1-001

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, 21 NOVEMBER 2005

1-002

IN THE CHAIR: MRS BERÈS

(The meeting was opened at 3.15 p.m.)

1-003

Chairman. – Ladies and gentlemen, welcome to this meeting of the Committee on Economic and Monetary Affairs. We shall proceed straight away to the exchange of views with the President of the European Central Bank, Jean-Claude Trichet.

Mr Trichet, since your last speech before this Committee, you have made it known that important decisions may be taken by the Central Bank. You can be sure that the members of the Committee will be listening very carefully to everything you have to say today about this, as the prospects for growth in the European Union as a whole, and in particular in the euro zone, remain fragile.

Without further ado, I give you the floor for some introductory comments, which, as usual, should not be too long. You may then have a round of questions, according to a now well-established protocol.

1-004

Jean-Claude Trichet, *ECB* **–** *(FR)* Mrs Berès, members of the Committee on Economic and Monetary Affairs, I am delighted to appear before your Committee today, and to continue with our regular dialogue. As you are aware, our quarterly meetings are very important to the European Central Bank.

I will start by evaluating the economic and monetary situation.

1-005

(DE) I should then like to make a few comments about how things stand with the financial integration of the euro zone. The progress of the integration of the European financial system is of great interest to the ECB. As the arguments adduced on this subject in public fora are often qualitative in character, the ECB has recently, and for the first time, published a range of indicators for the relative integration of financial and banking markets, and I shall later be summing up their conclusions.

1-006

Madam President, let me start with the economic and monetary issues. At the time of my last appearance before the European Parliament, we expected the underlying trend in real economic growth to remain modest in the short term. I said that the conditions were also in place for positive fundamental factors to influence the outlook and for economic activity to pick up beyond the short term. The most recent data and indicators available have confirmed our working assumption of a gradual ongoing strengthening of economic activity. According to Eurostat's flash estimate, released on 15 November, euro area GDP rose by 0.6% quarter-on-quarter in the third quarter of 2005, after increasing by 0.3% quarter-on-quarter in the second quarter of 2005. Notably, the euro area economy has shown a marked degree of resilience to the increase in oil prices.

Looking ahead, on the external side, it is projected that ongoing growth in global demand will continue to support euro area exports. On the domestic side, it is projected that investment will benefit from continued favourable financing conditions and from the robust growth of corporate earnings. Consumption should gradually recover, broadly in line with expected developments in real disposable income. At the same time, the outlook for economic activity remains subject to downward risks, relating mainly to oil prices, concerns about global imbalances and weak consumer confidence.

Turning to price developments, recent increases, mainly in energy prices, have pushed headline inflation rates to levels significantly in excess of 2% and along a path higher than previously expected. According to Eurostat's release on 16 November, annual HICP inflation was 2.5% in October 2005, compared with 2.6% in September and 2.2% in the two preceding months. It is likely that HICP inflation will remain elevated in the short term. In interpreting current inflation rates, it is important to make a distinction between temporary, short-term factors and factors of a more lasting nature. While some developments might prove to be transitory, markets still expect oil prices to remain at historically high levels,

driven mainly by buoyant global demand and also, to some extent, by fragilities on the supply side. This suggests that the impact of energy prices on overall price developments may be more lasting than in the past.

Whilst our scenario is based upon the preservation of price stability in line with our definition, beyond the short term, concerns exist about the medium-term upside risks to this scenario. Upside risks relate to ongoing uncertainties surrounding oil market developments, to a potentially stronger pass-through than has so far been observed – on account of higher oil prices being passed on to consumers via the domestic production chain – and to potential second-round effects in wage and price-setting behaviour. In addition, possible further increases in administered prices and indirect taxes have to be taken into account.

Let me turn to the monetary analysis, which also points to increased upside risks to price stability over the medium to longer term. Liquidity in the euro area is very ample in terms of all plausible measures. Moreover, the strengthening of monetary growth observed since mid-2004 has gained further momentum over the past few months, driven by the increasingly dominant impact of the low level of interest rates. Furthermore, the growth of credit, especially mortgage loans, remains very robust at the level of the euro area as a whole.

In conclusion, the economic analysis indicates that energy price increases, in particular, imply upward revisions to the outlook for short-term price developments. Some of the contributing factors can be expected to be temporary, but others are likely to be more lasting. Domestic inflationary pressures over the medium term remain contained in the euro area, but significant upward risks have to be taken into account. Moreover, the monetary analysis identifies increased risks to price stability over the medium to longer term. Overall, cross-checking the information from the two pillars confirms that strong vigilance is warranted to keep inflation expectations in line with price stability.

That is why, after two and a half years of maintaining interest rates at a level, which, as I have often said here, is historically exceptionally low, I would consider that the Governing Council is ready to take a decision to move interest rates and to moderately augment the present level of ECB rates in order to take into account the level of risks to price stability that have been identified. We would thus withdraw some of the accommodation which is embedded in the present monetary policy stance, while the policy would remain accommodative. This move would aim at coping with inflationary risks in order to maintain and preserve full confidence in price stability and to continue solidly anchoring inflationary expectations. This move would therefore contribute to sustainable growth and job creation in the euro area.

As regards fiscal policies, a number of countries have presented their budget plans for 2006 and the European Commission has presented its autumn forecasts. No significant progress has been made in fiscal consolidation, and the outlook for countries with excessive deficits is a matter of great concern, as there is a high risk of commitments for this year and next year not being met. All parties involved in the forthcoming decisions have an important responsibility to ensure the proper functioning of the overall fiscal framework in the future. This would be the most effective way of contributing to the enhancement of the growth prospects of the euro area and building confidence in public finances before the challenges of population ageing set in. Countries with fiscal imbalances should give priority to the timely correction of these and should implement the revised pact rigorously.

As regards structural reforms, I would again like to stress the need to increase the flexibility of labour and product markets in order to achieve a more dynamic and competitive European economy, to increase its resilience to shocks and to help foster the adjustment processes within the euro area. Structural reforms are also of relevance to the speed and smooth operation of adjustment mechanisms within the euro area. Competitive patterns across the euro area countries are depending on developments in unit labour costs within the euro area. Since the start of EMU, cumulative increases in unit labour costs have posted significant differences across countries. It must be stressed that a degree of difference in such cumulative increases in unit labour cost rates are a natural feature of a well-functioning monetary union. As such, they may reflect welcome catching-up processes or necessary adjustments to past shocks. In this respect, the degree of flexibility within the euro area may well have been underestimated in its early phase of existence. However, at the same time there is no room for complacency, because in some euro area countries, wage developments have substantially and persistently exceeded labour productivity growth, leading to relatively strong and sustained increases in unit labour costs, higher inflationary pressures and losses in competitiveness. This may be due, at least partially, to wage rigidities, such as an explicit or de facto indexation of nominal wages to prices, or high reservation wages determined by the level of unemployment benefits, as well as to a lack of competition in some sectors. Structural reforms aimed at addressing these issues would support unit labour cost developments that are conducive to price stability and would smooth out the functioning of adjustment mechanisms in the euro area, thereby strengthening the foundations for sustained growth in output and employment.

