3-002

COMMITTEE ON ECONOMIC AND MONETARY AFFAIRS
MONETARY DIALOGUE WITH MR JEAN-CLAUDE TRICHET, PRESIDENT OF THE EUROPEAN CENTRAL BANK
(in accordance with Article 113(3) of the EC Treaty)
BRUSSELS, WEDNESDAY, 19 DECEMBER 2007

3-003

IN THE CHAIR: MRS BERÈS

(The meeting was opened at 10.05 a.m.)

3-004

Chairwoman. – Ladies and gentlemen, we have been joined by Mr Jean-Claude Trichet, President of the European Central Bank. As is customary, I shall invite him to deliver his initial briefing, and let me remind you that the two subjects we identified as the main themes of this exchange of views were, firstly, developments in the property market and their impact on monetary policy and, secondly, the implications of the globalisation phenomenon in terms of inflation.

3-005

Jean-Claude Trichet, *ECB – (FR)* Madam Chairman, ladies and gentlemen of the Committee on Economic and Monetary Affairs, it gives me great pleasure to appear before your Committee today.

I shall begin my remarks with an assessment of the economic and monetary situation and set out the considerations underlying our recent interest-rate decisions, as I always do. I shall then brief you on the action taken by the ECB in the field of monetary policy in response to the tensions in the money markets as well as on the stability of the financial system in the euro area.

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inally, I should like to make a few remarks regarding the effects of globalisation on price trends as well as developments in the property market.

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Let us begin with the economic and monetary developments.

3-008

Since my previous appearance before the European Parliament in early October, incoming information has fully confirmed our view that, in a context of vigorous money and credit growth and sound economic fundamentals in the euro area, the risks to price stability over the medium term are clearly on the upside, as I said on behalf of the Governing Council after our meeting on Thursday, 6 December. The recent substantial increase in oil and food prices, together with unfavourable base effects from energy prices owing to the marked decline in oil prices a year ago, are having a strong upward impact on inflation in the current context. Looking ahead, the inflation rate is expected to remain significantly above 2% in the near future and it is likely to moderate only gradually in the course of 2008. Hence the period of temporarily high inflation rates would be somewhat more protracted than previously expected.

Looking further ahead, the December Eurosystem staff macroeconomic projections foresee annual HICP inflation to be between 2.0% and 2.2% in 2007, to then rise to between 2.0% and 3.0% in 2008, before moderating to a range of 1.2% to 2.4% in 2009. Compared with the September staff projections, the ranges for 2007 and 2008 have shifted upwards. These staff projections are based on two key assumptions. The first is that recent oil and food price dynamics and their impact on HICP inflation will not have broadly based second-round effects on wage-setting behaviour. The second key assumption is that growth in profit margins will moderate over the projection horizon. These two assumptions imply, in the context of the staff projections, a continuation of overall contained domestic cost pressures, which contributes to the moderation in inflation projected in 2009.

It is the view of the Governing Council that the risks to this medium-term outlook for price developments are fully confirmed to lie on the upside, mainly relating to possible further rises in oil and agricultural prices, increases in administered prices and indirect taxes beyond those foreseen thus far. In addition, against a background of sound economic fundamentals, stronger than currently expected wage dynamics may emerge, while an increase in pricing power in market segments with low competition could materialise.

As regards economic activity, incoming information confirms the sustained nature of economic expansion in the euro area, with real GDP growing by 0.7% quarter-on-quarter in the third quarter, while indicating some moderation in the fourth quarter. Overall, the economic fundamentals in the euro area remain sound.

Our scenario is based on the expectation that the global economy will remain resilient, with the slowdown of the economic growth in the US partly offset by the continuous strength of emerging market economies. However, in view of the potential impact of ongoing financial market volatility, and repricing of risks on the real economy, this assessment remains surrounded by a high level of uncertainty. In the Governing Council's view, the risks surrounding the outlook for economic growth lie on the downside.

The monetary analysis confirms the prevailing upside risk to price stability and medium to longer-term horizons. On the basis of the latest available data covering the period to the end of October, the underlying

money and credit expansion remains vigorous, even taking temporary factors into account such as the flattening of the yield curve, the financial market turmoil and specific transactions associated with the restructuring of certain banking groups. Therefore, monetary and credit developments continue to require very careful monitoring, not least with a view to better understanding the response of the private sector to increased market volatility.

The ECB's Governing Council stands ready to counter upside risks to price stability, in line with its mandate. Against this background, on 6 December we decided to leave the key interest rates of the ECB unchanged. The Governing Council will monitor very closely all developments. In particular, for the recent increasing inflation to remain temporary, it is essential that price and wage-setting behaviour remains unaffected by current inflation rates, so as to avoid the emergence of second-round effects. By acting in a firm and timely manner on the basis of this assessment, the Governing Council will ensure that such second-round effects and risks to price stability over the medium term do not materialise. To firmly anchor inflation expectations in line with price stability is even more important at times of financial market volatility and increased uncertainty. In this respect, the Governing Council will continue to pay great attention to financial market developments.

Let me tell you that, after the Governing Council has defined the monetary policy stance necessary for maintaining price stability in the medium term, in line with its mandate defined by the Treaty, the ECB has the responsibility to ensure the smooth functioning of the segment of the money market that we influence. I should like to underline – once again – that these two responsibilities are clearly distinct and should not be mixed.

Since we last met in October, tensions continue to be observed and during the last period, banks expressed concerns about their liquidity needs over the year-end. The new-year period is traditionally a period of scarce liquidity, as market activity is subdued and banks are preparing their year-end balance sheets.

In its open market operations, the ECB therefore pursued its endeavour to contribute to the smooth functioning of the euro money market. In particular, we renewed our two supplementary long-term refinancing operations and lengthened the maturity of the main refinancing operation, settling on 19 December from one to two weeks, thus facilitating the coverage of the year-end liquidity needs of banks. For this specific operation, we announced that we would satisfy all bids received at 4.21% or above, the 4.21% level being the weighted average rate of the previous main refinancing operation one week before. This announcement was consistent with our earlier communication and actions. It aims at minimising the uncertainty banks face when bidding at this operation, which is covering the end of the year, and at keeping interest rates close to the ECB's minimum bid rate.

In the main refinancing operations since the beginning of August, the ECB allotted significantly larger amounts of liquidity than under normal circumstances, with the aim of limiting the volatility of very short-term rates around the ECB's minimum bid rate. These large amounts of liquidity have always been absorbed later on during the maintenance period, so that the ECB has only provided banks with a liquidity needed for the fulfilment of their reserve requirement on average over the maintenance periods. Let me also underline that we only lend against very solid collateral. As always we did not change in any respect our collateral policy over the period.

Overall, the ECB's actions permitted the maintenance of very short-term rates close to the ECB's policy rate. The tensions which are observed in the longer-term money market rates are due in particular to the persistence of uncertainties surrounding the financial health and liquidity needs of financial institutions, as well as the impact of the ongoing global financial market correction, with a general reappreciation of risks. Under these tense circumstances, let me mention that, by reducing the volatility of the very short term rates around the key policy rates of the ECB and by containing pressures in the interbank term money market, the ECB's monetary policy operations have contributed to a better resilience of the European financial system without – of course – eliminating the causes of the tensions originating outside the money market.

During this period the Eurosystem remained, as usual, in close contact with other major central banks. In this context, on 12 December the ECB, the Federal Reserve, the Bank of England, the Bank of Canada and the Swiss National Bank announced measures designed to address elevated pressures in short-term funding markets. In particular, the ECB participates in joint action with the Federal Reserve and the Swiss National Bank. The ECB will offer up to a total of USD 10 billion in two successive auctions to Eurosystem counterparties against ECB-eligible collateral.

