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The Honorable Jens Weidmann,
President Deutsche Bundesbank

Questioners: Jane Hartley, Chief Executive Officer, Observatory Group and Trustee of the club

Glenn Hubbard, Former Chairman of the club and Dean of the Columbia University School of Business

Andrew Tisch: Good afternoon everyone. Welcome to the 421st meeting of the Economic Club of New York, now in our 105th year. The Economic Club of New York is the nation's leading nonpartisan forum for the discussion of economic policy. More than 1,000 guest speakers have appeared before this club in more than a century. In that time, our guests have presented ideas and concepts that have helped to reshape the world's economies. That tradition has been supported by contributions from the 166 members of the club's Centennial Society. Their names are listed in the program and I thank you. We'd also like to welcome the students who are here with us today from a number of different colleges. Your attendance here is made possible by our membership.

Today I'm pleased to welcome Dr. Jens Weidmann, President of the Deutsche Bundesbank, who has just attended the spring IMF meetings in Washington. Dr. Weidmann was appointed President of Deutsche Bundesbank and member of the Governing Council of the European Central Bank just about one year ago. Prior to this, Dr. Weidmann was Head of the Department of Economic and Fiscal Policy of the Federal Chancellor's Office. Dr. Weidmann obtained his PhD at Bonn University and joined the International Monetary Fund in Washington, DC. He served as Secretary General of the German Council of Economic Experts and Deputy Head of the Economics Department at the Deutsche Bundesbank before his position in Chancellor Merkel's office in Berlin. Following Dr. Weidmann's remarks, he will be questioned by two of our club members. Dr. Weidmann, welcome, and the podium is yours.

The Honorable Jens Weidmann: Thank you very much for the kind words of introduction. Ladies and gentlemen, it's a pleasure to be here and see so many familiar faces also. And since we are at the Big Apple, let me start with some words about apples. George Bernard Shaw is said to have made an interesting remark about apples. "If you have an apple and if I have an apple, we exchange these apples, then you and I still have each an apple. But if you have an idea and I have an idea and we exchange these ideas, then each of us will have two ideas." And I think these words perfectly encapsulate the intention of the Economic Club of New York and of today's event. Ideas multiply when you share them and they can become better when you discuss them. I'm therefore pleased and honored to be able to share some of my ideas with you, such a distinguished audience.

In a long list of speakers, I'm the third Bundesbank President to speak at the Economic Club. The first was Karl Otto Pohl in 1991, and there are some of you, I heard, that still remember his appearance here, followed by Hans Tietmeyer in 1996.

Although only a few years have passed since then, the global economic landscape has fundamentally changed in the meantime. Just think of the spread of globalization, think of the introduction of the euro, think of the Asian crisis, or the dotcom bubble. All these events and others have constantly shaped and reshaped our world.

And most recently we have experienced a crisis that once again will change the world as we

know it-- economically, politically, and intellectually. It is this new unfolding landscape that provides the backdrop to my speech. And I shall address two questions. The first one, where do we stand? And the second one, where do we go from here?

Now of course it is the second one that is the more tricky one. And in answering it, we should be aware that every small step that we take now will determine where we stand in the future. Specifically, I will argue that measures to ward off immediate risks to the recovery are closely interconnected with efforts to overcome the causes of the crisis. They're interconnected much more closely and vitally than proponents of more forceful stabilization efforts usually assume.

But, first, let us see where we stand at the present juncture.

Where do we stand? When we look back from where we are standing right now, we see a crisis that has left deep scars. The International Labor Organization estimates that up to 56 million people lost their jobs in the wake of the crisis. And this number equals the combined populations of California and the state of New York. But we are all aware of, we are all aware of course that these and similar estimates have to be taken with a grain of salt, in this case probably a larger grain of salt.

