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COMMITTEE ON ECONOMIC AND MONETARY AFFAIRS
MONETARY DIALOGUE WITH JEAN-CLAUDE TRICHET,
PRESIDENT OF THE ECB
(pursuant to Article 113(3) of the EC Treaty)
BRUSSELS, MONDAY, 11 JUNE 2007

1-003

IN THE CHAIR: MRS BERÈS

(The meeting was opened at 4.00 p.m.)

1-004

Chairman. – Mr President of the Central Bank, we are talking about the content and the nature of the European Parliament's important dialogue with the Central Bank, with specific regard to the way in which that dialogue operates. Having said that, it is true that, from a formal point of view, our meetings are important events.

Following the practice on which we agreed some time ago, two preferred issues have been set aside for this exchange: firstly, the Central Bank's role with regard to financial stability, and then the exchange policy, in particular the issue of possible world imbalances in relation to developments in Asia.

Without further delay, Mr Trichet, please take the floor for your introduction.

1-005

Jean-Claude Trichet, *ECB***. –** *(FR)* Madam Chairman, members of the Committee on Economic and Monetary Affairs, I am delighted to appear before your committee today to hold our regular dialogue, as you have said. In fact, from time to time, when responding to questions, I point out that the European Parliament gets to ask the Central Bank to explain its policy and its analyses more often than is the practice in the United States of America.

As always, I shall begin with an assessment of the economic and monetary situation.

1-006

(DE) I would then like to discuss two issues in greater detail, starting with the EU's framework for the regulation, supervision and stability of financial markets, including the role of the euro system, and then moving on to business finance in the euro zone, and this is also discussed in the ECB's structural report, which I would like to present to Parliament today.

1-007

And of course, I shall respond to any questions you have.

Since my previous appearance before the European Parliament in March, incoming information has confirmed our view that economic growth in the euro area continues to expand at a pace significantly stronger than expected a year ago. Regarding price developments, upside risks to price stability prevail over the medium to longer term, as identified by both our economic and monetary analyses. Thus, in order to ensure that longer-term inflation expectations remain solidly anchored at levels consistent with price stability, on 6 June the Governing Council of the ECB decided to raise the key ECB interest rates by 25 basis points. After this decision, given the positive economic environment in the euro area, our monetary policy is still on the accommodative side, with overall financing conditions favourable, money and credit growth vigorous, and liquidity in the euro area ample. Let me explain the Governing Council's assessment underlying its decision.

Starting with the economic analysis, real GDP grew by 0.6% quarter-on-quarter in the first quarter of 2007 and thus again was somewhat stronger than previously expected. Looking ahead, conditions are in place for the euro area economy to continue to grow at solid rates. Euro area exports continue to profit from robust and broad-based growth in the global economy. Domestic demand in the euro area is expected to maintain its relatively strong momentum, as employment growth continues to get stronger, supporting real disposable income. Investment should remain dynamic, benefiting from financing conditions which remain favourable. This positive outlook is reflected in the latest macroeconomic projections of Eurosystem staff, who foresee average annual real GDP growth in a range between 2.3% and 2.9% in 2007 and between 1.8% and 2.8% in 2008.

In the Governing Council's view, the risks to this favourable medium-term outlook for growth are broadly balanced over the shorter term, while the balance of risks remain on the downside at medium to longer horizons. These relate mainly to external factors, notably potential protectionist pressures, possible further oil price rises, global imbalances and potential shifts in financial market sentiment.

Turning to price developments, annual HICP inflation was, according to Eurostat's flash estimate, 1.9% in May, unchanged from April but somewhat higher than expected a few months ago, in particular owing to increasing oil prices over recent months. Looking ahead, the short-term profile of annual inflation rates continues to be determined largely by current and past energy price developments, as last year's volatility in energy prices leads to significant base effects. Against this background, the Eurosystem staff projections foresee average annual HICP inflation of between 1.8% and 2.2% in 2007, slightly revised upwards compared with the March projections, and of between 1.4% and 2.6% in 2008.

In the Governing Council's view, risks to the outlook for price stability remain on the upside over the medium term. Notably, these risks are on the domestic side. They relate mainly to emerging capacity constraints and, closely related, stronger than expected wage dynamics, which would pose significant upside risks to price stability. In addition, pricing power in market segments with low competition may increase in such an environment. It is therefore crucial that all parties concerned meet their responsibilities. Wage agreements in particular should be sufficiently differentiated to take adequately into account price competitiveness positions, the still high level of unemployment in many economies and sector-specific productivity developments.

Cross-checking with the monetary analysis confirms the prevalence of upside risks to price stability at medium to longer horizons, given the continued strong underlying rate of monetary expansion in a context of already ample liquidity. While, from a medium-term perspective, there are several indications that higher short-term interest rates are now influencing monetary dynamics, they have not, as yet, fully translated into a significant dampening of the overall strength of the underlying rate of monetary and credit expansion.

Fiscal developments in euro area countries in 2006 turned out to be significantly better than anticipated and the latest available forecasts suggest a further reduction in the government deficit-to-GDP ratio of the euro area over the period 2007-08. However, this reflects more cyclical improvements in the context of a favourable macroeconomic outlook rather than structural progress. The current economic 'good times' should be used to rapidly redress the remaining budgetary imbalances in euro area countries, as well as to accelerate the adjustment towards their medium-term objectives of sound budget positions with a focus on expenditure restraint. As agreed by the euro area finance ministers at the Eurogroup meeting in Berlin on 20 April, taking advantage of the favourable cyclical conditions would enable most euro area members to achieve their medium-term objectives – MTOs – in 2008 or 2009, and all of them are committed to achieving their MTOs in 2010 at the latest. This is particularly important with a view to reducing the still high government debt ratios and preparing for the fiscal challenges arising from population ageing.

Allow me to stress on this occasion that in the Governing Council's view it is crucial for the smooth functioning of EMU that all countries comply with the rules and provisions of the Stability and Growth Pact, given that the Stability and Growth Pact is an indispensable part of the institutional setting.

As regards structural reforms, the Governing Council fully supports any efforts that enhance competition, increase productivity and foster economic flexibility, thus promoting higher sustainable real GDP growth and sustainable employment. Exploiting the complementary nature of reforms would increase their benefits in terms of long-term economic dynamism and price stability. Higher productivity growth will allow increases in real wages without negatively affecting employment, thereby supporting the income growth of the euro area workforce.

In fact, as a reflection of reform efforts undertaken so far and as a result of continued wage moderation in a number of countries, euro area employment has increased by more than 12 million people since the start of Stage Three of EMU in 1999, which compares very favourably with the increase of just over two million in the eight years before 1999. According to the latest Spring Forecast by the European Commission, prospects are for another 3.8 million employed people in the euro area in the period 2007-08. These are, of course, the Commission's forecasts, and we will see exactly what happens.

Let me now turn to an issue you asked me to discuss today, which is the framework for financial regulation, supervision and stability and the way in which it can cope with the challenges stemming from increasing financial integration.

Starting with financial regulation and supervision, the Lamfalussy framework was introduced with the purpose of speeding up the process of adopting Community legislation and making its implementation more consistent at the national level. As such, the Lamfalussy framework in itself represents an important institutional innovation and therefore we have always shared the stance that it should be exploited to the maximum possible extent.