Let me now say a few words on the very important issue of financial integration in Europe. The ECB has a keen interest in this area, as financial integration enhances the smooth and effective transmission of monetary policy impulses. It is also an important factor in safeguarding financial stability. Financial integration also enhances the efficient functioning of payment and settlement systems. Under Article 105 of the Treaty, the Eurosystem supports, without prejudice to the objective of price stability, the general economic policies in the Community. Financial integration, which is a priority

Community objective, can promote the development of the financial system, thereby raising the potential for economic growth. We support this process through various activities. For example, it acts as a catalyst for private-sector initiatives, such as the STEP – short-term European paper – initiative.

A prerequisite for any action by the ECB is an analysis of the state of financial integration in the euro area. Because the relevant arguments in discussions on this topic are often of a qualitative nature, the ECB sought to devise a way of capturing, in quantitative terms, the state of financial integration in the euro area. On 30 September 2005, we published our first annual report and a first set of 20 indicators on financial integration in the euro area. Based on these statistics, the report provides an overall assessment of the degree of financial integration in the main segments of the euro area financial market, namely the money market, the government bond market, the corporate bond market, the equity market and the banking markets. The main conclusion is that the degree of integration varies greatly depending on the market segment, with integration being much more advanced in those market segments that are closer to the single monetary policy.

Our indicators show that the unsecured interbank money market has been fully integrated since early 1999. As regards the repo market, while it has a lower degree of liquidity, in particular in the longer-term segment, the indicators also suggest a high degree of integration.

Government bond markets have also achieved a very high level of integration, mainly due to the disappearance of exchange rate risk in the euro area and the convergence of inflation expectations across countries. Another notable feature is the emergence since 1999 of a euro corporate bond market, which did not exist before. Our studies suggest that this market segment is fairly integrated in the sense that the country of issuance is only of marginal importance in explaining yield differentials.

In other market segments, there is potential for further advances in integration. This is true for the equity market and for the banking markets. Our findings confirm that retail banking markets, for example mortgage markets, are generally far less integrated, whereas the euro area interbank –or wholesale – market and capital market-related activities show signs of increasing integration.

In order to extend the assessment of financial integration in the euro area, the coverage of the indicators will be further enhanced next year, in particular by adding new indicators relating to the integration of financial institutions and financial market infrastructures.

In conclusion, with its first publication of indicators of financial integration in the euro area, the ECB has initiated a regular monitoring of the progress of financial integration.

I am now ready to respond to your questions.

1-007

Alexander Radwan (PPE-DE). – *(DE)* Madam Chairman, this, Mr Trichet, is now the second time that you have addressed the subject of flexibility – the flexibility of the structural reforms and that of the European internal market, both of which are of vital importance in terms of economic growth and of the relevant compensatory mechanisms.

Ever since I entered Parliament – admittedly, as recently as 1999 – I have heard these demands made both by your predecessor Mr Duisenberg, and by you. What is going on in this area does not, in view of the debate on the services directive, appear to give much in the way of grounds for optimism. I would be interested to see the scenario from your angle. What significance does it have for the European Central Bank if the flexibility and the structural reforms, which have been demanded for something like decades, are not forthcoming? What effect will that have on the Bank's future work or its future interest rate policy?

Secondly, you mentioned that there will be a change in interest rate policy and that no perceptible progress has been made in the consolidation of budgets, especially of those that are in a highly critical condition. What are your expectations? On the basis of what calculations are you working? You are holding out the prospect of a course of action that will have effects on budgets. To what extent do you expect it to delay the consolidation that you are calling for?

1-008

Jean-Claude Trichet, *ECB*. **–** On the first question on flexibility, all I can say is that in a world where science and technology are moving extraordinarily rapidly – much more rapidly than before – and where globalisation is introducing new elements of permanent change, not being sufficiently flexible first of all decreases the level of growth potential of any economy and unfortunately decreases the capacity for job creation. It seems to me that in today's world, where again the rapidity of change is very well documented at present, the opportunity cost of being relatively inflexible has considerably augmented. We can see that even inside the euro area, where those economies that are more flexible than average and more flexible than others are having remarkable economic success. I do not want to mention too many of these economies, but let us take Ireland as an example of a flexible economy taking advantage of the rapidly changing world, with an above-

average per capita GDP and absolutely remarkable successes in job creation and growth. There is no reason why the whole of the euro area would not be in the same situation in our analysis.

I mentioned that the Governing Council of the ECB would be ready to increase interest rates. It would be with the intention to preserve and maintain price stability, the delivery of price stability and the credibility of the delivery of price stability in the medium and long term. A number of governments are issuing bonds on a 5, 10, 30 or even 50-year basis. If they have very low market interest rates with these duration periods, it is because the European and global investors and savers have confidence that my own institution, its Governing Council and the euro system will deliver, over the medium term, the long term and the very long term, very low inflation in line with our definition of price stability. So I trust that by being faithful to our mandate we will create the best possible conditions in the medium, long and very long run to allow the economy of the euro area to behave as properly as possible, for growth to be sustainable, for job creation to be dynamic and for refinancing of outstanding debt to be operated in a way which would be as little damaging as possible. Of course it is also important that the fiscal policies themselves are helping the various economies at stake.

1-009
Cristóbal Montoro Romero (PPE-DE). – *(ES)* Madam President, Mr President of the European Central Bank, this is a sad afternoon. Millions of Europeans are hearing the news that the mortgage payments on their houses are going to rise. It is a sad afternoon for millions of small and medium-sized businesses in Europe.

When the President of the European Central Bank announces this, I believe that it is important for him to explain even further what he meant by his last comment: the responsibility of the national governments, which must do their duties in the field of budgetary policy.

Mr Trichet, when we have to explain to millions of Europeans that we are going to leave behind a situation in which interest rates have been historically positive and favourable, perhaps we should also insist – as you did just now in the last part of your reply to Mr Radwan – on the idea that budgetary policies have an important role to play in terms of preventing further rises in interest rates and that, in terms of budgetary consolidation, the national governments must do their duty and prevent the increase in interest rates from jeopardising the still weak economic growth throughout Europe, which is matched by equally weak employment creation.

1-010
Jean-Claude Trichet, *ECB*. **–** Firstly, I would say that the people of Europe – the 311 million citizens of the euro area – are asking us to be vigilant and to guarantee price stability. That is the message we are receiving from all the polls. They are asking us to deliver price stability, as we are required to do under the Treaty. You know better than I, because you have your own constituencies, that they are not necessarily that happy with what they see on a day-to-day basis. We are there to guarantee that, whatever shocks we have to deal with, we will deliver. Again, it is the message of the people.

Secondly, it must be said that we are used to 2%. This is lower than the rate set by the Bundesbank – before the euro – since World War II. It was very daring of us – for the 311 million citizens of Europe, not only for 80 million Germans – to set the rate so low. We could do so because we have credibility in the eyes of the Europeans and the rest of the world. We maintained our credibility and we continued to have a correct anchoring of inflationary expectations throughout the two and a half years we maintained this exceptionally low level of interest rates. Before the euro, nobody thought that it would have been possible for the ECB to maintain for two and a half years, and for 311 million people, a level below that of the level set by the Bundesbank. I mention the Bundesbank, but I could mention other central banks that had attained a very high level of credibility. That has to be taken into account.