But also look at government debt. Between 2007 and 2011, gross government debt as a share of GDP increased by more than 20 percent in the euro area and by about 35 percent in the United

States. And I think we all agree that the crisis was unprecedented in scale and scope. And the first thing to do was to prevent a recession from turning into a depression. And thanks to the efforts of policymakers and central banks across the globe, this goal has been achieved. Following a slight setback in 2011, the world economy now seems to be recovering. In its latest World Economic Outlook that we have discussed over the weekend in Washington, the IMF confirms that global prospects are gradually strengthening and that the threat of a sharp slowdown has receded. Looking ahead, the IMF forecasts global growth to reach 3.5 percent in this year and 4.1 percent next year. For the same years, inflation in advanced economies is expected to reach 1.9 percent and 1.7 percent respectively.

Basically, I share this view of the IMF. But being a central banker, I'm not as calm as the IMF when it comes to inflation. Taking into account rising energy prices and robust core inflation, prices could rise faster than the IMF expects.

We have to be careful that inflation expectations remain well anchored and consistent with price stability. And in this regard, the discussion about the mandate of the euro system that currently takes place in some of the countries in Europe is certainly not helpful. Expectations getting out of line might very well turn out to be a non-linear process. Or in other words, if they move, they move abruptly and they move rapidly. And if this were to happen, it would be difficult and expensive to rein in expectations again.

And even though the outlook for growth has improved over the past months, some risks remain—the European sovereign debt crisis being one of them. And this seems to be the one risk that is weighing most heavily on peoples' minds–not just in Europe but also here in the United States.

And as a reaction to this, the member countries of monetary union have committed to ambitious reforms and recently substantially increased their firewalls, and over the weekend the IMF's increase in resources complements these efforts. And this notwithstanding, the sovereign debt crisis is not yet resolved. The renewed tensions over the past two weeks are a case in point. Thus, we have to keep moving, and each step that we take has to be considered very carefully. As I have already said, each small step we take now will determine where we stand in the future.

Where do we go from here?

Three things have to happen in the euro area. First, structural reforms have to be implemented so that countries such as Greece, Portugal, and Spain become more competitive and then reach higher growth rates. Second, public debt has to be reduced – a challenge that is not, by the way, confined to the euro area. Actually on an aggregate level, the figures for the euro area look even better than those for other countries, including the U.S. Third, the institutional framework of monetary policy has to be strengthened or overhauled, and we need more clarity about which direction the monetary union is going to take in this respect. And I think we all agree on this,

including the IMF in its latest World Economic Outlook. But I think the key here is to strengthen incentives for some public finances and not to weaken them by fiddling around with the institutional framework. I'll come back to this later.

However, there is much less agreement on the correct timing of these measures. Since the crisis began, the imperatives I have just mentioned have tended to be obscured by short-term considerations. And this tendency seems to be becoming stronger now that the world economy is getting back on track.

This view is reflected, for instance, by Lawrence Summers who wrote in the Financial Times about four weeks ago, referring to the U.S, and I quote now... "the most serious risk to recovery over the next few years is that policy will shift too quickly away from its emphasis on maintaining adequate demand, towards a concern with traditional fiscal and monetary prudence."

And it is in this spirit that some observers are pushing for policies that eventually boil down to even more of the same. Firewalls and ex ante risk sharing in the euro area should be further extended, consolidation of public debt should be postponed or, at least, substantially stretched over time, and finally monetary policy should play an even bigger role in crisis management.

And I explicitly do not wish to deny the necessity of containing the crisis, for instance by building firewalls. But all that, all that has been gained in this time, all that is gained by building

those firewalls is the time to address the root problems. The proposed measures would buy us time, but they would not buy us a lasting solution. They would not address the root causes.

And five years after the bursting of the subprime bubble and three years after the turmoil in the wake of the Lehman insolvency, we have to ask ourselves the following question. Where will it take us if we apply these measures over and over again – measures which are obviously geared towards alleviating the symptoms of the crisis but which fail to address its underlying causes? In my view, this would not take us very far. There are two substantial reasons for that. First, the longer such a strategy is applied, the harder it becomes to change track. More and more people will realize this and they will start to lose confidence. They will lose confidence in policymakers' ability to bring about a lasting solution to our problems. And we should bear in mind that the euro area crisis is primarily a crisis of confidence: confidence in the sustainability of public finances, confidence in the competitiveness of some countries, and also confidence to some extent in the workings of the monetary union itself.