Through its actions as well as the joint efforts with other central banks, the Eurosystem, as well as the community of central banks, have shown their capacity to cope with a number of challenges that the euro and global money market are currently facing. More than ever, in this period of tensions, lucidity in the diagnosis, rapidity in the decision, and absence of complacency are of the essence. This absence of complacency is particularly necessary as regards financial stability.

I would like to share with you our assessment of the financial stability situation as described in the ECB's recent Financial Stability Review. Let me discuss briefly the role of financial institutions and authorities in coping with the present financial market correction.

With financial systems undergoing a process of de-leveraging and re-intermediation, uncertainty

surrounding the financial stability outlook for the euro area has heightened and may persist until it becomes clearer how the potential balance sheet effects of the turbulence will be spread across individual financial institutions. Clarity is also needed concerning liquidity commitments to off-balance sheet vehicles, and the magnitude of assets that may be re-intermediated back on to the balance sheets of euro-area financial institutions. The process of improving clarity, which started when Q3 2007 financial statements became available, will be advanced further when institutions publish their annual audited accounts for 2007 as a whole.

Given the uncertainties, the adjustment process in the financial system in the coming period may be challenging, and we have to be prepared for risks to materialise at any time. That being said, there are mitigating factors, including a broadly favourable economic outlook, the largely sound balance sheets of households and firms, and the generally sound capital positions of core financial firms. This should not, however, provide any grounds for complacency – I said that before – given the heightened uncertainties. In a fluid environment where financial system conditions may unexpectedly change, prudence is of the essence for both policymakers and financial institutions.

As to the policy lessons to be learned in order to avoid the recurrence of similar disruptions in the future, I would say that, while it is still too early to draw firm conclusions, there is a common understanding on the key issues requiring further analysis. In this respect, let me recall a few topics. First, the need for the financial industry to provide more public information about securitisation, credit risk transfer and complex structured products. Second, the need for rating agencies to review their methodologies for complex structured products and to address very seriously potential conflicts of interest. Third, the need for investors to review their investment behaviour excessively reliant on ratings. Fourth, the need for supervisors to implement the new capital framework under Basel II as rapidly and effectively as possible and to reflect on possible improvements of the framework, including the enhancements of the supervisory regime for liquidity risk. In this context, I will mention that the ECB, with the assistance of the Banking Supervision Committee, is carrying out work on banks' stress-testing and contingency funding plans.

On all the issues mentioned above, work is already under way at both international and European level. The ECB is strongly supportive of the Financial Stability Forum, as well as of the European initiatives discussed in the ECOFIN Council. In this context, I would like once again to stress the importance of effective cooperation in policy actions to be taken at the international level.

Let me very quickly turn to the impact of globalisation on price developments. The direct, and perhaps most visible effect of globalisation for consumers, is its implication for relative prices. On the one hand, globalisation has dampened increases in euro-area import prices of manufactured goods given a rising share of imports from lower-cost countries such as China and the new EU Member States. On the other hand, rising demand associated with globalisation has contributed to the significant increases observed in world energy and other commodity prices. All these evolutions warrant close monitoring, in particular given the risks of second-round effects. In the case of food-related commodities, it also underlines the importance of efficient supply side adjustment in agricultural commodity markets. This is particularly important here in front of the European Parliament.

A separate but nonetheless potentially equally important channel through which globalisation can affect inflation involves the indirect price impact of increased competitive pressure. On balance, I would say that, not only is the net effect of globalisation on euro-area prices difficult to accurately gauge, taking into account the two contradictory effects that I have mentioned, but it may also be changing through time. For this reason the ECB continues to very actively monitor possible ongoing changes in the inflation process which would be due to the globalisation phenomenon.

I would like to say a few words about developments in the real estate sector. As with other asset prices, residential property prices are closely monitored by the ECB in terms of our economic analysis. Within this context, while we take the euro-area real estate sector into account in assessing risks to price stability, we certainly do not target house prices or, for that matter, any other asset prices. We do monitor asset prices closely because of the potentially high costs for price stability and for the economy as a whole that are associated with strong appreciations and rapid reversals in asset prices. Also, our monetary analysis, as you know, covers the monitoring of money and credit, which often reflect the evolution of prices and house purchases in this sense. A strategy which, on top of our economic analysis, regularly assesses money and credit developments, has an important benefit on the monitoring side in that it can contribute to identifying and limiting the emergence of unsustainable developments in asset prices.

In terms of recent developments in the euro-area real estate sector, the latest available data on house prices appears to support the notion of a certain cooling in euro-area housing market developments after a prolonged period of unusually high growth rates in many euro-area countries. That said, house price growth generally remains relatively buoyant in the euro area – on average – when seen from a historical perspective. So, again, we have to continue to follow very carefully what happens in this domain.

The most recent information that we have from our monetary assessment, in particular the annual growth rate of loans to households, was that in October we had growth rates of 6.8%, from 7.0% in the third quarter and 7.5% in the second quarter. In this sense, I have to say

that there is no indication that the financial market turmoil has as yet limited lending to households, the moderation of which started as long ago as the second quarter of 2006, taking into account the rate increase which started in December 2005.

I am now at your disposal for questions.

3-009
Chairwoman. – We shall now begin the first round of questions.

3-010
Alexander Radwan (PPE-DE). – *(DE)* Mr President, in view of what is happening at the present time, one might get the impression that exerting influence on ECB policy, which politicians have not managed to do – thankfully, I must emphasise, for the EPP-ED Group is very clearly in favour of an independent European Central Bank – is precisely what the financial markets seem to be doing now. The behaviour of market players, which has been irresponsible in some instances, is compelling central banks in Europe, as well as in the United States, to pursue policies that may not serve the banks' own primary aims.

My question comes back to the effects of the crisis in the sub-prime mortgage market. Both in the US economy and in many European economies, we fear that more high risks are about to be dicovered in the coming year in what we call the market, whatever it actually is – that market to which all good things are ascribed and from which bad things are invariably dissociated.

This is my question: what does the ECB expect, and how are we in Europe prepared now for the scenarios that might materialise? Some national economies which have never been in the spotlight to date are now, as you know, being counted among the aspirants in the discussion about the year ahead.

My second question is this: what have we learned from these events? What are the lessons for our supervisory structure in Europe? Do you believe that the present supervisory structure, the cooperation between supervisory authorities in Europe, is adequate? What do you think of the way in which mortgages are financed in Europe? Even in the light of the present fiasco, we still tend to say that adjustable interest rates remain the best solution, and that sub-prime markets should be developed in Europe.

And the most important point in my view is this: what lessons can be applied to the interest-rate policies of central banks? You will be aware of the increasing number of voices asserting that it is precisely the Americans' policy of keeping interest rates low in recent decades that has fostered the development of the bubbles which have caused the current fiasco in the market. Do we not have to learn from that and draw the right conclusions?

3-011
Jean-Claude Trichet, *ECB***. –** Thank you very much indeed for your questions, which of course are very detailed and extremely pertinent. I said that it was no time for complacency and that a large amount of uncertainty was the mark of the times. What we are all expecting is that, progressively, transparency and the publication of results and certified accounts will introduce more and more clarity into the situation and will enlighten all market participants and all institutions so they can make their judgement.