If the Governing Council decides to increase rates, it is because there are a number of signs that the risks are increasing. It is our duty to prevent that. Prevention is always better than cure. Prevention is the way to allow growth and job creation to be sustainable. If a cure is necessary, then it means that prevention did not work and it is too late. A cure requires a medicine, which is very adverse for growth and job creation. That is why, again, we trust that there is no contradiction between being credible, vigilant and doing what everybody in the world and in Europe expects us to do, because it is the best way to contribute to sustainable growth and job creation.

1-011
Ieke van den Burg (PSE). – I apologise for arriving a bit late. My train was delayed, but that gave me an opportunity to read the speech you gave to a group of bankers last Friday, Mr Trichet, in which you gave us the big scoop and explained a bit more clearly what your intentions were with respect to interest rates. I was surprised that you did not say anything to them about their duty to boost investment in Europe, particularly now that we in the European Union have arranged a capital adequacy directive on the basis of the Basel II agreement, which gives big opportunities for banks and investment firms in Europe to use advanced risk management systems.

Do you not think that this ought to be part of your remarks about the economy in general, instead of always repeating those words about structural reforms in Member States? I would like you to place more emphasis on the need to boost investment in view of the risk of this interest rate increase for the fragile economic situation at the moment.

1-012
Jean-Claude Trichet, *ECB*. – In front of you, Madam, your colleagues and you, Madam President, insisted on the fact that confidence is certainly a decisive ingredient in Europe at the present time. I have explained why we are not entirely satisfied with the level of investment, which is absolutely true. I said myself several times that it is time to invest. It is time to invest because the financial environment is exceptionally favourable. At this very moment it is exceptionally favourable. There are opportunities of all kinds: science and technology are moving very rapidly and are triggering investment in a large part of the world.

My sentiment was that it was perhaps because, as far as both entrepreneurs and households are concerned, confidence in the future was not sufficiently well enshrined. I would certainly continue to give this message. I trust that the economic agents in Europe can have confidence. At least they can certainly have confidence in stability. We are ourselves an anchor of stability. We are, if I may say, the guardians and guarantors of stability and of confidence. There is also the fact that we have experienced two and a half years of exceptionally low interest rates. We will take care that inflationary expectations remain well anchored. That will permit the yield curve to continue to be favourable, and that is something which is also of great importance.

Clarity and visibility in medium-term fiscal policies and structural policies are also very important for confidence, both for households and for entrepreneurs. I would certainly call again on all economic agents, including banks, to ensure they fully understand the situation we were in. Europe has a lot of potential. Europe has exceptional human resources. The figures show that Europe's yield curve is much better than that of the US. Europe has the capacity to grow and create jobs. Europe is not imbalanced. There are a very large number of elements that are objective and favourable. What is perhaps still needed is confidence, and we will do all that we can to help build confidence.

1-013
Ieke van den Burg (PSE). – I see you also made a speech last week – you see that I have had plenty of time to study them! – to CEIOPS, the level-three committee on insurance and pension funds. I understand you made a strong appeal for good cooperation between the different level-three committees in view of the increasing cross-border and cross-sector developments involving financial conglomerates. Do you think that the current system is adequate or would you like to see it move a bit further in that cross-border and cross-sector direction?

1-014
Jean-Claude Trichet, *ECB*. – I certainly consider the Lamfalussy framework to be a good one, and I believe that the level-three groupings are also very useful. I noted on that occasion that were various speeds of working for the various level-three committees. That was normal, because the situations were not the same and, as you said, I really think there should be very good cooperation between the level-three committees. This is very important, because these issues are intertwined, particularly as regards the insurance business and the banking sector.

1-015
Dariusz Rosati (PSE). – We all agree that the ECB is an institution that should be forward-looking in its monetary policy. You have given us some figures concerning past inflation over the last few months, but you have not given us any specific figures for the future, especially for the next six to eight quarters, which, I would say, would be the most relevant for monetary policy decisions. What is the system of inflation forecasts that the ECB has been using in its monetary policy and what do these forecasts tell you in terms of future inflation developments?

1-016
Jean-Claude Trichet, *ECB*. – Your question is very timely. The problem is that we have now embarked upon a euro-system-wide exercise for forecasting both inflation and growth, and we will have the results of this forecasting exercise during the next meeting of the Governing Council. So I will make that public at that time. I do not have any fears yet, but I have every reason to believe that we will see an increase in the staff of the euro-system's projections by comparison with the September projections, which were done by the staff of the ECB itself.

We are basing our own projections on the basis of a state-of-the-art concept and we are in that respect close to the other international institutions that are embarking on their own forecasting. We are trying to be state-of-the-art. All I can say at this moment is that all the indications I have bring me to the conclusion that, because of the price of oil, we will be higher than in the previous projections.

1-017
Dariusz Rosati (PSE). – I should like you to elaborate on the second-round effects, because you mentioned several times the risk of pass-through from oil price increases to other monetary developments. Would you give us some more evidence of that, especially as far as wage developments are concerned, and perhaps other indicators that would justify your fear that second-round effects are spiralling gradually out of control?

1-018
Jean-Claude Trichet, *ECB*. – That is a very important question. I have always said that risks have increased, not that second-round effects had already materialised. As a matter of fact, if they had already materialised it would have been too late. Prevention would not have been operating; we would have to cure and not prevent; we would be in a totally different

world. The problem is how to analyse risks and how to judge that these risks are increasing in order to allow for appropriate prevention.

From that standpoint, I would mention four major signals that show us that risks are on the increase. There is the accumulation over time of headline inflation being over and above our definition of price stability. That per se and the accumulation of that is something which is per se a risk. It is not too much for me to say that, but you know that our definition of price stability is less than, but close to, 2%. Every year except 1999, we have unfortunately had an average headline inflation which was over and above 2%. In 2000 it was 2.1%, in 2001 it was 2.3% and in 2004 it was 2.1%. If I take the last 12 months, I would say that it is 2.2%. Of course there are good reasons for this. It was the result of a number of shocks, including oil shocks. Of course, we did not lose credibility, but, again, there is this accumulation. I shall continue to mention the other signals as our dialogue continues today.

1-019
Margarita Starkevičiūtė (ALDE). – Our ECON Committee experts suggest that we have to be a little more provocative when we are debating with you, Mr Trichet, so if I may I would like to put a question about monetary policy. A few weeks ago Gordon Brown published an article in the *Financial Times* where he suggested that the monetary policy of the ECB should be a little bit more flexible and should include adjustment to business cycles. Some other experts suggest that it is necessary to set up a monetary policy committee within the ECB board. What is your reaction to this, and do you think it is necessary to discuss these issues?

1-020
Jean-Claude Trichet, *ECB*. **–** Well I will certainly not comment on the monetary policy of the UK or of other central banks. Let me only tell you that again we put rates for two and a half years. As I speak, they are at a level lower than that which had been attained by the Bundesbank since World War II, and that goes not only for 80 million German citizens, but for 311 million European citizens. Nobody would have thought that it was possible to do that. It is entirely based on our credibility.