But there is a second reason why the "more of the same" will not take us far. The analgesic we administer comes with side effects. And the longer we apply them, the more the side effects increase, and they will come back to haunt us in the future. In the end, it's just not possible to separate the short and the long term. You will be tomorrow what you do today.

With these two caveats in mind, let us take a closer look at the suggested policy mix. For the

sake of brevity, I shall focus on monetary and fiscal policies only.

To contain the crisis, the EMU member states have built a wall of money. And that wall of money recently reached the staggering height of 700 billion euros. And as I have already said, ring-fencing is certainly necessary, but again, it's not a lasting solution. It might even distract from solving the root causes of the crisis. As Robert Zoellick put it in a recent FT interview, "the firewall preoccupations distract from the fundamental issue. What should the EU do to help Italy and Spain retain political support for its reforms?"

And it's not the sky that is the limit – the limits are real and they're financial and political. And to talk in the military terminology that a lot of the proponents use in the current discussion regarding the ever increasing size of firewalls, there is no nuclear option in Europe regarding the firewalls. And in the face of such limits, the Eurosystem is now seen as the "last man standing." Consequently, some observers are demanding that it play an even bigger role in crisis management. More specifically, such demands include lowering interest rates, providing more liquidity, and executing even larger purchases of sovereign assets.

But does the assumption on which these demands are based hold when we take a closer look at it? In the end, monetary policy is not a panacea and the central bank firepower is also not unlimited, especially not in a monetary union. True, again this crisis is exceptional in scale and scope, and extraordinary times call for extraordinary measures. But the central banks of the

Eurosystem have already done a lot to contain the crisis. And if you look at our balance sheet, you will see that it doubled, more than doubled between 2007 and the most recent data. Now we have to make sure that by solving one crisis, we are not preparing the ground for the next one.

Take, for instance, the side effects of low interest rates. Research has found that risk-taking becomes more aggressive when central banks apply unconditional monetary accommodation in order to counter a correction of financial exaggeration, especially if monetary policy does not react symmetrically to the build-up of these imbalances. And in the end, putting too much weight on countering immediate risks to financial stability will create even greater risks to financial stability and price stability in the future.

The Eurosystem has applied a number of unconventional measures to maintain financial stability. These measures helped to prevent an escalation of financial turmoil and constitute a virtually unlimited supply of liquidity to banks. But monetary policy cannot substitute for other policies and it must not compensate for policy inaction in other areas.

If the Eurosystem funded banks that are not financially sound, and did so against inadequate collateral, it would redistribute substantial risks among national taxpayers of the different countries in the monetary union. And such implicit transfers are beyond the mandate of the euro area's central banks. Rescuing banks, or even countries using taxpayers' money is something that should be only decided by governments and the parliaments behind them.

By overstepping the mandate in this respect, central banks risk their independence, but monetary policy would also nurture the deficit bias that is inherent in a monetary union of sovereign states. In a monetary union, as you are probably aware of, you can externalize the effects of bad fiscal policies to your neighbors. And it's obvious that you tend to be less prudent when you have somebody else footing the bill of your action.

And that's why the EU treaty has been designed to minimize this deficit bias of the union and ensure fiscal discipline by prohibiting monetary financing to the central bank, by postulating a no-bailout clause, and by the Stability and Growth Pact. We can debate later on whether these rules have been adhered to and how they can be strengthened.

But in this regard, and I think this is a key message today that I would like to deliver to you, the situation of the Eurosystem is fundamentally different from that of the Federal Reserve or that of the Bank of England. And I think this has to be acknowledged in the debate.

Moreover, extensive and protracted funding of banks by the Eurosystem replaces or displaces private investors. This breeds the risk that some banks do not reform unviable business models. And so far, progress in this regard has been limited in a number of countries of the euro area. And the Eurosystem has also relieved stress in the sovereign bond market. And we should not forgot that market interest rates signal the state of public finances not only to the public but also to the governments and are an important incentive for reforms.

And don't misunderstand me or misinterpret me, markets certainly do not always get it right. They underestimated sovereign risks for a long period. Now I would say they are exaggerating it. However, past experience has taught us that their signal is nevertheless the most powerful incentive we have. Anyway, I would not rely on political insight or political rules alone.