I would say that I expect that more transparency – which is really the key word – will progressively permit better judgement by all market participants and institutions. At the same time, we must not be complacent, and we know that at any time risks can materialise: this is absolutely clear. We also have to keep in mind that we are in any case in a process of reappreciation of risks in general in global finance, and we know that the starting point was not a sustainable one. We know this, because it was our judgement and, I have to say, the judgement of some private institutions – certainly the judgement of the constituency of central banks – and we made the judgement public several times, a long time ago. So, again, this process of the reappreciation of risks is one which is ongoing and, in this respect, whatever the turbulences, the difficulties and the risks that we have to cope with, it is a process which was probably necessary, because we said ourselves that the previous features of global finance were not sustainable and that there was an underpricing of risks in general.

Now, what did we learn? I said myself that perhaps it is still a little early to draw definitive conclusions from what we are observing, but we certainly must draw all the conclusions and not put aside any particular segment of global finance. You mentioned the supervisory authorities. I would say that one of the lessons – and it goes very much in the direction that we had always anticipated – is that a very close connection is necessary between central banks on the one hand and supervisory authority on the other. We made public the position of the Governing Council of the ECB – the position of the Eurosystem in this respect – a long time ago, but what we have observed very much confirms the pertinence of this doctrine of the Eurosystem. We trust that decisions from now on should take that into account.

You asked for the sub-prime market in Europe – I would not recommend starting any kind of sub-prime mortgage market in Europe, as you can imagine. I think it is the last thing we should do, with the experience that we have. I would not say that central banks are responsible for what we are observing – certainly not. I think that we have done what it was necessary to do, particularly as regards the European Central Bank. You might remember that the main request I had regularly – even here in our dialogue – was to call upon the ECB to lower rates and be as accommodating as possible. I had to tell you that we were very sorry but we had to do our job, and our job was to deliver price stability. That is our mandate; it is also, I have to say, what the people of

Europe are very much demanding – not merely asking for, I would say demanding.

As I said, and I will conclude with this, we differentiate completely between our responsibility for our primary goal, which is to deliver price stability and be credible in the delivery of price stability – this commands a certain level of interest rates. Then, at that level of interest rates, we have the responsibility of having an appropriate functioning of the money market, particularly on the segment which is the shortest segment of the money market that we directly influence.

3-012
Chairwoman. – Thank you, Mr President. In the context of this dialogue, I believe it is also important that you provide answers and that you hear the Mermbers' questions. I should be grateful if you would adhere to speaking times without obliging me to interrupt you, because otherwise when we finally reach the end of the list of speakers there will be frustration among all those who have been unable to put their questions to you. I believe it is just as important and consistent with the true meaning of dialogue that you are able to hear what the Members of Parliament have to say to you.

3-013
José Manuel García-Margallo y Marfil (PPE-DE). – *(ES)* In recent days we have welcomed before this committee the Council – represented by the Portuguese Minister – yesterday the Commission – represented by Commissioner McCreevy – and now the President of the Central Bank. I think that this is a good opportunity to try to understand what is going on.

What I have gathered up to now from the previous meetings – and feel free to correct me – is that the only thing that we do know is that we know very little about what is going on.

There is a liquidity crisis and attempts have been made to resolve it through coordination with the Federal Reserve and a massive injection of funds yesterday. Clearly the Euribor has fallen as a result of that injection. According to many experts, it has not yet fallen enough.

However, when it comes to the second crisis, the crisis of trust – what damage have the financial institutions suffered – the level of uncertainty is very high.

According to the media today, the most important global credit-rating agency is claiming that the financial institutions, both American and European, have only revealed a quarter of their losses.

In my view, this indicates that there have been regulatory shortcomings as well as shortcomings in terms of supervision and control. Financial engineering in the creativity of new products and new vehicles has taken precedence over regulation and supervision, and now the hope, if I have understood the word correctly, is for transparency, i.e. the publication of audited results that reveal to us the magnitude of the disaster.

What I would most like to know, however, is to what extent the Central Bank intends to act: flexibility of collateral, flexibility of time and interest, flexibility of a change and/or possibility of a reduction in interest rates, taking into account that the functioning of the markets is probably now as important or more important than price stability.

My second very specific question that I want to put to the Council and to the Commission – and both have referred to the President of the Central Bank – is what is going to happen to the euro, given that we are in a currency system. We would like the answer to this, as I am sure you probably would, Madam Chairwoman.

3-014
Jean-Claude Trichet, *ECB***. –** We are living in a market economy at the level of Europe and at the level of the world. In a market economy you have risks, and risks can materialise. If you are in an economy where there are no risks and where risks do not materialise, you are not in a market economy, you are in the Soviet Union. In the Soviet Union there were no risks and they did not materialise until the economy itself evaporated. So what we have to do is to be as alert as possible in identifying risks, in trying to prevent risks from materialising and in trying to prevent the materialisation of risks that will create systemic problems of the first magnitude.

That is the way we look at it in a market economy, where prosperity, growth and sustainable growth in the long term rely upon risk-taking. If risk-taking has any meaning then from time to time it will materialise.

Having said that, it is particularly true that we are experiencing an ongoing process of great magnitude which, as we see, can be found on both sides of the Atlantic and which is a combination of a number of phenomena that originate in the sub-prime mortgage market but also have to cope with this ongoing market correction of a significant magnitude, which corresponds to a reappreciation of risks in a large array of different markets.

So it is not surprising that you comment that uncertainty is very high: it is true, uncertainty is very high. It is an ongoing process, the situation is changing, it is moving, so it is not surprising that the assessments that are made on the immediate situation also change over time.

I count on the lucidity and on the capacity of all private institutions, as well as public institutions, to meet their responsibilities, to help progressively reassess the situation and make it possible to go back to a more normal situation. However, it is true that this ongoing process can reserve surprises and again I understand your comments. As far as the central banks are concerned, we try to do what is necessary. Again, do not forget our two responsibilities, one of which is the Treaty mandate to deliver price stability. I would not answer in any other fashion as regards the question of flexibility on interest rates and so forth. Interest rates are

dependent on the delivery of price stability in the medium term.

Flexibility of collateral: we have not had to take any decision in this respect. As I said, we have not changed our collateral policy in any respect. We have absolutely nothing to do with that. This is important when you hear that there is perhaps some kind of bailing out and so forth. As I said earlier in August, there is absolutely no bailing out. We are lending for the short term on the basis of the good, very solid collateral that we have had since the beginning of the ECB. It is only the way. We are lending at a certain price, which is the price that we consider appropriate for the monetary policy stance.

3-015

Chairwoman. – Mr President, you took four and a half minutes for your reply instead of three, and I must object. We shall never get through our business. I know that you are very fond of this forum and that it is a good channel for you to convey your messages, but the reverse is also true …

3-016

Karsten Friedrich Hoppenstedt (PPE-DE). – *(DE)* The situation seems to be serious, Mr President. I have heard many contributions from you, but they were never as long, nor did they contain as many facets, and even your typed speech was longer than ever before. This means that the situation must be far more serious than in past years.

Naturally enough, I also have one eye on the other side of the Atlantic, as we all have. As I indicated yesterday, the US economy has grown by 4 200 billion over the last seven years, but at the same time the level of borrowing has risen by 21 300 billion. That represents a huge increase in the debt-to-GDP ratio, which naturally leads to steady devaluation of the dollar and reduced purchasing power. This, of course, creates the possibility of stagnation, the potential extent of which is difficult to assess. Through that stagnation, the rising tide of US debt would affect the global economy and possibly impact on the support of many countries that take out loans in the United States to prop up the dollar. I mean that the Governors must surely break out in a cold sweat when they review the situation, because when investment opportunities stagnate or decline in the United States, we certainly feel the pinch here.

How do you assess the position? You cannot swim against the US tide, but how do you see it impacting on Europe?

Let me ask one final question. You have said that banks should engage in other forms of risk management too. We have just discussed Solvency II and the quantitative impact studies in which thousands of large companies took part. Is there not some means by which banks could also undertake a meticulous examination of all possible scenarios and arrive at a quantification of the medium-term risks?

