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The Honorable Jean-Claude Trichet
President of the European Central Bank

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Questioners: Jack Hennessy,
Former Chairman, Credit-Suisse First Boston

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Introduction

Chairman Barbara Hackman Franklin

It's my great pleasure to welcome you to the 376th meeting in the 97th year of the Economic Club of New York. This is the sequence of our program today. We will first hear from our guest of honor, then have our usual question period, and that will end at 1:25, and then your main course will be served. So we'll get right to our program.

We're especially fortunate to have with us today our most distinguished guest of honor, the President of the European Central Bank. Jean-Claude Trichet is the second president of the ECB. He began his eight-year term in November 2003. He stepped into a very important post at a most crucial time. It's his charge to advance the bank's main objective – to maintain price stability.

Defining what one interest rate best serves the current Eurozone countries is challenge enough, but one of the greatest challenges facing Mr. Trichet during his term is the largest ever expansion of the European Union. Ten countries in central and eastern Europe and the Mediterranean will join the EU on May 1 of this year. The European Union will then include 25 countries with 450 million people. And Mr. Trichet and the ECB will face the daunting task of extending the Eurozone to these new countries.

As he pointed out in his eloquent speech in Washington last Friday, "No single path towards the

Euro can be identified or recommended to all of them" since the situation of those economies varies widely. That would seem to make the accession process all the more complex. He has said recently that he needs nerves of iron as European integration proceeds. We can see why but we're sure he has them.

Long regarded as one of the world's most brilliant central bankers, Mr. Trichet's distinguished career spends three decades as a financial policymaker in France and includes two terms as Governor of the Bank of France. He was a member of the Council of the European Monetary Institute from 1994 to 1998 and thereafter a member of the Governing Council of the ECB. He's been widely hailed for both his skills and his pragmatism, but he's also noted for discipline, persuasion, and the ability to resist political pressure. All of these are important traits that will serve him well in this crucial time ahead.

And I might add, he's also known for his ability, when necessary, to employ what we fondly know here as Greenspan-speak – great erudition with interpretation left to the individual listener. We are indeed grateful that this extraordinary figure in the world of international finance is with us today, and I am very pleased and proud to introduce Jean-Claude Trichet, the President of the European Central Bank. (Applause)

The Honorable Jean-Claude Trichet

President, European Central Bank

Thank you very, very much indeed for this very nice introduction. Madam Chairwoman, ladies and gentlemen, dear friends, it's a great pleasure and a great honor to be here. I've been asked to be as concise as possible because I understand that after the exposition I will be in the hands of Monsieur Lipsky and Monsieur Hennessy and they will ask me all possible indiscreet questions, you can imagine.

Extreme concision is always a challenge and it reminds me of the story which I was told by John Major. I was not alone to be told that story. Once he was going to the Soviet Union at the time of Soviet Union and he had prepared the visit very carefully with staff and he had a lot of economic dossiers to try to understand better the Soviet Union. So he came and he was asking the head at the time of Soviet Union – I will not give the name of the head – and he was asking could you sum up the situation, the economic situation of the Soviet Union, we want to understand better, very concisely in one word. Then the head of the Soviet Union was reflecting a little bit and said, in one word, in one word I would say good. Immense stupefaction in the British delegation, the Prime Minister said, I'm very surprised. I mean we worked a lot to prepare the visit. I can tell you I did not expect that you would say that. Could you elaborate a little bit, in two words? Then the head of the Soviet Union reflected and he said, well, if you want me to elaborate a little bit, you said in two words, I would say no good. (Laughter) So let me elaborate a little bit, in a little

bit more than two words.

Only five years ago we engaged in a grand enterprise of institutional design that irreversibly tied together the economic and monetary destiny of eleven, then twelve nations. In five days from now, as Barbara said, the European Union will complete its largest ever expansion. What was originally a Community of 6 will become a Union of 25 spanning a geographic area that used to be divided by an iron curtain. Today we can watch some 450 million Europeans dismantling the barbed wire of political hatred and economic seclusion that had split the continent for more than half a century. We can watch Europe once again engaging in a concerted effort to overcome differences and manage diversity.

