European Central Bank: Press conference – introductory statement

Introductory statement by Mr Jean-Claude Trichet, President of the European Central Bank, and Mr Vítor Constâncio, Vice-President of the European Central Bank, Frankfurt am Main, 13 January 2011.

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Ladies and gentlemen, the Vice-President and I are very pleased to welcome you to our press conference. Let me wish you all a very Happy New Year. I would also like to take this opportunity to welcome Estonia as the seventeenth country to adopt the euro as its currency. Accordingly, Mr Lipstok, the Governor of Eesti Pank, became a member of the Governing Council on 1 January 2011. Following the adoption of the euro by Estonia there are now 331 million citizens using the euro as their currency. We will now report on the outcome of today's meeting, which was also attended by Commissioner Rehn.

Based on its regular economic and monetary analyses, the Governing Council confirmed that the current ***key ECB interest rates*** still remain appropriate. It therefore decided to leave them unchanged. Taking into account all the new information and analyses which have become available since our meeting on 2 December 2010, we see evidence of short-term upward pressure on overall inflation, mainly owing to energy prices, but this has not so far affected our assessment that price developments will remain in line with price stability over the policy-relevant horizon. At the same time, very close monitoring is warranted. Recent economic data are consistent with a positive underlying momentum of economic activity, while uncertainty remains elevated. Our monetary analysis indicates that inflationary pressures over the medium term should remain contained. Overall, 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 our aim of keeping inflation rates below, but close to, 2% over the medium term. The firm anchoring of inflation expectations is of the essence.

Overall, the current monetary policy stance remains accommodative. The stance, the provision of liquidity and the allotment modes will be adjusted as appropriate, taking into account the fact that all the non-standard measures taken during the period of acute financial market tensions are, by construction, temporary in nature. Accordingly, the Governing Council will continue to monitor all developments over the period ahead very closely.

Let me now explain our assessment in greater detail, starting with the ***economic analysis***. Following the 0.3% quarter-on-quarter increase in euro area real GDP in the third quarter of 2010, recent statistical releases and survey-based evidence confirm that the positive underlying momentum of economic activity in the euro area remained in place towards the end of 2010. Looking ahead at 2011, euro area exports should benefit from a continued recovery in the world economy. At the same time, and particularly taking into account the relatively high level of business confidence in the euro area, private sector domestic demand should increasingly contribute to growth, supported by the accommodative monetary policy stance and the measures adopted to restore the functioning of the financial system. However, the recovery in activity is expected to be dampened by the process of balance sheet adjustment in various sectors.

In the Governing Council's assessment, the risks to this economic outlook are still slightly tilted to the downside, with uncertainty remaining elevated. On the one hand, global trade may continue to grow more rapidly than expected, thereby supporting euro area exports. Moreover, strong business confidence could provide more support to domestic economic activity in the euro area than is currently expected. On the other hand, downside risks relate to the tensions in some segments of the financial markets and their potential spillover to the euro area real economy. Further downside risks relate to renewed increases in oil and other commodity prices, protectionist pressures and the possibility of a disorderly correction of global imbalances.

With regard to price developments, euro area annual HICP inflation was 2.2% in December, according to Eurostat's flash estimate, after 1.9% in November. This was somewhat higher than expected and largely reflects higher energy prices. Looking ahead to the next few months, inflation rates could temporarily increase further. They are likely to stay slightly above 2%, largely owing to commodity price developments, before moderating again towards the end of the year. Overall, we see evidence of short-term upward pressure on overall inflation, stemming largely from global commodity prices. While this has not so far affected our assessment that price developments will remain in line with price stability over the policy-relevant horizon, very close monitoring of price developments is warranted. Inflation expectations over the medium to longer term continue to be firmly anchored in line with the Governing Council's aim of keeping inflation rates below, but close to, 2% over the medium term.

Risks to the medium-term outlook for price developments are still broadly balanced but could move to the upside. Upside risks relate, in particular, to developments in energy and non-energy commodity prices. Furthermore, increases in indirect taxes and administered prices may be greater than currently expected, owing to the need for fiscal consolidation in the coming years, and price pressures in the production chain could rise further. On the downside, risks relate mainly to the impact on inflation of potentially lower growth, given the prevailing uncertainties.