After all, monetary policy must not lose sight of its primary objective which is to maintain price stability in the euro area as a whole. Delivering on this primary goal of maintaining price stability is essential for safeguarding the most precious resource a central bank can command which is its credibility.

To sum up: what we do in the short run has to be consistent with what we try to achieve in the long run – price stability, and financial stability for instance. And this implies a delicate balancing act – a balancing act we shall upset if we overburden monetary policy with crisis management.

And all in all, this debate about the role of monetary policy puzzles me, especially when it takes place in Europe because we have been there already a long time ago. We have had this debate a long time ago. In Europe, until the 80s some central banks were not independent. And we had central banks like the Banca d'Italia for instance that were financing a sizable part of their government's budget directly. And we all know the results of this period, and of this

experiment. High inflation rates, higher volatility and uncertainty, distortions of economic decisions, and an arbitrary redistribution of wealth. Inflation expectations adjusted and risk premium were higher and so were financing costs.

And it was against this background that the countries of the monetary union decided and agreed to establish rules with constitutional character to grant the central banks independence, prohibit monetary financing, and to ensure that the overriding policy goal of monetary policy is price stability. So sticking to these rules is not an absurd obsession of some, let's say German bureaucrats that you all assume, especially in the Bundesbank. But it belongs to the lessons learned and it's one of the constitutional elements of monetary union. Because again these rules have constitutional character, and I'm wondering sometimes how you can inspire trust in a system by asking to violate its rules.

So what about consolidation and structure reforms? Here, too, we have to strike the right balance between the short and the long run. The proponents of delay argue that countries embarking on ambitious consolidation efforts or far-reaching structural reforms at the present moment would place too great a burden on recovery. And they do not deny the necessity of such adjustment steps over the medium term, but in the short run they consider it more important to maintain adequate demand and avoid unsettling people and nurture the recovery.

But in the end, the current crisis is, as I said, to a large extent a confidence crisis. And if already-

announced consolidation and reforms were to be delayed, would people not even lose more confidence in policymakers' ability to get to the root causes of the crisis? In my view, we can only win back confidence if we bring down excessive deficits and boost competitiveness. And it is precisely because these things are so unpopular that makes it so tempting for politicians to rely on monetary accommodation instead. And it's precisely for the reasons that we have the rules and that we have the provisions of the EU treaty.

And it is true that consolidation, in particular, under normal circumstances, might dampen aggregate demand and economic growth. But for me the question is: are we in normal circumstances? It is quite obvious that these days everybody sees public debt as a major threat. The markets do, politicians do, and people on Main Street do.

And a widespread lack of trust in public finances weighs heavily on growth. There is uncertainty regarding potential future tax increases, while funding costs are rising for public and private creditors alike. And in such a situation, consolidation might inspire confidence and actually help to foster economic growth, or to put it in economists' language, the multipliers are probably much smaller now than in normal times.

And in my view, the risks of front-loading consolidation are thus being exaggerated. And in any case, there is little alternative. In the end, you cannot borrow your way out of debt; cut your way out of debt is the only viable approach.

So allow me to conclude by going back to the beginning of my speech. I have stressed that we have to embark on reforms that make the crisis countries more competitive; that we have to reduce public debt; that we have to further improve the institutional framework of monetary union. That is an often underestimated aspect.

But the spirit of my argument has already been expressed succinctly some 20 years ago by Karl Otto Pohl. In his speech here at the Economic Club, I'm not sure whether it was really here, but at least at the Economic Club he said: "The true function of a central bank must be, however, to take a longer-term view." And after five years of the crisis, the long term might catch up with us much faster than expected. Thus, we have to think about the future now – and we have to act accordingly as well. Thank you very much for your attention.

QUESTION AND ANSWER PERIOD

ANDREW TISCH: Don't go too far. You'll be right back here in about 14 seconds. Anyway, first of all, thank you very much for your observations, your insights, your ideas. We really appreciate that. Dr. Weidmann will now be joined by two club members who have been designated as our questioners. Jane Hartley is the Chief Executive Officer of Observatory Group and a trustee of the club. And Glenn Hubbard, former Chairman of the club and Dean of the

Columbia University School of Business. If you have any questions, also you can email them to questions@econclubny.org. and our President Jan Hopkins will read them. Anyway, Jane, the first question is yours.

