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Interview with Mario Draghi, Governor of the Bank of Italy and Chairman of the Financial Stability Board

“We need a European economic government”.

Handelsblatt: The whole Europe is worrying about the Greek crisis. What can Greeks do to sort out its financial problems?

Draghi: I think the best and only thing they can do is to come out with a credible fiscal adjustment plan to be implemented promptly. The more delayed the commitments are, the less effective they are on reducing spreads on government bonds. The quicker they do it the better, and I should say they started doing. The Commission and the Ecb, and the IMF to some extent, were involved as well. They must have been persuaded by the fiscal plan. Of course we have now to monitor its timely implementation because that is as important as designing it. Greeks have clearly seen there is a political price to pay and that it is unavoidable.

Handelsblatt: Are you confident in the Greek plans?

Draghi: Yes, but I would like to see its implementation.

Handelsblatt: Do we need stricter rules?

Draghi: Yes, we obviously need stricter rules. It too early to specify which ones, but the Greek crisis has shown that this construction has to be made more resilient.

Handelsblatt: What have you in mind?

Draghi: My opinion does not differ from the one expressed by your Minister of Finance, Mr. Wolfgang Schäuble. The first thing to bear in mind is that we were able to create a pillar of stability with the euro and we have to do everything to preserve it. No matter what many critics say, we had low inflation, low financing costs and we have been amazingly protected by the world turbulence because we had the euro. So we have to preserve the stability and the credibility of this concept. the Greek crisis has shown that this construction has to be made more resilient because it has shown potential cracks.

Handelsblatt: What can be done to make the euro stronger?

Draghi: First of all we should ask ourselves why are markets so nervous, not only with Greece but also with other countries. Incidentally the spreads have gone up also on AAA rated countries, not only on the A or AA rated countries. Markets are nervous because financial market conditions have enormously worsened, within the euro and outside the euro-area. But the other reason for markets to be nervous is that they do not see clear on how we collectively will get out of the exit strategies. The first thing we have to do is to have a clear, well defined, well-timed exit strategy from the high budget deficits. This is on top of our list of priorities.

Handelsblatt: Which is the second priority?

Draghi: I think we have to extend the Stability and Growth Pact. So far, we have been able to have a monitoring mechanism and to some extent an enforcing mechanism of the balance sheet. We have to reinforce this concept and extend it to structural reforms. The reason why countries do not grow is because they have not undertaken structural reforms which facilitate growth.

Handelsblatt: Do you have anything specific in mind?

Draghi: For the people who have been part of the creation of the stability and growth pact this discussion goes back to the late nineties and it was suggested at that time by several people, myself included, that we should do more in making pension reforms, market reforms, competition reforms and so forth. These are the reforms that make you grow in the end. At that time, some of the countries objected that these things were so engrained in their history and social texture that they would not accept to have the same discipline that they could accept in the budgetary area.

Handelsblatt: What are the implications in the present situation?

Draghi: I think it is now the time to make one step further. At least for the countries that are in the euro we need some mechanism that basically induces greater cooperation among governments and greater discipline. Ultimately, price stability, budgetary discipline and economic growth are the three pillars of financial stability. This refers to the medium term but we have to start working now because this will not be done in a month.

Handelsblatt: What can be done in the short term?

Draghi: In the case of a fiscal crisis like the one in Greece, if we have a mechanism of identification and intervention that is clear, well-designed, markets will provide all the money that the countries want. What markets do not want is to be trapped in a confused muddled situation where they do not see clearly – a situation in which nobody would be ready to lend. If there is clarity and firmness of direction investors are there to lend the money. Only at the end of this, if we think we need some kind of emergency financial assistance like the one that Mr. Schäuble proposed, we can think about it.

Handelsblatt: Do you agree with Minister Schäuble?

Draghi: The Minister rightly makes a point there. Now we have pooled monetary policy so it is considerably complex for the IFM dictate discipline to some country without saying anything on the monetary policy. Still, this is the other “macro-lever” of the IMF.

Handelsblatt: Are you in favour of a European Monetary Fund?

Draghi: I think that if things are well done in laying out the monitoring and implementation mechanism probably you would not need a European monetary fund. We cannot think that the European fund would actually resolve the issue. I would not start from the financing of the crisis, but from the solution of the crisis. In the present market conditions, though, an emergency financing at rates higher than market rates, could only respond to temporary liquidity problems, but it would be wrong to make this mechanism the linchpin of our actions.

Handelsblatt: Do we need a new structure for the enforcement mechanism? If so, what kind of structure?

Draghi: Not so much a structure, but we need a concept very much along the way we had with the stability and growth pact, a concept to be endorsed by the governments

Handelsblatt: Another Pact?

