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, 4 March 2010.

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Ladies and gentlemen, the Vice-President and I are very pleased to welcome you to our press conference. We will now report on the outcome of today's meeting of the Governing Council, which was also attended by Commissioner Rehn.

Based on its regular economic and monetary analyses, the Governing Council decided to leave the ***key ECB interest rates*** unchanged. The current rates remain appropriate. Taking into account all the information and analyses that have become available since our meeting on 4 February 2010, price developments are expected to remain subdued over the policy-relevant horizon. The latest information has also confirmed that the economic recovery in the euro area is on track, although it is likely to remain uneven. Overall, the Governing Council expects the euro area economy to grow at a moderate pace in 2010, in an environment marked by continued uncertainty. The outcome of the monetary analysis confirms the assessment of low inflationary pressures over the medium term. All in all, we expect price stability to be maintained over the medium term, thereby supporting the purchasing power of euro area households. Inflation expectations remain firmly anchored in line with the Governing Council's aim of keeping inflation rates below, but close to, 2% over the medium term.

At today's meeting we also discussed, in view of economic and financial market developments, how to proceed with the gradual phasing-out of our non-standard operational measures. In this respect, we decided to continue conducting both the main refinancing operations (MROs) and the special-term refinancing operations with a maturity of one maintenance period as fixed rate tender procedures with full allotment for as long as necessary – and at least until the end of this year's ninth maintenance period on 12 October 2010. In the case of the special-term refinancing operations, the fixed rate will be the same as the rate used in the respective MRO. The Governing Council also decided to return to variable rate tender procedures in the regular three-month longer-term refinancing operations (LTROs), starting with the operation to be allotted on 28 April 2010. Allotment amounts in these operations will be set with the aim of ensuring smooth conditions in money markets and avoiding any significant spreads between bid rates and the prevailing MRO rate. Furthermore, the Governing Council decided, in line with its decision on the 12-month LTRO of 16 December 2009, to fix the rate in the six-month LTRO to be allotted on 31 March 2010 at the average minimum bid rate of the MROs over the life of this operation.

With today's decisions, the Eurosystem continues to provide liquidity support to the banking system of the euro area at very favourable conditions, thereby facilitating the provision of credit to the euro area. At the same time, these decisions help to avoid distortions associated with maintaining non-standard measures for longer than needed. The Governing Council will continue to implement the gradual phasing-out of the extraordinary liquidity measures. In order to counter effectively any threat to price stability over the medium to longer term, the liquidity provided will be absorbed when necessary. Accordingly, we will continue to monitor very closely all developments over the period ahead.

Let me now explain our assessment in greater detail, starting with the ***economic analysis***. Over recent quarters, the euro area has continued to benefit from the significant macroeconomic stimulus provided and the measures adopted to restore the functioning of the banking system, as well as from the ongoing recovery in the world economy. According to Eurostat's first release, in quarter-on-quarter terms euro area real GDP increased by 0.1%

in the fourth quarter of 2009, after growing by 0.4% in the third quarter. Available indicators suggest that the economic recovery in the euro area is on track, although it is likely to remain uneven. In particular, a number of special factors are at play, including adverse weather conditions in parts of the euro area in the first quarter of 2010. Given this uneven pattern, it is more appropriate to look through the quarterly volatility and to compare growth developments on a half-yearly basis. Looking ahead, the Governing Council expects real GDP growth to remain moderate in 2010, owing to the ongoing process of balance sheet adjustment in various sectors and the expectation that the low capacity utilisation is likely to dampen investment and that consumption is being dampened by weak labour market prospects.

This assessment is also reflected in the March 2010 ECB staff macroeconomic projections for the euro area, which foresee annual real GDP growth in a range between 0.4% and 1.2% for 2010 and between 0.5% and 2.5% for 2011. Compared with the Eurosystem staff projections published in December 2009, the range for real GDP growth in 2010 is slightly narrower, while for 2011 the range has been revised slightly upwards, reflecting notably stronger activity worldwide.

The Governing Council continues to view the risks to this outlook as broadly balanced, in an environment marked by continued uncertainty. On the upside, confidence may improve more than expected, and both the global economy and foreign trade may recover more strongly than projected. Furthermore, there may be larger than anticipated effects stemming from the extensive macroeconomic stimulus being provided and from other policy measures taken. On the downside, concerns remain relating to a stronger or more protracted than expected negative feedback loop between the real economy and the financial sector, renewed increases in oil and other commodity prices, the intensification of protectionist pressures and renewed tensions in some financial market segments, as well as the possibility of a disorderly correction of global imbalances.

With regard to price developments, euro area annual HICP inflation was 0.9% in February 2010, according to Eurostat's flash estimate, after 1.0% in January. Inflation is expected to be around 1% in the near term and to remain moderate over the policy-relevant horizon. In line with a slow recovery in domestic and foreign demand, overall price, cost and wage developments are expected to stay subdued. In this context, it is important to emphasise that inflation expectations over the medium to longer term remain firmly anchored in line with the Governing Council's aim of keeping inflation rates below, but close to, 2% over the medium term.

