

Financial Times: Let's talk about the pace of financial reform, regulation. Why were the reforms as proposed under Basel III watered down?

Jean-Claude Trichet: I do not want to prejudge in any respect the upcoming meeting we have on this issue. I will only say that we need the same rules at the global level, a level playing field globally. And now at the global level we have the full participation of the emerging world, which, by the way, is one of the major structural transformations of global governance over the last three years. The G20 has substituted for the G7 as the premier forum for international economic cooperation. We have also profoundly transformed the global governance of central bank cooperation with full ownership by the central banks from emerging economies. That is something which I would call a 'silent revolution' in global governance.

One thing is certain - and I'm sure that all my colleagues share this view: We cannot again in the next years be put in a situation where the financial sector is about to collapse in the advanced economies and at the global level, or a situation in which it is necessary on both sides of the Atlantic, for taxpayers to put approximately 27 per cent of GDP on the table to stabilise the system and avoid a major global depression. We cannot do that twice. The people in our democracies would not accept that.

This is not, of course, to say that the 27 per cent of GDP was spent or lost, but that was the level of additional taxpayer risk that had to be put on the table, on both sides of the Atlantic.

Financial Times: You said, when we saw you in December 2008, that the airbags had been taken out of the financial system. This was just after Lehman collapsed. Do you think the airbags are now being put back in the system?

Jean-Claude Trichet: I would say it remains a good metaphor for what we are trying to work out, by consensus, among the G20 countries.

Financial Times: You've done a number of jobs which have been at the heart of the construction of the euro, and you've just been through the worst financial crisis in 60 years, where as you say, the financial system almost collapsed. What do you think are the qualities that a central banker needs today?

Jean-Claude Trichet: It seems to me that in periods that are marked by turbulence, unexpected events, a high level of uncertainty - and I'm afraid that a large part of the reasons for this are structural - central banks are the institutions that have a mandate for price stability, a sense of direction, a stake in overall stability in a medium and long term perspective. They are independent. They can be precisely those anchors of stability that I would say an economy and society need even more in times that are very demanding and very turbulent. That would perhaps be the best way to sum up the responsibility of central banks.

Financial Times: Are you concerned, in the wake of this crisis that there's been any weakening of support for the concept of central bank independence?

Jean-Claude Trichet: If I take a global perspective, it seems to me that one of the lessons that has been drawn from the crisis, or taken into account, is that the concept of independent central banks having a stake in stability, and a medium to long term perspective, has been recognised as the right concept.

Financial Times: Very soon, you're going to be chairing the new European Systemic Risk Board, which will take an EU view, so you will actually be including the United Kingdom in your work, your daily outlook, I suppose. To what extent do you think the UK should fear or embrace this process?

Jean-Claude Trichet: I expect that the cooperation with the UK authorities, particularly with the Bank of England, and for me personally with its governor, will be extraordinarily close. It's a job at the level of the EU 27 where you will need a very close cooperation between Mervyn King and all of us, and I expect that this is the way we are all looking at it.

http://www.ft.com/cms/s/0/c5fcc1e4-d643-11df-81f0-00144feabdc0,dwp_uuid=0e8db19e-d52b-11df-ad3a-00144feabdc0.html#axzz1KW9ferd

Saving the euro: Bound towards a tense future

By Tony Barber

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“Europe will be forged in crises, and will be the sum of the solutions adopted for those crises.”

Penned more than three decades ago, Jean Monnet’s insight on the European Union, which the French statesman was so instrumental in founding, has certainly stood the test of time.

Today, with the crisis of April and May still reverberating around the eurozone, the future of Europe’s economic and monetary union will be shaped by the extent to which policymakers embrace, or shrink from, closer integration in response. Few know this better than Dominique Strauss-Kahn, the International Monetary Fund’s managing director and former French finance minister, who laid out the alternatives in a speech last month in Brussels.

