# 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 am Main, 3 March 2005.

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Ladies and gentlemen, it is our pleasure to welcome you to this press conference. The Vice-President and I will now report on the outcome of today's meeting of the Governing Council of the ECB, which was also attended by Prime Minister Juncker and Commissioner Almunia.

On the whole, we continue to see no significant evidence of underlying domestic inflationary pressures building up in the euro area. Accordingly, we have left the key ECB interest rates unchanged. These interest rates are at historically low levels and are making an important contribution to the economic recovery. At the same time, upside risks to price stability over the medium term exist. These require continued vigilance on the part of the Governing Council.

I shall now explain our assessment in more detail, turning first to the economic analysis. According to Eurostat's flash estimate, real GDP in the euro area grew at a quarter-on-quarter rate of 0.2% in the fourth quarter of 2004. In addition, third-quarter real GDP growth was revised down to 0.2%. This overall outcome for the second half of last year was disappointing. However, the composition of demand growth in the fourth quarter also offered some positive signs with regard to the underlying trend. The strengthening of domestic demand and, in particular, consumption may point to the recovery in economic activity in the euro area regaining some momentum.

There are a number of reasons why the weaker real GDP growth in the second half of 2004 could be a transitory phenomenon. On the external side, growth in the world economy remains strong, supporting euro area exports. On the domestic side, investment is expected to continue to benefit from very favourable financing conditions, robust earnings and greater business efficiency. Consumption growth should benefit from anticipated developments in real disposable income.

Accordingly, we expect continued economic growth in 2005 and 2006. This assessment is also reflected in the new ECB staff projections, which will be published today. Euro area real GDP growth is projected by the ECB's staff to be, on average, between 1.2% and 2.0% in 2005 and between 1.6% and 2.6% in 2006. These projections are lower than those published in December 2004, reflecting the weaker economic developments in late 2004. Available forecasts from international and private sector organisations convey a broadly similar outlook.

The picture emerging from the projections contains a number of risks. On the external side, high and volatile oil prices and persistent global imbalances pose downside risks to growth. As regards exchange rates, we confirm our position – expressed when the euro rose sharply – that such moves are unwelcome and undesirable for economic growth. On the domestic side, there are uncertainties surrounding the evolution of consumption, while the very favourable financing conditions and the recovery in corporate earnings could lead to higher investment growth than currently projected.

Turning to consumer prices, annual HICP inflation declined quite substantially in January 2005, falling to 1.9% from 2.4% in December 2004. This was largely a result of base effects from developments in indirect taxes and administered prices in some countries. In February, according to Eurostat´s flash estimate, annual HICP inflation was 2.0%.

In the coming months, annual inflation rates are likely to fluctuate around 2%. Looking further ahead, there is no evidence that stronger underlying domestic inflationary pressures are building up in the euro area. Over recent quarters, wage increases have remained moderate. In the context of moderate economic growth, this trend should continue.

These views are also embodied in the ECB staff projections. Average annual HICP inflation is projected by the staff to lie between 1.6% and 2.2% in 2005 and between 1.0% and 2.2% in 2006. These projections are broadly unchanged from the Eurosystem staff projections published in December 2004 and consistent with forecasts recently released by international and private sector organisations.

Several upside risks to these projections need to be taken into account, notably future oil price developments. Developments in indirect taxes and administered prices may also again surprise on the upside. Furthermore, continued vigilance is required regarding the potential risk of past price increases leading to second-round effects in wage and price-setting throughout the economy. In this respect, developments in longer-term inflation expectations 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 the strengthening of M3 growth observed since mid-2004. This increasingly reflects the stimulative effect of the historically very low level of interest rates in the euro area. As a result of the persistently strong growth in M3 over the past few years, substantially more liquidity in the euro area exists than is needed to finance non-inflationary economic growth. This could pose risks to price stability over the medium term and warrants vigilance.

The exceptionally low level of real interest rates is also further stimulating private sector demand for credit. Growth in loans to non-financial corporations has continued to pick up in recent months. Moreover, demand for loans for house purchase has continued to be robust, contributing to strong house price dynamics in some regions of the euro area.

To sum up, the economic analysis confirms that underlying domestic inflationary pressures remain contained, while medium-term upside risks to price stability exist and will 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.

Turning to fiscal policies, the Governing Council notes that, while some progress with fiscal consolidation and the correction of excessive deficits is envisaged in euro area countries' updated stability programmes, further consolidation in a number of countries is needed. In particular, several countries do not plan to pursue an appropriately ambitious adjustment path and are not targeting close-to-balance or in-surplus budgetary positions by the end of the programme horizon. In addition, in some cases, fiscal targets are based on rather favourable growth assumptions and on insufficiently specified measures.

With respect to the Stability and Growth Pact, discussions now need to be brought to a convincing conclusion with an outcome that safeguards fiscal discipline. The credibility of the excessive deficit procedure needs to be fully preserved. This is not only fundamental for macroeconomic stability and cohesion in the euro area but also for confidence and growth prospects in all Member States.

In this regard, the Governing Council welcomes the decision by the ECOFIN Council, based on a recommendation by the European Commission, to move, for the first time, to the next procedural step in the excessive deficit procedure and to give notice, in accordance with Treaty Article 104(9), to Greece. The Governing Council also takes the view that the extension of the deadline, from 2005 to 2006, for correcting the excessive deficit pushes the room for interpretation of the rules and procedures to the limit. It is now indispensable for Greece to take effective action to correct its severe fiscal imbalances.

As regards structural developments, the euro area has seen relatively low trend productivity growth since the mid-1990s. An analysis of the determinants of productivity shows that lower productivity growth in the euro area has been partly related to higher employment due to greater participation of lower-skilled labour. Sustained wage moderation and some progress in labour market reforms aimed at increasing labour market participation appear to have partially shifted production towards a more intensive use of labour.

There are also indications that the slower pace of productivity growth observed in the euro area since the mid-1990s reflects an insufficient use of new productivity-enhancing technologies. While productivity growth has increased in sectors that produce information and communication technologies or provide related services, it has declined in many other areas of the economy. This points to structural rigidities in the euro area that prevent or hinder the fast and effective dissemination of new technologies and improved production processes across the economy.

Against this background, structural reforms that stimulate innovation, investment and productivity, and promote the use of new productivity-enhancing technologies are crucial. Stimulating product market competition, facilitating restructuring and improving human capital through adequate educational systems and "on-the-job" training are likely to speed up productivity gains from the use of new technologies.

We are now at your disposal for questions.