I intend to focus my remarks on the challenges of executing monetary policy in a very rapidly changing world – not only because of enlargement but for a number of reasons. A world in which high-speed structural changes – whether spurred by spontaneous economic forces or institutional evolution – may put time-tested economic models at risk and defy policymakers' search for easy recipes.

I will also describe the mechanisms that the ECB has set into place to protect itself against the risk of serious misperceptions and policy mistakes. My conjecture is that these mechanism can explain a great deal of the reasons why the institutional transition in Europe has so far been accomplished in a smooth manner and visibly has been a success. And I will argue that the same

mechanisms are also appropriate to prepare Europe for all the new challenges, the numerous new challenges that lie ahead.

Let me dwell a little bit central banks and uncertainty. The ECB, like all central banks, and you referred to Alan Greenspan here, I hope I will be as, I would say up to the challenge that he's been, we all are faced with several dimensions of acute uncertainty. The economy is continuously hit by disturbances that are often difficult to identify in real time. Even when policymakers are able to correctly assess the source and the nature of a disturbance affecting the economy, tracking its propagation profile and assessing its final impact on the key variables of interest to policymakers is a daunting task.

Econometric theory has spent decades devising sophisticated tools to isolate different types of shocks from the tangle that appears in the data. But inference is often non-robust across various identification schemes and real-time identification remains central banks' Holy Grail. As a consequence, central bankers are given little guidance by theory in their daily endeavor to filter out noisy data.

The task of policymakers is further complicated if they suspect that customary cyclical movements are compounded by ongoing change in the deep structure of the economy. For one thing, structural change amplifies the identification problem. It is difficult to ascertain whether the dynamic force that we see appearing on the screen is going to be reversed and eventually

vanish, or will become ingrained in the underlying economic mechanism for many years to come. But more importantly, in case a structural change is truly underway, macroeconomic relationships derived from empirical regularities and historical averages are bound to lose significance. A new set of relationships would need to be estimated and tested. But serious diagnostics for structural stability rarely give definitive answers and re-estimation requires sufficiently extended spans of data that simply do not exist.

We could observe those structural changes on the global scale in the past decade on both sides of the Atlantic. And this has not been very kind to policymakers' aspiration to a comfortable set of stable structural relations usable for policy analysis. At a minimum, the second half of the '90s and the early years of the century have sent us stark reminders that the economic structure does not hold still for long. Our recent experience in coping with economic change has provided more than one stress test of the macroeconomic models that are in use in our institutions. Let me give you several examples.

On this side of the Atlantic, the policy debate has primarily focused on technological innovation, the spread of information technology and globalization. Many distinguished analysts have identified in the combination of these three dynamic factors the main structural force behind the reduction in economic frictions and the narrowing of the ability of any single market player to influence prices and dictate market conditions domestically. This course of events has increased competition and I would say that the same phenomenon has also reduced policymakers'

confidence in what seems to be previously well-tested economic relations.

It has loosened the association between output growth and inflation, between those two variables and employment. And many U.S. observers were left wondering whether the intense capital deepening of the last few years, and the associated measured growth in productivity, may have shifted substantially the relationship between output and inflation. This is, of course, one of the major challenges you are very close with. I have to say that, of course, we will have exactly the same influences of the new technology, the spread of information technology, even if we are observing with a certain delay the very same phenomenon.

Financial markets have also been a very important source of structural discontinuity that was not here in the first financial market of the world, that I will dwell too much on that. We have all witnessed the frantic rise and the subsequent shake-up of some of the market's behavior. In addition, we have seen an unprecedented wave of mergers and acquisitions, facilitated by deeper and extraordinarily more liquid financial markets. This wave has affected domestic markets, but also has very much transformed profoundly the overall structure of the corporate sector. This is seen in the U.S. This is seen in Europe, and perhaps a little bit underestimated in Europe as far as the restructuring and reshaping of the productive sector through, in particular, mergers and acquisition is concerned.