“My main message is that the centre must be given a greater role in national fiscal policies if Emu is to become a more effective, and more resilient, monetary union,” he said. “But of course I recognise that such a delegation of fiscal powers to the centre could meet political resistance in some countries, where the appetite for ceding further control to Brussels is already weak.”

Such waning appetite is found in unexpected places. In few countries is resistance to setting up a US-style central fiscal authority stronger than in Germany. The experience of leading, and underwriting, this year’s eurozone rescue embittered public opinion. It also reinforced Berlin’s insistence on stricter rules, backed if necessary by financial penalties, political sanctions such as a suspension of voting rights and even – the ultimate “nuclear option” – expulsion.

Some countries, such as Finland and the Netherlands, sympathise; others – mainly in central and southern Europe – do not. “Is it enough simply to say we’ll have more sanctions? To my mind, no,” says one eurozone finance minister. “Then there are very difficult issues, such as an orderly exit from the eurozone, which to my mind is a very misguided idea. It’s more about Germany trying to show how serious we all must be about fiscal consolidation. There’s a huge legal question mark over whether it could be done.”

Reconciling these clashing views on economic governance is a task today’s eurozone leaders can no longer postpone. The need to maintain credibility in the eyes of the US, China and other global partners, not to mention financial markets, demands action. However, politicians, central bankers and EU strategists say it is far-fetched to speculate that the euro’s existence is at risk. As Alistair Darling, former UK chancellor, puts it: “The political penalty, never mind the economic penalty, would be so immense that I can’t see the big countries abandoning it.”

The real question is how to equip the eurozone with the revised rules and reinforced institutions needed to prevent upheavals and provide a long-term framework for prosperity and financial stability. A task force led by Herman Van Rompuy, the bloc’s full-time president, is leading the effort. The European Central Bank as well as the European Commission have also provided significant input.

Mr Van Rompuy's task force is due to present its recommendations in late October but it is questionable how ambitious they will be. In May it appeared there was general agreement on the need to strengthen budgetary discipline; address divergences in competitiveness and macroeconomic imbalances; and establish a permanent crisis management and resolution regime. But for some the launch in August of the eurozone's three-year, €440bn European Financial Stability Facility to help countries in severe difficulties has diminished the sense of urgency about setting up longer-term arrangements for handling Greek-style emergencies.

This is not true in Berlin, where policymakers want to replace the EFSF with a mechanism that would oblige private creditors to bear some costs of a sovereign debt rescheduling. But with the EFSF not due to wrap up its work until June 2013, a permanent solution remains some way off – and much may happen to throw the eurozone off course, including even a Greek debt restructuring.

Doubts also persist about the effectiveness of the latest proposals, expected to take effect next year, for enhancing budgetary surveillance. They start with earlier submission of national budgets for Commission and peer review. Policy recommendations would follow, aimed at ensuring each government adheres to eurozone rules and overall European economic objectives. Governments would adjust their budgets accordingly. However, France and Germany say the system must avoid "encroaching on the budgetary prerogatives of national parliaments" – a potentially crippling reservation.

As during the fierce arguments in the 1990s over the stability and growth pact, the eurozone's fiscal rule book, today's disputes centre on the question of whether governments will ever submit to rules that foresee automatic punishments – or even "quasi-automatic sanctions", as the ECB proposes – for fiscal indiscipline. The lesson of the first 11 years of monetary union, most European politicians concede, is that peer pressure is an insufficient deterrent. "The problem is that you have potential sinners sitting in judgment on current sinners. That is why we must have more automaticity," says Jörg Asmussen, state secretary at Germany's finance ministry.

But sanctions such as a suspension of voting rights appear impermissible under the EU's Lisbon treaty – and after the arduous experience of negotiating and approving that charter, few outside Germany are eager for prompt reform. "It would be a recipe for a series of political dramas that would certainly not be desirable," says one high-level policymaker who helped construct May's eurozone rescue plan.

