European Central Bank: Press conference – introductory statement

Introductory statement by Mr Willem F Duisenberg, President of the European Central Bank and Mr Christian Noyer, Vice-President of the European Central Bank, at the press conference, held in Frankfurt am Main, 30 August 2001.

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Ladies and gentlemen, I am here to report on the outcome of today's meeting of the Governing Council of the ECB, which was also attended by Mr. Reynders, President of the EU Council, and Mr. Solbes from the European Commission.

Following its regular examination of monetary and economic developments and analysis of their implications for the maintenance of price stability in the euro area, the Governing Council decided to lower the key ECB interest rates by 25 basis points. The Governing Council considers that the available evidence points to an improvement in the outlook for price developments. This is particularly apparent from the information under the second pillar of the ECB's monetary policy strategy, while that related to the first pillar remains consistent with a favourable outlook for price stability in the medium term.

Let me elaborate somewhat on the assessment provided under the two pillars of the monetary policy strategy of the ECB.

With regard to the first pillar, the three-month average of the annual growth rates of M3 was 5.9% in the period from May to July 2001. However, this figure needs to be corrected for holdings of money market paper and short-term debt securities by non-residents of the euro area, which, according to preliminary estimates, have contributed around three-quarters of a percentage point to annual M3 growth.

The increase in the rate of growth of M3 over the past few months must be interpreted carefully. It reflects the relatively flat yield curve and the recent weakness in stock markets, both of which made the holding of short-term deposits and marketable paper included in M3 attractive. As it also reflects the fact that consumers needed a higher level of transaction balances to finance the past rise in energy and food prices, recent increases in M3 growth may be transitory and, hence, do not necessarily have implications for price stability in the medium term. In addition, the annual rate of growth of loans to the private sector, although still high, has continued to decline over recent months.

Regarding the second pillar, there are clear signals of lower inflationary pressures from the demand side. Recent data on economic activity indicate that real GDP growth in 2001 will most likely be lower than was expected a few months ago. This is due in part to external demand, which has remained weak and below expectations, owing to slow growth in economic activity in the United States and persistent economic weakness in Japan, which have spilled over to other regions of the world. In addition, consumption growth in the euro area has been dampened by losses in real disposable income related to past increases in consumer prices. All these factors also had a negative impact on investment.

This notwithstanding, over time, the expected decline in consumer price inflation, to which the strengthening of the exchange rate has contributed, should support the growth of domestic demand. Further positive effects on euro area economic growth should stem from the full impact of tax reductions in several euro area countries and from the fact that financing conditions in the euro area are favourable.

A concern with regard to the outlook for price stability in the coming years has been the possible emergence of second-round effects, via wages, of past increases in consumer price inflation. The information available shows that wage moderation prevailed in the first quarter of 2001. It is essential that this trend continues and, at the current juncture, two factors support the view that this should indeed be the case. First, the slowdown in economic activity which I just mentioned may contribute to containing inflationary pressure stemming from the labour market. Second, there are encouraging signs, such as those coming from data on consumer and producer prices, which confirm that the increase in consumer price inflation was temporary and that, in the absence of further unfavourable shocks, it is likely that price stability will be restored in the not too distant future. The downward movement in import prices which has gradually been taking place over the past few months should support this process. The falling trend in consumer price inflation will contribute to containing inflation expectations of economic agents, thereby influencing price and wage-setting behaviour. This view is confirmed by bond yields, which indicate that financial markets expect inflation developments to be well in line with price stability in the medium term.

Overall, as several indicators are pointing to an abatement of inflationary pressures, the new level of interest rates is compatible with the maintenance of price stability over the medium term, which, in turn, is essential to create a favourable environment for sustainable economic growth.

At this juncture, I should like to express concern about the impact that slower growth may have on the determination of the governments of some countries to adhere strictly to the Stability and Growth Pact in the context of their existing stability programmes. Under the present circumstances, the automatic stabilisers should only be allowed to work fully in those countries whose budget positions are close to balance or in surplus. Let me emphasise that a medium-term perspective is essential for the conduct of fiscal policies in all euro area countries. Short-term discretionary measures aimed at strengthening domestic demand risk having an unwelcome impact on the economy, not least on account of time lags. In addition, if such measures are not consistent with the Pact, they may undermine the credibility of the consolidation process.

In their efforts to set the conditions for further expanding the production potential of the euro area, governments should also give more impetus to the implementation of structural reforms. Selective fiscal reforms, including those related to pension reforms, should provide the correct incentives to economic agents. Labour and product market reforms will be beneficial to employment growth in the euro area and improve the resilience of the euro area economy to adverse shocks in the future.

Finally, I should like to draw your attention to a press release that was issued today on the ECB Decision on the denominations, specifications, reproduction, exchange and withdrawal of euro banknotes.