**Conversation between Jean-Claude Trichet, former president, European Central Bank, and David Marsh, chairman, OMFIF, 19 July 2021, published 21 July 2021 with OMFIF *Global Public Investor 2021***

**DM:** Welcome, Jean-Claude Trichet, former president of the European Central Bank, a quintessential person to talk about the findings of our survey. Could I start off on the renminbi? Our survey shows a very impressive pickup in the number of central banks that want to purchase the renminbi as a reserve currency, particularly in Africa. Has the renminbi come of age as a reserve currency?

**JCT:** China occupies a major part in the global economy, and is expanding very rapidly. Yet the renminbi's share in the composition of reserve assets is still very low today according to the IMF, only 2.5%, compared with around 59% for the dollar and 21% for the euro. That is miniscule at present, but it is due to increase considerably in the future. Your survey shows that the trend is developing fast, and is overdue in many respects. But the problem remains that the renminbi is not yet fully convertible. When the renminbi becomes fully convertible, I expect a big jump ahead. This is the view of Chinese friends, including the former governor of the central bank, Zhou Xiaochuan, who called for complete liberalisation of the renminbi. That time will come. And when it comes, you will see the full realisation of your survey.

**DM:** Will the problems with the US hold the Chinese back?

**JCT:** I don't think that strains between the US and China, if they remain at the present level, will prevent the renminbi building its presence and global reach. The degree of economic and trade coupling between the US and Chinese economy remains extremely important. Many American firms have their products manufactured in China. Unless there is an absolute catastrophe, for example with military action, we should continue to observe significant relationships between both economies.

**DM:** I would like to turn to the question of sustainable assets. This has been given even greater prominence by the devastating floods in Germany and other parts of northwest Europe, which most politicians blame on global warming. We see in our survey that 92% of central banks already invest in green bonds. A majority says they are going to continue. There's also a lot of interest in sustainable equities. Will criteria for sustainable performance now become the fourth reason why central banks invest in reserve assets, next to the traditional attributes of safety, liquidity, and return?

**JCT:** What happened in Germany and in Belgium, with all the fatalities, is another wake-up call for all of us, to understand that climate change is a very important issue, and that we have to mobilise all possible resources and energy to cope with it. It is good that we have a global consensus now, with the change of the US administration. As regards central banks, the just-published action plan of the ECB puts climate change at the heart not only of what they are doing in portfolio investments, but also of monetary policy operations, including collateral, purchase of corporate tradable securities, and so on.

**DM**: Will this set a pattern?

**JCT:** In my opinion, that is something that most central banks of the world will follow, to the extent that they do not hamper their primary mandate to ensure price stability. In the case of Europe, the treaty says, provided you deliver price stability, you can support the other policies of the European Union, including the Green Deal. That is what the ECB has decided, unanimously: to embark on a sustainability policy which is comprehensive, across the complete spectrum of the central bank.

**DM: S**ome central bankers such as the Bundesbank's Jens Weidmann have maintained that if central banks go too far in politically fighting climate change, this will impede their operations based on price stability and could also affect their independence. Do these arguments hold water?

**JCT:** In the past, when I had hearings at the European Parliament, I made myself the distinction between the investment portfolio - reserve investment - on the one hand, and monetary policy, on the other hand. Finally, the governing council has decided not to make that distinction. At the same time, the ECB is very clear that the primary mandate is price stability – that is extremely important for its credibility. That is why there was unanimity in taking the decision.

**DM:** We have 18% of respondents saying they intend to reduce their euro holdings over the next 12 to 24 months, while 20% said this regarding the dollar. What does this tell us about the general desire for reserve currency diversification?

**JCT:** If you take the perspective of the last 20 years since the inception of the euro, the trend is very clear. The dollar made up 71% of reserve assets in 2000. In 2020, for the last quarter of last year, it's down to 59%. Other currencies are taking up the 12% missing share; the euro has risen by 3 percentage points, from 18.3% to 21.2%. No change for the yen, a significant rise for sterling; and the Canadian and Australian dollar have augmented too. And the renminbi went up from zero to 2.5%. So that that is the trend. There will not be any dramatic change, that would be to the detriment of all partners. If the euro's presence were to increase massively, the euro would appreciate. That is not necessarily opportune given the present state of the European economy. And if the dollar declined precipitously in importance, that would also be very bad for the world and for the US. So smooth, progressive, orderly changes are of the essence. That is more or less what we have observed over the last 20 years.

**DM:** 66% of respondents expect the new assets to be issued by the European Commission as part of the Next Generation EU deal will become a permanent part of their portfolios. Has the European safe asset now arrived? If the euro really did challenge the dollar, wouldn't that lead to some perturbations in the European economy?

**JCT :** The big difference between the euro and the dollar is not the currency. The euro is a credible currency as is the dollar. At times when I was ECB president, there was criticism that the euro was too strong. The real difference is that you have a single Treasury in the US and you do have not, until now, a euro area Treasury. That makes an immense difference for the size, depth and liquidity of the tradable safe securities denominated in both currencies. So I am not surprised that the emergence of safe assets representing the full euro area is welcomed by many investors around the world. This Next Generation EU plan is highly important for the life of Europe. But we will not get overnight a European Treasury like the US Treasury. And so a significant difference between the US and the EU will remain, in terms of size, depth and liquidity of the safe securities market. Maybe it is good that there will not be a dramatic overnight change, for the reasons we have mentioned before.

**DM:** Our poll states that 26% of the central bank plan to expand their corporate bond holdings and 21% say they're going to increase the equity holdings. Does this not lead to a conflict of interest when central banks become so much involved in markets where they are themselves helping to set the valuations? Is there a danger that central banks are doing too much - and getting into markets where there will be conflicts of interest?