3-017

Jean-Claude Trichet, *ECB***. –** If I understand the question correctly in relation to the impact of the sub-prime mortgage evolution and the present market correction on the real economy, I would say that, concerning the United States, we in the ECB rely very much on the assessment of the Federal Reserve system, which considers that a slowdown is on its way without dramatic events. As I said in my introductory remarks, the slowing down in the US on the one hand and the very impressive growth in the emerging world on the other hand – the combination of the two – would not change our overall economic environment very significantly.

So the baseline scenario that our staff has computed, even if there has been a certain reviewing down as you know, will continue to suggest that growth next year could be around our potential. That is the baseline scenario.

I also said, and it is the sentiment of the Governing Council, the risks to this scenario lie on the downside – that is clear – and we are back to the uncertainty that has been mentioned. It is important nevertheless to see that until now all the information we have had in the form of hard data or survey data and all the information that we have on the monetary side, on the credit side of the coin, does not suggest anything but continuation of growth, which would be around potential. But again, risks lie on the downside: that is clear.

As regards the financial institutions in general, we are back to the question of what lessons do you draw from the situation. As I said in the introductory remarks, we certainly should not be complacent in any respect when we draw the lessons of this phenomenon. Certainly a lot of improvements have to be carried out by the commercial banks and financial institutions themselves.

In a market economy, of course, the first responsibility lies with the market participants and institutions. They have to considerably improve their own risk management, they have to considerably improve their understanding of the risks they are taking, they should not blindly rely upon rating agencies; this is clearly demonstrated by the present situation. They have to reflect on their business model. The 'originate and distribute' model clearly has a lot of drawbacks as it has been practised, which we see now in a way that speaks for itself. I could on. There are lots and lots of improvements to embark on.

3-018

Elisa Ferreira (PSE). – Mr President, I understand what you said about risks in the market economies, but the problem is when we do not have a clear perception of the level of risk and when this lack of perception can affect the credibility of the whole system. I think this is the dangerous thing about what is happening.

Concerning the role of the ECB: yesterday we had a meeting with monetary experts which confirmed that there is no correlation between the level of growth of

M3 and the consumer price index. On the other hand, they recognise that there is a close link between this increase of M3 and the price of stocks, both in the stock market and in real estate, creating some sort of bubble, and that it is from these areas that we can have a long-term or medium-term impact on consumer prices. On the other hand, internal consumer price increases are not a consequence of the M3 level, but rather of external strong demand by emerging economies, which will remain for a long time. So the adaptation of supply will also take a long time.

I welcome the fact that you have decided not to increase the interest rate, in spite of the inflationary pressures, because I think it does not match with the scenario. But what kind of philosophy or perception does the ECB take from this crisis and all these elements: in particular, what about reshaping trust? I understand, and I agree that you did a good job concerning the role of the last resort lender; but when it comes to reshaping trust, what do you think of the recently passed Fed regulation in relation to mortgages, of Mr Padoa-Schioppa's suggestion, and of the global meeting that you – the ECB – had with the different central banks?

How do you address the systemic international risks that have not been addressed? What is the role of the ECB in this context? This is a more structural question.

3-019

Jean-Claude Trichet, *ECB***. –** First, on the monetary analysis, which is one of our two pillars, you are right when you say that it gives very important information on what is likely to happen concerning longer-term inflation. As you know, our own concept of monetary policy is that it is the cross-checking of the two analyses that allows us to have a better understanding of inflation in the medium to longer term for the purposes of monetary analysis. Of course it is absolutely clear, as you said, that the wealth effect of prices, of all kinds of assets in general, then has an impact, through demand, on inflation in the longer run. So you summed up part of our monetary policy concept very well, if I may say so.

Now, our main problem in the present circumstances is, of course, to avoid second-round effects. If we had second-round effects, then we would be in a totally different universe. It in unavoidable that we have to cope with the hump of headline inflation, because of the price increases in oil, commodities and food. If we had second-round effects, it would become permanent. All our efforts are being made to ensure that it is a temporary hump, which will not bring price stability into question, in line with our definition over the medium term. For those second-round effects not to materialise, we have to be there and say that we would not hesitate to do whatever is necessary to prevent them from materialising. So do not be surprised if we remain alert and if we tell market participants, economic agents, social partners and all price setters, that we would not hesitate to do whatever is necessary to avoid second-round effects.

Again, the real question is how to reshape trust in the system. We remember, as was said, that after the Asian crisis we were lucky enough to draw on a series of lessons and they proved – most of them proved – to be lucid and effective. We can see that now, because the emerging world is behaving quite properly at the present time. The problems that we are discussing are the problems of the industrialised world, not the problems of the emerging world. Because I trust that appropriate lessons were drawn from the Asian crisis. We have to do exactly the same; what is envisaged by the Federal Reserve seems to me to go very much in the right direction.

3-020

Dariusz Rosati (PSE). – Mr President, you gave us the opinion of the Governing Council that the medium-term risks to price stability lie on the upside. I could not agree more. The data that are coming to us from the market and from statistical institutions show that we have already had high inflation over the last several months, inflation exceeding the target of the ECB, and that this inflation will remain high, close to 3% in 2008. The main driving forces behind this high inflation, that is food prices and oil prices, will remain here for quite a long time.

Most observers consider these prices, especially food prices, to be a reflection of structural adjustments on both the supply and demand side, so these are not purely temporary phenomena. Also, monetary and credit aggregates have been growing very vigorously over the last two to three years and will probably continue growing at double digit rates in 2008.

Against all these upside risks, you decided not to react at your last meeting and the lack of reaction is based on the clear assumption, as you say, that the second-round effects will not materialise. I would like to ask you: how do you justify this assumption against such a consistent picture of upside risks that emerge in the medium run?

Secondly, this behaviour is in striking contrast to the previous behaviour of the Central Bank. I especially remember the last decision in December last year, when the so-called 'upside risks' were much less severe than they are now, and nevertheless it decided to increase the rates. My second question is: does this moderation today mean a change in the reaction function of the Central Bank and what does it mean for the future of monetary policy in the euro area?

3-021

Jean-Claude Trichet, *ECB***. –** First of all, let me clarify that the projections which have been made by the Eurosystem staff are the projections of the staff and not the projections of the Governing Council. This is the difference between our monetary policy concept and an inflation-targeting policy concept, where the projections are the projections of the Governing Council, of the Monetary Policy Committee.

The Eurosystem staff are telling us that we are likely to have inflation of between 2.0% and 2.2% this year – we

will see – between 2% and 3% in 2008 and between 1.2% and 2.4% in 2009. It is their assumption in producing those figures that there will be no secondary effects. What we ourselves say is that we will not tolerate second-round effects. This is what we say.

As I also said, this relies entirely on our own credibility – on the credibility of the Governing Council of the ECB, as seen by all price setters, social partners and all those who have an influence on prices. This is the situation. This is the reason why we are alert and we have to be alert. It is also the reason why I say: do not mix up the present market turbulences on the one hand and the monetary policy rate on the other. We are totally separating the two.

We consider that we have to fix the rates at the appropriate level and then, at that level, to take care of the appropriate functioning of the money market. This is something which is fundamental. All I can tell you is that, at the moment when I was speaking, explaining the last decision of the Governing Council, the Governing Council considered that it had to remain totally alert. I informed you of this much, perhaps you remember, and that the level of interest rates was in line – taking into account this permanent alertness – with the delivery of price stability in the medium term, in line with our definition. Having said that, again we will do whatever is necessary.

