European Central Bank: Press conference - introductory statement

Introductory statement by Mr Willem F Duisenberg, President of the European Central Bank and Mr Lucas Papademos, Vice-President of the European Central Bank, at the press conference held in Frankfurt, 6 February 2003.

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Ladies and gentlemen, the Vice-President and I will report on the outcome of today's meeting of the Governing Council of the ECB.

We have reviewed **monetary, financial and economic developments** and have incorporated new information into our assessment. Overall, the current monetary policy stance remains appropriate to preserve a favourable outlook for price stability in the medium term. Consequently, we have kept our key interest rates unchanged. Their low level should help counterbalance the negative effects on economic activity that currently stem from the high degree of worldwide uncertainty and should, thereby, contribute to a sustainable economic recovery in the course of 2003. For the time being, we still assume that the high degree of uncertainty will decline in the course of this year. However, at this juncture it is very difficult, if not impossible, to form a conclusive judgement on the impact of geopolitical developments on the world economy in general, and the euro area in particular.

Turning to the analysis under the **first pillar** of our monetary policy strategy, the three-month average of the annual growth rates of M3 declined to 6.9% in the period from October to December 2002, from 7.1% in the period from September to November 2002. The continued strong monetary growth reflects an ongoing pronounced preference for liquidity in an environment of high financial, economic and geopolitical uncertainty. However, it also mirrors the low level of short-term and long-term interest rates in the euro area.

Although liquidity remains ample, it is unlikely at this stage that it will give rise to inflationary pressures, given the current economic environment and the expectation that some of the portfolio shifts will be reversed once the financial market uncertainty diminishes. This assessment is also supported by the continuing moderate growth of loans to the private sector.

As regards the information under the **second pillar**, economic activity in the euro area remained subdued around the turn of the year, as suggested by recently published data and survey information. These indications are broadly in line with previous expectations which suggest a gradual increase, starting in the second half of the year, in real GDP growth rates to levels close to potential. Whereas the appreciation of the euro over recent months may contribute to dampening export growth to some extent, the price competitiveness of euro area companies remains favourable in a medium-term perspective and export growth should benefit from the expected recovery of the world economy. Therefore, recent exchange rate movements should not fundamentally affect the main scenario for the economic outlook.

At the same time, several factors contributing to the general climate of uncertainty are still in place. In particular, investors remain risk averse against the background of ongoing geopolitical tension. Further turbulence in the oil markets could have a negative impact on economic activity throughout the world and, thereby, also on euro area employment. These concerns are also weighing on consumer confidence. Finally, the accumulated macroeconomic imbalances give rise to uncertainty about the strength of the recovery in other major economies. Taken together, there remain downside risks to the outlook for euro area economic activity.

Considering price developments, according to Eurostat's flash estimate, annual HICP inflation decreased to 2.1% in January 2003, from 2.3% in the previous month. As usual, these estimates are subject to uncertainty and there is no precise breakdown available as yet. However, it appears that compensating factors played a role: on the one hand, there was upward pressure from the recent hike in oil prices and from various increases in indirect taxes and administered prices at the beginning of 2003; on the other hand, the strengthening of the euro and benign base effects are dampening consumer price increases. These two latter factors should also help to further reduce annual rates of HICP inflation over the next few months. However, given the high volatility in oil markets, short-term forecasts for HICP inflation are currently subject to a particularly high degree of uncertainty.

Beyond the immediate future, the gradual pass-through of the appreciation of the euro, together with the expected moderate improvement in economic growth, should reduce inflationary pressures. The most likely outcome remains that inflation will fall and eventually stabilise at a level below 2% in the course of 2003. A major condition for price stability to also prevail in the medium term will be moderate wage developments. Wage moderation would also help improve the prospects for economic growth and further employment creation. It is therefore of particular importance that the upward trend in wage growth finally comes to a halt. However, the indications for this are still mixed, despite weak economic activity throughout last year.

As for **fiscal policy**, the framework laid down in the Treaty and the Stability and Growth Pact limits the risk of fiscal imbalances occurring, and therefore contributes significantly to favourable financing conditions for the private sector. At the same time, it allows an appropriate medium-term orientation of fiscal policy which fosters confidence and thereby growth. In order to fully reap the benefits of this framework, it is important that countries respect its objectives and implement appropriate consolidation plans where needed. Hence, the commitments made in the stability programmes and the requests to further improve fiscal positions, as subsequently agreed in the ECOFIN Council, must be met in full. These benefits would be magnified if the underlying policy measures were part of a comprehensive reform strategy to support economic growth.

It is, in fact, the implementation of **structural reforms** at the micro level that ultimately raises the production potential, improves flexibility in the economy and makes the euro area more resilient to external shocks. Clearly, lack of progress in structural reform is one of the key factors currently hampering a recovery in confidence. Therefore, the Governing Council welcomes a recent communication by the Commission on the implementation of the Broad Economic Policy Guidelines. It emphasises the need to step up the pace of labour market reform to achieve the Lisbon objectives, to fully implement the Internal Market and to enhance competition in product markets as well as to foster capital market integration, entrepreneurship, a knowledge-based economy, and research and development. We fully share the Commission's assessment that policy inertia and backtracking are widespread. Against this background, renewed momentum in the process of structural reform will be crucial to foster confidence among consumers and investors.