This entails in practice that all four levels of the approach should work at their best and, when this is not the case, appropriate measures should be taken. It is therefore important – as has been the case so far – to monitor systematically the practical implementation of the framework to identify areas for possible enhancement. While at the beginning, the monitoring activity concentrated on the regulatory part of the approach (notably levels 1 and 2), the focus has rightly turned more recently to the supervisory level (i.e. Level 3). One of the main challenges concerning Level 3 activity is to ensure that the deliberations of the supervisory committees concerning cooperation and convergence are applied consistently in practice.

In this respect, the practical implementation of the recommendations contained in the Report on Financial Supervision prepared by the Financial Services Committee and endorsed by the ECOFIN Council on 5 May 2006 represents an important milestone. More generally, the forthcoming review of the Lamfalussy process represents an important occasion for further reflection about the efficiency and effectiveness of the current EU supervisory setting. It will be important to identify the practical steps that will further strengthen the supervisory role of the Level 3 Committees.

Turning to the framework for financial stability, the ECB supports in general the current discussions at EU level to enhance the arrangements for handling financial crises, never forgetting that a crucial responsibility must remain with the private sector itself. It is important indeed that all competent authorities for financial stability, namely central banks, supervisory authorities and ministries of finance are well prepared and have a common understanding of how to manage potential financial crises with a cross-border dimension, whilst avoiding any moral hazard.

In this respect, we should not ignore the fact that significant progress has already been achieved to enhance financial crisis arrangements through the work of relevant forums, including the Economic and Financial Committee, the Financial Services Committee, the ESCB Banking Supervision Committee and the Committee of European Banking Supervisors. The 2005 memorandum of understanding on cooperation and exchange of information in crisis situations is a relevant example in this respect. I see the current discussions as focusing on crisis resolution and their outcome should be, in my view, in line with three main principles.

First, the principle of flexibility: the arrangements on crisis management and resolution should be flexible enough to keep pace with market developments and to handle the specific features of the actual crisis. Second, the principle of consistency: there should be coherence between the framework for crisis prevention – which is based for the most part on prudential supervision – and the framework for crisis management and resolution. This implies acknowledging the current institutional distribution of responsibilities between home-country and host-country authorities also in a crisis situation. Third, the principle of the primacy of private sector solutions as regards crisis resolution: again, the arrangements should avoid any kind of moral hazard that could provide the wrong incentives for risk-taking by the financial industry.

Concerning the specific role of the Eurosystem, the system has arrangements and procedures in place for the effective performance of its functions in crisis situations as well as for the provision of emergency liquidity assistance by the national central banks. These arrangements are periodically reviewed and tested also through the conduct of simulation exercises. The most recent exercise took place in May 2006. These simulations allow a high degree of preparedness to be maintained within the system. The outcome of these reviews so far has shown that the Eurosystem is well equipped to cope with a financial crisis situation of a liquidity nature with an area-wide dimension.

Finally, I would like to take this opportunity to present to the committee the ECB's Structural Issues Report, which this year deals with corporate finance in the euro area.

The aim of the report is to analyse the main features of the functioning of the market for corporate finance in the euro area, including the specifics of the national markets and the conditions applicable to borrowers. Given the great interest in the issue of access to finance for small and medium-sized enterprises, the report also analyses how financing patterns differ across large, medium and small enterprises. Finally, the report discusses the recent trends observed in the corporate finance landscape of the euro area over the past few years and how they have influenced the availability of external finance for firms. Let me briefly summarise some of the results.

First, firms' financial structures are relatively homogeneous across euro area countries. Still, even after taking into account the average firm size and sectoral composition across countries, some cross-country differences remain, which may be explained by the remaining differences among legal and institutional frameworks in the various countries and economies.

Second, regarding SMEs, the report indicates that several of the differences in the financial position of firms according to size which had been identified in previous studies are driven mainly by the relative weights of SMEs and large firms in the various sectors, and to some extent by the relative weights of SMEs in the various member countries of the euro area.

At the same time, the report also highlights that some differences across size classes remain regarding the reliance on bonds and the share of financial to total assets, which is lower for SMEs, and in terms of the reliance on bank loans and cash, which is higher for SMEs. The latter may point to the need to keep liquid balances to finance future projects. Small and medium-sized firms also tended to be in a somewhat weaker financial situation, as indicated, for example, by their higher level of indebtedness.

Finally, concerning the role of financial intermediaries in providing finance to firms, a two-tiered process has been identified. Firstly, bank lending has become even more prominent in the last two or three years. Secondly, the link between the banking sector and the markets has been strengthened significantly, with commercial banks shifting from acting as

traditional financial intermediaries to functioning as credit risk originators and sellers as a result of securitisation processes and the increasing use of credit derivatives.

To conclude on the report, first, the growing importance of structured finance and increased competition between banks and other financial intermediaries may provide corporations with easier and cheaper access to external finance.

Second, as credit granted is evaluated on a more mark-to-market basis and the banking sector becomes more and more competitive, the speed of transmission of monetary impulses to bank interest rates is expected to quicken. That is an important change that we have to look at carefully.

Third, it is likely that credit risk will be less concentrated on banks, thereby making them less vulnerable in the event of shocks, whilst it remains to be fully understood if and where credit risks are again concentrating on some particular sub-sectors in the non-bank constituencies.

And fourth, we must be aware of the fact that episodes of mispricing of credit risk will necessarily be followed by adjustments. It depends on all the parties concerned that such adjustment is smooth and orderly and not abrupt and sharp, which in the second case would be adverse for the global economy.

I am now at your disposal for questions.

1-008
Chairman. – Mr Trichet, I would like to thank you for that presentation. I would point out that, as on several previous occasions, you have to a certain extent made your own choice from amongst the subjects that we wanted you to mention in your introduction. In fact, you have prioritised one of the two issues for which we had wanted an introduction to our discussion, in the end only dealing with the issue of the role of Central Banks in terms of financial stability.

Perhaps we need to re-assess the way in which we prepare this first part of your speeches to our committee, since we had chosen two subjects and only one has been mentioned. I would have thought that, given that the monetary dialogue is open to Parliament, it is not unreasonable that we should wish to name issues on which we want the Central Bank to enlighten Parliament's representatives. I am sure, however, that during the questions that we shall put to you on the second subject, that of exchange policies, you will have the opportunity to clarify things for us.

We shall open up to questions and, as is customary, Mr Radwan, group coordinator for the Group of the European People's Party (Christian Democrats) and European Democrats, will speak first.

1-009
Alexander Radwan (PPE-DE). – *(DE)* Madam Chairman, since Mr Trichet has spoken about Europe's positive economic development, not least as regards its impact on the unemployment figures, I will not now be asking any questions about the exchange rate. In Germany, the European Union's largest economy, there is currently a great deal of very lively debate about the introduction of minimum wages, which takes as its starting point the conditions that we, in Germany, enjoy as compared with other countries. I would be interested to know, Mr Trichet, how you think minimum wages might affect the German economy and hence also that of the European Union, particularly if labour law remains unchanged.