Largely for this reason, France and Germany have proposed a compromise under which a majority of eurozone countries could make a "political agreement" to exclude offending member states from specific votes. In February 2000 EU countries froze diplomatic relations with Austria after the far-right Freedom party joined the ruling coalition. Seven months later, the EU concluded that the sanctions had been politically counterproductive and lifted them.

Another weakness is "the 'Brussels-talking-to-Brussels' syndrome" identified by Alessandro Leipold, a former senior IMF economist. The annual economic guidelines (known as stability and convergence programmes) that every EU government must send to Brussels may mean something to the Commission and other governments, but they "are virtually unknown in member states, are not part of the national public debate, and are ultimately removed from day-to-day policymaking".

Similar criticisms are levelled at the EU's latest 10-year programme – Europe 2020 – for boosting growth, jobs and competitiveness. This sets out targets on employment, research and development, energy use, education and poverty reduction. But Fredrik Erixon, of the European Centre for International Political Economy think-tank, says: "The belief that one central strategy can fit the entire European Union –

27 economies with different reform needs and priorities – borders on a central planning mentality that can only do damage to economic growth.”

Whether at EU or national level or both, however, action is essential. Relative economic and geopolitical decline appears a distinct likelihood unless Europe improves growth rates. The region’s real domestic product growth averaged 2.25 per cent a year between 1981 and 1993; slipped to 2 per cent from 1993 to 2003; and now stands at a meagre 1 per cent.

Small wonder that business leaders emphasise Europe’s need for more open markets, more entrepreneurial dynamism, better education systems and an overhaul of public sectors. “Sometimes I have the sense that the future is in the Asia-Pacific region, and you have quick growth in the US and Canada, but here in Europe we are sort of standing still, not really willing to accept the fast changes taking place in the world,” says German industrialist Jürgen Thumann, president of the BusinessEurope employers’ lobby. He bemoans the lack of a US-style risk-taking culture. “There are some sectors where Europe is not participating at all, such as information technology and pharmaceuticals. There is no European iPhone, is there?”

European politicians say that the western world’s financial crisis, originating in high-risk US mortgage loans and morphing into a European sovereign debt emergency, is accelerating a redistribution of global economic weight from west to east and north to south. “I’m not sure that Europe will ever have the exactly the same voice that it had five or six years ago. The world is changing massively under our eyes,” says Christine Lagarde, France’s finance minister. She adds hopefully: “But the wheel turns.”

Miguel Angel Moratinos, Spain’s foreign minister, dismisses the threat of irrelevance. “I don’t want Europe to be a museum. I want my people to be first in high technology, first in higher education. Surely we can do that, if we introduce some reforms and combine our political willpower?” he asks. “Everybody now considers that we’re in decline. But I’m telling you that the contrary is true, because we’re taking action at the right moment to be ready to maintain our capacity, influence and competitiveness in the 21st century.”

In its search for economic rejuvenation, Europe is not short of ideas. Expanding the single market must be the starting point, says Laurence Parisot, head of French employers’ federation Medef. “The average British, French or German guy doesn’t really understand the single market but businesspeople do understand.” Without the single market, Europe would have been much harder hit by the crisis, she adds.

“American companies grow fast because their first home is their domestic market, which is so huge. It’s the same for China. So Europe absolutely needs to keep and develop its single market. Among intellectuals and some politicians it might be different,” Ms Parisot concedes. “We might be in danger of a return of nationalism and protectionism. But leaders of the French business community are not among those who like to criticise Europe.”

Extending the single market into areas such as services and the digital economy is a cause dear to many policymakers, from France’s Jean-Claude Trichet, ECB president, to Italy’s Mario Monti, former EU internal market and competition commissioner, who presented a report on the subject in May. However, the single market binds together not just the eurozone but the entire 27-nation EU. For each group of nations, debate over the single market’s extension raises the same hard choice – whether to go for closer integration.