Let me also mention, of course, as a very important cause of structural change, a very important

challenge, some sources of structural changes that are specific to Europe. I would like to emphasize three dimensions in this respect. One is related to the institutional switch that the creation of the single currency has represented for the nations that have adopted the Euro. It was not clear at the outset to what extent the introduction of the Euro would affect financial markets and price and wage-setting behavior. Indeed, times of institutional change are times in which private expectations may fail to coordinate on a focal point. The widely held presumption then was that the statistical patterns emerging from past data might not be informative of the structure of the new economic entity, and inference drawn on its basis might even be misleading. Those were times in which the measure of uncertainty was closer to a 'Knightian concept,' I would say, wherein probability distributions for model coefficients would not even be known or even be existent.

Let me also mention en passant that although the process of preparing for the adoption of the single currency has been very carefully crafted, much remains to be accomplished on the side of constructing more generous statistics across the countries participating in the Euro area and the elaboration of tools and models for the analysis of the economic data.

Another dimension which was characteristic of Europe was the ongoing efforts of the Euro area to implement structural reforms in the labor and goods markets. These reforms aim to make these markets more flexible, strengthening the Euro area's competitiveness and its resilience to shocks. Several such reforms have already been implemented and many more are to come and have to

come. This is a factor that adds uncertainty to the stability of economic relationships in the Euro area, a factor that the central bank has to take into account when taking policy decisions.

The third dimension of structural change in Europe is that associated with enlargement. You mentioned that, Barbara, as a very important point and I highly share that view. The integration of these new countries will affect the European economy through a change in trade patterns, capital and labor flows, and a higher level of competition. One notable source of dynamics in structural relationships looking forward will be the convergence across income and productivity level. For acceding countries as a whole, per capita income today for the 75 million that are joining in, is less than half of the average of the Euro area so the potential for trade creation, redirection of existing trade and production specialization patterns is enormous. In the end, increased prosperity and living standards will be forthcoming for the full body of the Union. And along the way, the drive towards reallocation of production and re-specialization will call, of course, for changes.

To sum up the structural challenges we have to cope with, I would say that in Europe today we have all the challenges that the U.S. had in the past and have today to cope with because we are living in the same universe of industrialized countries, mature industrialized countries with a technological shock, the globalization challenge which is absolutely extraordinary with the development of China and India, with the ongoing structural reforms. And then, of course, you have an advance on us, undoubtedly, but it is exactly the same kind of challenge that we have to

cope with.

But on top of that, on top of all the challenges that we share, we have two other additional challenges. One is ongoing construction of a single market with a single currency. And I draw your attention that it means something; make the thinking experience for only one second. Fancy that there are different currencies in New York, in Massachusetts, in California, and in Florida and imagine what it would mean for the single market of the U.S. And now fancy that we are creating a single market with a single currency and that it started only five years ago. And on top of that, we have enlargement. Not only are we creating our own, and deepening our own single market with a single currency as the achievement of the single market, but we have the new commerce. And again, don't underestimate then the boldness of the Europeans which added up to the, I would say, normal challenges of mature, big, continental industrialized economy, these additional challenges.

Now let me say a few words on the ECB monetary policy concept itself in order perhaps to understand better what we are doing. Europe's transition to the single currency marked a time in which the single extraction problem in understanding economic developments was most acute. I already said that. Yet, the transition was smooth and the abrupt switch in the process by which agents form their expectations, that many observers had predicted, did not materialize after all. So, amidst the challenges that loom in our future, we are reassured that we did make it and that it bears testimony to our capacity to weather difficulty.

I'm in New York. I remember the New York mood in year '97, or even New York mood in the beginning of '98, the first quarter of '98 – not after the first quarter fortunately. But in an audience like this one, I would say that in '97 and even in the first quarter of '98, the number of Euro-skeptics was probably 85% as an average. And those 85% around this table would in '97 and beginning of '98 trust that it was impossible that the 1st of January, '99, only nine months ahead we would have a single currency. I must confess, myself, I was quite surprised. I was quite surprised not to have a single currency; I was surprised that 85% of the New York market participants, of the New York leaders, of the New York well-informed persons could not understand that the historical evolution was such that it was certain that we would have a single currency.