3-022
Wolf Klinz (ALDE). – *(DE)* Mr President, allow me to begin where Mr Rosati left off. Without the turbulence in the markets, the ECB's interest rate would surely now be higher than 4%, probably even 4.5%. In other words, you are simply emphasising – as indeed you explained before – that you regard the smooth functioning of the euro money market as one of your responsibilities.

If that is the case, would it not be clearer to say from the outset that the European Central Bank has two tasks, the first being to guarantee price stability and the second to guarantee the operation of the euro money market? That would also make it comprehensible why we now have an interest rate of four per cent rather than the four and a half per cent we would surely have if your only commitment were to price stability.

Point 2: the US legislators are in the process of adopting a law that will fix mortgage interest rates for a five-year period. This is a massive intervention in market mechanisms. Do you believe it is justified, or do you not see it rather as merely shelving the problem until a later date?

Point 3: The President of the Kreditanstalt für Wiederaufbau (KfW), the German Reconstruction Loan Corporation, which is also the major shareholder in the troubled IKB, said that if she had known what the total bill would be for saving the IKB, which had a shortfall of almost ten billion euros, she would not have agreed to prevent its collapse. How do you respond to that?

3-023
Jean-Claude Trichet, *ECB***. –** I am not sure that I got the last question, I am sorry.

3-024
Wolf Klinz (ALDE). – The President of the KfW – that is the bank that controls the IKB, the bank that is in trouble in Germany – said just two days ago that, had she known how much money it will cost her to save the IKB, she would not have done so. She would have let the bank go bust. What is your reaction to that?

3-025
Jean-Claude Trichet, *ECB***. –** To take the first remark, which was a comment on our own attitude: again you see with what clarity I say that we do not mix the two. I say that very clearly, because a number of observers – of market participants – have a tendency to compare various behaviours and to mix the two.

No, we do not mix the two, and I say very clearly: we do not mix the two and we will do whatever is necessary. Our reasoning is that we have to deliver price stability in the medium run. In our own understanding of the situation, it has nothing to do with what might be necessary, at whatever level of interest rates, to take care of the appropriate functioning of the money market. This is very important.

We have several angles on the US decisions. One angle is the help which is given – or would be given – to borrowers to face up to their commitment. It seems to me that you were alluding to that measure. I will not pronounce myself; I do not have a complete analysis of what it would do. It is very much a way to help individuals as well as to help the overall situation. It is also very much a decision made by Congress in the United States and not at all, of course, by the Central Bank.

On the other hand, there is a totally different approach, which is to avoid irresponsible lending. This is what is prepared by the Federal Reserve, and I said that I thought it was a very good move to go in this direction and to prevent irresponsible lending.

Concerning your last question, you informed me of this declaration by the President*in*, and I will reflect on that remark.

(Laughter)

3-026
Guntars Krasts (UEN). – Mr President, global financial systems are becoming more and more integrated; they are visible and we have seen them strengthen over the past decades. This sets unprecedented challenges that are beyond those which can be managed only by the central banks. For instance, the interest rate rises of the United States Fed interacts rather directly with monetary policy in Asia. At the current stage this means additional price pressure beyond current Community price increases, let us say for oil or food.

I am interested to hear your assessment of possible coordination of the central banks – and not only central banks, because this issue goes beyond the instruments that the central banks can sometimes apply for control. What institutional arrangements, structural reforms, would need to be carried out by the European Union Member States to prepare for this very globalised, very interactive global financial world? Do you have some ideas on this?

3-027

Jean-Claude Trichet, *ECB*. – I think that you are absolutely right in mentioning the fact that in the world now there is a very deep and intimate level of financial integration. It is very striking to see to how great an extent global finance has changed over the recent period of time. I have already mentioned the Asian crisis and the recognition that we were all interdependent and that a medium-sized country in Asia could trigger turbulences of the first magnitude that would have an impact at a global level. We had full confirmation of this integration recently.

The Central Bank's approach is very much that the prosperity of the global economy is closely associated with this free circulation of capital and this optimisation of capital and location all over the world, which has created a new functioning of the global economy. So we consider that this integration of financial markets is a very precious asset.

The counterpart is that we have to reflect at a global level on any kind of changes or improvements that we judge appropriate. This is a lesson that we have already drawn from previous turbulences – the creation of the G20 at a global level, ministers and governors of the major participants in the global economy around the table. We have created the Financial Stability Forum, which is also a way to address the issues at a really global level.

As you know, at Central Bank level, we have very intimate cooperation in our own constituency of the various meetings under the auspices of the BIS in Basel. So I would say that there is fully fledged recognition that we have to reflect mature possible changes and possible actions. The lessons that can be drawn from the present turbulences will have to be drawn at a global level. Of course it is then up to each economy and continent to implement through its own decision-making process – I hope as rapidly as possible – the lessons considered appropriate.

3-028

John Purvis (PPE-DE). – Mr Trichet, that was an interesting answer to the question from Mr Krasts, and I agree that a global market is wonderful. But what happens when we have sovereign states or private commercial operations hoarding some of that precious liquidity and capital? I think this is the situation we are in now. I compliment the ECB on its actions over the last few months and up to the present in trying to counteract this liquidity problem that we have.

I saw one of your opposite numbers saying that maybe we will reach a limit as to how far we can go in this. I would just like your estimate: is there a limit to how much you can prime the markets? The figures are mind-boggling, but is there any limit – and if there is a limit, are we getting anywhere close to it?

What is the impact of these huge amounts of money on your own ECB balance sheet? I would be interested to see your year-end balance sheet when it comes out. But if the banks go on hoarding cash – which seems to be the prime problem – do you think there is a case for you, or your national central bank colleagues, to get some of these chairmen and chief executives of the banks together, knock their heads together a bit and get them to start resuming normal business? – because really that is where the problem seems to lie.

3-029

Jean-Claude Trichet, *ECB*. – My first remark is that we are lending on a short-term basis with exactly the same collateral as was decided on when the institution was first founded. We have not changed, and we have not lost collateral in any respect. We are – as I said in the introductory remarks – not borrowing liquidity definitively. We are getting back all the liquidity and, taking everything into account, we have displaced the liquidity in time, but we have not added liquidity.

What we have done is to preserve the very short-term end of the money market in line with our minimum bid rate. When you look at the maintenance period, you will see that this action by the Central Bank aims to maintain as appropriate an order as possible in the shorter-term end of the money market.

As I said, we do not pretend to cure the situation. The situation originates outside the money market. I think it would probably be naive to think that we could call upon the various CEOs and tell them nicely to lend and borrow together as is required for appropriate functioning. No, because it comes out of something which is real. We have real problems that are not yet solved.

Of course, we have to pave the way for those issues – those tensions that originate outside the money market – to be progressively cured. What we are doing is keeping a steady hand *(Intervention from the floor: 'sticking plaster')* in the short term on the money market. We do not pretend to do anything, but we had said publicly that we would do that and we are only doing what we said. Again, you are absolutely right if you say that, implicitly, it does originate outside the money market. That is absolutely clear.

3-030

Cornelis Visser (PPE-DE). – I would like to address another issue, which is the meeting Mr Trichet had with the Chinese authorities. As you are aware, the current yuan rate and the link with the dollar is a problem for our economy. The problem could become even bigger with a change in the rates of the dollar and the yuan: if they go up, we will have another inflation problem. So I

think it would be good if the Chinese authorities also had an independent rate for their currency.

I was wondering what was the result of your meeting with the Chinese authorities on this issue, and whether they are also convinced there should be a moderating impact on the yuan on the world market or whether they will still continue to link it to the dollar?