JANE HARTLEY: Thank you Andrew. Dr. Weidmann, we're thrilled to have you here. And I'd like to second Andrew in saying thank you so much for your very insightful remarks. My first question. Potential changes to political leadership in Europe over the coming months might slow fiscal austerity plans and affect some of the agreements previously reached. The weekend's elections in France and the collapse of the Dutch government are emblematic of this dynamic. How does the Bundesbank feel about these political challenges that Europe faces?

THE HONORABLE JENS WEIDMANN: That's a dangerous question you ask, asking a central banker to comment on policy. We feel much more comfortable commenting on fiscal policy usually than on these very acute political developments. But I think political uncertainty is an issue within the monetary union. And you mentioned the very obvious, let's say potential structural breaks with the French election, but also with the Greek elections that are looming with the uncertainty regarding the implementation of the Greek program from there on.

So basically I'm back to my, to the initial point I was making which is credibility. And credibility, and I will come back to a second point which is national sovereignty, but let me start with credibility and take, perhaps surprisingly for a German, I like to quote Voltaire sometimes

who said that "at the bottom of each problem sits a German." So we are known to be very pessimistic.

But let me start on an optimistic tone here. We have a chance for change in Europe. And I think a lot of the measures you have been seeing in Europe and have been enacted and are starting being implemented, you would never have expected this in previous years. So there's a change, a chance for a new beginning here regarding fiscal consolidation but also competitiveness. And this is the first point.

So let me try being optimistic. And also I think policymakers in Europe have recognized that the framework we were having in monetary union that consists of one common monetary policy and seven independent national fiscal policies has, let's say it creates tensions that we have to solve. We thought having a solution for this with a Maastricht approach that was based on, let's say the responsibility of the single member states and the no-bailout clause. Everybody was supposed to solve his or her problem on his own. And we saw that this approach lacks credibility. It lacks credibility because also the rules were not adhered to and the rules were bent at the end even by France and Germany. So we needed a bit about the framework.

And policymakers have, took a first crack at this at the October and December Council of, European Council. And they came up, they were talking about fiscal union, at the end they came up with a fiscal compact. Fiscal compact is supposed to strengthen the rules of the Maastricht

approach. But the question is do you believe this? And certainly the announcement as such is not the game changer in the institutional framework that we would like to have. And also there you have to build up credibility with concrete policy actions. This is what has been lacking in the past.

So I was, let's say intrigued by the announcement of the Spanish government that on the day of the signing of this fiscal compact, announced a unilateral deviation from the agreed fiscal consolidation pact. So the question is really do governments want to bind themselves? And if you want to go even further, are governments willing to give up national sovereignty, either by binding themselves or by delegating national sovereignty to a super-national thing, institutional, which would be the second approach.

I mean I said there are two approaches. The one is the Maastricht framework and the other one would be to move towards a fiscal union. But a fiscal union for me is not just socializing that. A fiscal union for me is a completely different framework which involves deep structural change in the constitutions of our member states. And talking only of the one side of this thing which is a fiscal union, and everybody might have a different perception of what this really comprises, is dangerous. It erodes the stability fundament of the monetary union.

And let me just refer to the recent suggestions that we've heard just today, I think from the IMF, to come up with a joint liability scheme in Europe. But without having the tools to enforce fiscal

discipline, I mean I'm not sure you would give your credit card to me to do some shopping without having some say on what I do with it. But this is another point, this is distributional consideration. But what worries me more as a central banker is the effect on fiscal discipline. And we know all this. There is this deficit bias that I referred to and this deficit bias gets even worse if you're not accountable for your actions.

And if you socialize debt, this means that at the same time you need a European level that is able to enforce fiscal discipline and it means that you have to give up national sovereignty. And the question is, is there an appetite, a political will to give up this national sovereignty? And the second point is, is there political support, broad public support to give up this national sovereignty. And then I think you also have to be careful. This is certainly not a short-term fix. I mean, as I said, it requires constitutional changes in 17 countries. And although I'm not saying that this might not be the way forward and we certainly need more political integration, I'm just saying that this is no quick fix to our issues.