There is a very simple way to increase all rates in Europe, and that would be for us to lose our credibility. The result would be absolutely immediate. The level of euros that are in the hands of non-residents in terms of negotiable financial instruments and of deposits amounts to more than EUR 3 trillion. They have no particular empathy for us. They are managing their capital in the best way possible and they have to tell their own people that their management was absolutely sound, without any challenge. So again, we are credible. It is because we are credible that we could deliver.

You mentioned what was forthcoming. I should like to mention the dynamism of monetary aggregates over 12 months in the third quarter – just so you have the figures. In the euro area it is 8.5%, in the US it is 3.9%, in Japan it is 2%. That is for broad money. If I take narrow money in the euro area it is 11.2% over 12 months. In the US it is 0.9%, in Japan it is 4.4%. Credit to the private sector during the last six months in the euro area has been up 9.8%. I do not say that to dramatise; it is one of the signals we have. We have a two-pillar strategy, we look at everything, but nobody here can say that there is a lack of liquidity in Europe, or that insufficient growth is a result of this lack of liquidity, because nobody would tell you that and the figures do not confirm that. So again, we will deliver price stability. It is our mandate. It is the best way to contribute to sustainable growth and job creation.

1-021
Margarita Starkevičiūtė (ALDE). – I have one question concerning the problem of the new Member States. Recent polls show the quite negative reaction of the people of the new Member States towards the introduction of the euro. What can the ECB do in the way of information campaigns, for example, to improve the attractiveness of the single currency? It is a matter of concern to us.

1-022
Jean-Claude Trichet, *ECB*. **–** I believe that, at least in terms of cooperation between the central banks, the preparations that are ongoing with the ten new Member States are very good. This particularly applies, it must be said, within the eurosystem ESCB framework, because the central banks of the ten newcomers are all being fully involved in all our committees. As you know, we already have observers from Romania and Bulgaria, although of course they cannot yet vote. I feel we have an exceptionally confident relationship with the ten newcomers, their central banks, the governors and staff. We are doing all we can to facilitate their progressive entry into ERM II which, as you know, already has seven members – 6 + 1 (Denmark), which is in ERM II and is an extraordinary good de facto member of the euro area, with brilliant results and full satisfaction to be part of the euro area. We will continue to do so and to prepare for it in the best way possible.

1-023
Eoin Ryan (UEN). – I just have two questions. What you have done in the eurozone has been a huge success in terms of keeping interest rates down throughout a long period, and no-one could argue with that. As an Irish Member, I do not think that our entry into the euro gets nearly as much credit at home as it deserves. I think it has been hugely beneficial to our economy as well as other things.

However, looking at the eurozone and the 311 million people that you have talked about, do you not think that it is a little bit early for us to start putting up interest rates? Economics is about numbers, but it is also about confidence. We are talking about putting up interest rates once, and now there are discussions about whether it will go up a second time. In countries where there have not been structural reforms, low interest rates have probably been one of the things that have been slowly driving the economy. Do you not think that this is going to have a negative knock-on feeling within those economies, and what is your reaction to that?

Secondly, where do you see interest rates settling to do the job that you believe they need to do to control inflation?

1-024
Jean-Claude Trichet, *ECB*. **–** As I said, I wish that all European economies had a structural environment like that of Ireland, because I really believe that then we would have more flattering growth and more dynamic job creation. That being said, our move would maintain and preserve confidence. Confidence is not given to us totally freely, no matter what we do. Confidence is given on the basis of facts and figures and action when action is needed. It is exceptional that we were able maintain these extraordinarily low rates during that long period while keeping inflationary expectations strictly under control. It is a great success. I really believe that we will continue to preserve price stability and to be credible in preserving price stability and therefore to maintain and preserve confidence.

To respond to your second question, I do not see this at all as the start of a series of increases in interest rates. We in the Governing Council have always judged our rates – whether we increase, decrease, or keep them as they are – to be in line with what we judged to be appropriate for delivering price stability. We believe that we have never been far away from what would be a desired level of rates. We always considered that we were at the right level, so there is no process of catching up in our own concept of handling monetary policy. We do serenely and calmly what is needed to ensure price stability, but it would not be a good ex ante working assumption to think that we are at the start of a series of interest rate increases.

1-025
Eoin Ryan (UEN). – So your plans are for only one rate increase?

(Laughter)

1-026
Jean-Claude Trichet, *ECB*. **–** We will do what is necessary. I cannot say that the good rates will be much higher or that we are at the start of a long series of increases.

1-027
Eoin Ryan (UEN). – Some commentators are saying the opposite, so it is good to hear you clarify it.

1-028
Jean-Claude Trichet, *ECB*. **–** We will do what we have to do. If we do not, we will lose credibility, which would be the best recipe for interest rates to increase massively.

1-029
John Purvis (PPE-DE). – Mr Trichet, you have long complained about the lack of structural reform. Ireland is your exception, your great example, but all the others are apparently not doing what they should do. You bemoaned the lack of imposition of the original stability pact and are regretful about the new flexible one, and now you are imposing interest rate increases, perhaps as a sort of discipline, or presumably in an effort to force structural reform on the Member State governments.

Another item that you have recently mentioned is the question of bond ratings, namely that you will not accept bonds rated less than 'A –'. On that specific issue, I would ask you, do you think that is a sufficiently strong signal? No Member State is anywhere near being down to 'A –', and some of them are pretty profligate, so do you think the line should be a little bit tougher on what you would accept in the way of bonds as collateral?

Secondly, are you in a battle and a war with the Member States to force them into a more structural reform mode?

1-030
Jean-Claude Trichet, *ECB*. **–** I shall answer the second question first. We are not in a battle with anybody, and certainly not with governments a priori. The paradox of the situation as regards structural reform is that we all agree: the Commission has very good ideas and proposals; we totally back the structural reforms; and the governments, at Heads of State and Government level, have signed the Lisbon Agenda and re-signed, in Brussels, the restart of the structural reform endeavour. The problem is delivery. My understanding is that if delivery is so difficult, it is because we have to convince the people of Europe that with that delivery we would all be better off, that growth and job creation would be much better, and it is not easy to convince our own people of this.

I would say that we are part of an explanation exercise, an educational exercise, which is obviously difficult. We must convince our people as a matter of urgency. In democracies you do what the people accept that you do; that is the inflexible rule of democracy. I do not want to embark on a hit parade of those countries who are lucky enough to have convinced their people on a bipartisan basis that it was much better to carry out those structural reforms, but it seems to me that success is clearly associated with such reforms.

As regards the bond rating, because a number of questions on the matter had been asked, we made clear in the Governing Council since January 1999 the rules that we would be applying from the beginning of the euro. The rules were that for collateral, for taking papers as collateral in our own monetary policy operations, we would not take public or private paper – we treat public and private papers in exactly the same way – at a level lower than rating 'A', or, as you said, 'A –' to be absolutely precise. We really said that. It was a clarification on what we had been doing since the setting-up of the euro. All those people involved in the markets who visited our website knew that already, because we were displaying what we were doing on the website. Perhaps it would have been better to be clearer, because I could see that it had some impact in terms of communication. But again, it was exactly what we had been doing since the very beginning.

1-031
John Purvis (PPE-DE). – On structural reform – if I can go back to that – are you happy with the initial signs from Berlin of a 3% increase in value added tax, and so on? Do you think this will bring Germany closer to what you would like to see, or is it just going to weaken its economy from what are the beginnings – the slight green shoots – of some sort of improvement?