You also, when talking about financial stability, mentioned the Lamfalussy procedure; I would be interested to know whether the Lamfalussy procedure, and the way in which supervisors in Europe cooperate, are adequate to deal with the developments we have been seeing over recent months. I am thinking here of the takeover of ABN AMRO by a British bank, of the way in which the UniCredito bank group, which has a presence in Austria, Eastern Europe and Germany, may well be planning to take over a bank in France, and also of the Bank Santander in the United Kingdom. Are the supervisors and their collaborative arrangements adequately prepared for the eventuality of a bank in one of these countries getting into difficulties and the same happening to another bank in the same group? Are you satisfied with these arrangements, or should we be working towards even closer cooperation within the European supervisory system?

Are you or are you not satisfied with what has emerged from the G8 Summit on the subject of hedge funds?

1-010
Jean-Claude Trichet, *ECB***. –** Thank you very much for your questions.

We have been in touch with the Commission's Secretariat in order to present some conclusions. As you have seen, this question of exchange rates was put to one side because on these questions I am the President of the ECB, which is one of the two major central banks in the world from that standpoint, and what I have to say is very brief, so it would not have been enough to present to you.

On your first question, Mr Radwan, we believe that wage moderation and unit labour cost moderation is absolutely of the essence and that we should continue to practice moderation in this respect. This is true for all countries, including

Germany; it is true for all sectors; it is true for all firms and it is true at every level of qualification. In order to get the full picture, one has to look very carefully at the present level of unemployment, in the economy or in the sector or in the qualification concerned. In a number of cases the level of unemployment is still unacceptable in the EU area as a whole and in specific economies. We have to look at the current level of competitiveness and at the expected growth of labour proactivity to conclude on nominal wages and salary increases.

We really believe that it is because we had responsibility exerted by social partners that we have created more than 12 million jobs. I say more than 12, but in fact it is closer to 13 million jobs, and, as you have seen, the Commission expects that trend to continue.

Therefore I would say we should be very rational in making changes to any particular framework, and that goes for all economies in all fields.

1-011
Alexander Radwan (PPE-DE). – My question was that we are having a discussion in Germany about *minimum* salaries of 7.4 or 7.5 euros all over Germany, from Bavaria to the north and east of Germany.

1-012
Jean-Claude Trichet, *ECB***. –** We *(inaudible)* ourselves that these minimum wages would be differentiated to take into account the various situations of sectors – I do not know, firms would probably not be difficult – but at least sectors and perhaps regions, taking into account various situations. That would be our recommendation. Again, it is not our responsibility to decide, but that of the executive branches and parliaments.

On the Lamfalussy procedure, we do not consider that we are in the best of the word 'possible' as regards possible difficulty, particularly in the cross-border institutions, whether commercial banks or investment banks – all institutions that are under supervisory authorities in various countries. That is why we call upon all the parties concerned – in particular the supervisory authorities, some of which are central banks, – to cooperate as actively as possible within the current Lamfalussy framework. I was invited by the secretariat of the committee in London and I said that it was very important that all supervisory authorities should be as active as possible in cooperating very closely in having no reservation in considering that there was superior interest at the level of the EU as a whole and on taking care of the interfacing with the industry to be exactly the same, because we have the same concept at the global level, we have the same directives. It is absolutely abnormal that the implementation of the same directive is not interpreted in the same way by the various supervisory authorities. The industry is right to say that it is very abnormal, we are not asked for the same information, we are not informed of the same interpretation of the directives, which should be unique.

On the last point, again, yes, more cooperation, but giving all its chance to the Lamfalussy framework.

On hedge funds, I understand that the G8 consensus goes very much in the direction of giving impetus to the conclusion of the Financial Stability Forum. I am very much in agreement with the conclusion of that Forum, with a strong message to the supervisory authorities to step up their supervision of the core intermediaries, a very strong message to the core intermediaries themselves to ask them to step up their risk management and their interfacing with the highly leveraged institutions, because it is a problem not only of the hedge funds but also of all highly leveraged bodies, including private equity firms.

Then, there is also a message for the industry itself – the private sector itself in this industry of highly leveraged institutions – to work on benchmark behaviour that would be optimal. I think that is fully in line with what we recommended ourselves. It now depends on the active implementation of these guidelines.

1-013
José Manuel García-Margallo y Marfil (PPE-DE). – *(ES)* I would like to ask two very brief questions.

The President of the European Central Bank will agree with me that the proper operation of the European financial markets – the financial market as a whole, in its entirety – largely depends on the independence of the regulators, who have been mentioned previously.

Recently – on 2 April, to be precise – the President of the Spanish regulatory body, the Spanish Securities and Exchange Commission, handed in his resignation to the very government that had appointed him.

In a hearing before the Congress of Deputies, the Spanish Parliament advocated a series of reforms. I would like to know the President of the Central Bank's view on this issue, whether he believes that the Spanish regulatory body has operated correctly, and, if not, what reforms should be introduced.

Secondly, a completely separate question relating to the issue of mortgage credit. Just 1.1% – I believe that these are the precise figures for mortgage credits – is of a cross-border nature, which means that the mortgage markets are still essentially of a national nature.

The Commission has published a Green Paper and has set up two working groups that have completed their conclusions. We are awaiting a White Paper.

I would like to know how the President of the Central Bank believes the consolidation or construction – we are talking about its construction rather than its consolidation – of this market would affect the availability of mortgages, interest rates, the housing market, etc.

1-014
Jean-Claude Trichet, *ECB***. –** Thank you very much for those two questions.

In reply to the first one, there is a global consensus to consider that supervisory authorities should be independent. This global consensus crystallised after the series of crises at the end of the 1990s and at the beginning of this century, with the Asian crisis and a number of other crises in the industrialised world. Therefore it was very important for the authorities in charge of the surveillance of banks – and more generally of regulated institutions – to be independent. Manuel Conthe and I were both members of the European Monetary Committee at the beginning of the 1990s. We worked closely together and I appreciated his efforts enormously at that time.

On mortgage credit, I fully share your implied view that if we had a more integrated market in this respect in Europe we would be better off. You know that we are calling for financial integration as one of the most important endeavours associated with the single market, but also associated with the euro area and the single currency endeavour. You are absolutely right that the mortgage market is segmented nationally to an extent that is not normal in a single market with a single currency. It is also true that it is one illustration of the fact that retail banking generally is not fully integrated. We are far from full integration.

Therefore, we fully support all the efforts made in this respect and certainly all the Commission's efforts, which Parliament supports in this respect. It is not easy, but a lot of homework has to be done at the level of Europe as a whole, but also at the level of the euro area, in this field.

1-015
John Purvis (PPE-DE). – Mr Trichet, continuing with the theme of debt and leverage and issues like that, if indeed we were to come to some sort of a turning point in the economy of Europe and with all the debt that has been building up on the housing side and the private sector, private buy-outs with huge amounts of debt, all the complicated securitisation and credit derivatives that have been developing, the pressures on companies to be much more efficient in the use of their capital and therefore to borrow more, and to return funds to shareholders, with perhaps in some Member States considerable amounts of debt arising, are you quite confident that in these circumstances you have a complete grip of the situation and will be able to deal with such a crisis if it were to arise? I think it is beginning to be a headline in the papers that maybe the time is coming for this turnaround. Are we fully prepared?