3-031
Jean-Claude Trichet, *ECB*. – First let me remind you of what I have already told you that, since the G7 meeting in Florida in February 2004, we have had a joint position with the United States, the UK, Japan, Canada and of course the full body of the euro area including Germany, Italy, France – all the members of the euro area. We have a joint message for emerging Asian currencies, in particular the yuan, namely that it should be more flexible, which means that it should appreciate. That was the first clear message in this direction, at the beginning of 2004.

Since June and July 2005, there has been an appreciation of the Chinese currency vis-à-vis the US dollar. At the most recent meeting of the G7 we gave the same message concerning emerging Asian currencies and the yuan, with the addition that we were thinking that an acceleration of the appreciation was in the interests of all parties concerned. So I am referring only to what has been made public and the joint, publicly expressed position. In Beijing we explained why we trusted that it would be in the interests of all parties concerned to go along this line, which again was not new because we had said that already, but it was a particular way of conveying the message.

3-032
Astrid Lulling (PPE-DE). – *(FR)* Mr President, the Governor of the Central Bank of Luxembourg, whom you know well, recently caused a stir in my country by speaking out publicly against wage indexing. You know that automatic adjustment for inflation at all costs, as practised in Luxembourg, would make any country less competitive, as Mr Mersch says, and all the governors of the central banks in the eurozone would agree.

Are you speaking to the President of the Eurogroup about the problem of indexation, which is treated as a sacred cow in the Grand Duchy?

My next point is that you are plainly right to be worried about the inflationary forces. Indeed, a highly reputable German newspaper, the *Handelsblatt*, is even saying, and I quote:

3-033
The European Central Bank, under the presidency of Jean-Claude Trichet, is compromising its reputation as a stability-driven central bank.'

3-034
(FR) With regard to second-round effects, the paper says that

3-035
'the dreaded second-round effects will more than likely come into play around 3%'.

3-036
(FR) and we have reached 3%.

Now, given your powerlessness to influence oil and food prices, do you not believe that the very first thing for you to do is to address national and regional governments, local authorities and the European Commission to urge them to stop driving up institutional prices and the rates of VAT and excise duty through measures such as the significant increase in minimum rates of excise duty on diesel? You are still ready to preach moderation to industry and labour – you said you would be tough on them – but you never cite governments or the European Commission. Why do you handle governments and the European Commission with kid gloves when it comes to preaching moderation?

3-037
Jean-Claude Trichet, *ECB*. – *(FR)* Thank you very much, Mrs Lulling. These are good questions, which deserve direct answers.

We ask all those responsible for increasing administered prices and for indirectly raising prices to refrain from ordering such increases, especially in what are, objectively speaking, difficult times, for many other reasons. This has always been my message – let me emphasise that – and the inflationary risk factors we have cited have always included increases in administered prices and indirect taxes in excess of those already in the pipeline, which are themselves considerable, and in some cases very considerable.

Since the euro was created we have had inflation being driven to an absolutely abnormal degree by these indirect taxes and administered prices. I therefore entirely endorse what you are saying. There is a very powerful message in all of this, namely that inflation is the product of an extremely complex set of factors, including these institutional increases, which are truly a matter for parliaments and governments.

Secondly, yes indeed, the indexing of wages and prices – for it is not only wages that are index-linked but all sorts of prices too – is a very bad thing. It is correct that economies in which there is no indexing enjoy a huge advantage over non-indexed economies at times of externally induced shocks. In fact, the non-indexed economy will preserve its competitiveness, will easily find its way back to its former state of price stability, and its unit production costs will not be affected by the temporary hump in headline inflation, whereas the indexed economy will lose its competitiveness and find itself confronted with higher unit production costs. It is therefore a fact that, especially in difficult times, indexing penalises countries by making them less competitive and hence inevitably restricting their long-term growth and reducing employment. Such countries find themselves in a situation that is less conducive to employment.

Accordingly, our message is essentially that we must take care to eliminate gradually the instances of indexation in our economies. That, of course, is especially true of a vast continental economy with a single currency such as that of the euro area.

3-038
Antolín Sánchez Presedo (PSE). – *(ES)* I have two very specific questions, Mr Trichet.

You are doing an excellent job at avoiding credit restrictions. I would like to know if you have any information on the impact the current situation might have on SMEs.

The second question is basically about globalisation: price stability and financial security begin far beyond our borders. We see this in the agricultural markets, which are international markets. The problems also stem from the US real-estate sector. They have an impact here, so we increasingly need to look at the issues from a global perspective.

Specifically, you are working closely with the US Federal Reserve and central banks of other countries, but – apart from providing these facilities – are you developing any specific approach to dealing with future liquidity and credit risks? Clearly, what is happening elsewhere in this respect is going to affect us too.

You visited India and China last month. Over the last 18 years you have been participating in the G7. You therefore have much experience of the need for international financial architecture. Could you provide us with some details on this aspect?

3-039
Jean-Claude Trichet, *ECB***. –** Concerning the impact on the SMEs, let me just say again that we are totally separating what we do as regards the monetary policy stance, which aims to preserve price stability over the medium term, in line with our definition, and what we do on the money market. On the money market, we take care of the segment of the money market – which of course is the shortest segment that we can directly influence – and we take care it is close to our minimum bid rate, which is, again, defined by our own assessment of the monetary policy stance.

As regards the outstanding credit to the private sector in general, there are a lot of differences between the various economies in the EU area but, if I take the EU area as a whole, we have, as you know, a very dynamic, outstanding growth of credit. This is one of the counterparts of M3 that we are looking at with great attention. This is the reason why we have not seen ourselves until now in the figures that we are gathering on the recent episode.

We have to take this into account when we proceed with our monetary analysis and overall analysis of the appropriate decisions to be taken. The dynamics: for instance taking the outstanding credit to non-financial corporations and taking everything into account, we have figures that are close to 14%, which is very dynamic. Of course there is probably a very complex underlying phenomenon, with re-intermediation of some credit and probably with the tightening of credit conditions in other cases. But the overall result that we have before us is, as you see, very high.

As regards what is done in the United States, it is clear that they are reflecting intensively on lessons to be drawn from what has happened. It originated in this particular segment of the real estate mortgage market, and many lessons will have to be drawn. I have already commented on what was envisaged by the Federal Reserve – something we would certainly have considered appropriate – but we will see. This is work in progress on the other side of the Atlantic.

My last point is that I would confirm that any lesson we draw from this turbulence will have to be drawn at the global level, and certainly not forgetting that we are all interdependent. It is true that we in the industrialised world, and particularly on both sides of the Atlantic, are affected, but it is also true that we have to draw lessons that would be fit for the global economy as a whole, just as, when we drew lessons from the Asian crisis, we reached conclusions that were fit for the global economy as a whole. I would – as I have already said – urge all of us to work very actively to draw all the appropriate lessons.

3-040
Mariela Velichkova Baeva (ALDE). – Mr Trichet, you have commented to a certain extent on the context of my question. However, I would like to take advantage of a recent phrase of yours, that your central bankers look at countries with the unexciting lenses of numbers, facts and figures. Could you please use those lenses at this very moment and give an estimate of the outcome from the financial turbulence for European investors and industries, including the financial sector, which play a significant role in the American market.

3-041
Jean-Claude Trichet, *ECB***. –** This is a very important question, but I will give you a response which is very close to what I have already said. As regards the United States, we rely very much on the diagnosis of the Federal Reserve, which has proved to be wise over the period that we are experiencing. As I have said, they think that there will be a slowing down of the US economy but that the US economy will continue to grow at a significant pace, in spite of this slowing down.