With Croatia, several other south-eastern European countries and possibly Iceland likely to expand the bloc’s membership to more than 30 over the next decade, EU institutions will require yet another redesign. In principle, the purpose should be to drive Europe’s efforts to act and speak with one voice, with a view to maximising its influence in a world marked by rivalry as much as co-operation among seven or eight great

powers. But politicians and high-level EU officials caution that it would be rash to assume that the next wave of expansion will bring closer integration. If anything, the financial crisis has exposed and accelerated a trend towards the partial renationalisation of decision-making powers.

One recently retired Brussels-based policymaker, witness to every EU crisis since the late 1980s, says that the Lisbon treaty, which required eight years of negotiations before it came into force last December, is anything but a leap towards ever closer union. The lesson, he says, is that Europe may have passed the high-water mark of post-1945 integration.

The EU isn't stabilised. It's fragile," he says. "We haven't gone beyond the point of no return. Of course, it won't disappear. But decline is possible."

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European monetary policy

Trigger-happy

The European Central Bank is planning to raise rates too soon

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THE formal decision has yet to be made. But the surprise now will be if the European Central Bank (ECB) does not raise its policy rate at its next meeting on April 7th. After the ECB's governing council met in early March, Jean-Claude Trichet, the bank's president, could scarcely have semaphored an imminent rate rise more clearly. Despite the tsunami in Japan and the conflict in Libya there has been no hint of second thoughts among the 23 members of the council. A rise, expected to push the rate up from an historic low of 1% to 1.25%, would put the ECB well ahead of the Federal Reserve and probably beat the Bank of England (whose rate-setters meet on the same day) to the draw as well.

The increase may be small but it would mark the turn in the interest-rate cycle. And the case for early tightening looks flimsy. True, euro-wide inflation has risen in recent months above the ECB's target of "below but close to 2%". But the overshoot, to 2.6% in March, has been primarily driven by higher energy costs, reflecting the jump in world oil prices. Measures of "core" inflation, which exclude more volatile things like energy and food, have remained at around 1%.

Mr Trichet argues that monetary tightening is needed to ward off "second-round" effects of rising commodity prices, whereby wages and prices respond to an initial upward jolt by spiralling higher. Yet wages are placid in the euro area, rising by just 1.4% in the year to the final quarter of 2010. Inflation expectations, whether measured through surveys or from the gap between conventional and inflation-linked bonds, show no sign of taking flight.

That is hardly surprising. The German economy sprinted ahead last year, growing by 3.6%, but euro-wide GDP rose by only 1.7%. Even though the recession was the most wrenching of four downturns in euro-area countries since the 1970s, the recovery has been among the weakest. That has left the economy operating 3.5% below its potential, according to the OECD. This hefty spare capacity should bear down on inflationary pressures.

Business surveys point to rapid growth in early 2011, but this follows a weak patch in the second half of last year in which GDP rose by only 0.3% a quarter. Moreover, there are some signs of a loss of momentum—hardly surprising as higher oil prices fuel worries about the global economy. A composite measure of confidence among businesses and consumers in the euro area compiled by the European Commission, which tends to track GDP growth, has come off a recent high (see chart).

The ECB uses a "monetary cross-check" when setting interest rates. But even the most neurotic monetarist would find it hard to get worked up about the latest figures, which show broad-money supply rising by just 2% in the year to February and lending growth still muted by historical standards. As for the argument that a rise in rates is overdue because the current stance is exceptionally loose, the economy has taken an exceptional blow.

It is hard to avoid the conclusion that there is more to the ECB's eagerness to raise rates than a straightforward appraisal of economic prospects. The central bank is painfully aware that it has been dragged into fiscally muddy waters by buying government bonds from debt-afflicted countries like Greece, Ireland and Portugal. That makes the ECB all the keener to reaffirm its credentials as a doughty inflation-fighter by brooking no delay in raising rates now that its target is being exceeded.