1-032
Jean-Claude Trichet, *ECB*. **–** I am not here to give good marks and bad marks here and there. There are, undoubtedly, good things and bad things being done in the euro area. To me, all actions directed at reducing fiscal deficits are good, and all actions directed at maintaining or reducing public spending as a proportion of GDP in most of the countries where it is obviously too high – at European or world level, in terms of competition – are good.

Of course, we are looking at what is being done not on a country-by-country basis, but on the basis of the 311 million citizens of the eurozone. We have to be credible for only one signature – the signature of the euro. That signature has a global and European existence, and is judged as a synthesis. It is on the basis of all the information we have coming from everywhere that we take the appropriate decision that we maintain and preserve our credibility.

1-033
Sahra Wagenknecht (GUE/NGL). – *(DE)* Mr Trichet, my question also has to do with expectations for inflation. I must apologise for arriving rather late, since my flight was delayed in landing. I have looked quickly through what you said at the beginning and found nothing on this subject. I think it is obvious that inflation rates, when considered sector by sector, have, over recent years, been drifting away from each other in a way rarely seen before. Inflation in some sectors – energy for example – is very high, but there are, on the other hand, in some Member States at least, positively deflationary tendencies in some consumer goods, such as clothing, durable consumer goods and so on.

Bearing in mind the fact that the European Central Bank has published a whole array of analyses and working papers stressing the need for greater account to be taken in future of this diversity in pricing, I would now like to ask you whether those who take the decisions have paid any attention to them; I get the impression that they have not. If only the aggregate inflation rate is taken into consideration and it is, so to speak, used as a pretext for a debate on interest rate increases, then I have to say that I think we are lagging behind the state of expert discussion in this area.

Is, then, any attention being paid to these expert debates, these analyses and the emphatic statement that one inflation rate is of course not the same as another, since there is a difference between inflation increasing across all sectors and its increasing only in isolated instances?

Secondly, do you really think it is responsible, in this situation, with extremely low growth rates and high levels of unemployment, to increase interest rates in this way and thereby stifle yet again whatever recovery there is?

1-034
Jean-Claude Trichet, *ECB*. **–** As you know, the calculation of the CPI – Consumer Price Index – relies on a variety of prices. Some are going up, some are not moving much, and others are going down. It is clear that what we call the CPI is the result of a complex calculation.

As you mentioned yourself, there is a great variety of price developments. However, what counts is the overall pertinent indicator, which is the average, i.e. the mainstream consensus the world over. You know that better than anybody, because, again, if you asked the man or woman in the street, they would tell you that, taking everything into account, things are going up, and going up a little too much. That is what I hear everywhere. So I think there is not much doubt about that – at least on headline inflation.

Let me mention other signs that the risks are on the increase. As I have already mentioned, headline inflation has been over and above our definition for a long time now. As I also mentioned, monetary aggregates have been going up. Real interest rates have been slightly negative for a long time. I mentioned the figure of 2% for two and a half years. During that time, as an average, inflation was a little over 2%. The calculation of the real interest rates showed that short-term real interest rates were slightly negative. That is something that cannot necessarily continue for ever. The anchoring of inflationary expectations is also extraordinarily important, because all future prices depend on what we all – households, entrepreneurs and social partners – have in mind as regards future inflation.

There are signs that there is an upwards trend both in our surveys and in break-even inflation that we are extracting from the financial markets. This set of indications makes up an overall synthetic signal that makes us think that the risks to price stability are on the increase, and therefore that we have to be responsible, taking account of our own mandate. Again, our mandate and being faithful to it is the best way to continue preserving an environment that is favourable to growth and job creation.

1-035
Karsten Friedrich Hoppenstedt (PPE-DE). – *(DE)* Mr President, last Saturday, in Hanover, the German defence forces gave both Gerhard Schröder, the outgoing Federal Chancellor, and his Minister of Finance, a send-off in the shape of a military retirement ceremony. It was a very impressive event. Less impressive, though, are the gigantic holes in the budget that both Mr Eichel and Mr Schröder have left behind them. The coalition agreement does say – and this has already been alluded to in passing – that value added tax for 2007 is to be increased by 3% in order to make the budget, to some degree, roadworthy.

As you are based in Frankfurt and monitor the German financial scene in particular, I would like to know, in view of the expected 1.8% growth for the German economy, which is indeed laid down in that country's budget, precisely what value you attach to these measures in terms of the tension that exists between consolidation, inflation and growth for the years 2007 and 2006?

1-036
Jean-Claude Trichet, *ECB*. **–** As I have already said, I would certainly not embark on a judgement or appreciation of what the coalition has done over recent weeks. From our perspective, there are things which are good and others which are perhaps less so. But it is not the ECB's responsibility, or mine, to give good marks and bad marks here and there. There are general guidelines. Reducing the deficit as rapidly as possible would be good for Germany, good for the euro area and good for growth, because it increases the confidence of the people of Germany that things will go in the right direction. Everything that goes in the direction of reducing public spending as a proportion of GDP is good, because it increases Germany's competitiveness and that of the euro area as a whole, as Germany accounts for about one third of the area. It also allows us to go in the right direction. Of course, everything which goes in the direction of more flexible markets is extremely important, because it would facilitate the elevation of the growth potential, create more growth, more job creation and more resilience to shock – we cannot exclude shocks.

In the decision-making process at the ECB, we cannot engage in a quid pro quo. We cannot do this or that because country X or country Y did this or that. We always have to take account of everything that is being done at the level of this vast continental economy that includes more citizens than the United States of America. The euro area encompasses more people than the US: we are 311 million people and we have to look at the whole of this vast continental economy to take our own decision incorporating everything done by Germany and the coalition agreement, and everything done by all the others. Then we have to be credible in the eyes of 311 million people and in the eyes of the European and world markets that are constantly judging us on a real-time basis.

1-037
Antonis Samaras (PPE-DE). – It seems to me that the Commission does not buy your argument on inflation, interest rates and confidence. Last week, the Commission downgraded its 2006 growth forecast from 2% to 1.1%. It also pointed out that even if countries maintain their interest rates, inflation will still fall to 1.8% by 2007. So if you raise the rates, are you not taking a major risk of inducing a major recession only to avoid the more minor problem that is inflation? Do you not see that recovery – which I believe is the major agony of the average European citizen – is too fragile to support an interest rate increase?

1-038
Jean-Claude Trichet, *ECB*. **–** As you know, the world over, including across the Atlantic, the trust lies in that price stability, in line with the definition that you are giving of price stability, which is more or less the same everywhere. Across the Channel, as you know, it is 2%. Price stability is a necessary condition for sustainable growth and job creation, so we do not see a contradiction between price stability and growth and job creation. I believe that the people of Europe do not see the contradiction, because they are asking for both. And they are right to ask for both, because one is the necessary precondition for the other. If you go to the people of Europe and say to them 'Look, we will have a little bit more growth but I warn you in advance that there will be more inflation', they would reject that immediately on the basis of common sense. Fortunately, that common sense corresponds to the economists' thinking, which is again that the necessary condition for sustainable growth and job creation is price stability. I could elaborate on that, of course.