This assessment is also reflected in the March 2010 ECB staff macroeconomic projections for the euro area, which foresee annual HICP inflation in a range between 0.8% and 1.6% for 2010 and between 0.9% and 2.1% for 2011. Compared with the Eurosystem staff projections published in December 2009, the range for 2010 has been adjusted marginally downwards, while the range for 2011 has been adjusted slightly upwards.

Risks to this outlook remain broadly balanced. They relate, in particular, to further developments in economic activity and the evolution of commodity prices. Furthermore, increases in indirect taxation and administered prices may be greater than currently expected, owing to the need for fiscal consolidation in the coming years.

Turning to the ***monetary analysis***, the annual growth rate of M3 turned slightly positive in January 2010, rising to 0.1%. This reflects mainly a base effect and confirms the assessment of continued weak monetary growth. Together with the negative annual rate of growth in loans to the private sector (equal to –0.6% in January 2010), the latest data support the assessment that the underlying pace of monetary expansion is moderate and that, in the medium term, the inflationary pressures associated with monetary developments are low. The growth of M3 and loans to the private sector is likely to remain weak also in the coming months.

At the same time, actual monetary developments are likely to be weaker than the underlying pace of monetary expansion, on account of the downward impact of the steep yield curve. This fosters the allocation of funds away from M3 and into longer-term deposits and securities. On the other hand, the narrow spreads between the interest rates paid on different M3 instruments imply a low opportunity cost of holding funds in the most liquid components included in M1, which continued to grow at a robust annual rate of 11.5% in January.

The negative annual growth of loans to the private sector conceals ongoing opposite developments: positive, strengthening annual growth in loans to households on the one hand and negative, declining annual growth in loans to non-financial corporations on the other hand. Such differences are consistent with historical patterns and cyclical regularities, which suggest that loans to non-financial corporations can be expected to remain weak for some time after economic activity has picked up. At the same time, the cost of financing for enterprises has declined and the sector as a whole has continued to make extensive use of market-based financing as a substitute for bank financing.

Banks have continued to reduce the size of their overall balance sheets over the past few months, but the challenge remains for them to manage this adjustment while ensuring the availability of credit to the non-financial sector. To address this challenge, banks should use the improved funding conditions to strengthen their capital bases further and, where necessary, take full advantage of government support measures for recapitalisation.

To sum up, the current key ECB interest rates remain appropriate. Taking into account all the information and analyses that have become available since our meeting on 4 February 2010, price developments are expected to remain subdued over the policy-relevant horizon. The latest information has also confirmed that the economic recovery in the euro area is on track, although it is likely to remain uneven. Overall, the Governing Council expects the euro area economy to grow at a moderate pace in 2010, in an environment marked by continued uncertainty. A ***cross-check*** of the outcome of the economic analysis with that of the monetary analysis confirms the assessment of low inflationary pressures over the medium term. All in all, we expect price stability to be maintained over the medium term, thereby supporting the purchasing power of euro area households. Inflation expectations remain firmly anchored in line with the Governing Council's aim of keeping inflation rates below, but close to, 2% over the medium term.

As regards ***fiscal policies***, high levels of public deficit and debt place an additional burden on monetary policy and undermine the Stability and Growth Pact as a key pillar of Economic and Monetary Union. It is of paramount importance that the stability programme of each euro area country clearly defines the fiscal exit and consolidation strategies for the period ahead. This requires determined efforts, notably on the side of countries with high deficit and debt levels. All countries will be required to meet their commitments under the excessive deficit procedures. Consolidation of public finances should start in 2011 at the latest and will have to exceed substantially the annual adjustment of 0.5% of GDP set as a minimum requirement by the Stability and Growth Pact. A strong focus on expenditure reforms is needed. The Governing Council issued, on 3 March 2010, a statement on the additional fiscal consolidation measures announced by the Greek government.

In all euro area countries, the key challenge in order to reinforce sustainable growth and job creation is to accelerate ***structural reforms***. Policies should be adopted which open up market access and increase competition. Overall, it is essential to set the stage for long-term investment in innovation so as to create new business opportunities. Sectoral support schemes implemented to cope with the immediate effects of the crisis should now be phased out. In labour markets, moderate wage setting in several economies and sufficient labour market flexibility are required in order to avoid higher structural unemployment over the coming years. These structural reforms should be supported by an appropriate restructuring of the banking sector. Sound balance sheets, effective risk management and transparent, robust business models are key to strengthening banks' resilience to shocks and to ensuring adequate access to finance, thereby laying the foundations for sustainable growth and financial stability.

We are now at your disposal for questions.