You know the story of this – it was not in New York – it was in profound America – the story of this professor in Europe who was called to participate in a very important colloquium on the Euro in year of '96. So he was very flattered. He had prepared a fantastic exposition and beautiful slides to project. Then he came, it was a university, say in the Midwest. And he was very surprised because at 9 o'clock, it was the time where the colloquium was supposed to start and there was absolutely nobody. Only papers, Colloquium on the Euro. So he was a little bit surprised. He waited ten minutes – 9:10, a person entered the room and sat down. So he progressively realized that he would have to deliver the exposition in front of a very, very meager audience.

Well, having crossed the Atlantic and having prepared a beautiful exposition, he embarked in delivering the speech. He had, as you might expect, very meager applause. And he was packing everything and leaving the room when the guy in the room said, sir, sir, please, don't leave the room, I'm the next speaker. (Laughter) That illustrates perhaps a little bit, a little bit the mood. And, of course, there are lessons to be drawn on communication across the Atlantic from, not the story, but from the reality of the skepticism I've been mentioning.

Now, let me turn again to the monetary policy concept. On the eve of the Euro changeover, markets immediately recognized the new rules of the game. They adjusted swiftly to the new monetary policy environment. Money market developments indicated that monetary policy was reasonably predictable from the start. Euro area medium and long-term inflation expectations, as measured by survey data – and that is very, very impressive – have remained around 1.8%, 1.9%, consistently pointing to a high degree of credibility of the ECB's official announcement that it would aim to maintain inflation below 2% over the medium term.

In this respect, long-term inflation expectations aligned themselves with the low levels of the best performing economies that were merged into the Euro. This is all the more remarkable given that the ECB started without a track record of its own, by definition, and was faced with a number of sizeable, mainly upward, price shocks hitting the Euro area economy since the setting up of the Euro.

Faced by an environment characterized by an exceptional measure of uncertainty, the ECB identified three principles for an efficient monetary governance. These three principles – stability, comprehensiveness, and transparency – have been incorporated in the monetary policy concept that has guided our course since 1999.

On stability, I will be very brief. There is a general recognition today that price stability is highly desirable from an economic standpoint. It preserves an economic environment conducive to the optimization of resource allocation and therefore permits to foster sustainable growth and job creation. And I would say that in a world of accelerated changes, as I said, the concept of stability is even more of the essence. The central bank has the responsibility to be an anchor of stability, price stability being the ultimate goal and one of the preconditions for financial stability.

We have considered that we had from the very beginning to very precisely define what we meant by price stability. And we said, below 2% in our, I would say, review of the monetary policy that we organized last year, we added below 2%, close to 2%, which is absolutely fully in line with the inflation expectations I've been mentioning which are, since the very setting up of the Euro, around 1.7, 1.8, 1.9. This precise definition had, of course, an advantage of permitting to anchor inflation expectations and to enhance transparency and accountability of the central bank. Because everybody knows what we are aiming at, and you can compare what we are delivering with what we said we were aiming at.

But it was also absolutely instrumental – and I draw your attention to that because it is something which is not often said in the market literature, if I may – it was also very important, very instrumental in preserving continuity in the moment of the transition from the previous national currencies to the Euro. The Euro was given the same definition of price stability as the one attributed to the most credible previous currencies, those currencies that were benefitting from the lowest market interest rates. And this has, I would say in our opinion, contributed very significantly to one of the most remarkable, and I have to say, discreet, process of the setting up of the Euro which was that from day one until today, the Euro was given the best yield curve available in the economies of the Euro area.