1-039
Antonis Samaras (PPE-DE). – I basically have a different viewpoint, and I am afraid that difference is rather inflexible.

1-040
Pervenche Berès (PSE). – *(FR)* On behalf of the Socialist Group in the European Parliament, allow me, Mr Trichet, to put on a different hat for a moment and question you again on the issue of the prospective rise in interest rates.

You said that Ireland was an exemplary economy: maybe it benefits from constant fiscal privileges?

You said that citizens were more concerned with price stability and that it should be a principal objective. It must be that we do not meet the same people or we do not listen in the same way, because as an extension to the previous question, I think that it is possible to open the debate on consolidation of growth, with a monetary policy to support that recovery of growth in order to consolidate it within a three-year period. The prospect of a rise in interest rates concerns many people, particularly as part of the inflation that has been recorded as a result of the increase in oil prices and basically, as some are saying, without the increase in oil prices we would almost be in a situation of deflation.

How can this rise be justified at a time when growth is fragile, at a time when the measures introduced by the great coalition in Germany remain a cause for concern for some observers in terms of the prospects for consolidating that growth?

I will now move on to the second point. You said that you were not here to produce a hit parade of the Member States. According to some articles in the press, you were going to differentiate between the debts of the Member States, and in order to do so you were also going to use the analyses carried out by rating agencies. As we know about the whole debate surrounding the credibility and quality of work of these rating agencies, I think there are grounds to seriously question this change in the Central Bank's policy.

1-041
Jean-Claude Trichet, *ECB*. **–** *(FR)* I have already mentioned the four main points, but there are also others that lead us to believe that the risks are increasing with regard to future inflation and that it is therefore appropriate for us to prevent these risks from becoming a reality.

I will not return to the argument that we are not yet seeing these risks materialising in the second-round effects, because if we were seeing them, it would be too late. It would no longer be a case of prevention, but one of cure, and cure is always, in this area as in many others, much more difficult.

I would, however, like to draw your attention for a moment to the fact that it is not in anyone's interest to dramatise the situation. We are doing what we have to do. We must be vigilant and take steps to ensure price stability. Do you think that, in 50 years' time, the world market would believe that we were going to ensure price stability if we had become a passive Central Bank? Do you think that we would have a shred of credibility? We have not been passive in the past. We have kept interest rates extremely low, which would have been unthinkable before the euro, for 311 million people over two and a half years, but during those two and a half years, we said: if we need to act, we will act. We never promised anyone that we would remain passive, because that would be the best way to lose our credibility and, once again, if our credibility is lost then all the market rates will rise.

Our credibility is the most precious monetary and financial asset that Europeans have. Once again, if we lose it – God forbid! – because we are faithful to our mandate, we will take the decisions that need to be taken to maintain it, as I have said very clearly today. There is a very simple way of achieving a massive increase in interest rates: all we need to do is go back to the average level of credibility that existed before the euro. Then we calculate the arithmetic mean of credibility and the arithmetic mean of market interest rates and see what we get. A probable increase of 250 base points, along almost the whole of the yield curve. This is unthinkable, because we are here, and we are here to maintain the best possible credibility, in your eyes, in the eyes of our fellow citizens, and in the eyes of all those who are observing us and have euros, have negotiable instruments that make our interest rate markets.

One last point that I will mention in passing as an entirely subsidiary argument. Look at the academic literature and the various rules that are suggested here and there; we are not following any of those rules, but if I mentioned the particular rule on this matter or other rules, you would see that they all agree with what I am saying. I therefore say nothing more about it, and in any case, we are not following these rules.

May I, however, ask you to have some confidence in us? After all, what we have achieved was unthinkable; no one thought that we would be able to preserve, for the benefit of the whole of the euro zone in Europe, the confidence that had been built up by the Bundesbank, by the Bank of the Netherlands for example, and, why not, by the Bank of France, after many long years of work to achieve a high level of credibility and a very low level of market interest rates.

1-042

Pervenche Berès (PSE). – *(FR)* Mr Trichet, I assume that you will answer my second question in writing as we have run out of time. You ask us to have confidence in you. Allow us to question you regarding the change that we are sensing in your policy. I believe that is precisely the point of this monetary dialogue that we have with you.

1-043
Pier Luigi Bersani (PSE). – *(IT)* Madam President, I take note of the fact that, from what Mr Trichet has said, the ECB seems to be of a mindset that envisages a moderate adjustment of rates, but not an automatic phase of increasing rates and, therefore, a slightly different situation to that of the United States.

I should like, however, to ask a question on a specific point, which relates to the price of oil. I should like to know how the ECB interprets this issue, because we are undoubtedly encountering structural changes in the relationship between supply and demand and, as Mr Trichet was saying, fragilities on the supply side and unpredictable growth in the world. Nonetheless, by all accounts extraction costs and investments in the sector are not increasing a great deal, while supplying countries' revenues and companies' profits are soaring.

Are these assertions justified? If they are justified – if, that is, it is very difficult today to distinguish between what is permanent and structural and what can be transient or speculative – then do you not believe, Mr Trichet, that it would be useful for the negotiating powers of consumer countries, and of Europe in particular, to be strengthened and for Europe to send out a message to the market, by preparing energy efficiency and energy saving plans that could be implemented in the event of a huge soar in oil prices? Is there anything Europe can do, faced with this problem?

1-044
Jean-Claude Trichet, *ECB*. **–** Thank you very much for your question. It is a very important one, because the world and Europe in particular are very much under the influence of these increases in oil prices.

I have a number of comments, and I can agree with much of what you have said. Firstly, we are in a totally different environment to the first and second oil shocks in the 1970s and 1980s. It is not just a supply shock, it is very much a demand shock. There is an explosion of demand from emerging Asian countries, in particular, but not only, China. This, of course, makes a big difference, in particular as regards the duration of the shock, because that it seems that we have a permanent shock, which is taking place over a long period of time, and not a one-off shock, as was very much the case in the first and the second oil shocks. That has to be taken into account, including in monetary policy and in the handling of economic policy as a whole.

Another element – which is also related to the CPI, which has already been mentioned – is that this oil shock caused by increased demand from Asia also has other aspects. Asia is importing oil to produce many manufactured goods and the prices of those goods are going down. So we have prices that are going down and other prices that are going up. What exactly, then, is the meaning of the calculations that some are making by only taking into account core inflation? They omit the prices that are going up and they maintain in their analysis of inflation the prices that are going down. However, both are two sides of the same phenomenon: the explosion of emerging economies and emerging markets in Asia and in the emerging world in general. So, again, it is extremely important for the central banks all over the world to understand exactly what is happening.

I can also agree very much with your remark on unpredictability. Those who consider that the best predictor possible is still the future market, and consider this to be the only objective indicator that you can retain for the medium-term projection for the price of oil, have always been disappointed because the future market is incorporating a very poor level of information. They start from the spot price and then it diminishes a little over time, year after year. But this is neither real, pertinent information nor a good predicator, even if it is the only one we have at our disposal.

Then again, we have other elements. You also mentioned the influence of speculation. What kinds of risk premia associated with geostrategic risks are involved in the price of oil today? All these remarks are question marks. We have to be prepared for very different scenarios. Nobody can claim that it would be a good predictor.

