European Central Bank: Press Conference - introductory statement

Introductory statement by Mr Willem F Duisenberg, President of the European Central Bank, and Mr Christian Noyer, Vice-President of the European Central Bank, at the Press Conference, held in Frankfurt, on 5 October 2000.

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Ladies and gentlemen, the Vice-President and I are here to report on the outcome of today's meeting of the Governing Council of the ECB. The following decisions were taken today:

1. The minimum bid rate on the main refinancing operations of the Eurosystem will be raised by 0.25 percentage points to 4.75%, starting from the operation to be settled on 11 October 2000.

2. The interest rate on the marginal lending facility will be raised by 0.25 percentage points to 5.75%, with effect from 6 October 2000.

3. The interest rate on the deposit facility will be raised by 0.25 percentage points to 3.75%, with effect from 6 October 2000.

Including today's adjustment, since November 1999 we have raised ECB interest rates by a total of 225 basis points, with the objective of sustaining price stability in the euro area over the medium term. Today's decisions continue to aim at ensuring that upward pressures on consumer prices stemming from oil prices and the foreign exchange rate of the euro do not translate into more permanent inflationary tendencies. It is important to address these risks adequately in order to preserve steady GDP and employment growth in the medium term.

Let me explain our decisions in greater detail by reporting on our regular examination of recent monetary, financial and economic developments and their implications for monetary policy aiming to maintain price stability in the medium term.

Starting with the first pillar of the monetary policy strategy of the ECB, the three-month average of annual *M3 growth* declined to 5.3% in the period from June to August 2000, from 5.5% in the period from May to July 2000. As had been indicated earlier, in August the preparations of telecommunications firms to transfer the funds due in early September to purchase licences in the German UMTS auction appeared to have a temporary upward impact on M3 growth. Taking this special factor into account, short-term developments in monetary aggregates seem to be more moderate than the August data would suggest. This notwithstanding, from a medium-term point of view, liquidity conditions continue to be ample in the euro area. This assessment is based on the protracted deviation of M3 growth from the reference value since the start of Stage Three of EMU, coupled with the still relatively high growth of loans to the private sector. Hence, risks to price stability stemming from monetary developments remain on the upside.

Turning to the second pillar, we had a thorough discussion on the main factors of relevance to the outlook for price stability at the current juncture.

One important factor under examination was the *price of oil*, which reached new peaks in mid-September before falling to some extent more recently. Contrary to earlier expectations, energy price developments did not moderate but rather continued to put considerable upward pressure on HICP inflation rates.

The low *external value of the euro* has heightened the risks of increases in import prices gradually being passed on to consumer prices.

As you are aware, the recent movements in the exchange rate of the euro gave rise to concerns, which the ECB shared with the governors and ministers of finance of all the G7 countries, that it might have adverse implications for the world economy. In order to address these concerns, on 22 September, at the ECB's initiative, the monetary authorities of the United States, Japan, the United Kingdom and Canada joined the ECB in a concerted intervention in the foreign exchange markets. The ECB and its partners will continue to monitor developments closely and to cooperate in foreign exchange markets as appropriate.

Within the euro area, data are pointing to strong *real GDP growth* in the second quarter of 2000, confirming our previous positive expectations for this year and for 2001. While the possibility cannot be ruled out that the increase in oil prices as such may temporarily dampen growth dynamics over the short term, the forces underlying solid growth in the medium term remain in place. These relate to external demand, which is supported by a strong world economy, as well as to domestic demand, which is supported by both continued favourable financing conditions and strong employment growth. Today's decisions should contribute to maintaining these overall prospects by preventing the emergence of expectations for inflation in the medium term. In fact, when monitoring bond market developments we saw our policy confirmed by continued expectations of lasting price stability and robust growth. We are committed to keeping this picture intact.

Monetary policy continuously needs to ensure that current inflation rates do not affect inflation expectations and thereby both price-setting and wage formation. It is particularly important that this message be understood in an environment in which oil price and exchange rate developments may lead to *HICP inflation rates* remaining above 2% for a more protracted period than earlier expected. We are currently seeing the direct effects of such external developments on the HICP rate of inflation, with 2.3% in August and, most likely, a higher rate in September. Earlier expectations that the high annual increase in energy prices would gradually moderate in the course of 2000, owing to a levelling-off or even decline in energy prices, have not materialised thus far. Hence, it will be some time before HICP inflation returns to rates below 2%. The action which we have taken today should be understood as a means of maintaining confidence in price stability over the medium term.

As I said at our previous press conference, higher oil prices imply a loss of income for the economy as a whole. In a market economy, the rise in the price of energy is to be reflected in relative price adjustments, so it should affect supply and demand in relation to both particular sources of energy as well as other goods and services. It will be important for social partners to continue to act as responsibly as they have done in the recent past. Wage moderation has made an important contribution to the progress in job creation and in reducing unemployment observed so far. A continuation of this attitude will be a key factor in contributing to non-inflationary growth at a robust pace and should ultimately result in higher employment and the preservation of real income growth for wage earners as well as in sustainable conditions for companies.

The governments of the euro area countries can help the economy to adjust smoothly to the increase in energy prices in several ways. One way is to step up efforts towards structural reform aimed at enhancing the functioning of labour and product markets. This will increase the resilience of the economy to adverse shocks, increase competition and ensure appropriate price-setting by companies. Governments must avoid the mistakes of the past, when fiscal policies were relaxed in response to the effects stemming from increases in energy prices. At the current juncture, fiscal policies should avoid any procyclical bias and should aim at reaching sustainable fiscal positions in the medium term more quickly.