1-016
Jean-Claude Trichet, *ECB***. –** It is clear is that we have taken a number of measures based not exclusively but in particular on the observations that you are making. You mentioned the loans to households for financing real estate. It is absolutely clear that, thanks to what we have been doing, we have observed some reduction in the rate of growth in this particular segment, at the level of the euro area as a whole. I am referring as you know always to the level of the Governing Council in the euro area as a whole.

Taking loans to households, the last figure was +7.6%, all loans to households at the level of the euro area in April. It was 7.9% in March. In the last quarter of 2006 we were at over 8% and in the second and third quarters of 2006, we were at over 9%. You will see that we have 9%, 8%, 7.9%, 7.6% so it is a slowing-down of the rate of growth, which remains largely superior to the growth in the euro area in value terms, even at a time when growth is satisfactory, as everybody knows. So your remarks remain absolutely justified and I draw the attention of a number of observers to this particular point.

To arrive at the level of 7.6% in the euro area as a whole means that some are much higher and some are lower, and I know that in your own country things are higher. That is absolutely clear.

I was speaking about the outstanding growth of loans. If I take the loans to non-financial corporations, in April they were growing over 12 months at the level of 12.2% – after 12.4%, so a very slight reduction, but it is clear that we look carefully at all the information which is given by the monetary analysis. I had the opportunity to say in front of Parliament that it was one of the reasons why we engaged in the increase in rates in December 2005 at a time when we had a lot of very good advice not to do that, and you might remember that. The monetary analysis played a role in convincing us that we

had to increase rates. At this time we are fully vindicated by all international institutions, by all observers, they do not dispute that we were right to do that.

1-017
Ieke van den Burg (PSE). – Perhaps I could first link to this question and then come back later with my questions about supervision.

First, with regard to this issue of growth of highly leveraged institutions, and in particular the growth of private equity firms, this also leads to other structures of company financing. Could you say more about the concerns regarding these developments, which, as you say, are growing? I wonder whether increasing rates is a sufficient response with a view to changing these developments.

Another issue linked to this is that we have recently noticed that the Bank of China is also investing in private equity companies in Europe, so there are both direct and indirect investments in Europe. This could mean something for the exchange rate but also for the increasing of these phenomena and the liquidity included in this part of the financial markets, the non-regulated markets. Maybe you could say more about that?

1-018
Jean-Claude Trichet, *ECB***. –** This is a very important issue and I would fully concur that we have a lot of work to do. I have already said that we were in very strong agreement with the overall consensus that has been taking shape under the German Presidency. It seems to me that we have to be fully aware of the fact that it is a global issue: it is not an issue that any one particular economy or continent can deal with, because it is fully global.

We all accept and recognise that the highly leveraged institutions in general have contributed enormously to the prosperity of global finance and of the global economy. In real terms they have brought about a level of depth and liquidity in all capital markets that is also very important.

That said, if we want to have a full picture, we have to consider the speed of developments in this highly leveraged industry. In particular I would say that the hedge funds, for instance, have total assets under management that is in the order of magnitude of USD 1.5 trillion, which is enormous, especially compared to a few years ago. Therefore it is a development which has come about extremely quickly and is very much in parallel with the developments of these new derivative instruments, particularly but not exclusively credit derivatives. We have a simultaneous incredible transformation of global finance. Again, the market has asked for this. It corresponds to market supply and demand. It is something that we have to fully recognise as an important contribution to global prosperity.

On the other hand, we have to identify the risks and not be complacent, because this very rapid development can entail a number of risks. That is why we think that by asking all the parties concerned and not introducing – because it is clear that there is no consensus on this and we did not recommend it ourselves – an administrative regulation of these highly leveraged institutions. Instead we must go about asking the core intermediaries – those which are under supervision – to enhance their own risk management and control of the counterparty risks that they are embarking on, asking the supervisory authorities to improve their own control of this handling of supervisory risks by the core institution but also – and this is in the consensus of the G8, and again we had recommended that and it is what the Financial Stability Forum had recommended – to ask the industry on a number of points to work out under its own responsibility, without being ordered to do anything, to work out appropriate benchmarks for best practice. This is one of the most important avenues along which we have to proceed more generally for any new issues that are emerging from global finance, taking into account the present levels of creativity and vitality in global finance.

1-019
Joseph Muscat (PSE). – Mr Trichet, I have some very straightforward questions. Would you be comfortable in advocating the creation of a single European financial services authority in the long term? If yes, and if you think this is realistic, what is a realistic timeframe in your opinion? Thirdly, what kind of relationship would you envisage between your institution and such an institution?

1-020
Jean-Claude Trichet, *ECB***. –** It is indeed straightforward. I would say firstly that the position of the Governing Council of the ECB is that we have to give the Lamfalussy framework all its chances. I could check this, but in my opinion we are far from having exploited all the potential opportunities afforded by the Lamfalussy framework, including Level 3, which is the level relevant to your comments. Our position is crystal clear in this respect.

I trust it will not be the case, but if it is demonstrated that the Lamfalussy framework cannot deliver, then your questions become pertinent, but at the present time there is no case for me to respond to. I trust that it is possible to deliver fully within the Lamfalussy framework.

In response to your second question, we in the Governing Council of the ECB are of the opinion that a close link between supervisory function and responsibilities and Central Bank functions and responsibilities is of the essence. We in the

Governing Council of the ECB are not in favour of a straight separation, as is the case in some countries. We are much closer to the position of our friends in the US Federal Reserve system. We have exactly the same view on the need to have a close link between the Central Bank and these supervisory responsibilities.

1-021
Joseph Muscat (PSE). – It is basically a 'no, but ...' rather than a 'yes, but ...'!

1-022
Jean-Claude Trichet, *ECB***. –** If you like!

1-023
Sophia in 't Veld (ALDE). – Madam Chairwoman, I shall be very brief. I have one topical question regarding SWIFT. We have known about the SWIFT case for about a year now and since January the European Commission has been holding what it calls 'exploratory talks' on the basis of what mandate we do not know. We have had very little information about the contents of the talks, but I was told last week that the exploratory talks have led to an agreement, which will be put before the Council within a matter of weeks. Have you been informed about the contents of such an agreement?

My second question concerns today's topic – stability. There are new governments in France and in my own country, the Netherlands, and I wonder how you assess their new policies. Are they sustainable and are they in line with the preventative measures laid down in the revised Stability and Growth Pact? If I look at my own country, the government is committed to that Pact, but it bases its planning on the assumption of a 2.75% growth rate over the next couple of years. Would you not say that is too optimistic?

Finally, I fully endorse your call for wage moderation, saying that it is of the essence. In this respect, I wonder how you feel about the top managers of big companies – people who are already pocketing millions every year – granting themselves wage increases of up to 12% and then telling their staff that there have to be layoffs and wage moderation. Would you address the same appeal for moderation to these people?

1-024
Jean-Claude Trichet, *ECB***. –** I noted that!

(Laughter)

As regards SWIFT, I have already had the opportunity to present the Governing Council's position. I mentioned that not only had I had the opportunity to present our own analysis, but I have also received a letter from Mr Pöttering. I have written to Mr Pöttering, keeping you fully informed, Madam Chairwoman. It is a complex issue on which you know our position.