Internal politics are also at play. Mr Trichet is due to step down at the end of October. A succession battle is under way in which the views of Angela Merkel, the German chancellor, will be crucial. That makes it sensible for candidates on the governing council like Italy's Mario Draghi to take a Germanic line on anything that smacks of inflationary excesses.

Whatever the precise rationale, the ECB move will exacerbate the emerging divide between core euro-zone members with sturdier public finances and peripheral economies that have run up too much debt. In Germany, a small rise in interest rates will barely scratch the economy. In Spain, whose prospects are crucial if the debt crisis is to be contained (see [article](#)), it will hurt households with mortgages, most of which are variable-rate. And in Greece and Ireland, as they push through austerity programmes, it will feel as if Pelion is being piled on Ossa.

<http://www.nytimes.com/2011/04/15/business/15norris.html?emc=eta1&pagewanted=print>

April 14, 2011

Resentment Is Rising In Euro Zone

By FLOYD NORRIS

The real Golden Rule, it has been said, goes like this: He who has the gold, rules.

They are trying that in Europe these days. Germany has the gold and it sees no reason other countries should not do as the Germans say.

The prescription for the so-called peripheral countries of the euro zone is simple: Enact the reforms Germany thinks are needed. Cut spending. Take wage and benefit cuts. Reform your tax system to produce more revenue, which may mean raising tax rates or just forcing people to comply with existing laws. Require people to work longer and retire later. Follow austerity as far as the eye can see.

Do all those things, and the rest of Europe will provide grudging assistance.

To some with the gold, this is simply a morality play. "They had their fun," a former European central banker told me a few weeks ago, speaking of the peripheral countries. A different official used the same words last week.

In each conversation, I was reminded that the creation of the euro led to interest rates declining sharply in peripheral countries and to economic booms. Those countries lost competitiveness in export markets because they tolerated inflation and did not hold the line on wages. Now, those who partied deserve the pain of hangovers.

It is probable that countries will follow the German prescription. From the perspective of a national government, the alternatives may seem worse.

But democracy can be messy. Will populations go along?

There are a couple of hints that they may not. One comes from Portugal, the other from Iceland, which is not in the euro zone but is in a mess.

In Portugal, the government is seeking a European bailout but seems not to have the authority to agree to one. The opposition has forced elections, which it is widely expected to win, but it won't say what it will do. In the meantime, the situation is in limbo, which may force Europe to help out before it can get any enforceable promises of reform.

In Iceland, the issue is whether the population should pay for the sins of its banks. The banks had big operations in Britain and the Netherlands, and when they collapsed, the British and Dutch governments made good on the deposits. The government of Iceland promised to pay the money back.

The amount is \$5.8 billion, 46 percent of Iceland's gross domestic product in 2010. A similar bill sent to the United States would call for a payment of \$6.8 *trillion*.

I'm not really clear on why Iceland should be responsible. No doubt its bank regulators performed abysmally. But where were the British and Dutch regulators when the banks were taking in deposits from their citizens?

For reasons good or bad, Iceland's citizens appear to be reluctant to pick up the bill. Nearly 60 percent of voters turned down the agreement backed by their government, which called for Iceland to pay the money over 30 years beginning in 2016. Britain and the Netherlands now plan to ask something called the European Free Trade Association Surveillance Authority to order Iceland to pay.

Both the Irish and Greek governments embraced the required austerity to get European help, and electorates threw out those deemed responsible for the mess. But there are signs that the new governments are losing support, and there is no indication of early economic recovery. Portugal's government fell precisely because the opposition would not sign off on the required austerity.

What would be happening without the euro?

Neither the boom nor the bust would have been as great in the peripheral countries. But when the bust did arrive, the currencies of those countries would have plunged in value. That would have made them poorer and unable to afford the imports they once bought. Prices, measured in local currencies, would have risen. In Ireland, where a property boom collapsed, that would have ameliorated the problems faced by homeowners who owe far more than their homes are worth. Exports would have gained competitiveness, stimulating some growth.

