

## Trichet: Technocrat and fighter

By David Marsh

Jean-Claude Trichet, the president of the European Central Bank, is a man who lives on the frontiers of poetry and rhetoric.

A man of Letters, a man of Arts, a man of History (all with dignified capital letters, as the French would have it), he could easily have ended up in a university declaiming the verses of Homer rather than at the helm of a monetary institution now engaged in a life-or-death struggle for the soul of the single currency.

Trichet is a technocrat, but he is a fighter. He is an ideologue driven by the force of ideas; and he will defend the euro to the end. Although he derides the notion of a theoretical clash of cultures between the Anglo-Americans and the continental Europeans, Trichet certainly believed in this juxtaposition of opposites nearly 20 years ago, when he was catapulted into the hot seat as the first independent governor of the Banque de France, called upon to defend the sanctity of the French franc against the depredations of the D-mark in the great currency battles of the early 1990s.

With slightly less than a year and a half before he retires in October 2011, Trichet now faces his sternest test. His greatest headache may turn out to stem not from the forces building up inexorably for an eventual rescheduling of Greek debt, but rather adverse movement of the dollar, which seems to be undergoing a seismic shift on the foreign exchanges as investors around the world reassesses the main components of the dollar-euro duopoly.

Many emerging market official institutions made a big investment in the euro when the single currency was born 10 years ago, and have been extending their currency diversification strategy ever since. Now, with the euro labelled a weak currency by the people who should know best, the Germans, we may see euro holdings being diversified yet again -- back into the dollar.

Foreign exchange strategists know that seminal shifts in currency values often work in long cycles. The dollar has now chalked up six successive months of gains against the euro. The move looks likely to be extended a while longer yet. Trichet's earlier good fortune was to take over at the ECB in November 2003. This was at a time when a strong dollar that had plagued his predecessor, Wim Duisenberg, had started to give way to what turned out to be a long period of relative dollar weakness. This allowed Trichet to escape from the psychological pressure that had preoccupied Duisenberg, take control of monetary policy and preside over a period of moderate increases in interest rates in an atmosphere of Bundesbank-like rigor.

The long secular period of euro strength however came to an end in summer 2008. Trichet's final period in office now looks likely to be overshadowed by a bout of euro weakness that will make monetary policy a great deal more difficult than he has experienced before.

The challenges will be made all the more intense by the splits opening up in the euro bloc which essentially pit Germany against most other members. The threat is far broader than the important, yet essentially technical, issues of whether the European Central Bank should purchase European government bonds or relax its criteria for lending to commercial banks -- issues that have hogged the headlines for weeks.

Axel Weber, the Bundesbank president, has risked isolation on the 22-member ECB Council by publicly criticizing the May 10 government bond decision, a day after it was made in an emergency telephone conference as an adjunct to the 750 billion euro IMF/European bailout for weaker states.

Juergen Stark, the ECB board member who looks likely to inherit Weber's present job if the latter takes over as ECB chief from Trichet in October 2011, has supported the principle of Weber's action, but has taken a slightly more diplomatic stance in public.

But Karl Otto Pöhl, the former Bundesbank president, still an authoritative figure on the German financial scene, has rubbed salt into the wounds by saying that European governments and the ECB have fundamentally changed the basis for monetary union. He foresees further euro weakness, "because we [the Germans] are effectively giving guarantees for a range of weaker currencies that should never have been allowed to enter the euro." Pöhl charged that Europe should have announced a Greek debt restructuring six months ago. The bailout had now been decided, he added witheringly, to protect French and German banks to and to rescue "rich Greeks."

In the old days when the Bundesbank held sway over Europe, even the most rebellious Bundesbank Council member would have hesitated before publicly disavowing a monetary policy decision taken by majority vote. Yet, perhaps goaded by Trichet's evident desire to railroad through the government bond decision without sufficient discussion, Weber did not shrink from broadcasting his judgment of "considerable risks to stability."

The ECB has largely declined to discuss the impact of internal payments imbalances on the euro's problems, hiding behind the comfortable but irrelevant statistical truth that the euro area has a small overall current account surplus. However, in a speech in Rabat on May 28, Lorenzo Bini Smaghi, a member of the ECB's six-person board, made a rare admission that one of the reasons behind recent unrest was that "during its first 11 years, the euro area economy experienced a strong convergence in real economic activity together with a significant divergence in nominal cost and price developments, which gave rise to large payments imbalances within the Union."

Bini Smaghi impetuously took a sideswipe at Germany by criticizing how "in one large euro area country it was thought that public support for swift action [on a liquidity package] could be achieved only by dramatizing the situation, for instance, by telling the public that 'the euro is in danger' or by considering the possibility of expelling a country from the euro area."

In remarks clearly aimed at Merkel's recent emotional parliamentary speeches, Bini Smaghi said, "Such words are like fanning the flames.... the cost of the support package could only increase following such dramatic declarations."

He added: "The media, of course, have a field day reporting on such apparently inconsistent activities." Bini Smaghi's remarks of course were immediately seized upon by The Wall Street Journal as one more sign of euro-schism.