I said very clearly that I thought it was absolutely necessary that there be appropriate discussions at appropriate levels between the EU and the US authorities with the aim of providing absolute certainty for the various financial institutions concerned as well as for SWIFT. I have no specific information at this time as regards what is going on between the authorities on both sides of the Atlantic.

I take it that it is absolutely indispensable that an accord be reached. The fight against terrorism is absolutely of the essence and we are constantly being reminded of that. It has an immense potential impact on financial stability. At the same time, the legal frameworks have to be fully respected on both sides of the Atlantic, but at this point I cannot give you any further information. We fully apply the recommendations we have received, in particular for our own clients, who are fully informed of the situation on the other side of the Atlantic in terms of their own data.

As regards new governments in general, in a vast continental economy of 318 million people elections are always taking place. Since I was appointed President of the ECB I have seen elections in Germany, Spain, Italy, the Netherlands, France and Belgium – we have 13 very vibrant democracies and very important elections are taking place every four or five years. Changes of government are possible and are observed permanently.

I noted with enormous interest that last week both the President of France and the new Prime Minister of France said that they would meet their European commitments. Both said that publicly. The second round of elections has yet to take place in France, so we do not yet have a parliament. We will therefore see what happens, but it was important from all angles, including the partners of France, to see that there was a confirmation of the previous commitments that were taken as regards the Stability and Growth Pact, including the Berlin statement, which I mentioned a moment ago.

On the question of wage moderation, responsibility exerted by social partners is true for all, so the response to your question will be very simple: 'true for all'.

1-025

Alain Lipietz (Verts/ALE). – *(FR)* Madam Chairman, Mr Trichet, it seems from your speeches and your replies that we have a problem: that of the assignment of sectoral credits. On the one hand, you express your concern that productivity in Europe has not grown sufficiently, and that there have therefore not been enough credits for small enterprises, particularly in own funds – we can see that in the detail of your text – and, on the other hand, you are worried about the rise – which is slowing, it is true, with figures of 0.1 or 0.2% – in consumer credit, which tends to be concentrated on real estate, posing the risk of a property bubble.

Curiously, you respond to this issue by means of greater transparency in the financial system and hence more direct responses in your approach to credit policy, as if you were using the Central Bank's interest rate as a lever in terms of credit policy. Well, not only is it not very clear how this lever can direct credits in a particular direction, but you also have countries that are in the process of disconnecting it completely. For example, the new French administration has just decided to deduct mortgage interest from taxes. In other words, we are going to find ourselves once again in a situation in which, whatever interest rate you set, since they will be deducted from taxes, the property bubble will be able to continue until it bursts.

What measures, then, do you intend to propose in order to direct credit rather more in the direction you wish, that is to say, more towards small and medium-sized businesses and more towards investment in productivity?

1-026

Jean-Claude Trichet, *ECB*. – *(FR)* Thank you for your question, which raises the overall problem of our ability or inability to have a selective credit policy. As you know, we do not believe that credit policy can be selective, and I must tell you that, as I stand here talking to you now, there is a very broad international consensus that such a policy is not possible.

We are then faced, in the euro zone, of course, but also in all the large industrialised economies, with decisions that are taken freely by borrowers and lenders. However, we believe, in fact, that, if the market is meant to be totally competitive and totally transparent in every one of its sectors, we must achieve an optimum corresponding to maximum growth and, hence – all things being equal – to maximum job creation. Furthermore, we are still not necessarily in the best possible position when it comes to transparency, competition and the level of modernisation, let us say, of the economy.

We are sure of that, if only because we are still – as I said and as I believe can be demonstrated in the area, for example, of credits for households, all credits being taken together, and very much so in that of credits for small and medium-sized enterprises – we are still, as I was saying, dealing with markets that are vertical, national, segmented and not integrated at the level of the entire euro zone – which is paradoxical in a single currency zone – and even less so in the European Union as a whole. We therefore encourage all of the partners to move in the direction of total financial integration.

As far as your specific example is concerned, we are in fact faced with an increase – a particularly large one in some countries – in loans for housing finance. To give you the figures for April: more than 8.6% of this segment of household loans went on household loans used to finance housing. I highlighted the fact that there was a slowdown. This slowdown has also been particularly apparent over, let us say, the last two or three years. We are therefore aware that we are facing a slowdown in a development that has been particularly fast right across the euro zone as a whole.

My final point is that we are going to look closely at the decisions taken when the time comes by the French Government and French Parliament, since these decisions are parliamentary decisions.

1-027

Eoin Ryan (UEN). – Just to come back to what Mr Trichet was talking about, interest rates can sometimes take up to a year to fully have an impact on any economy. As we have been seeing a continuous rise in interest rates for some time now, Mr Trichet, will you be looking at the idea of a pause in these interest rate increases to see how exactly what impact they are having on the economy? If you consider property – and I suppose one of the countries that is constantly mentioned on this is Ireland – it certainly seems to be having an impact on slowing the property down in Ireland. Are there any differences between the inflationary pressure as it is today and as it was in say 2001, when interest rates peaked at 4.75%?

Secondly, what is your own opinion on the introduction of a common consolidated corporate tax base for EU Member States?

1-028

Jean-Claude Trichet, *ECB*. **–** The first question relates directly to the recent ECB Governing Council discussions. On behalf of the Governing Council, I said that after the 25-basis-point increase of our rates, given the positive economic development in the euro area, our monetary policy was still on the accommodative side. I also said that the overall financing conditions were favourable, monetary and credit growth were vigorous and liquidity ample.

I did not mention a pause. I said that we would act in a firm and timely manner. We do whatever is necessary at any time to counter the inflationary risks that we see. The current inflation expectations that we extrapolate from surveys, panels and financial markets are anchored at the level of around 1.9%. I cannot say that I am fully satisfied with 1.9%, but it is in line with our definition of price stability, i.e less than but close to 2%.

If we were not deemed by observers, savers, investors, market participants and those who use very long-term reasoning to be alert and able to take the appropriate decisions at any time, we would not have an anchoring of our inflation expectations at 1.9% for the next 10 or 20 years. The various governments that are borrowing on a 50-year basis would not benefit from our own credibility to deliver price stability over the next 50 years.

You can hypothesise. What would the inflation expectations be if we were not there with our credibility and a feeling on the part of all observers that we will do what is necessary in a timely fashion? It must be fully understood that we are in a position in which we do whatever is necessary to anchor inflation expectations solidly, and this allows us to have the best financial environment under the circumstances; to have sustainable, non-inflationary growth in the long run; and to have sustainable job creation. When we look at the past, it is clear that we made the right decisions in the first eight years of the euro. It therefore seems to me that there is an additional element to convince there, which is an important one.

As regards tax harmonisation, all that goes in the direction of good public finance, of optimisation of the overall taxation in order to foster sustainable growth and job creation is good. We know that it is the full responsibility of the executive branches, including a right of veto that is given to each of them, but all that goes in the direction of harmonisation, if it is accepted across the board, is important in our view.

I should like to draw your attention to the fact that there are enormous differences between the level of public spending as a proportion of GDP between the various countries. An order of magnitude would be a 20% difference in percentage of GDP between the highest and lowest spenders. Therefore, how would you fully harmonise all taxation elements if there are such differences in spending? It is very important to consider that those who have a very high level of public spending have to consider whether this level is fully justified in terms of optimisation and efficiency of the spending. The residual issue on harmonisation of taxes would remain very important and unsolvable if we retain the enormous differences at the level of spending.