But of course there are no separate currencies. There is no provision for allowing a country to leave the euro zone. That idea was not even considered when it turned out that Greece had lied its way into the club. In retrospect, everyone might be better off if it had been kicked out.

It is hard to see how the euro zone can be undone, but it is even harder to see how it will prosper. The reforms being pushed on the peripheral countries seem to call for slow growth, at best, for a very long time. Unfortunately, bad economies do not produce extra tax receipts, which are needed for fiscal improvement. Perhaps starving those economies will eventually make them leaner and meaner. Perhaps it will kill them first.

When the euro was created, some hoped, and others feared, that the Continent would move closer to a unified government. Some euro backers said countries would more closely align their fiscal policies with those of Germany to avoid a crisis. They were right about the need, but wrong about the action. Instead, the boom enabled countries to put off reforms.

In a speech in New York this week, Andreas Dombret, a member of the executive board of the Bundesbank, Germany's central bank, said national governments in the euro zone remained "in charge of sound fiscal and economic policies," but there was now "a strict framework that exerts pressure toward discipline in order to ensure that every country acts in a way that is consistent with the interest of having a stable common currency."

In other words, elected governments can make decisions, so long as they are good ones.

Last week the European Central Bank raised interest rates, a move that made a lot more sense for the German economy than for most of the others in the euro zone.

Mr. Dombret praised that decision. "It is essential that inflation expectations remain anchored," he explained, adding, "It goes without saying that we did not complain about the headline of the Financial Times article on the rate hike. The article was entitled 'E.C.B. becomes Bundesbank.' "

There is a risk over time that democracy will lead Europe to splinter. Germans are angry about having to pick up the bill for bailouts of other countries, which is one reason the German government felt called upon to insist on that "strict framework." Others are resentful of the enforced austerity.

If European economies somehow grow enough, those resentments may not matter much. But if not, voter anger may intensify and demand that something change. Maybe the Germans will want to cut off their prodigal neighbors. Maybe the neighbors will decide they would be better off with a new currency and without overbearing demands for austerity that prevent recovery. In either case, populist politicians demanding the demise of the euro might win elections. The fact that European law does not allow for such a possibility would make the situation messier, but in the end voters would have their way.

It would be good if the debate in Europe focused less on justice — Is it fair to ask Germans to bail out profligate Greeks? Is it fair for Europe to force wage cuts on citizens who were not responsible for the financial excesses of their countries' banks? — and more on how to quickly get devastated economies growing again.

<http://www.nytimes.com/2011/04/27/business/global/27draghi.html?emc=eta1&pagewanted=print>

April 26, 2011

Sarkozy Backs Italian Official to Lead Central Bank

By LIZ ALDERMAN and JUDY DEMPSEY

PARIS — The high-level politicking over who will be the next president of the European Central Bank moved closer to resolution on Tuesday. But it is not yet a done deal.

President Nicolas Sarkozy of France said he would support a respected Italian monetary official, Mario Draghi, to succeed Jean-Claude Trichet when he steps down later this year. Mr. Sarkozy made his unexpected announcement at a joint news conference in Rome with Prime Minister Silvio Berlusconi of Italy.

But in the political brinksmanship common with appointments at top European institutions, Mr. Sarkozy's move may have made it harder for Chancellor Angela Merkel of Germany to endorse Mr. Draghi.

Germany's finance ministry, led by Wolfgang Schäuble, has recently warmed to the idea that Mr. Draghi is the best-qualified person for the job. But Mrs. Merkel faces a delicate task in preparing German voters for the prospect of an Italian's having responsibility for keeping European inflation under control and managing the fate of the euro.

Mr. Sarkozy, though, expressed no such reservations.

"France will be very happy to support an Italian for the presidency of the E.C.B.," he said. "I know Draghi well. We support him not because he is an Italian but because he is a man of quality."

Mr. Sarkozy made the announcement without consulting Mrs. Merkel, according to a German official who insisted on anonymity.

