Questions and Answers

Following the formal presentation, Mr. Trichet took questions from the audience.

GUILLERMO ORTIZ: Well, Jean-Claude, you have given us a great tour de force, no? You have really introduced a conceptual framework to help us understand something that's evolving day to day, which is an understanding of monetary policy. You have introduced this concept of conceptual convergence that I'm sure will be discussed widely.

Let me ask Minouche to start the Q&A.

NEMAT (MINOUCHE) SHAFIK: Yes, that was fantastic.

You've given us this framework of conceptual convergence in the six areas where there's an emerging consensus in central banking. I wanted to ask you to explore a bit more the areas of conceptual divergence—in particular, exit from unconventional monetary policies, the debate about how to minimize the spillovers for emerging markets, and what more, other than clear communication, might be needed to make that successful. And the issue about mandates, single mandate, dual mandate, multiple mandates—there are still quite a few big areas where there isn't convergence, and I wanted you to just talk a little bit about those.

GUILLERMO ORTIZ: Just following up on the last part, so I don't have to ask another question—and you mentioned forward guidance as an important part of your speech. So what are the limits of forward guidance, contingent forward guidance, let's put it that way? It seems that for every state of the world, you try to guide the markets regarding the path of reaction functions or interest rates. There are more questions that are raised about the thresholds that are implied in this conditional forward guidance.

JEAN-CLAUDE TRICHET: Well, first of all, on the first question, of course my own angle of vision was to identify what was really conceptual

convergence. But you're absolutely right, of course, we are in two different universes. When you are in Europe, you have at least the ECB with a primary mandate, which is the primary mandate of the Treaty, and which says you go for the price stability—but of course, price stability understood as a necessary, but not sufficient, but the necessary condition for the other goals to be attained. So the idea that there are other goals of the society, of the European single-currency area, but again, they are depending, themselves—and I trust that I am very close, that we are very close to Paul's remark; Paul's last remark was "I don't like too much the multiple mandate. I like the Central Bank to concentrate on price stability." And that's very clear—very, very clear.

But of course, the law in the United States of America is mentioning three goals, that's clear. And I did not suggest that it was not the case.

But fancy that we have, as I said, the same definition of price stability in the advanced economies, it seems to me it was not noted, to my knowledge, the remark—I don't know whether it was made already—that the SDR [special drawing right] has the same definition of price stability, seems to me something which is profound. I even dare say in my own paper that perhaps it played a certain role to explain the most bizarre observation of this worst crisis since World War II, which was that there was no crisis of the currency of the advanced economies. Everybody would have expected that we would have this kind of dramatic ups and downs between the various currencies, but since the crisis, we have had no such dramatic evolution inside the advanced economy currencies—no open crisis. Anyway, that's a point.

So I fully agree with you, of course: a lot of differences remain. But my suggestion is that—and this is, of course, something which deserves much more understanding, there was—I'm speaking under the BIS, and I'm speaking a little bit as the previous chair of the Global Economy Meeting—there was no meditation to see whether we should converge or not. It's a de facto convergence, under stress. And I interpret that also as the central banks' being, each of them, at the heart of the crisis, in each economy, more or less reasoning to consider—regrouping on some de facto . . . without any consultation, ex ante consultation—means something in their own, I would say, preservation of values, the double values of central banks.

And to you, Guillermo, I would say I mentioned trial and error. We see, really, forward guidance tested with some rhetoric or commitment, and then changing and changing and changing. I think it's the way, if I may, in market economies, and open economies, that you function. And

again, it seems to me that the convergence towards the four conditions I have elaborated has some merit.

But I agree with your implicit remark: it's a very dangerous thing. Because if you miss the point, you might risk, a little bit, your credibility. And credibility, for a central bank, is what is absolutely crucial. If you lose credibility, for institutions that are anchoring, in the long term, their own society, you are, of course, risking everything, if I may.

But you see, my first point was that I am very hostile to forward guidance. Then I think I was absolutely justified in the first mode of forward guidance, which was unconditional. It was clearly unacceptable. On the present mode, I decided that I could not—if it respects the four elements, particularly considering the stakes when you have business cycles that are not really the same between the various economies, and clearly the market is correlating all that in a way which is obviously a big, big problem.

GUILLERMO ORTIZ: Thank you, Jean-Claude.

Let me open the floor and gather a few questions, two or three questions, perhaps, and Jean-Claude, you can answer them all, please.

QUESTIONER: *Jean-Claude, we all appreciate your being here. It was a remarkable recitation of problems, analysis. I sat here thinking, rather than a question, how fortunate we were that Jean-Claude Trichet was the head of the European Central Bank while all this went on, and had to deal with a crisis within Europe, as well as the more general crisis among the industrialized countries. And without your experience and understanding, I don't know where the world would be today. So I just want to express the thought that these remarks you made today, with their wide-ranging insights and influence, are greatly appreciated, I'm sure, around the world. You're the right person to make this speech at this time.*

I might, here and there, have a shading or two of differences, but let me take one. You emphasized the importance of central banking in the area of supervision, and I've often made that point myself. You have a particular challenge in Europe because you haven't had unified supervision, so you have to devise some way of unifying the supervision, and who does it. Are you satisfied with the situation that now exists in Europe, and the degree of influence that the central bank has? And are you worried at all—you touched upon this very lightly—that the central bank has too much responsibility, or is felt to have too much responsibility at some point, is the essential independence being jeopardized?