1-029
Zsolt László Becsey (PPE-DE). – *(HU)* I would like to ask you two brief questions, Mr President. The first one relates to the fact that Slovakia, in cooperation with the European Central Bank, recently adjusted the central rate level because of the very rapid strengthening of the Slovak koruna. My question is how do you think that it can be included in the rate stability Maastricht criterion in two years? Can it be included?

My second question is to do with the fact that recently I have been hearing very ambitious statements from the Russians, to the effect that Russia is getting stronger. Can you envisage that the rouble will be convertible to any world currency or reserve currency? And therefore, will the role of the Russian rouble in general grow in global economic operations, as well as in international transactions, compared to the current situation?

1-030
Jean-Claude Trichet, *ECB*. – As regards your first point, the Slovak currency is part of ERM II. As you know, decisions have been taken which, in our view, were appropriate. I do not want to elaborate more on that.

As regards the criteria as regards the stability of the currency, we will see what our assessment is when the time comes. I note that the currency has been revalued, not devalued.

As regards Russia, we look for all currencies in the world that can sustain that position to be convertible, to play full convertibility and the rule of flexible rates that are the rules for the major currencies in the world, so we will see what happens, but the closer the Russian economy is to having a rouble that is fully convertible, the more happy we will be.

1-031
Gay Mitchell (PPE-DE). – Mr Trichet, I have asked you about asset inflation on every occasion for two-and-a-half years, and I am glad to see that a lot of people are taking an interest in it here today, so I will not go over it in any great detail. I do, however, want to ask you one question in relation to asset inflation.

How does the ECB take into account asset price inflation and contraction in its monetary policy? Do you have any concerns about a danger of a fall in asset prices in the US or Europe that could bring about recession in either or both areas? Could you tell us how you address that particular concern?

Secondly, in your remarks you said that the risks to favourable medium-term outlook for growth are broadly balanced over the shorter term, while the balance of risks remains on the downside in medium- to longer-term horizons. You say that

these relate mainly to external factors, notably to potential protectionist measures and possible further oil price rises, and then you mentioned global imbalances. It is on this issue of global imbalances that I want to ask you a direct question.

I am the rapporteur for the ECB report for 2006, and I noted recently, as part of my preparations for that report, that the Commission has issued a report over the last ten days or so, in which it mentions agreement under the aegis of the IMF on global imbalances. Some of my colleagues dismiss this with a wave of the hand and say 'Oh, this is the annual motherhood and apple pie stuff, it is all aspirational'. Is it aspirational, or is it new? Is there anything new in the whole area of agreement on global imbalances?

1-032
Jean-Claude Trichet, *ECB*. **–** In reply to your first point, our position is the following: we have a primary mandate, which is Consumer Price Index stability. That is the yardstick against which we are judged by our fellow citizens and by observers. That is absolutely clear.

Asset inflation is linked to our dealings, because if asset inflation turns out to be capital gains it fosters demand, and fostering demand exerts an additional pressure – all things being equal – on prices. It pushes prices up, and the reverse occurs where capital losses are concerned. Therefore, there is an overall appreciation. When concentrating on price stability, it is important to take everything into account, including developments in the asset price direction.

It is also important in our particular case, because we have two pillars: we look at both the economic and monetary analyses. When we look at the monetary analysis, we look, as I said, at the dynamics of components and counterparts. When we look at the dynamics of counterparts, we look at the dynamics of credits. I gave you a number of examples of these dynamics of credits. Asset inflation can be triggered in turn by these dynamics of credits, and it is particularly visible in the field of real estate, but it can be visible in many other fields. Our own primary mandate is price stability and credibility in that field. As I have mentioned, that credibility is high at the moment, but it cannot be taken for granted forever: we have to prove it.

That being said, it seems to me that our concept of monetary policy makes a place indirectly and directly for asset inflation. I remember when you drew our attention to asset inflation, it was absolutely clear that there is a permanent discussion on what exactly it means for monetary policy.

Again, we would certainly not embark on any kind of superior index, mixing up CPI and an asset inflation index. We would never go in that direction. I stuck to what I have said on the two pillars and the way they are helping us to take fully into account the influence of asset inflation in the medium and long run. I am speaking of algebraic influence, because it could be positive or negative.

As regards the global imbalances, we have had a multilateral exercise on global imbalances with the US, France, Japan, China and Saudi Arabia. The euro area was part of these discussions. We published in Washington the conclusion of those discussions. It was an interesting way of giving practical expression to what we believe at the global level to be the homework that each of us has to do, which, for the euro area, was very much a question of structural reforms. For the United States, it was very much a question of good fiscal policy, with special attention given to savings, in particular household savings.

Therefore, we have an addition to the communiqué of the G7 that is a further development of the homework that has to be done by the various partners. I trust that we made progress and we all recognised – at the level of the ECB and at the level of the Council the Eurogroup and the Commission – that it had been a good and useful exercise.

Of course, everything depends on delivery by us and by our partners. A number of them have also to deliver. The idea that it is a joint exercise – that we all bear part of the responsibility for the sustainable global growth is so flattering and that we are observing now – is something that came out very clearly in the discussions.

1-033
Pervenche Berès (PSE). – *(FR)* I will start by returning to this issue of global imbalances, because you continue to tell us that the Central Bank cannot pursue two mandates and that its mandate is price stability and that the exchange rate is not a factor, which no doubt explains its place within the first pillar.

At the same time, it is very clear that we are in a situation in which Europe – the European economy – could suffer greatly from a situation in which the dollar continues to depreciate while the euro, as an indirect consequence, appreciates considerably. When these issues are raised in the Eurogroup or in the Ecofin Council, it is very clear that each Member State comes up with its own strategy in line with its own export segments, but that, at the end of the day, this is very much a matter of common interest. Indeed, as this affects the Member States' economies in different ways, and as its impact on a euro zone economy has repercussions on trade between a given Member State and the others, this is in actual fact a common issue. How, in your view, should or could this issue be usefully dealt with within the Eurogroup?

Next, we are seeing the idea take shape here and there that, basically, the major monetary agreements of the Plaza or Louvre agreement kind are the only solution – the only way out – if we want a comprehensive agreement. Do you believe that we can move in the direction of such a strategy? Do you believe, once again, that the strategy is conceivable, or totally unrealistic and belonging to the monetary policy of the past?

1-034

Jean-Claude Trichet, *ECB*. **–** *(FR)* As I say, I am speaking in my capacity as President of the European Central Bank. In other words, I am not an economist with no administrative responsibility. I am not just an observer. Nor am I an investor or saver. Rather, I am the President of the European Central Bank. I sign the G7 communiqués, which are a distillation of the consensus reached between the main players, be they governments or central banks, within this very sensitive area of exchange rates within a global system in which we have had floating exchange rates for, let us say, 35 years. It follows that we need to know what we are talking about. We have had a system of floating exchange rates for 35 years.

You were asking me about the procedures. Let me say that we sign the G7 communiqués together. They are signed by the executive and monetary authorities on both sides of the Atlantic and Pacific and, of course, by our British and Canadian friends, too.