Draghi: Yes, another Pact. In the euro area we need a stronger economic governance providing for more coordinated structural reforms and more discipline.

Handelsblatt: Going back to the EMF, do you think it might send the wrong incentives?

Draghi: This danger exists and we must do whatever we can to consider it just an emergency measure exclusively for liquidity purposes. Nobody wants to think about the Fund as a mechanism that could resolve the crisis. Countries must not rely on the availability of a fund where we can draw on when having difficulties. I don't think that Mr. Schäuble or anybody thinks this.

Handelsblatt: Would you recommend stricter rules for countries which do not respect the agreements?

Draghi: Yes, we need stricter rules providing for an economic and political cost higher than it is the case today for any deviation from the rules or for the use of financial means not coming from the market.

Handelsblatt: Because of the financial crisis, rating agencies have been highly criticised. Do you think the Ecb should provide for its own ratings, as some have suggested?

Draghi: No, I do not think that would be right. The creation of an European rating agency could represent a solution if we have no trust in the American rating agencies or in any other. But this task should still not be entrusted to a central bank.

Handelsblatt: Why have the experiences with credit rating agencies been so unsatisfying?

Draghi: Loopholes in regulations have allowed for conflicts of interest. One should wonder why the rating agencies did not see the big amount of dubious financial products being created between 2005 and 2008 and why they could not rate it properly. One of the answers is that the issuers were basically a few big investment banks. So, for some of these rating agencies it became clear that 90% of their business was done with these banks. This is exactly why they have been captured by the banks. Much has been done to change this, but there is still a lot to be done.

Handelsblatt: What are you thinking of?

Draghi: We have a project in the FSB now where we, as regulators, are looking for a way to reduce the importance of rating in regulation. We must look for alternatives and define other mechanisms.

Handelsblatt: But markets need ratings....

Draghi: Markets need rating. Investors want ratings. At the FSB we think there is the need for a better differentiation. One thing is a triple-A government bond, one other thing is a triple-A structured bond. It is always possible to have a structured bond in a way that it has a triple-A, even if the components are “junk. So we must have ratings from the agencies which allow investors to distinguish one triple-A from another triple-A.

Handelsblatt: When are we going to find a solution? Which are the further steps in the reform of financial regulation?

Draghi: One of the two most important projects the FSB now has is the capital and liquidity regulation, the reform of Basel 2. Its implementation is scheduled at the end of 2012.

Handelsblatt: Is it right to fear that Basel III might limit credit flows, prejudging economic recovery?

Draghi: First of all I hope that by then the recovery will be on its way. There is a risk but I think fears are exaggerated. Banks have done a lot already in raising capital. We should reach a globally accepted definition of capital. The Basel Committee and the FSB are working so that the timing chosen for the implementation of the new rules do not prejudice economic recovery.

Handelsblatt: Are you confident that we will have a globally coordinated regulation? Lately we have seen a lot of tension between the EU and the US.

Draghi: I think those tensions are being exaggerated. Many of the proposals now being publicly discussed, like the “Volcker rule” or a tax on banks in the US and the UK, have already been discussed by the FSB.

Handelsblatt: You have been criticised for having worked at Goldman Sachs, the US investment bank accused of having been involved in dubious transactions with Greece. What can you tell us about it?

Draghi: When I left the Italian Treasury, in 2001, we had no rules in Italy forbidding to take a position in an investment bank. Nevertheless, I went to Harvard and taught for six months there. Then I entered Goldman Sachs. Since the beginning I made it clear that having worked 10 years with governments and government officials, it would be very embarrassing to ask them to do business with Goldman. I therefore insisted to develop my own clients in the private sector. And that’s what happened. I did that for about 3-4 years.

Handelsblatt: Any country among your clients?

Draghi: No, I have never made any transaction with any government. The reason is simple: I was too busy doing corporate investment banking with private clients.

Handelsblatt: Have you ever been to Greece?

Draghi: I have never been to Greece for working reasons. Those transactions were done before my arrival at Goldman Sachs. There have been further transactions with Greece but I have never been

involved. I would also like to point out that I was not deputy CEO, because that position does not exist at Goldman Sachs.

Handelsblatt: When you think now about Goldman Sachs and Greece, do you think it was a good idea for Goldman to help Greece mask its budget?

Draghi: That's where the difference lies, the difference in purposes. One is debt management, the other one is debt concealment. That concealment is a very bad thing. If Greece had made a mess of their budget but not lied about the numbers, it would be much easier for them and for all of us.

Handelsblatt: Which are the qualities of a good ECB president? Talking about monetary policy, do you consider yourself an "hawk"?

Draghi: You should ask ECB observers if they think of me as a "dove". You must always keep in mind price stability and monetary policy credibility and their crucial importance for growth

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