JEAN-CLAUDE TRICHET: Thank you very much, indeed.

GUILLERMO ORTIZ: Could we have a couple of more questions?

QUESTIONER: *You are, as a central banker, in a particularly hard place, and how do you balance the push, kicking the can down the road, through excessive monetary easing, and that leading to subsequent bubbles which may not be as visible, or not be the same as the previous bubble, and may manifest in other assets? And how do you make sure that the return to normal avoids recession or, long-term, even structural damage? And it's a tricky situation. Probably there are no easy answers, but I'd love to hear your thoughts on it.*

GUILLERMO ORTIZ: Thank you. Other?

QUESTIONER: *Jean-Claude, that was a wonderful lecture, and I thought, in particular, the clarity of this distinction between two categories of unconventional central bank behavior was important. And I wanted to ask one question that comes from that.*

So as I understand it, you're saying there's a category of unconventional central bank behavior which we have to understand is essentially addressing market disruptions, perhaps helping the transmission mechanism of monetary policy, credit easing, et cetera. And then there's another category which is essentially dealing with the problem of the zero lower bound, and saying we've got to go beyond that through trying to reduce long-term yields, or by directly attempting to create more reserves, more money, which hopefully, through the money multiplier, is then going to have a nominal demand effect.

Now, you talked about convergence. Well, I think it's fair—and disagree with me if I've got it wrong—that, broadly speaking, the ECB's policy has stuck, at least in its rhetoric or its statements, to the earlier of those. It talks about overcoming problems in the monetary transmission mechanism, and it also asserts that it is not trying to increase central bank reserves. Indeed, it asserts that all of its measures are sterilized in some fashion.

So my question is, if we have these two models, and if, broadly speaking, the United States has transitioned, as you described, from Ben's initial statement, which was credit easing, to this more quantitative easing thing—if it has done that, are there some circumstances in which you could imagine the ECB having to do it? And if it had to do it, would it be able to do that? At the moment, in the ECB and the euro zone, inflation running clearly below the 2 percent target, if it stays stuck there, are there some circumstances in which

the ECB has to move to that category 2, pure quantitative easing? And how does it do it in this complicated environment where there is not a one-to-one relationship between a central bank and a debt-issuing national government?

GUILLERMO ORTIZ: Thank you. Let's take the last question.

QUESTIONER: *Yes, actually, I think it's over here. So Jean-Claude, a question just from the financial markets, the forward—*

JEAN-CLAUDE TRICHET: Next-to-last question.

QUESTIONER: *Yes, the forward guidance that has been introduced has not been very well received in terms of upward pressure on the front end of yield curves after, specifically, the Bank of England, but also the ECB and the Fed. So what can be done to further convince markets that forward guidance is credible? And maybe if you could elaborate: is it a communication problem or how else to make market participants believe the separation between UMP and rates?*

JEAN-CLAUDE TRICHET: Thank you.

QUESTIONER: *We're going to give you a lot of questions so you can choose which ones you want to answer. So my question is more reflective. So one aspect of your convergence, which I think agrees with Ms. Shafik, that's very nice. I think that this lecture will be known as the convergence lecture and debated about whether the convergence is actually there, of course. That's why you're being with the provocative dimension.*

But my question is, in the latter parts in particular, the latter parts of both four and five, I guess, or four, five, and six—whether one could imagine the central banks having converged and gone there in terms of unconventional monetary policy of type one or type two, and even forward guidance. Can you—are these permanent instruments? Can and should these be permanent tools in the central bank's toolkit, in particular, the unconventional monetary policy? Can and should they be permanent, or can we stick them back in a box and lock them up and throw away the key?

JEAN-CLAUDE TRICHET: Thank you very, very much indeed. So I take the question—really, I don't choose between questions as the questioner is recommending.

First, thank you very much indeed. I always thought that the central bankers were forming a very strong brotherhood of mutual admiration. So.