Without wanting to be too concise, I would summarise matters as follows. Firstly, the excessive volatility and the uncoordinated movements on the foreign exchange markets are undesirable from the point of view of economic growth. Secondly, I note that the Japanese authorities, expressing their opinion at the last two G7s – those of Washington and Essen – said that they thought the Japanese economy was undoubtedly on the road to recovery and that exchange rates should reflect this basic economic data. Thirdly, I also note with great interest that the US Treasury Secretary and the US monetary authorities said that a strong dollar was in the interests of the United States.

Those are the three important points I wanted to emphasise at this stage.

1-035

Ieke van den Burg (PSE). – I would like to thank you for going into more detail in your introductory speech about your views on crisis management and resolution. I have the impression that recently in the press this was expressed slightly differently, as if you were of the view that it was not desirable to make arrangements on this because of the moral hazards issue and at the suggestion that not the private sector, but the public sector, should solve these types of problems. However, now you are making it clearer, and it is indeed very important that these types of arrangements are made.

My question relates to the home/host situation. It is very probable that such a crisis may occur in a bank based in a host country, in a smaller country, for instance one of the new Member States, which has a very dominant foreign finance sector. How do you imagine that the central bank of the home state of such an international bank would be responsible for this lender of last resort, lender of last liquidity responsibilities, if the crisis particularly touches on such a host country, where it is perhaps only a minor activity of this big international bank, but for this small country it could be a very vast and important element. How do you conceive solving this problem without having real European arrangements, or, going a step further and linking to what my colleague, Mr Muscat, said, without a European supervisory structure and involvement of the European Central Bank in this European structure?

1-036

Jean-Claude Trichet, *ECB***. –** Thank you for your two questions. In reply to the first question, let us be absolutely clear: if we have a liquidity problem and if there is a case for emergency liquidity assistance, we in the euro area have tested the functioning of the emerging liquidity assistance, the intervention of the Governing Council, the interventions of the various national central banks which would be concerned; that is something which functions well.

To be absolutely clear, we are very much in favour of the closest possible cooperation when we are over and above the liquidity, when we have a solvency problem, for instance. However, we are not for an ex ante arrangement on burden-sharing with taxpayers' money. That is very clear. We do not believe it would be appropriate, because it would hamper the need for the private sector to be fully responsible. We do not believe such arrangements not exist in any particular country. It would not be appropriate either at the level of any particular country, the level of the euro area, or at European Union level. The question of moral hazard there is very important.

That does not prevent us from thinking that we can make progress in identifying principles to be respected, identifying the various parties concerned that would have to have discussions in such a case, taking into account the fact that we always favour private sector solutions that would save the taxpayer money.

That is precisely the response I will give to the second question. When you have a cross-border operation, the fact that you would have a cross-border crisis, which is the working assumption, the fact that you have worked sufficiently on the principles that should be respected by all partners, including supervisory authorities – not only supervisory authorities, but also all the other partners, including treasuries, central banks – means that these principles would be as clear as possible.

The network of partners concerned with that particular cross-border institution would be clearly identified and we truly believe that we can make progress in this field, again, fully avoiding the moral hazard that would be associated with the ex ante commitment, in any circumstances, of taxpayers' money.

1-037
Wolf Klinz (ALDE). – *(DE)* Madam Chairman, Mr Trichet, a few weeks ago, we saw from the way in which a temporary fall on the Chinese stock market brought forth immediate response from other stock exchanges around the world just how the international financial markets are increasingly interconnected.

The first question I would like to ask about this has to do with whether you are persuaded that the Chinese supervisory authorities are so professional in their work that no errors on their part could cause a crisis that might have been avoided by proper professional supervision.

Secondly, there are regions in Europe – Montenegro and Kosovo, for example – that are not part of the European Union, yet in which the euro is the *de facto* currency. Who is actually in charge of the supply of the euro mass and of other related matters in these regions? Is what is going on there included in your analyses and statistics?

Thirdly, we know that one country of the European Union is actually bound by treaty to bring in the euro; that country is Sweden, which, since its people do not want the euro, is not making any real effort to join Club Euro, and my fear is that something similar could well end up happening in various new Member States in Central and Eastern Europe, for the Czechs seem not to be particularly interested in the introduction of the euro, the Poles have their misgivings about it, and so on and so forth, so how can the European Central Bank ensure that these states actually do discharge their treaty obligations and stop evading the adoption of the euro by means of constant tactical manoeuvres and manipulations?

1-038
Jean-Claude Trichet, *ECB*. **–** *(DE)* Thank you for your very interesting question.

1-039
I hope to be able to respond to you soon in German.

First, it is absolutely clear that China is on its way to modernising its economy and finance. I would say that it is half way there. We are advising them, which is their own sentiment, and I have no doubt that they are resolutely going in the direction of more and more market economy channels in their own domestic economy and domestic finance. You know that we have an important message for them as regards the exchange rate.

However, as regards the question of supervision, I really believe that they are seeing continued progress. It is not for me to judge exactly where they stand, but I know that they realise that they have to continue working very actively to modernise *[inaudible]* and what they have been doing recently shows us that they are not inactive, including in the field you mentioned.

As regards Montenegro, we are very clear on our own position: 'euroisation' is not a way to bypass the Exchange Rate Mechanism II and the checking of stability inside ERM II. We have always maintained that and it is a rule that is pretty well known by all our friends. The case of Montenegro is very special. That country is not yet a member of the European Union. We are in a world where that question will be asked once they are in. However, if and when they are in, it is clear that euroisation is not a way to bypass the Maastricht criteria. That is our legal analysis.

On the third question, we are already 13 countries, with 318 million people. I know you are considering whether to advise that we should perhaps be 15 countries in the future. You are absolutely right to mention that out of the 27 countries, 25 are called upon by the Treaty to enter into the euro area. That is crystal clear. We say that it is up them to do all that is necessary for the criteria to be run, but it would be against the spirit and the letter of the Treaty to act voluntarily not to meet the criteria. You are absolutely right.

The best argument I have when I am speaking of the interest to enter into the euro is twofold: I have the examples of Denmark and Ireland. Ireland is in the euro area. It has the best performance as regards not only growth but also job creation and GDP per capita – Ireland has a GDP per capita which is much higher now than the average of some that are in the euro area but also some that are outside the euro area – much higher than France, Germany, Italy and the UK. It is a good argument to consider that being in the euro area at least does not hamper growth, job creation or prosperity in terms of GDP per capita.

When I look at Denmark, which is an economy that has an opting-out clause, which follows our monetary policy and where you have – I am speaking under the watchful eye, perhaps, of Danish citizens – a fully-fledged agreement across the board in the society to consider that this shadowing of the euro monetary policy serves Denmark very well, it is also an argument that is quite solid.

All that being said, it is by running the euro area as well as possible and applying the Treaty fully that all of us – the 27 – will do our job. That is what I would say.

1-040
José Manuel García-Margallo y Marfil (PPE-DE). – *(ES)* Thank you very much, Madam Chairman.

Mr President of the Central Bank, I shall take this opportunity to ask you a very specific question from a geographical point of view. It relates to my country, but it may be useful for the other countries as well.

As you know, the growth of the Spanish economy is quite considerable, but there are two dark clouds hanging over it. Firstly, the issue of prices, which I shall not go into now, and secondly, the problem of our external deficits.