1-045
Wolf Klinz (ALDE). – *(DE)* Mr President, in response to your last question, I have confidence in you, just as I had confidence in the *Bundesbank*. I was fortunate enough to be there in Frankfurt last Friday when you made your announcement, which has been the cause of so much comment. I was less surprised by the substance of the announcement than by how and where it was made.

I do not think there is much of a difference between the economic situation last Friday and the way it was at the time of the last meeting of the ECB's Board, and so I want to ask why it was that you made your announcement now in what was, after all, a rather unconventional way? Might it be that you wanted to send a very powerful message to the politicians, some of whom have, over the last few weeks, been impertinently attempting to interfere in your work? Might it be that you, at the same time, wanted to send a very strong message to your colleagues on the Board of the ECB, who, one gathers, have not always been of one mind and have vigorously debated which course is the right one to take? Last but not least,

might it not be that you wanted to send a clear signal to the German Government four days before Mrs Merkel's entry into the Chancellor's office?

1-046
Jean-Claude Trichet, *ECB*. – First of all, there is no disagreement in the Governing Council of the ECB. We are living in a very vivid, opinion-based democracy and the press is extremely active. That is a very good thing! We are living in a modern world that is as open and vivid as possible. But I have to mention that what I read did not reflect our thoughts.

We are very keen on having a united Governing Council. Our responsibilities are very heavy, as I have already said. We are the guarantors of the credibility of the euro and the European signature the world over. It is a very heavy responsibility and we intend to be up to this responsibility. I am the spokesman for the Governing Council, I am the President of the Bank, and I judged it appropriate to say what I have said to you and what I said last week, all things considered. I do not want to give a list of everything I have read in the papers and heard in the media which made me think it was good to say what I am saying. I have read all kinds of comments and gossip on the Governing Council and the ECB and what we might or might not decide to do. I believe that I was right in giving a useful clarification on behalf of the Governing Council and with its full agreement.

1-047
Sophia in 't Veld (ALDE). – Mr Trichet, one subject that has not yet been raised is that of relations with the US and your new colleague, Mr Bernanke. I was wondering whether you have already discussed with him your future cooperation and, in particular, whether you have shared your concerns about the current economic and financial policies of the United States, such as running a growing budget deficit and a current account deficit.

Secondly, several Members here have already made reference, for example, to the 3% increase in VAT in Germany. You started your speech by insisting very forcefully on the importance of structural reforms. In the light of that I am a bit surprised at your timidity in your comments on, let us say, cosmetic and in some cases even counterproductive policies in some of the Member States, notably, the largest offenders against the stability and growth pact. You spoke about credibility; they will make it much more difficult for you to maintain that credibility. I think you would have an interest in denouncing much more forcefully their lack of structural reforms.

1-048
Jean-Claude Trichet, *ECB*. – On the second question, we are, as you know, always considered to be much too intrusive by most of our interlocutors. From time to time, and it is very pleasant music to my ears, you think that perhaps we are not being sufficiently intrusive! We try to be serene but to say what we think. Everybody knows that we think that rigorous implementation of the stability and growth pact is necessary and of the essence, not only for fiscal policy, but also for growth and job creation. This is because of the confidence element and the fact that rational expectations are very powerful in this field, including, of course, in the major countries.

On the first question, I know Alan Greenspan's successor, Ben Bernanke. He has a fantastic reputation. I congratulated him very warmly on his appointment. We know, because he made the point very clear, that he would be continuing the monetary policy pursued in the United States. It is important that he, like his predecessor, believes that solid anchoring of inflationary expectations is of the essence. He has made this point clear several times and I believe it to be important. He also believes, like his predecessor and all of us, that price stability is a necessary condition for growth and job creation. It is a belief that is held on both sides of the Atlantic.

1-049
Sophia in 't Veld (ALDE). – Mr Bernanke himself must be worried about the same things that we are worried about. If he has his inflation targets, instability and so on, then he too must be worried about the US budget deficit and the current account deficit. I was wondering if you had discussed that.

1-050
Jean-Claude Trichet, *ECB*. – I do not want to speak on behalf of Ben Bernanke. Alan Greenspan will be the Head of the Federal Reserve until the end of January. I have to mention that as well. I said that the first paradox is that we all agree on structural reforms: we *all* agree. There is consensus on the diagnosis and consensus on the prescription. The problem is delivery. I would say that at a global level we also all agree on the diagnosis. We all agree that structural reforms are of the essence in Europe; we all agree that correcting the lack of savings in the US is of the essence in the US – of course fiscal policy is part of that correction; and we agree on what the rest of the world could do. We all agree, we all sign up and of course the delivery is what is complicated at the global level in the US as well as in Europe. That is clear.

1-051
Zsolt László Becsey (PPE-DE). – I have two short questions relating to enlargement. First, do you think that it is realistic that within roughly one year the eurozone can enlarge? The small new countries in ERM II will have to prepare themselves for the conversion of interest rates and inflation rates; they will have to carry out tactical and legislative preparations for accession to the euro to make this realistic.

Second, what about the big new countries: the bad ones, the divergent ones? I have to mention my own country, Hungary. If somebody is undisciplined, what can the Union do? Mr Almunia is threatening sanctions, but I do not really think that it is a good message to start sanctions against the new countries. Via what other means do you think the EU or you can influence the situation and bring to the new corridor the Hungarian policy, and to protect your national bank, also, which is under political attack?

1-052

Jean-Claude Trichet, *ECB*. – On enlargement, I would say that we are entirely devoted to being as professional and helpful as possible in organising the good functioning of ERM II. We consider it our duty that entry into the euro happens under the Maastricht criteria as required by the Treaty, and not just, of course, in terms of immediate compliance with those criteria, but also in terms of sustainable compliance.

I will not embark on any indication of what would be a likely period to enter. We will see. It is a very important: technically and professionally it has to be perfect. Of course, the political will has to be there, but that exists in quite a number of economies and countries involved. So again, let me say that we will do all we can to ensure that this enlargement, including entry into the euro, is a full success. There is a lot at stake, and there is a joint interest involving the countries concerned and the 12 countries that are already in the euro area.

As regards the fiscal policy of some countries, I would say again that the stability and growth pact must be rigorously implemented. That, of course, goes for all 25 countries. The stability and growth pact links all 25 countries. Sanctions relating to the euro area apply to the group of 12, but the stability and growth pact and its rigorous implementation is valid for all 25 Member States.

1-053

Werner Langen (PPE-DE). – *(DE)* Mr President, I, too, am among those who do not mince their words in saying that the European Central Bank was right in its interest rate and stability policies. Let me say that those who are now criticising you for your unambiguous statement, are in many cases one and the same with those who tended, over previous months, to deliver frequent criticisms of your alleged timidity.

I do think, though, that – as you yourself said – core inflation is low. You do not, of course, know how inflation is going to develop. What I would like to know is to what degree your announcement was affected by the growing disparity in interest rates between us and the dollar zone, for that, surely, is at least as important a factor in this decision.

My second point is that growth is low in the European Union, and this is something that affects both the big Member States, Germany and France. This is where what is one of the currency union's advantages tends to become one of its defects. The former interest difference of up to 1000 basis points, which is what these two countries had in the 1990s, along with low interest rates, is no more. The figure is now no higher than 50 basis points. What must these two big euro zone states do to overcome this competitive disadvantage, and what can you do to compensate for it?