**JCT:** Particularly in the advanced economies, central banks have embarked massively on purchasing tradable securities. That has not been to optimise their portfolio investments, it was certainly not for them to take risks, but because it was called for by their own monetary policy considerations. We had a very abnormal situation particularly in the advanced economies since the last great financial crisis.

Growth and productivity progress have been much lower, equilibrium real interest rates were going down significantly and low inflation strongly reduced national interest rates. And that explains why, to prevent the risk of deflation, central banks embarked resolutely in non-standard actions. But this will not go on for ever.

**DM**: What about the danger of a conflict of interest?

**JCT**: I don't believe, for one second, that - because they will be worried about the effect on the valuation of their own portfolios – the central banks will be prevented from raising interest rates. The course of action that the central banks have taken will not go forever. In any case, it is not sustainable in the long run! So, I expect that the situation will improve considerably. I am quite happy that now we are more or less out of the danger of deflation. For 10 or 12 years, central banks have been fighting to get this. Of course, the present situation has to be very carefully monitored by the central banks in line with their responsibility for price stability, without deflation and without inflation, in the medium and long run. And I am happy that all central banks of the major advanced economies maintain this goal of price stability with the same figure, 2%.

**DM:** Should central banks now not be calling actively for higher wage rises? That would be one way of pushing up the inflation rate to 2%, or maybe a bit more. This is one of the areas covered by Gordon Brown, the former British prime minister and chancellor of the exchequer, in his new book on repairing the flaws in the world economy.

**JCT:** I agree with Gordon Brown. The relative loss of bargaining power of labour is part of the difficulty the central banks have had during the last 12 years. There are a lot of reasons for very low inflation and the danger of deflation. The loss of labour bargaining power is one of them. In the US, it is very clear that you cannot eternally have a very flat remuneration of workers and employees; it is already a big political problem. The same observation can be made in other advanced economies, even when they are at full employment.

**DM:** An astonishing 45% of pension funds we surveyed now invest in gold. You have just been speaking about a revival of inflation. What does this interest in gold tell us about confidence in the world economy?

**JCT:** The central banks cannot lose their credibility by letting inflation rise unduly. If there is a real danger of inflation, they will change their monetary policy, because it is essential for their own credibility, for the stability and prosperity of their own economies. So I don't interpret this increase in investment in gold as a sign of absence of confidence in the present currencies. It's more part of overall diversification into speculative investments. In a portfolio managed at a global level, maybe you consider you wish to have a portion of speculative assets that are less correlated with your other investments.

**DM:** Getting the right balance between fiscal and monetary policy is important. 74% of central banks in our survey said that they thought monetary policy was having an excessive influence on financial markets and pricing, but only 42% felt that it needed to be actively changed. What do you think should be the right monetary-fiscal balance, bearing in mind that, in Europe, we still very accommodative fiscal policies, unlike after 2010?

**JCT:** We had an absolute necessity of active fiscal policy at the time of the Covid-19. It was done very well, in my opinion, by all countries on both sides of the Atlantic. But we should not consider that it should go on forever. Otherwise we would be in a long-term unsustainable position. Had some European countries, at the beginning of the century, followed the budget discipline of the stability and growth pact, we would have avoided the dramatic European sovereign risk crisis. We paid a very high price for that. At present, countries' fiscal policies must be as active as possible so as not to overburden the central banks. The Covid-19 health situation is the main priority. But I would hope that the gigantic expansion of US fiscal policy does eventually come to an end.

**DM: T**he old adage of the saints: 'Lord make me holy, but not yet.' The last time that the European Central Bank raised interest rates was in July 2011, 10 years ago, when you were president. Was that a mistake?

**JCT:** I do not think so. People forget we had inflation close to 3% at that time. It would have been a blessing, of course, during the years afterwards! So we had to give a signal that monetary stability was of the essence, it was part of the conditions for setting up the ECB. Many observers believed at its inception that the euro would be a total mess, that it was unthinkable that the euro could be a credible currency. But we made it a credible currency. At the same time, as the action on interest rates was decided, the ECB was intervening massively, with an extraordinary non-standard monetary policy, to purchase government bonds of Greece, Ireland, Portugal, Spain and Italy. It was the first time a central bank was massively intervening in a targeted totally non-standard policy to counter an abnormal situation in terms of monetary policy transmission in the euro area. So I was, on the one hand, in these extraordinary demanding circumstances, extremely bold and being criticised for being extremely bold. And, on the other hand, I wanted to demonstrate that I didn't wish to take risks with the currency stability and wished to maintain its credibility in the eyes of all European citizens.

**DM:** So this was a quid pro quo. The final question is on the future of the central banks. One of Gordon Brown's points is the need to have a more joined up approach between the central banks and the fiscal authorities. He also says the central banks should not hesitate to step in for the private sector, if that is needed, as it was certainly after the 2008 crash. If this is the new world, what changes are needed in the mentalities, motivations and mandates of central banks?

**JCT:** Most central banks in the word are still very attached to price stability, monetary stability, currency stability, which is very often in their first mandate. Second, they have a responsibility for financial stability. This can be linked to monetary stability because, if you have financial instability, this impacts prices in erratic fashion, up or down. Central banks cannot be the only game in town. They have to do whatever is necessary to fulfil their own mandate. But they cannot solve all problems alone. It is important that they also communicate with all other partners, governments, parliaments, the private sector, entrepreneurs and labour unions, which also have responsibilities for a better functioning of the economy. So I see the central banks doing their job, on the one hand, with all the monetary tools they have acquired, and on the other hand, being very eloquent in communicating with all the other partners. If they are not sufficiently eloquent and convincing - on structural reforms, on fiscal policies, on private sector responsibilities - they will become the only game in town! So it is very important that the central banks get this balance right.