Turning to the ***monetary analysis***, the annual growth rate of M3 increased to 1.9% in November 2010, after 0.9% in October. This strong increase is in part related to base effects and volatile factors. The annual growth rate of loans to the private sector also increased, rising to 2.0% in November from 1.5% in October. Looking beyond the special factors that operated in November, broad money and loan growth is still low, corroborating the assessment that the underlying pace of monetary expansion is moderate and that inflationary pressures over the medium term should remain contained.

The interest rate constellation continued to exert a significant impact on the growth of monetary aggregates. Looking at M3 components, the interest rates paid on short-term time deposits remained higher than those paid on overnight deposits. As a result, annual M1 growth continued to moderate, standing at 4.6% in November 2010, while the annual growth rate of other short-term deposits continued to become less negative. At the same time, the yield curve has lately become steeper again, implying that the attractiveness of short-term deposits included in M3 has declined somewhat compared with more highly remunerated longer-term assets outside M3.

The annual growth rate of bank loans to the private sector continued to increase in November, partly owing to special factors. At the sectoral level, this strengthening increasingly reflects the upward movement in the growth of loans to non-financial corporations, which stood at –0.1% in November, after –0.5% in October, thereby further confirming that a turning point was reached in the course of 2010. The growth of loans to households remained stronger, at 2.7% in November after 2.9% in October, but the latest data point to some signs of a levelling-off.

Over the past few months banks have expanded the provision of credit to the private sector in an environment in which the overall size of their balance sheets has remained broadly stable. The challenge remains to expand the availability of such credit when demand picks up further. To address this challenge, where necessary, it is essential for banks to retain earnings, to turn to the market to strengthen further their capital bases or to take full advantage of government support measures for recapitalisation.

To sum up, the current key ECB interest rates still remain appropriate. We therefore decided to leave them unchanged. Taking into account all the new information and analyses which have become available since our meeting on 2 December 2010, we see evidence of short-term upward pressure on overall inflation, mainly owing to energy prices, but this has not so far affected our assessment that price developments will remain in line with price stability over the policy-relevant horizon. At the same time, very close monitoring is warranted. Recent economic data are consistent with a positive underlying momentum of economic activity, while uncertainty remains elevated. A ***cross-check*** of the outcome of our economic analysis with that of the monetary analysis indicates that inflationary pressures over the medium term should remain contained. Overall, 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 our aim of keeping inflation rates below, but close to, 2% over the medium term. The firm anchoring of inflation expectations is of the essence.

Turning to ***fiscal policies***, in view of the ongoing vulnerability to adverse market reactions, countries need to do their utmost to meet their deficit targets and put government debt-to-GDP ratios firmly on a downward trajectory. In this regard, the Governing Council takes note of the recently announced measures in some euro area countries to reduce their very large fiscal imbalances. Where necessary, additional corrective measures – preferably on the expenditure side – need to be swiftly defined and implemented. At the same time, all euro area countries should pursue ambitious and credible multi-year consolidation strategies. This will help to strengthen confidence in the sustainability of public finances, reduce risk premia in interest rates and improve the conditions for sound and sustainable growth. Any positive fiscal developments that may emerge, reflecting factors such as a more favourable than expected economic environment, should be exploited to make faster progress with fiscal consolidation.

Substantial and far-reaching ***structural reforms***, complementing fiscal adjustment, should be rapidly implemented to enhance the prospects for higher sustainable growth. Major reforms are particularly necessary in those countries that have experienced a loss of competitiveness in the past or that are suffering from high fiscal and external deficits. The removal of labour market rigidities would further support the adjustment process of these economies. Increasing product market competition, particularly in the services sectors, would also facilitate the restructuring of the economy and encourage innovation. Such measures are crucial for enhancing productivity growth, which is one of the main drivers of long-term growth. All these structural reforms should be supported by the necessary improvements in the structure of the banking sector. Sound balance sheets, effective risk management and transparent, robust business models remain 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.