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, 12 January 2006.

*   *   *

Ladies and gentlemen, the Vice-President and I would first like to express to all of you our best wishes for the New Year and welcome you to this press conference. Let me now report on the outcome of today's meeting of the ECB's Governing Council, which was also attended by Commissioner Almunia.

On the basis of our regular economic and monetary analyses, we have decided to keep the **key ECB interest rates** unchanged following the increase of 25 basis points on 1 December 2005. The information which has become available since then supports the assessment that an adjustment of our very accommodative monetary policy stance was warranted. It remains essential to keep medium to long-term inflation expectations in the euro area solidly anchored at levels consistent with price stability. Such anchoring of inflation expectations is a prerequisite for monetary policy to make an ongoing contribution towards supporting economic growth and job creation in the euro area. Maintaining price stability over the medium term is our guiding principle, and we will consistently apply it when examining new information, making our judgements and taking decisions. With interest rates across the whole maturity spectrum remaining historically low in both nominal and real terms, and with our monetary policy stance remaining accommodative, we will continue to monitor very closely all developments with respect to risks to price stability over the medium term.

Allow me to explain our assessment in greater detail, turning first to the **economic analysis**. According to the information available, real GDP growth did indeed improve in the second half of 2005, as we expected. According to Eurostat's first estimate, real GDP grew at a quarter-on-quarter rate of 0.6% in the third quarter of 2005, compared with 0.4% in the second quarter. The breakdown of GDP data for the third quarter of 2005 confirmed a stronger contribution from domestic demand. Moreover, recent economic indicators and survey data support the view that the expansion of economic activity broadly maintained its momentum in the fourth quarter of 2005 and will continue to do so in the first months of 2006, notwithstanding the impact of high oil prices.

Looking further ahead, the conditions remain in place for sustained growth of economic activity, in line with our staff projections and other available forecasts. On the external side, the continued strength of global demand should support euro area exports. On the domestic side, investment should further benefit from continued very favourable financing conditions, robust corporate earnings and gains in corporate efficiency. Consumption growth should gradually rise, broadly in line with expected developments in disposable income.

Risks to this outlook for economic growth continue to lie on the downside and relate to high and volatile oil prices, concerns about global imbalances and the level of consumer confidence in the euro area, although the latter is improving.

Turning to price developments, annual HICP inflation was 2.2% in December, according to Eurostat's flash estimate, compared with 2.3% in November and 2.5% in October. This decline was the result of some relaxation of earlier tensions in oil and petrol markets. Nevertheless, annual HICP inflation rates are expected to remain at elevated levels over the short term, mainly on account of the most recent increases in oil prices and some adverse base effects. Beyond the short term, indirect effects of past oil price rises on other components of the price index may gradually materialise, and already announced changes to administered prices and indirect taxes can be expected to have an upward impact. Meanwhile, wage increases have remained moderate over recent quarters. All in all, the information available remains consistent with the scenario for price developments as reflected in the December staff projections.

Risks to this scenario remain on the upside and include further rises in oil prices, additional increases in administered prices and indirect taxes, as well as – more fundamentally – potential second-round effects in wage and price-setting behaviour. It is therefore crucial that the social partners continue to meet their responsibilities also in the context of a more favourable economic environment.

Turning to the **monetary analysis**, the annual growth rate of M3 moderated somewhat in November, but remained very robust, mainly owing to the stimulative impact of the prevailing low level of interest rates. The strong growth of M3 continues to be driven by significant contributions from its most liquid components. The growth of loans to the private sector – and, in particular, mortgage borrowing – has strengthened further over recent months, from already rapid rates of growth. Against this background, price dynamics in the housing markets need to be monitored closely. Liquidity in the euro area remains ample by all plausible measures. Strong monetary and credit growth in a context of already ample liquidity in the euro area points to upside risks to price stability over medium to longer horizons.

To sum up, the economic analysis suggests that some upward impact on HICP inflation will result from the indirect effects of recent oil price rises and already announced changes to administered prices and indirect taxes. It also indicates that risks to price stability over the medium term remain on the upside. This assessment is confirmed by **cross-checking** the economic analysis with the monetary analysis. It is essential that such risks do not affect medium-term inflation expectations, which need to remain firmly anchored at levels consistent with price stability. Monetary policy can thereby effectively contribute to sustainable economic growth and job creation. Accordingly, we will continue to monitor very closely all developments with respect to risks to price stability over the medium term.

As regards **fiscal policy**, most euro area countries have submitted their updated stability programmes, which include their medium-term budget plans. The upcoming assessment of these programmes by the ECOFIN Council and their subsequent implementation provide an opportunity to forcefully underpin the commitment to sound fiscal policies and the rigorous implementation of the Stability and Growth Pact. This would have an important positive effect on confidence. This effect is likely to be considerable if emphasis is given to well-defined and credible consolidation measures, restraint in expenditure commitments, and the incorporation of fiscal measures into a comprehensive and growth-friendly reform agenda.

With respect to **structural reforms**, the Governing Council welcomes the ECOFIN Council's Conclusions of 6 December 2005 on the Lisbon National Reform Programmes and the intended response to the challenges of globalisation. In fact, the process of international economic and financial integration, characterised by strong growth in trade and capital flows, has been one of the driving factors behind the rise in Europe's prosperity over the past decades. The ongoing transformation of the world economy, reflecting technological advances and the entrance of new economies into the world market, again offers great opportunities in terms of higher living standards. In order to translate these chances into achievements, Europe would greatly benefit from more flexible labour and product markets so as to speed up the necessary changeover from contracting to expanding activities and to minimise adjustment costs. It would also profit considerably from a more stimulative business environment which fosters the ability to innovate, invest and create new firms. Moreover, a fully operational EU internal market, including for services, offers great opportunities. The initiatives taken to relaunch the Lisbon strategy are a welcome step in the right direction.

We are now at your disposal for questions.