulation suggested by the institutions and participants in the market themselves vis-à-vis the imposition from above of administrative rules, I think we are in agreement on this. As I have said, it seems to me that we should always adopt the practice of asking participants in the

market themselves and the institutions themselves how they see the issue of improving their own conduct. It is a healthy practice, since everyone should consider themselves responsible. One of two things – either this exercise is convincing or it is not. When we are in the presence of market participants who themselves say that they are completely incapable of doing what they should be doing themselves, obviously there is indeed scope for regulation and administrative rules. This has always been the case in the past, and it would be the case today. Once again, I am definitely not saying that we need to rule out regulation and new administrative rules in advance, whatever the market or institution involved, but it is good for the exercise to be carried out, in order to see what are the best principles that can be applied. I believe that in French one would not say benchmarking, but *parangonnage*.

With regard to offshore markets, unregulated areas that are, moreover, at the very heart of our own markets in the industrialised world and also, incidentally, in the emerging economies, or which are not regulated outside our markets, this is a question that arises. It is legitimate to ask it, especially when one sees the phenomena that we have observed. Nevertheless, I note that to date the majority of the problems we have had to face up to have not come about – this is a paradoxical situation, but it has to be acknowledged. That does not mean that this will always be the case; moreover, I myself am very cautious. When I told you that we had diagnosed the situation, this diagnosis ultimately covered all the markets, all the financial instruments, all the institutions and the general underestimate of the risks. You will remember that this was our diagnosis. But even so, it must be pointed out that these very-high-leverage and unregulated institutions were not at the root, if you will, of the turbulence we are currently having to face up to. Once again, this is not a reason for not addressing all the issues, and I myself have said this – I believe that we need to be as comprehensive as possible, as exhaustive as possible, when we are drawing lessons from what we have seen, and that is what we are currently in the process of doing.

On the last point, the Central European Bank, the Central European Bank's Governing Council has a line that is very clear when it comes to supervision in Europe. We think it is possible to do much more than is currently being done by way of what in the European jargon we quite legitimately call the Lamfalussy concept. We must go further – that is the European Central Bank's position. We are encouraging all the other authorities, naturally governments, and also the supervisory institutions, to go further. We are not saying today that in a way it has been proved that the Lamfalussy process was not enough, and that we need to go on to another stage of institutional development. So perhaps that is where you have regrets. But in any case, I can tell you that we are thinking, again on the basis of the Lamfalussy concept, that we can go further, that we need to go further, and our strength is at the disposal of those who want to go further, and there are many of them.

3-048

**Daniel Dăianu (ALDE). –** Mr President, you mentioned the name of Alexandre Lamfalussy. He wrote a very interesting book nine years ago about crises in emerging markets and in that book he highlighted the dangers of the emergence of what we call nowadays 'the shadow banking sector' against the background of globalising financial markets. He said we might find that for a while there will be higher efficiency due to financial innovation but at the end of the day we are going to end up with greater financial instability and uncertainty.

This is the point, because this is not a new episode. Intellectual heavyweights and policymakers have been giving warnings for years. The writing was on the wall and we neglected the dangers.

What worries me is that even now we are talking too little about systemic risk. The arrangements in both regulatory frameworks and in policy-making do not pay enough attention to systemic risk. I believe that the shadow banking sector has to be regulated.

I would also ask you what you think about commercial bankers. What about the incentive schemes which reward reckless risk-taking at the expense of prudence? What should be done about it? Can we allow them to regulate themselves?

3-049

**Jean-Claude Trichet,** *President of the European Central Bank***. –** You are absolutely right as regards the warnings about the shadow banks and particularly when Alexandre Lamfalussy said and wrote that. We need to remind ourselves that in the Basle II framework part of these SIVs or conduits backed by credit lines from the commercial banks were to be taken into account, whereas they were not in Basle I. That is why the Basle I regulation has permitted the 'originate and distribute' model to generalise on both sides of the Atlantic – but more on the other side obviously – with all the consequences that have been observed. Basle II is better than Basle I. Basle II is being reviewed by the Basle Committee in order to be sure that we take into account all the elements that you very rightly underline.

As regards the attitude of the commercial banks: commercial banks have been regulated for a very long period of time. When we speak of commercial banks we do not necessarily speak of self-regulation but of improving the regulation that has existed for dozens of years. Of course all regulations have to be updated and improved because we permanently have to cope with the imagination and creativity of the financial markets. We should not block that imagination and creativity but it is our duty to respond to the permanent innovations that we are observing.

To sum up, I would say that nothing should be forgotten. We have a stress test of real magnitude at the level of global finance as has been constructed and transformed very profoundly over recent years. We must draw lessons from this. Nothing must be put aside. We would

be very wrong if we were to give any sanctuary privilege to any part of the present system.

3-050
**President. –** Mr President, we have come to the end of this hearing. We have arranged to meet you on 25 June. Perhaps by that time we shall have a more comprehensive view of what can be done or what must be done. In any case, in the interim we shall have had an exchange of views with Commissioner Charlie McCreevy on 1 April. Obviously he too is one of the players to question in this evaluation of the current situation.

*(The meeting was closed at 12.30 p.m.)*