And I won't comment on the electoral campaigns in specific countries of the monetary union. I'm just saying that I think you have to discount probably what is said there on our mandate and wait and say and see what the future government's position on this will be. But I don't think that this debate is helpful. And again, as I said, I think we had this debate and we decided deliberately on a certain framework that makes a lot of sense in my regard.

R. GLENN HUBBARD: Thank you Dr. Weidmann for those very excellent remarks. I wanted to follow up on a reference you made in your speech to buying time. In the view of at least some analysts, bond purchases by the ECB are a mechanism for buying time in fiscal adjustment. Do you think those purchases are sufficiently linked to structural reform in peripheral countries in the eurozone? And if not, what more should be done?

THE HONORABLE JENS WEIDMANN: Well, this is also a tricky question. I'm getting only tricky questions today. Since I guess my position on the S&P is known and I've taken a critical stance regarding these sovereign bond purchases, I'm not telling any secrets. But my position is that they shouldn't be linked at all to any policy measures. It's not our job to reward or sanction policymakers for their actions. Our job is to do monetary policy. And if those purchases are needed to implement our monetary policy, we should do them. And we can debate whether they were necessary to do that. But it's not our job to say, hey, listen, you're a nice government, we like you, we decrease your financing costs. And the other government we don't like and we don't purchase. And I think this is a very dangerous game that touches the fundaments of a central bank's functions.

Just to extrapolate a bit what you said, if we are viewed as tipping off governments because we don't like their policy actions, who are we? We are not elected. If a democratically-elected government decides to implement or not implement something, and then the central banker comes along and says, hey, I have a different view. I sanction you or I reward you or whichever,

I think this is very dangerous because this will lead to questioning of our mandate. This is an overstepping, would be an overstepping of our mandate which is a threat to central bank independence. We have to respect the democratic institutions and there are some things that we can do. This is ensuring price stability. And there are other things that only governments are legitimized in doing. Redistributing risks, for instance, is one such thing. And we should stick to our respective mandate.

And what worries me is, I mean the crisis has pushed us all to the limits of our mandate. And what I describe here is, I think, not an abstract threat. It happens in a lot of countries that you have debates about the role and the mandate and the independence of the central banks. And I don't want to mention single countries but I guess everybody knows who I'm referring to. And I think this is not a very welcome development from a central banker's point of view.

JANE HARTLEY: Does the Bundesbank see the potential that the ECB efforts to keep inflation under control in Germany could lead to deflationary pressure in the other EU countries? And what criteria would the ECB consider in trying to make policy choices in such a difficult economic environment?

THE HONORABLE JENS WEIDMANN: I think your question goes to the heart of our policymaking. The European Central Bank, or the Eurosystem more precisely, does monetary policy for the euro area as a whole. So what matters for our policy decisions is the aggregate

inflation, is the average inflation in the euro area, and not the inflation rate in single countries. And I think we will need inflation, we always had, and we will need also in the future inflation differentials in the respective countries also to alleviate the adjustment process. But our goal is not to alleviate the adjustment process. Our goal is to ensure price stability for the euro area as a whole. And so that's our target.

And we will certainly in the future see an even increasing heterogeneity in the monetary union. It's clear that monetary policy by German standards or for the German economy is too expansionary. But that's not our yardstick. And we will have to use other instruments to cope with this phenomenon. And these instruments include for instance MAC or potential instruments that we are currently debating with our legislators. For instance, in Germany we're debating the legal act that would underpin a MAC or potential role for the Bundesbank that complements the role of the ESRB, which is the European body to this effect. And then we would act and would have to interfere for instance by changing risk rates or changing capital buffers to counter effects on a national, on a national economy insofar as they don't affect the overall average inflation rate. So this is key discussion. So there's an intrinsic mechanism to deal with this.