And I have to tell you that as well as the New York marketplace was not fully aware of the fact that we will have the Euro on the 1st of January, 1999, again in the same period of time I was mentioning – perhaps in '97 – the idea that the yield curve of the Euro would be the best yield curve available in the previous economies and not the average of the merging currencies, was not the mainstream sentiment of this marketplace. And we had to explain that we were benchmarking the Euro on the best possible behavior, that we had the right, if I may, to be given the best yield curve available. And it is exactly what has happened because the New York market was convinced that it was the appropriate way of looking at it. Of course, it's entirely based upon the credibility of the ECB. There is no past record earlier than 1st of January, 1999. There is no such thing as a single Euro area before that period. And so it's entirely based upon our own

credibility that we are given by markets, the 10 years, 30 years rate that we seek in our real curve.

A second principle that we retained is the comprehensiveness of the analytical framework. A central bank in its daily operations has to filter an enormous amount of information. It routinely seeks to define the state of the economy as new circumstances arise and evaluate their implications for the risks to price stability. As I tried to argue above, this is a highly demanding exercise, because shocks do not come about with labels and the economy is potentially always subjected to structural changes. As a consequence, it is clear for central banks that no simple rules linking policy to one or two privileged indicators can substitute for an accurate examination of economic developments in all decisions and forecasts.

From the very beginning, we felt the need to endow ourselves with a conceptual framework that could help it sort through a wealth of conflicting statistics and organize the various pieces into a reliable road map for internal analysis and communication with the public. And we thought that it was necessary to have what I would call a 'binocular' perspective over the economy, organized in an "economic analysis" on the one hand and a "monetary analysis" on the other hand. This policy framework which came to be known as the two-pillar framework permits to convey the notion of a diversified analysis and, in our view, ensures that no information is lost in the assessment of risks to price stability.

The short- to medium-term economic analysis with its focus on real activity and financial conditions is well-equipped to study shorter run deviations of inflation from its long-term trend. However, it often fails to track the mechanisms by which monetary factors act over extended horizons to nail down such trends. As a consequence, a monetary policy framework exclusively centered on such analysis would leave a loose end in the expectations formation process, to the extent that it would offer no anchor to anticipations of price developments as the horizon, over which these are formed, lengthens.

There are, we trust, therefore, some merits in cross-checking the indications for the monetary stance that emanate from the shorter-term economic analysis with those stemming from the monetary analysis. And I would add that it is perhaps, in relation with what I called the success of the transition, I said that we had to define monetary stability precisely and in continuity with the previous best experiences in Europe. The fact that we had a special challenge which was the absence of track records to credibilize what we would do over a long period of time, not only of course a two-year period but also a five-years, a ten-years, thirty-years period, because markets have to know on which credibility long-term to base their own expectations. The fact that we had this cross-checking with the monetary analysis, we trust, has been also instrumental in permitting us to extend immediately the very low market interest rates that existed only in a small number of economies to the full body of the Euro area. This credibility in the delivery of price stability had to be intact again not only on a short-term basis but on a long and even a very long-term basis.

Now let me mention a third principle which is transparency. And it is again something which merits perhaps to be explained for a very short span of time – the importance of open, candid, transparent communication with investors, savers, market participants, and the public at large. We have been told very often that we are not sufficiently transparent.

To the credit of the ECB, one has to recognize that we give a precise definition of price stability so that everybody can judge what we do in comparison with what we said we would deliver. But I would also add something which is currently underestimated. We have decided to explain in real time what we were doing when we were taking a decision. Namely every month after the meeting of the Governing Council which is the decision-making meeting for monetary policy once a month, we display immediately the analysis of the Governing Council. We publish it. It's a four or five page diagnosis. The president and the vice president embark into a press conference where they assess the diagnosis of the Governing Council and respond to questions. So that we had, since the very beginning, since day one of our monetary policy with the Euro, with a single currency, we had a very bold concept of transparency. I insist very much on that.

Of course, now perhaps we do not realize to which extent – it is still bold to have a press conference – but at the time it was even much bolder to introduce this concept. Because the diagnosis of the central bank was – in the state of the art of central banking in '99 – was to produce the minutes and to publish the minutes five or six weeks after the meeting so that the

market would have explanation only five or six weeks after. We started from scratch with a real time explanation and we contributed to changing a little bit the state of the art of central banking because now you have no central bank which would only take a decision without some explanation. So I don't insist on that.