As regards ourselves, the baseline scenario is that we would be close to our potential, close to 2%. I have already mentioned that we have the Eurosystem staff projections, which are not the projections of the Governing Council; we rely very much on the Eurosystem, but we also look at a large number of other elements. Let me remind you of the Eurosystem staff projections which for 2008 are growth of GDP between 1.5% and 2.5% and for 2009 growth between 1.6% and 2.6%.

In comparison with the September 2007 staff projections, the ranges projected for real GDP growth in 2008 have been revised slightly downwards, whereas for 2007 the new range lies within the upper part of the previous one. All this is to confirm that, for us, the baseline scenario remains around potential. I also said that we consider that the risks are lying on the downside. That is clear.

3-042

Zsolt László Becsey (PPE-DE). – *(HU)* Thank you, Madam Chairwoman. I would like to ask two questions. One is related to Mrs Lulling: you are not involved in politics, but nevertheless you could still consult her if price stability is that important. It is true, on the one hand, in the case of indirect taxation, where the Commission is fanatically submitting its inflation proposals, with which it places a burden mainly on those countries that are legally also bound, namely those who haven't even joined the euro area. Of course, those who are members can do whatever they want with their inflation, but those who are not members must be accountable. And the issue here is not only indirect taxation, but also the operation of the domestic market. There is the Services Directive, the Posting of Workers Directive, and I have just heard that there is something against hauliers too. All this is in essence nationalism, bringing about hysteria against the Poles and Romanians because they do not allow cabotage for hauliers since that would also reduce prices, and it would not only increase competitiveness, but would also bring prices down (sorry…) – the service prices, that is. Would you then consult with the European legislators, especially with the Commission and the Council?

My second question relates to the extension of the euro area. It seems to me that Slovakia remains quiet, though it has been a member of the IRM-2 for more than two years and wants to join in 2009. Poland and the Czech Republic are somehow playing a little game, and I feel that they do not really want to join the euro area in the near future because of one or two Maastricht criteria. I don't know what you think about this, Mr President – whether this has become a tendency now. And these countries have a contractual obligation to enter the euro area, but they are not very willing to do so. What is the current situation regarding this issue, and how do you asses this situation, which is somewhat new to me, in respect of the past year? Thank you.

3-043

Jean-Claude Trichet, *ECB***. –** As regards the first question, we have general messages for those responsible for indirect taxation and administrative prices. I have already responded to a question on that. It is a general remark and a general message that they should not impact headline inflation, for all kinds of reasons. It would do nothing but complicate our lives. But I cannot engage in any particular comment on the precise taxation issues that you have mentioned. At the ECB Governing Council level we do not engage in that kind of very precise measure or absence of measures.

I do not want to comment on any particular country. I would only say that the Treaty is absolutely clear. All economies that do not have an opt-out clause are to enter the euro area when they meet the criteria. The criteria, as you know, are both of a monetary stability nature, as regards inflation, long-term interest rates and the fiscal position. So I would only say that, as you know, the position of the ECB has remained unchanged since the beginning – all the criteria, nothing but the criteria and, on a snapshot basis and on a sustainable basis, exactly as the Treaty says. I will say nothing but that.

On that basis, as you know, there will be 15 members of the euro area as soon as 1 January next year, the euro area having started at the very beginning with 11 and then very rapidly increasing to 12.

3-044

Gay Mitchell (PPE-DE). – First of all I would like to say that I thought Mr Trichet's comments, for a central banker in relation to the credit rating agencies, were quite strong and I welcome them because I have been raising these concerns myself. The committee will, at my request, be calling in the rating agencies on 13 January, so it is necessary to address the questions which Mr Trichet and others have raised.

In relation to yesterday's meeting of the monetary experts, we had a brief discussion about a paper by Milton Friedman. I do not know whether you are familiar with it, I presume you are. It was a study of three markets, the US in the 1920s, Japan in the 1970s, and the United States again in the 1980s. It is a study of the effect of money supply and monetary policy on softening the landing and preventing chaos when we have had market crashes or turmoil. I presume you are familiar with that study. It seems to have credence.

If you are familiar with that study, Mr Trichet, could I ask you if you have had discussions with other banks – you mentioned Canada and the United States and Japan and Switzerland earlier – in relation to how monetary policy might soften any landing which might be facing us?

3-045

Jean-Claude Trichet, *ECB***. –** We all have our own economy with our own responsibility, and each economy has its own features. The features are not the same on both sides of the Atlantic. We are all responsible – and we are responsible for price stability in the medium and long run. We are all independent and all ultimately responsible to our own fellow citizens. Here you are representing your fellow citizens in the EU.

So it should not be surprising that we do not necessarily take the same decisions because again we are not in the same situations. What is certain is that we are permanently exchanging views on our monetary policy stance and on the reasons why we have such a monetary policy stance.

This is part of the overall framework because we meet very frequently, particularly amongst the constituency of

central bankers. We have very frequent meetings where we can exchange candidly all views with all central bankers, not only industrial central bankers but all central bankers from emerging countries and economies. So I can only tell you that, to my knowledge and considering all the elements involved in their decision, I really trust that, not only we the Governing Council of the ECB, but all other colleagues that I know are taking their decisions in their own context and that those decisions are justified.

3-046

Mia De Vits (PSE). – *(NL)* Madam Chairman, I wish to respond to the answer given by Mr Trichet to Mrs Lulling's question regarding indexation. You said, Mr Trichet, that automatic indexing is detrimental to the competitiveness of national economies. I, however, would like to focus for a moment on the other side of the coin, namely the purchasing power of the population.

At the present time we already have the problem of an adverse shift in the distribution between capital and productivity at the expense of wages and a fall in the ratio of wages to GDP. That has also been emphasised by Prime Minister Jean-Claude Juncker. So although you say that the problem has been alleviated through wage moderation on the part of management and labour, that has only led to the emergence of a new major problem in connection with the redistribution between capital and productivity.

Secondly, as far as indexing is concerned, the fact is that the rise in food prices and the rise in energy prices, even in countries like Belgium with automatic indexing, are by no means reflected in wage increases, which impoverishes the population. The percentage of food prices in the value of the index basket has increased in recent years. Moreover, as far as energy prices are concerned, a considerable amount of the money spent on energy is not taken into account in the price index.

On that last point – energy – I would like to ask your opinion. The market has not been fully liberalised, nor has liberalisation led to lower prices. Do you not therefore think that we must temporarily allow the imposition of maximum energy prices as long as we do not have total liberalisation?

3-047

Jean-Claude Trichet, *ECB***. –** We are in a single currency area at the level of a continent with 320 million people, and we all share that same currency. We all share this common destiny. If you have a hump in the headline inflation, which is the case, and if there is an automatic elevation of unit labour cost because of this hump, in comparison with what the spontaneous evolution would have been and in comparison with the situation in the rest of the euro area, taking into account that you regularly have such humps, which are probably unavoidable in a world which is under structural transformation of the first magnitude, the risk is that you will progressively see your unit labour costs grow more rapidly than the average.

But there is a single currency. That single currency has the same international purchasing power. It has the same characteristics in terms of competitiveness from outside, so you are taking an enormous risk of being progressively in a very adverse situation for growth and for job creation. It is our duty to say that.

I do not dispute that it is a very difficult point, a very touchy point. I do not in any way dispute that it calls for appropriate understanding and reflection by the parties concerned, but we have to make the point because it is an important point.

Our moderation message is not only for the social partners. It is moderation for all price setters. I said that in the introductory remarks: I mentioned price and wage setting behaviour – it is exactly the same phenomenon for the price setters. Avoid second-round effects. Indexation guarantees second-round effects. It is precisely what we want to avoid. It as simple as that, and that is something which again has to be said by us.