R. GLENN HUBBARD: Okay, I wanted to pick up on a comment you made in your speech referring to a quote from Larry Summers about the American situation where you had hinted that he perhaps was more favorable towards stimulus putting off fiscal adjustment. Do you think the United States is pursuing the right policy mix right now as balancing growth and fiscal

sustainability?

THE HONORABLE JENS WEIDMANN: You really like to put me in a difficult spot here. Let's put it this way. I think the attention that Europe currently gets is not always merited in the sense that I think the discussion would benefit from a broader approach to the problems. I hope that answers your question in a central banker's way.

ANDREW TISCH: Jan...

JAN HOPKINS: I have a question from the floor. Why do you say sovereign risks are currently exaggerated? Are you optimistic that reforms in Spain and Italy, for instance, will be successfully implemented?

THE HONORABLE JENS WEIDMANN: I say exaggerated because I think markets need time to understand the numerous reforms that are currently going on and they tend to over- and undershoot. And that's what we are currently seeing.

I think there are two things. The one element that you mentioned which is the reforms in the national countries and there we've seen ambitious reform programs, especially on the structural side. If you look, for instance, in Spain the labor market reforms that have been suggested there are now starting being implemented are quite courageous. And also Italy has suggested reforms

to this respect, and it needs time to digest what this means. And, of course, these reforms also need time to show their effect.

But there's, on the other side also the element of the institutional framework that I mentioned, that needs perhaps some more understanding and needs some re-working. So my perception right now is that also the very sudden shifts in risk perception are pointing to an overestimation of this risk. So nobody really know where....I mean I'm not claiming that I would know where the real risk premium lies but that's just my perception.

JANE HARTLEY: A follow up to that. Italy and Spain have experienced renewed concerns from the financial markets over their outlook. Is the Bundesbank happy with the fiscal policy efforts made by those two countries? And if the market pressure continues, what is the policy, the next policy action?

THE HONORABLE JENS WEIDMANN: I think the key, the key point here is that we should stick to our announced plans. I think you can always debate the details of a policy mix. A bit more, let's say stretching of the consolidation path, a bit more front-loading, and that's presumably a lot in the eye of the beholder. But we are past that stage. They all announced consolidation paths. Some of them are even in fund programs. So coming back now and to renegotiate these programs is, I think, a blow to credibility. And that's my key point.

And what bothers me and what worries me is immediately when tensions, renewed tensions arise, and I think in the case of Spain the, let's say, I would say the unfortunate communication of the Spanish government regarding the adjustment of its consolidation path, presumably also contributed to this market tension. The immediate reaction of everybody is to turn around and say, hey, what can the central bank do?

And this is what worries me in the sense that nobody asks what is the EFSF doing? I mean we built all these firewalls and they're in the responsibility of governments where they belong. And they have been constructed exactly for the purpose of stretching our structural reforms so that they are politically palatable. And they're not even discussed anymore. And this shows you that by, let's say conveying the impression that we are the "last man standing" we are the only one to act. You take on a role that puts you in a very difficult corner that is difficult to get out.

So I think our job now as the central banks is to put the responsibility back where it belongs. We have managed to calm the situation. The underlying problems haven't been fully addressed. So deal with it. And if you need time, use your instruments that you have designed. Use the EFSF Use the ESM. And if there's not enough in it, go back to your parliaments. That's where these decisions belong. But just to straighten this thing out, I think there's enough on the table now. And I also think that this rat race regarding the volumes of the firewalls is distracting attention. It's distracting attention, as I said, because in Europe and also in every other setting, this will only show you the limits of this approach much faster. Limits that stem from the fact that you

have a couple of countries that are guaranteeing other countries and also the financial sources of these countries are limited. But also limits of political acceptance. So the proponents of the nuclear option approach as they call it, as they label it themselves, I think they lead to us testing these limits much earlier. And there's enough on the table to stretch the consolidation policies for a very long time. If need there is, the instruments are there that can be used. So let the central bank do their job and let fiscal policymakers do their job.

ANDREW TISCH: Dr. Weidmann, again thank you. Jane and Glenn, Jan, thank you very much. Our next session will be May 10, lunch with Robert Zoellick, the outgoing president of the World Bank. Enjoy your lunch.