(Laughter)

So thank you. I will respond to your question. Of course, the Europeans have to cope with all the problems of the advanced economies and they are many, many, many, plus the fact that they have their own—I would say bold—very, very bold historical endeavor, and that doubles all their problems, all their challenges, all their difficulties. But it's, of course, very flattering to have a bold historical endeavor. So they have both, if I may, the merit of the boldness and fancy what just happened. Europe and the euro area, we are placed in the worst crisis ever since World War II, and the currency remains constantly credible. And the euro area not only preserves its integrity, but three new countries since Lehman Brothers are entering or have entered in the euro area. You do not necessarily know that. We were 15 at the moment of Lehman Brothers; generally, we are 18 now. So you see what's going on in Europe. So a lot of challenges for the ECB, obviously; a lot of challenges coping with 18 sovereign countries and with counterparts that are not a full-fledged political federation, of course. And that's because the banks—because one of your questions was on the ECB responsibility. We will see exactly where we go. The single supervisory mechanism has been decided and will be set up in a way which I trust is responsible. We do not know yet what will be the single-authority resolution. And that is something which is absolutely of the essence. And the banking union is not the same, of course, whether you have a strong resolution authority or not. I call for a strong resolution authority.

The second question was on the return to normal, and of course, it is all the question for central banks of, What do you do if you want to be sure that you are doing exactly what is appropriate? It's a permanent question. For the interest rate policy it seems to me that it's the usual permanent, where you are not increasing interest rates too early and then it might create problems for the real economy. In my own reading, the UMP, being essentially something which is countering abnormal behavior of markets—and I really trust that if we would make the counterfactual of not having embarked on or continuing this unconventional monetary policy, we would see the markets functioning extraordinarily poorly: I would say Lehman-like. We still have a lot of abnormal behavior, and in my opinion, we are disguising what we do because we do not want necessarily to insist on the fact that our markets are still functioning very abnormally.

But that being said, I would say in this reading, of course, the unconventional monetary policies are going up or down in volume depending on whether the market goes back or not to a normal functioning. In the United States, the best example would certainly be the ABS [asset-backed security] market. If the ABS market functions go back to normal, then you don't need, of course, the central bank to intervene on that market.

Don't forget that the case of the single currency is special. All commercial banks, everywhere in the euro area, have unlimited access to liquidity at fixed rate—the fixed rate being 0.5, and could go lower as has been said by the central bank, but they have unlimited access. So we are not in the case of the United States where you have a large number of institutions having access to liquidity but not absolutely all the economy. On top of that, of course, in the case of the United States, the banks are financing only 20 percent of the economy, when the banks in the single-currency area are financing 80 percent of the economy.

So I have this sentiment—I might be wrong, of course—that when you have an excess of liquidity, whether it's an enormous excess of liquidity or a smaller excess of liquidity, I have a difficulty to see really the difference. Of course, I got into all possible multipliers. I also looked at what happened in Japan and so forth. My sentiment is that if, again, any commercial banks can—provided, of course, they have eligible collateral—have access, unlimited access to liquidity. I remember I have even computed, when I was president, the difference between the unlimited access of liquidity of all our banks, looking only at the eligible collateral with all the haircuts, and they had approximately 3.5 trillion euros that they could get if they wanted at various durations, when they were asking something like 800 billion. So, it was such a multiple that it seems to me that the unconventional tool of the European is not that different from what is practiced in the United States, for instance. But we will pursue this discussion.

On the market not accepting the forward guidance: I mean, markets are markets. They might be right; they might be wrong. From time to time, they are plain wrong, but in the long term they are always right, so that's the problem—I would say market participants as well as central banks and other institutions.

But if a central bank—again, respecting all the other conditions for forward guidance—would see a really big difference in the timing of some moves in the market, in comparison with what it really thinks is in line with its own reaction function, it seems to me that there is a case to make

that visible and to display. It would be a simple application of principles of transparency. That being said, the market will do what it wants. And fortunately, in market economies, we cannot command the market. But at least the decisions which are taken by the various market participants would be enlightened by the fact that they would know on top of all what they trust, rightly or wrongly, and let's not forget that we should not overinterpret what the market is doing, because one of the problems, of course, of the market is that you have a lot of carry trade in the present period with all these zero interest rates. And still, in the rest of the world, you have remunerations that are much higher. So the carry trade is there, and we should be very careful not to overinterpret the market as if it had an intention—when you have the piling up of carry trade or the unwinding of carry trade, which, again, should not be necessarily overinterpreted. But it seems to me that transparency is always good if, again, it respects all the elements I mentioned, including the fact that the central bank has to be sure that it is consistent and time consistent, and if I may, despite the fact that it is a college which votes, transitive in its choice.

I really trust that unconventional policy cannot be the new normal, that the crisis in the advanced economies cannot be the new normal, and that we have to behave from being accustomed to be in this situation. It's very abnormal, and in my understanding clearly—and I'm following Paul Volcker, who is our master—if you are giving time to all the other partners and they don't put the house in order, we are only paving the way for major, major difficulties. And this discussion—we did not have this discussion when Latin America had to adjust. There was no case for all central banks in Latin America to say "We protect our societies" and so forth. The adjustment was necessary. They did it very well and they proved resilience in the present period, which is absolutely remarkable. And it's certainly a lesson for all of us, obviously. That's my own strong belief.

GUILLERMO ORTIZ: Well, thank you very much, Jean-Claude.

(Applause)