Spain's external deficit figures are very high – in relative terms, it is only behind the United States – and there are two schools of thought in this regard: those who believe that belonging to the Economic and Monetary Union facilitates the funding of this deficit and that it can continue for a certain amount of time at least, and those who believe that that may cause a serious problem. That is to say, to use an example that has been mentioned in the Spanish newspapers, we could wake up to a crisis of the kind Argentina faced when the Argentinean peso had to be untied from the dollar.

I would like to know your view on the limit or resistance of a country belonging to the Monetary Union, how far can their external deficit figures go without creating a serious problem in terms of growth, employment, well-being, etc.?

1-041
Jean-Claude Trichet, *ECB***. –** I have already said that when devising the recommendation to ship some of the parameters to social partners that were very important, where in particular the current level of competitiveness, the current level of unit labour cost, and the fact that you were gaining or losing market share in Europe and in the rest of the world, we would say the same to all economies concerned. We would tell them to look carefully at their unit labour costs and their level of competitiveness and see exactly what has to be done in this respect. Are they gaining market shares in Europe or losing market shares? Do they believe that their unit labour costs are too high already? If so, then they have to practise appropriate self-restraint in this field as well, as in others in terms of nominal revolutions, and to speed up labour proactivity and their own proactivity progress as much as possible. However, there is not a single recipe for any particular country. You have to look at the overall situation of the various countries concerned.

I have already given the example of Germany, which, because of reunification, had lost a lot of cost-competitiveness. Germany embarked on a very responsible policy over time. Over the eight years of the euro the unit labour cost has grown much less than the average in the euro area. Now Germany has regained its competitiveness and is in a position to see its cost-competitiveness being very good now, but it is after a period of appropriate handling of this aspect.

As regards Spain, there are elements which are good and others that are less good. You have to take all that into account. What is good is the current level of savings, which remains quite high in comparison with others, suggesting that the level of deficit of the current account is very much based on an investment which is higher than the average economy in the euro area, so there is a justification at least for part of the current account deficit.

On the other hand, it is clear that the progress of productivity is very meagre, and therefore unit labour costs have increased in a way which is higher than the average in the euro area. So it is clear that there is a tendency to lose competitiveness in comparison with the average in the euro area. All this has to be taken into account and we would recommend making maximum efforts.

The question comes from you, Mr Vice-Chairman, and I understand full well that you are interested in your country, but my response is valid for everyone. There are a number of economies which could make much more progress in improving their labour productivity, their yearly progress, and they should concentrate all efforts on that. Structural reforms are one of the main ways of delivering this kind of jump in labour productivity. It is certainly particularly important in the case of Spain. Appropriate responsibility and moderation in the nominal evolution is also something which seems to us to be very important.

All this corresponds to the correct handling of the various national policies, taking into account the fact that we have a single monetary policy at the level of the euro area as a whole.

1-042
Pervenche Berès (PSE). – *(FR)* I should like to return to the supervision issues because, throughout this exchange, you told us that everything that was contained in embryo in the Lamfalussy procedure was to be made full use of before considering other mechanisms. Taking account of what is on the table, the ability to implement sanctions is the issue that is often mentioned as one with regard to which the current mechanisms do not allow us to go far enough, a state of affairs that leaves uncertainties about the way in which this or that Member State is to apply sanctions and that opens the way to regulation tourism on the part of operators. Do you have any particular ideas about the way to move forward in this area?

In the same spirit, and turning now to cross-border actors, the idea of a lead supervisor seems more and more to be one of the ways of moving forward and of ensuring that, at the very least, there is a supervisor who genuinely exercises a monitoring function. However, it can also be seen how, in Member States in which a lot of operators are apparently supervised from elsewhere, there seems to be a problem with supervising the local markets, with the Member States concerned seemingly deprived of the material that would give them a good knowledge of their local markets. Everyone appreciates that in the field of supervision, including where money markets are concerned, there is a need, if the system is to work well, for sound integration at all levels, as it is by being close to the market that it is possible to supervise it properly, to be well informed of developments there and to keep on top of such developments. There is also a need to consolidate items of information in order, where necessary, to adopt a global approach.

How, using the current mechanism, is progress to be made in this area? I believe that very practical examples of how difficult it is to do this will be forthcoming. As you well know, these issues are to be re-examined in a related and parallel area – that of insurance – during the debate on Solvency II. How might the supervisors in the Member State in which the lead supervisor is apparently always elsewhere accept such a situation? That is a question that is put to us regularly and on which, perhaps, you might be able to shed some particular light.

1-043

Jean-Claude Trichet, *ECB***. –** *(FR)* Allow me to answer your first and, indeed, very important question. As I said, we have agreements on the same concepts at global level. These have been reached within the framework of the Basel Committee which, I might mention, is chaired by Nout Wellink, President of the Netherlands Central Bank, his predecessors having been Jaime Caruana, the Governor of the Bank of Spain and Bill McDonough, the President of the Federal Reserve in New York. We therefore maintain extremely close cooperation.

We then have the European directives. It is a particular paradox that, in the Europe of the 27, we can have differences of interpretation from one money market to another on the application of the same principles and texts. Moreover, I have to say that it is particularly outrageous that there can be a sort of perverse competition as to who will behave the most benevolently and agreeably towards the various institutions concerned. We should have, by definition, a perfectly level playing field, as our jargon would have it. No commercial advantage should be offered on the pretext that some person or institution apparently has a more agreeable, more sympathetic and, when all is said and done, less stringent view on how to interpret the rules. That much is clear, then. Obviously it is up to all of us, within the framework of this close cooperation, to ensure that this does not happen.

I take the point, made in your second question, about its being very important to have the greatest possible clarity when one is in the presence of a cross-border institution and, at the same time, not to demotivate anyone. This is an entirely practical aspect that brings us to what I consider to be one of the main considerations in implementing the level three Lamfalussy procedure. This consists in having a clear idea of the principles to be applied not only in case of difficulty but also in normal periods, as well as having partners and authorities that involve themselves and that need to be in constant contact. That is because there can be no question of their saying: I have no presence on the ground; you are the ones who are responsible; this may be happening on my own territory but I have absolutely no responsibility of any kind or even any insight into what is happening.

It follows that transparency really is necessary, and that responsibilities need to be clearly defined. However, it is also necessary for all the partners concerned to be in contact – spontaneously and as a matter of course – within the framework of close relationships characterised by trust. That is what is being striven for or, rather, what 'they' are striving for at level three and, I have to say, with a good deal of energy, as they are well aware of what a great challenge they face, and I do think – if I may repeat myself – that the Lamfalussy concept needs to be given every opportunity to succeed.

1-044

Chairman. – Thank you very much, Mr Trichet. We have come to the end of these two hours of monetary dialogue. Our next meeting will be in plenary, as we shall meet again in July in connection with the European Central Bank's annual report which, this year, for the first time – and it is to be hoped that this will become normal practice – will be examined at the same time as the annual report on the euro zone, and this in the presence of your two opposite numbers from other institutions, Commissioner Almunia and the President of the Eurogroup. We shall then meet again for the next monetary dialogue on 8 October 2007.

(The meeting was closed at 6 p.m.)