# European Central Bank: Press conference - introductory statement

Introductory statement by Mr Jean-Claude Trichet, President of the European Central Bank, and Mr Lucas Papademos, Vice President of the European Central Bank, Frankfurt, 2 December 2004.

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

All in all, the short-term outlook for inflation remains worrisome, but our assessment of price developments over the medium term is unchanged. At the current juncture oil price developments are having a sizeable impact on consumer prices in the euro area, while there is no significant evidence that stronger underlying domestic inflationary pressures are building up. Accordingly, we have left the key ECB interest rates unchanged at their historically low levels. At the same time, we recognise the existence of upside risks to price stability over the medium term. Continued vigilance is of the essence with regard to those risks.

I shall now explain our assessment in more detail, turning first to the economic analysis. After the positive developments in the first half of 2004, economic growth has moderated in the second half. In the third quarter of the year, real GDP growth is estimated to have been only 0.3% quarter on quarter, after 0.7% and 0.5% in the previous two quarters. According to Eurostat, the contribution of net exports turned negative, reflecting in particular high import growth, and private consumption was subdued, probably dampened by higher oil prices. At the same time, investment growth increased and inventories were built up. The available survey information for October and November points to ongoing growth in the fourth quarter, albeit at a more moderate pace than in the first half of this year.

The conditions remain in place for economic growth to proceed. On the external side, while global growth is showing some signs of moderation, it nonetheless is expected to remain robust. Euro area exports should continue to benefit from global demand conditions. On the domestic side, investment should be supported further by the very favourable financing conditions in the euro area, improved earnings and greater corporate efficiency gained through business restructuring. Finally, scope exists for private consumption to strengthen, particularly if uncertainties surrounding the extent and pace of fiscal consolidation and structural reforms are reduced.

Accordingly, we expect a gradual recovery in euro area activity over the next two years, with somewhat more moderate growth rates due to the impact of oil prices. This is also reflected in the Eurosystem staff projections. Euro area real GDP growth is projected to be between 1.6% and 2.0% on average in 2004, between 1.4% and 2.4% in 2005 and between 1.7% and 2.7% in 2006. Available forecasts from international and private sector organisations convey a broadly similar picture.

Downside risks to these projections stem in particular from potentially unfavourable developments in the oil market. In order to limit such risks, second-round effects in wage and price-setting must be avoided and fiscal authorities should refrain from taking measures which would prolong or distort the necessary adjustment process. Moreover, the degree of competition in the euro area energy sector is an important factor in allowing higher oil prices to be absorbed without significant distortions. Further progress in increasing competition in this sector would be highly beneficial.

Turning to consumer prices, annual HICP inflation was 2.2% in November, according to Eurostat's flash estimate, down from 2.4% in October. Over the coming months, inflation rates of above 2% are likely to persist, and some temporary further increase from current levels cannot be excluded. Looking further ahead, however, the information available so far indicates that HICP inflation would fall below 2% in the course of 2005 if no further adverse shocks occurred and it does not suggest that stronger underlying inflationary pressures are building up in the euro area. Wage increases have remained contained over recent quarters and, in the context of ongoing moderate growth and weak labour markets, this trend should continue in the future. Producer prices are rising, but this remains concentrated on energy and intermediate goods, which should limit the pass-through.

These views are also embodied in the Eurosystem staff projections. Average annual HICP inflation is projected to lie between 2.1% and 2.3% in 2004. As the impact of recent oil price increases and the effects of previous indirect tax and administered price rises gradually dissipate, annual HICP inflation is projected to be between 1.5% and 2.5% in 2005 and 1.0% and 2.2% in 2006. These projections are broadly consistent with forecasts recently released by international and private sector organisations.

Several upside risks need to be taken into account. Concerns relate in particular to future oil price developments and, more generally, to the potential risk of second-round effects in wage and price-setting throughout the economy. Further developments in indirect taxes and administered prices also need to be monitored closely.

Further insight into the outlook for price developments, at medium to longer-term horizons, is provided by the monetary analysis. The latest monetary data confirm that the downward trend in annual M3 growth observed from the middle of 2003 has not continued in recent months and has even reversed.

Over the course of 2004, monetary dynamics have been driven by two opposing forces. On the one hand, the historically very low level of interest rates in the euro area has stimulated M3 dynamics, in particular demand for the most liquid components of M3 contained in the narrow aggregate M1. On the other hand, portfolio allocation behaviour has tended to normalise over the past year following the exceptionally strong preference for liquidity observed during the period of heightened economic and financial uncertainty between 2001 and mid-2003. However, investors' preference for liquid assets seems to have remained greater than would typically be expected at the current stage of the economic cycle, possibly due to the fact that the economic and financial uncertainties in recent years have been relatively strong and protracted.

The very low level of interest rates is also fuelling private sector demand for credit. In particular, the demand for loans for house purchase has continued to be robust, supported also by strong house price dynamics in several euro area countries. Growth in loans to non-financial corporations has picked up further in recent months.

As a result of the persistently high growth in M3 over the past few years, there remains substantially more liquidity in the euro area than is needed to finance non-inflationary economic growth. This could pose risks to price stability over the medium term.

To sum up, the economic analysis suggests that underlying domestic inflationary pressures are contained, but a number of medium-term upside risks to price stability need to be monitored closely. Cross-checking with the monetary analysis supports the case for continued vigilance with regard to the materialisation of risks to price stability over the medium term. It is of the essence to avoid any spillover from short-term consumer price developments to long-term inflation expectations.

As regards fiscal policies, forthcoming budgets and stability programmes should send strong and confidence-building signals, namely that sound public finances and growth-friendly structural adjustments in public finances are being pursued. Concerning the European institutional framework, the Stability and Growth Pact and the excessive deficit procedure are the key fiscal cornerstones of EMU. These must remain firm. The Pact and the excessive deficit procedure should be fully respected in their current form, while their implementation could be improved, in particular as regards the preventive arm of the Pact.

Finally, let me support the calls expressed in the report of the High Level Group chaired by Wim Kok to renew the impetus in the Lisbon process and to sharpen its focus. In this context, we restate our strong support for all efforts on the part of governments, parliaments and social partners implementing the reform agenda and focusing on those reforms that will support employment growth, foster investment and stimulate innovation and productivity. Progress in this direction will not only enhance the underlying growth potential of the euro area economy over the medium term but will also help to bolster consumer and business confidence over a shorter horizon.

We are now at your disposal for questions.