Of course, I think that we have a merit there that the criticisms, the nice and amicable criticisms we have from time to time, are not justified as you see. But I also trust that we were bound to do that in the case of Europe because it was absolutely necessary taking into account the fact that we were 11 and then 12 different economies and countries, to be able to communicate in a single way on what we've been doing. And the fact is that we needed terms of reference to fully communicate without, in avoiding possible misunderstanding, misinterpretation with the various economies, the various countries, the various languages that were at stake.

So in a way also you can perhaps explain what we have been doing in this domain too as well as in the two previous ones – both if I may – by the necessity to optimize our monetary policy in taking account state of the art principles and longer experience of the central banking constituency, but also to optimize what we had as a unique environment for us which was the transition from a variety of economies and a big number of currencies to a single currency with all the constraints that were associated and the risks that were associated with the transition.

I was very eloquent at the very beginning on the necessity to be concise, Madam Chairwoman,

and I see that I am about not to respect the very strong instructions that you gave me. So I will conclude only in telling the American friends here, don't underestimate Europe. Europe is really trying to cope with the enormous challenges, the same that you are experiencing yourselves, plus the structural transformation of Europe itself from a divided set of economies and countries to a united economic and monetary union. This transformation is the, I would say, living proof that we were all right across the Atlantic in being sure that democracy and democratic ideas will triumph, that the market economy will triumph. It is that we are experiencing now. And I am sure that it will be a great, great success. Thank you for your attention. (Applause)

QUESTION AND ANSWER PERIOD

CHAIRMAN BARBARA HACKMAN FRANKLIN: Thank you very much Jean-Claude, for those really thoughtful remarks, candid too, and clear, which we appreciate. We are not Euro-skeptics. If we were once, we are no longer, and we will not underestimate Europe. Now, let's turn to our questions. We have two fine questioners. On the right, Jack Hennessy, former Chairman of Credit Suisse-First Boston and a former chairman of this club. And on the left, John Lipsky, who is Chief Economist of J.P. Morgan Securities. Jack, first question.

JACK HENNESSY: Thank you. I would just add my voice to that of Barbara in saying it was a brilliant exposition of the ECB and its role in evolution. And I think we too often forget, as you say, in the United States what's been accomplished in five years. Almost unthinkable, and I was

one of the 85% who did not for a minute believe you'd be able to do all of this. But I'm left with a certain doubt and I know given your penchant for transparency, you'd like to clear up any doubts we have here, there is probably, again an 85% perception on this side of the Atlantic that whereas the emphasis on price stability and the need to establish during this transition of introducing a new currency for 10 countries or 14 countries was absolutely essential and you had to give very clear benchmarks and very clear signals and therefore inflation targeting and a scrupulous following of the monetary aggregates was absolutely essential. Now I couldn't tell from your opening remarks whether you thought these mechanisms were still necessary in a period of huge change as you said and the changes of the future, of high octane change, rapid changes. The perception on this side is you perhaps should evolve into more policy tools. And as you know in this country there's a debate of should we be doing inflation targeting, and the majority said no. So I guess the question is are the current mechanisms you have and the analysis of the data sufficient to cope in the future or should you leave more discretion to the ECB in the future to cope with the monetary changes that will be necessary in the future?

THE HONORABLE JEAN-CLAUDE TRICHET: It's a very, very important question indeed. If I compare our monetary policy strategy concept with the U.S. one on the one hand and the inflation targeting on the other hand, I would say that we are not ourselves in the same concept as the inflation targeting concept. We are more; we are closer to the U.S. in that sense that we do not rely on a system of equation producing an inflation forecast to be the driver of our monetary decisions, which is the case in the pure inflation-targeting concept. Which I have to remind you