As regards this message of moderation for all, I am very clear on that too. I have already said that here. We have a moderation message for all and not only for the social partners. Of course the social partners' decisions have an immense impact on the overall cost competitiveness of any particular economy.

3-048

Pervenche Berès (PSE). – Mr President, I shall ask you one question, and then it will be the turn of Mr Dăianu, our new Romanian colleague.

Mr President, you call for moderation and you seek to combat second-round effects. To this end, you have given very clear indications as to what the Council or the Member States should do in terms of wage restraint and in terms of eliminating index-linked wages and prices. But can public opinion be receptive to this message at a time when, as Mia De Vits has said, the desire to restore confidence in the European Union's capacity for growth makes purchasing power the key issue? And what message should be sent to those who, through their excessive pay levels – and this is something you have condemned here on occasion, although I have not heard you do so today – are fostering, without shame and without reason, as Jean-Claude Trichet said here one day, an unacceptable climate of social tension?

You referred to the question of European legislation on mortgage loans, saying that perhaps the time had not yet come for that, but you have said nothing about variable rates. It is, however, a fact that variable rates are applied to property loans in a number of Member States. Do you think these practices accord with the state of the market?

Lastly, at yesterday's meeting with our experts – and this has been touched upon here this morning –, the issue of the tension between prices for movable and immovable property on the one hand and inflation with regard to everyday consumer goods on the other was raised in connection with the idea that similar tensions

had hitherto been experienced for both types of product, whereas today the prices of movable and immovable assets were perhaps tailing off, while the sources of tension affecting the prices of everyday consumer goods remained intact. How can these divergent factors be taken into account in a coherent manner?

That brings me to my last point. You mentioned your trip to China with Jean-Claude Juncker, President of the Eurogroup, and Commissioner Joaquín Almunia. The Treaty of Lisbon has given the European Parliament codecision powers in matters relating to trade agreements. Do you think that could have an impact on the agreements that might be concluded on exchange-rate policy?

3-049

Jean-Claude Trichet, *ECB*. – (*FR)* I believe I was as forthright as possible on the need to avoid second-round effects, on the fact that, at the present time, and at any time when there is an oil shock or commodity shock or food shock, as is the case today, the greatest danger is posed by second-round effects. A comparison can be drawn between the economies that managed to avoid second-round effects when the first oil shock occurred and those that did not. It is the difference between those that continued to grow at a reasonably satisfactory rate and to create jobs and those where the shock triggered a constant year-on-year rise in unemployment. In short, we have seen with our own eyes this very painful and very costly process, and that, of course, is why not only the European Central Bank but also the great majority of economists believe this to be a crucial issue. I said that this advice and this message of moderation were addressed to everyone. I think the words you ascribed to me were probably spoken by Jean-Claude Junker. What I said was that there were figures, pay levels and so on that did not tally with this general message.

As far as European mortgage loans are concerned, I said it would be particularly inadvisable to start any US-style sub-prime mortgage market in Europe, in other words to start lending money to impecunious people, which is the best way to get them into major difficulties and put the entire financial system in serious trouble. I did not say we should stop thinking about convergence of the European mortgage markets, quite the contrary. In the name of financial cohesion, we are entirely favourable to far closer integration of Europe's mortgage markets. That subject is certainly on the agenda.

As for variable rates and fixed rates, the euro area in which we live, as you are well aware, has diverse historical traditions and diverse financial structures. There are economies in the euro area which are very attached to fixed rates and others which are very attached to variable rates. Our view is that we must gradually put all the options on the counter in some way and make them available to consumers, and then we shall see what emerges gradually as the spontaneous behaviour pattern of average consumers throughout the euro area. In the meantime, however, there are, as you rightly indicate, quite considerable differences.

3-050

Pervenche Berès (PSE). – So do you not regard the present situation as an alarm signal about the excessive use of variable rates?

3-051

Jean-Claude Trichet, *ECB*. – *(FR)* I believe we must base our action to a great extent on the free decisions taken by individuals. I would not say from the outset that those of us who have experience of variable rates as well as a preference for them must abandon them. But I do believe that every European citizen and every European household must have access to each form of financing, with all its associated benefits and drawbacks. In this sphere, as in many others, it does not seem in any way odd to rely chiefly on people's honest appraisal. Let me repeat that some economies are strongly attached to variable rates and others to fixed rates. Why can we not gradually begin to offer both options as our financial systems become more closely integrated? We shall ultimately find out how individuals judge and compare these options.

I believe you mentioned one final question.

3-052

Daniel Dăianu (ALDE). – Mr President, I commend the European Central Bank for the injection of liquidity. I believe that under extraordinary circumstances, exceptional means should be used.

At the same time you have used a series of words like correction of markets, enhancing transparency, getting more clarity, shunning opacity of markets, but arguably – and you have also mentioned that – we can extract useful lessons from current events, from a very serious crisis in my view, but similar lessons could also have been learnt against the background of the Asian crisis, the long-term capital management episode. So I am asking myself if that is the case – and it is a very serious crisis which cannot isolate only the sub-prime market and use the sub-prime market as a way to deal with this crisis – are we not facing very serious flaws in our regulatory frameworks, in our regulations? If that is the case – and you also mentioned the single market and global financial markets – I believe that Tommaso Padoa-Schioppa has made very commonsensical comments in this respect. It is raising the issue of convergence of regulations which some people in the EU do not like.

But that issue also raises another issue, a very legitimate one. What is the content of the regulations? What is the nature of the regulations? How can we regulate financial innovations so that the detrimental effects of financial innovation do not bring about a systemic crisis?

3-053

Jean-Claude Trichet, *ECB*. – Again my understanding of what we are witnessing is that we have an ongoing market correction which is very significant, with elements of turbulence, elements of a high level of volatility. Again it is an ongoing process. It has been triggered by the sub-prime mortgage segment of the US market, but you are right to say that it is much larger

than that. It is the channel of propagation, but we have a number of other elements that we have to improve if we want to avoid such a phenomenon.

It deals with highly sophisticated instruments, it deals with the rating agencies – we have mentioned that already. It certainly deals with the way the commercial banks' business model has been progressively generalised in a number of economies with the 'originate and distribute' model and so forth. All this has to be taken into consideration.

On the banking surveillance question, I would say that there are provisional lessons which we can draw. Firstly, the Basel II framework should have been implemented as quickly as possible. As you know it is not yet fully implemented, not in Europe but not even the USA – later than in Europe. Of course the advantage of the Basel II framework is that it takes into account the back-up lines and credit lines that are associated with the conduits and SIVs and so forth. So we have already identified an improvement which should have already been implemented.

Now we certainly have to continue reflecting on that and on better coordination and close cooperation between surveillance authorities. As you know, the European way of looking at it is to say we will give the Lamfalussy framework every opportunity and exert political energy to go in this direction. It is certainly the ECB's position. We are very much encouraging the authorities in question and we have pushed in this direction in ECOFIN.

There are a number of issues at stake and some countries perhaps are resisting this close cooperation more than others, I do not commend that but it is extremely important that we make as much progress as possible.

I would also say, and I have said it already, that one of the lessons we can draw is to go in the direction we have always urged, namely that there should be a very close relationship between the central banks and the surveillance authorities. That is one of the lessons that we can draw.

3-054
Chairwoman. – That brings us to the end of this dialogue, and I believe we managed to cover all the ground in the course of our question-and-answer session.

We invite you to our annual meeting with the national parliaments, which will take place on 23 February and during which we shall be returning to the very subject you addressed in your final comments, namely the link between central banks and supervision.

And then we shall have our next regular monetary dialogue on 26 March. Until we meet again I wish you all a happy Christmas and a good start to the new year.

(The meeting was closed at 12.05 p.m.)