1-054

Jean-Claude Trichet, *ECB*. – On the first question, when the Federal Reserve decides whether or not to move rates, it does not look at the differential with the euro interest rates. When we act and judge the situation, we do not look at that differential. We look at our mandate, which is to preserve price stability over the medium and long term. We do that with this inflexibly faithful attitude to our mandate. I have no other comments on that.

On the second point, you are absolutely right. As I said myself, the introduction of the euro has totally transformed the interest rate pattern of the Member States. You are absolutely right to mention that from hundreds and hundreds of basis points of difference, we came down to a very meagre spread of differences between the various long-term interests, i.e. ten-year market interest rates. This is only because the euro itself is as credible as the best and most credible currencies were before it. What we have totally eliminated is the exchange risk which was incorporated in these enormous spreads which existed before. It could be said that the best and most credible currencies have given up their competitive advantage – the very low level of market interest rates – for free. To that I say first of all that it is in everybody's interests that Europe is as prosperous as possible. So the fact that countries that were used to much higher interest rates now have much lower interest rates is a good thing. One also has to bear in mind that, in the euro area, there are no longer exchange risks. Interest rates are extremely low in the countries that had higher interest rates before because there is no longer an exchange risk. But the risk was also eliminated for those economies which were in the best and most credible position before. They no longer have an exchange rate risk, and that is a win-win situation. There is no asymmetry in the composition of the euro. Every economy, every country is winning. It is a win-win situation. That is my understanding.

1-055

Gunnar Hökmark (PPE-DE). – I agree very much with what Mr Montoro Romero said earlier today. It is a sad message. I would add that what is really sad is maybe another dimension in what you have presented, i.e. is this the way it is? Because, you are right that we have very low interest rates and still investments are not rising.

In your analysis you pointed out many reasons why you see price increases coming up. You mentioned energy prices, deficits and structural situations, where I think you mean mainly the labour market. However, you did not mention the rise in investments as an explanation of why you have to face increased prices.

That leads me to the question: is this the way it is, that we cannot have more growth than seems to be predicted for the forthcoming years? As has also been mentioned, the forecasts for growth are very modest and hesitant, but you do not seem to be hesitant regarding the need to face up to price increases. Is it the case that the European economy cannot grow much more than predicted in the forecasts? If so, that is a really sad message and it underlines the need for structural reforms. Is what we now see in the forecasts the level of the growth potential we have? Perhaps that is the most crucial issue we have to face.

1-056

Jean-Claude Trichet, *ECB*. – I think that we have to be just when we speak of Europe. A lot remains to be done and there are a lot of structural reforms or reforms in general and improvements that are of the essence. It would be unjust not to recognise what has been done in the past, the potential that exists in Europe and the opportunities that exist in Europe. As I have already said, we have human resources of exceptionally quality, we are not imbalanced, we have sufficient savings to finance our investment and even a little bit more than our investment. We have a level of restructuring and reshaping in the productive sector that looks very much like what happened in the US in the 1980s and this is paving the way for a better future. So there are positive elements.

You mentioned investment, but credit to the private sector over 12 months is running at a pace of 8.9% and, over the last 6 months, at a pace of 9.8%. So that means something in terms of what the private sector is doing. It would be unjust to say that we are immobile and in a situation which is only negative. I see the glass as half empty, half full. Of course, the opportunity cost of not speeding up the reform programme seems to be very high because of the speed of global change and the speed of change in Europe. That is true. It is our duty to tell the truth.

If, with exactly the same fundamentals we have today, there was a little more confidence at household level and at business level, we would do much better. Confidence remains of the essence, and, as far as we are concerned, I say, on behalf of the Governing Council, you *can* have confidence, at least in our institution, in our actions and in what we are delivering.

1-057

Katerina Batzeli (PSE). – *(EL)* Madam President, Mr Trichet, we are in a period of numerous important derogations from the Stability Pact on the part of a number of Member States now; consequently, general policies and individual economic policies should again target the convergence of the national economies towards this Stability Pact.

However, this is often not the case in practice. Do you consider that the increase in the base rate by the ECB, as referred to earlier, for five years in Member States with a large public deficit and for the national markets which rely to a large extent on borrowing, might help bring about convergence?

Secondly, a few days ago, as I think Mr Purvis pointed out, the ECB said that it did not accept bonds with below an 'A' credit rating. Given the problematic financial position in numerous countries, this sort of announcement about the reduction in the credit rating has already created problems with government bonds and caused prices to fall, as in Greece over the last two weeks.

I should like to ask what your position is on an effort being shaped by the eurozone to throw off the image of the compressed core of EMU and start thinking along the lines of creating concentric circles, which will have significant economic and, possibly, institutional repercussions in the European Union.

1-058

Jean-Claude Trichet, *ECB*. – *(FR)* Regarding the first point, which concerns the Stability and Growth Pact and budgetary problems, the question is whether you are going to help us in raising interest rates. I can only reiterate our very strong conviction that, if we no longer have credibility in guaranteeing price stability in the medium, long and very long term, that is when market interest rates will rise. We therefore believe that by being credible and taking the appropriate steps now, we can preserve an exceptionally favourable market interest rate environment.

You also raised the question of the behaviour of the euro zone as a whole, as a vast unified economy, with a single currency. In this respect I can simply say three things.

First of all, if we compare the euro zone to the United States, which is a natural comparison as the two economies are of comparable sizes, we see a great deal of similarity in a whole series of indicators. We have the same standard deviations, the same fluctuations in, for example, inflation, from one place to another in the American economy and from one place to another in the euro zone economy. We also have the same standard deviations for growth itself, which is particularly interesting as it shows us that the euro zone has the characteristics of a vast continental economy.

It is perhaps the consistency of some of the differences that seems more significant in the euro zone than in the United States. One of the reasons for this could be that we have less flexibility than the United States. This is a point that deserves our attention.

We have also seen the changes in unit production costs, which are also consistent in the differences that are recorded and are something that should be considered.

In summary, I would say that many factors that we have observed lead us to think that we are in a similar situation to the United States of America. These include some factors that are positive or even very positive, because they show that there can be changes in relative competitiveness. For example, Germany has made fantastic improvements in its relative competitiveness within the euro zone, more quickly than we would have thought. There are also elements of consistency in some differences which, in my opinion, are worthy of close consideration by the governments and the Eurogroup and which are now being examined by the Eurogroup.

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Chairman. – Thank you, Mr Trichet, for that lively discussion.

You have asked for our confidence. You must be aware that it will not be given to you blindly. You will have realised during this dialogue that many members of this Committee will be closely examining, perhaps with some concern, the decisions that you take on 1 December.

In any case, you will have understood that there is not a consensus in our Committee on a rise in interest rates. We will undoubtedly have the opportunity to evaluate the initial effects, and perhaps to discuss its merits, at our next monetary dialogue on 20 February. As you know, this meeting will take place the day before the meeting that we now organise on an annual basis with the national members of parliament. We therefore hope that on that occasion you will be able to stay, for the evening as well. Between times we will have the opportunity to visit you in Frankfurt on 12 December with a delegation of 12 MEPS.

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