is overwhelmingly adopted by the emerging world and by a number of industrialized countries, including the U.K. So if I compare with this aspect of monetary policy, I would say we are closer to the U.S., much closer to the U.S. than to the U.K. That's absolutely clear from the very beginning, from the very beginning. We, of course, have a special stress on the monetary analysis for reasons that I have explained and I trust really that this special stress has served us very, very well. But again, we are not, on both sides of the Atlantic – in Europe and in the U.S. – if I may, the prisoner of an equation, of a system of equations, whether highly sophisticated or of an algorithm which would mechanistically guide monetary policy. That being said, we are all, in my opinion but I'm speaking under the control of Tim and on future speeches of Alan so I'm very cautious, but we all agree that, I would say price stability is a prerequisite for sustainable, long-term growth and job creation. And I could not find out a single speech here or everywhere in the world suggesting that we could have long-term sustainable growth and job creation with price instability – price stability being understood as avoiding inflation and avoiding deflation. So that we all consider that whatever the, I would say, mandate is formulated, and it's a little bit different on both sides of the Atlantic, nevertheless, we all are making our decision within the framework of the sentiment that price stability is a necessary condition for long-term growth and job creation. Not per se a sufficient condition but a necessary condition. And, of course, to deliver you need not only a good monetary policy with price stability, you need also structural reforms, you need also flexibility in the economy. You need all the other elements that are part of economic success and the capacity to absorb new technology and the overall, I would say, cultural attitude which would be open again to growth and job creation – anti-Malthusian

attitude. That's what I would like to say. So we feel, in a way, close to the inflation targeting because we have a precise definition of price stability, but I explained why it was so important in the European perspective. And I have to say that, as you know, it is also widely recognized that there are a lot of merits in giving a precise definition. I don't want at all to place myself in the place of the U.S. but I mentioned that en passant, but we do not again accept to be the prisoner of a system of equations, and then we are very close to the U.S.

JOHN LIPSKY: Thank you. First, allow me to add my note of welcome, and we're honored that you would spend your first visit to New York as the President of the ECB with us today. I also want to add my congratulations to you and your colleagues for the success that you've had as you've described to us in the past few minutes. I had the good fortune to live in Europe during the late 80s and early 90s and I got to see, in fact at the time the Maastricht Treaty was signed, so I got to see the role, the importance that EMU played in the process of political and economic reforms in Europe. My question, however, is a bit less philosophical. One of the disappointments in all the successes has been weak growth in the Euro area economy. And disappointing consumer spending has been one of the principle sources of this weakness in the Euro area economy over the past few years. One key problem appears to be that households think that their real spending power is growing slowly or not at all because oddly, Euro area consumers perceive that inflation accelerated sharply following the introduction of Euro notes and coins far faster than the inflation rate reflected in official figures. Do you agree with this assessment? And if so, what explains this wide divergence? How does this factor enter into the ECB's policy

deliberations? And what other factors explain sluggish household spending and what can we expect in the coming months and quarters?

THE HONORABLE JEAN-CLAUDE TRICHET: Again it's a very, very important issue that we have to understand as best as possible. It is true when you look at the figures, the level of disposable income on both sides of the Atlantic, the level of indebtedness of households, and the level of savings, if you would put the U.S. households with our own figures, you would probably trigger immediately an incredible boon of consumption because they would displace the arbitrage between consumption and savings, save less, and consume much, much more. The reverse thinking experience would be also possible. If you put the European household in the place of the U.S. household with the U.S. figures, you would have a dramatic diminishing of consumption and a dramatic increase of savings. So perhaps a good attitude would be just in between, if I may, merging the psychology and reaction and overall analysis, analysis of both household constituencies. That being said, of course, there are a number of reasons why on both sides of the Atlantic the reactions are that different. I don't want to elaborate on what's happening on this side of the Atlantic. On our side, I would say that there are a number of reasons, but amongst those reasons perhaps you have what you have said, that perceived inflation is considered for a variety of reasons as higher than real inflation as is substantiated and documented and as we trust it is. And that has driven us in the ECB Governing Council and me in particular, as president, to mention to public opinion and households in Europe that inflation figures, CPI, were reliable, that we were there ourselves to maintain price stability, that they