The European Central Bank's role in fighting inflation is a major preoccupation for Germany, and Mrs. Merkel retains an effective veto over the appointment, which is scheduled to be decided at a summit in June.

Mrs. Merkel had been hoping that an inflation-fighting German, or a banker from a North European country, would take the helm from Mr. Trichet, who is retiring in October. But her preferred candidate, Axel A. Weber, the former president of the German central bank, took himself out of the running earlier this year. Mr. Weber resigned from the Bundesbank in February.

Mr. Weber's exit pushed Mr. Draghi's candidacy to the forefront, despite widespread perceptions, particularly in Germany, that people from Mediterranean countries are not as prudent and responsible with money as those from northern nations.

Despite that stereotype, in the corridors of finance Mr. Draghi, governor of the Italian Central Bank, is widely respected as an experienced economic policy maker with sterling credentials and a knack for navigating turbulent political waters.

But Mr. Sarkozy's announcement, by appearing to pre-empt Mrs. Merkel, could complicate the process of selecting the next central bank president.

Mr. Sarkozy's remarks were all the more surprising because both he and Mrs. Merkel have sought to forge a closer relationship to keep the euro from unraveling amid the debt crisis.

They have also worked to overcome differences in their approaches to the central bank. Germany wants to keep the bank free from politics, while France, according to German officials, is more interested in influencing it.

It is not the first time Mr. Sarkozy has bewildered a crucial European partner by announcing policy without giving advance notice. But French officials insisted that they had been encouraged to support Mr. Draghi after Mr. Schäuble appeared to endorse him; they expect Mrs. Merkel to ultimately support him as well.

In return, France expects Germany to back a Frenchman for the seat that Mr. Draghi would vacate on the bank board, said senior French officials who spoke anonymously because of the political sensitivity of the matter.

Mr. Draghi has a reputation as a consensus builder — an important skill when running a central bank. Mr. Weber dropped out of the running in part because he was out of step with other members of the bank's policy-making committee.

Mr. Draghi, serious and direct, is also acutely sensitive to Germany's preoccupation with fighting the specter of inflation, and has spent the last few months underscoring his inflation-fighting credentials. In a rare interview in February, he said monetary policy should "first and foremost be geared toward price stability."

The central bank recently raised interest rates by a quarter percentage point, a move Mr. Draghi supported. Analysts expect the bank to lift rates perhaps twice more this year.

That policy has come under fire from some experts who warn that higher rates will choke off the faltering recovery in some countries. But Mr. Draghi's firm position on inflation has helped endear him to Mr. Schäuble, the German finance minister. He sees Mr. Draghi as someone who can guide a strict fiscal and monetary policy while keeping meddling politicians at bay, according to a German finance official, who spoke on condition of anonymity because he is not authorized to speak on the record.

Mr. Schäuble also holds the view that choosing a central banker from a southern European country would send a good signal to its troubled neighbors, the official said, because it might show that the politics and economics of the 17-member euro zone are not driven by northern countries alone.

If Mr. Draghi got the job, he would have to navigate the tricky financial and political imperatives of bailouts for the most stricken European countries. He would also have to weigh how much support the central bank can and will continue to give to troubled banks in countries like Ireland and Spain.

Mr. Draghi seems to have managed to overcome reservations about his role as a managing director at Goldman Sachs from 2002 to 2005. The investment bank was the lead manager for a 2001 derivatives transaction that allowed Greece to dress up its books in a way that brought it into the euro club, but Mr. Draghi has made clear that he was not directly involved.

On another monetary policy issue, Mr. Draghi has discreetly voiced concern about the central bank's continuing intervention in markets for European government bonds. He emphasized that intervention was justified only to make sure that the bank maintained its influence over interest rates, and not as a form of economic stimulus or stealth financing for overindebted governments.

Judy Dempsey reported from Berlin and Liz Alderman from Paris. Katrin Bennhold contributed.