could trust us when we said that we would maintain price stability which was our mandate, and then that they could trust that their purchasing power would be kept in good order over time. And then if they had the intention to invest or to consume, and were inhibited in this intention because of their fear that their purchasing power would not be protected; they should have the reverse attitude and embark into consumption and investment. It is not very often for a central bank to say that, frankly speaking, but we trusted that it was necessary because of this particular element which you have mentioned, John, and I trust is present. I wouldn't say that it is an overwhelmingly dominant feature of the attitude of the households, but it might explain part of the difficulty. Another part of our difficulty might also be associated with the sentiment of the household that I would say the overall public finances are not necessarily going in the best direction possible, and therefore we probably have a little bit of those recurrent effects – namely, the rational expectations that in the future you'll have to cope with difficulties that are not yet present, but will be present in the future. And that's the reason why we trust that we will improve confidence in putting in good order the public finance. And you have a number of other reasons. What is true in Europe, to conclude, is that we have a human resource of exceptional quality, of course the same as we all have – women and men of exceptional quality. We have savings and capital, and I would say in comparison with the U.S. abundant savings, abundant capital. We have technology. The technology is available everywhere in the world. And so we have all that is needed to have growth and job creation. And what we still perhaps need a little bit is confidence, and that's why we try ourselves to be confidence-inspiring. Not only on a shorter basis, but because of rational expectations on a sustainable medium, long-term, very long-term basis.

CHAIRMAN BARBARA HACKMAN FRANKLIN: Can we actually have one more short question...

JACK HENNESSY: There's no such thing as a short question, it's the answers you have to worry about, Barbara. (Laughter)

THE HONORABLE JEAN-CLAUDE TRICHET: Touche. (Laughter)

JACK HENNESSY: Let me just follow on the role of the private sector, the consumer. There's 100% consensus in the U.S., so it's probably wrong, that we need much more structural reform and much more rapid than has been taking place. We can see what's happened. It's been a lot. But in the American way of "what have you done for me lately," there is a belief that the private sector has to play a much larger role. There has to be much more labor reform. And right now the low growth and high unemployment by many is attributed to the fact that you're in the mid-40s of GDP for government spending whereas in the U.S. we're in the mid-30s. Does this worry you? Does the ECB have a role to play in bringing about this transition of a more privatization in entrepreneurial activity within EU? And do you think it's important?

THE HONORABLE JEAN-CLAUDE TRICHET: I'm tempted to say yes. (Laughter) So two remarks, only two remarks. First, we entirely share your diagnosis. It's absolutely clear that we

have an overall necessity to embark into structural reforms and sound, I would say, public finance that would call for allocating, as an average of course, I would say a more modest part of our GDP to public spending in general. It's really easy to say. We have to admit that it is very, very complicated to deliver. And it calls for very, very intense explanation to the general people. We are living in democracies. In a democracy, you finally do what the people want you to do. And if the people do not understand that everybody would be much better off if we would go in the direction you have suggested, it's very difficult. If the general people understand that it goes in the right direction, then everybody would be better off and we would have more jobs. And, of course, it is more easy. So pedagogy – tireless explanation – is really of the essence in this respect. But again, analysis entirely shared. A second point, I only want to mention en passant but I trust it is something which is important. When we look at the restructuring, reshaping that is underlying all over Europe in the private sector, in the productive sector, associated with all the challenges of a modern economy plus the single market which has triggered additional competition all over Europe, plus the single currency which has profoundly transformed by achieving, if I may, the single market, then you see that there is a very, very active and I would say very bold private sector, competitive sector in Europe which is perhaps doing the kind of job that was done in the U.S. in the 80s did not show up immediately in terms of macro figures, but might be paving the way for a much better future as it was observed here. So I'm very cautious in this remark. I don't want to be too definitive but I trust that there is also something which is less visible than macro figures but which is not to be neglected in the private sector in Europe. (Applause)

CHAIRMAN BARBARA HACKMAN FRANKLIN: Excellent, excellent. We really thank you for that excellent enlightenment that you have provided us. I could listen to you all afternoon, but we really can't do that. So please join me in thanking Jean-Claude Trichet. (Applause)