European Central Bank: Press conference - introductory statement

Introductory statement by Mr Willem F Duisenberg, President of the European Central Bank and Mr Lucas Papademos, Vice-President of the European Central Bank, Frankfurt, 6 June 2002.

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Ladies and gentlemen, Mr. Papademos, the new Vice-President of the ECB, and I will now report on the outcome of today's meeting of the Governing Council of the ECB.

The Governing Council undertook a comprehensive examination of **monetary, financial and economic developments** and considered the evidence that has become available since its last meeting on 2 May 2002. Notwithstanding the recent decline in inflation, the outlook for price stability in the medium term remains less satisfactory than expected a few months ago. However, the economic outlook is still subject to uncertainty. Further evidence is needed before we can fully assess the upward risks to price stability over the medium term. Against this background, the Governing Council decided to leave the key ECB interest rates unchanged.

Starting with the analysis under the **first pillar** of our monetary policy strategy, the three-month average of the annual growth rates of M3 decreased to 7.4% in the period from February to April 2002, down from 7.6% in the period from January to March 2002. While the high annual growth rate of M3 still partly reflects the portfolio shifts to liquid positions which occurred last autumn, and there was some normalisation in the development of M3 in early 2002, this trend towards moderation has recently been interrupted. In addition, annual rates of growth of loans to the private sector have stabilised over recent months.

As regards the **second pillar**, our expectations for a gradual recovery in real GDP growth in the euro area have been confirmed by Eurostat's recently published first estimates for real GDP growth. These preliminary estimates show an improvement of quarter-on-quarter growth rates from –0.3% in the last quarter of 2001 to moderately positive rates in the first quarter of this year. Moreover, business and consumer confidence has strengthened again more recently, as reflected in the data published by the Commission. Looking ahead, available forecasts all point to a continued strengthening in both domestic and foreign demand, relating to a more favourable external environment, sound domestic fundamentals and the absence of major imbalances within the euro area. Overall, they suggest that real GDP growth in the euro area should again be in line with potential growth later this year, with a further increase expected in 2003. Despite this rather positive outlook, the assessment of the short-term dynamics of real activity is still surrounded by uncertainty. Moreover, future oil price developments and economic imbalances elsewhere in the world economy remain elements of risk.

Turning to price developments, Eurostat's early estimate indicates that annual HICP inflation fell from 2.4% in April to 2.0% in May. However, this decline is mainly due to a base effect relating to the spike in HICP inflation in May 2001. Moreover, in the first months of this year HICP inflation excluding the more volatile items of energy and unprocessed food prices has remained stubbornly high, reflecting in particular trends in services prices. While a further decline in the annual inflation rate is possible in the short run, the medium-term outlook remains less satisfactory than expected a few months ago. Over recent weeks the exchange rate of the euro has appreciated. This will contribute to containing inflationary pressures, but it is still too early to assess the impact of exchange rate developments on the outlook for prices.

As stated on a number of occasions, the less satisfactory picture in the short term is due partly to a sequence of adverse but rather specific shocks to prices, including recent oil price increases. In principle, such shocks should unwind over time and therefore not affect the medium-term perspectives for price stability as long as past upward tendencies in prices do not become entrenched. The outcome of recent wage negotiations in some regions of the euro area is a cause for concern, especially in view of the negative impact this could have on continued employment creation. High wage increases must not spread across the euro area given that inflationary pressure, which would have unfavourable consequences for competitiveness, employment growth and consumption, is to be avoided.

At this juncture it is therefore particularly important for monetary policy to remain vigilant with regard to the further evolution of the key factors determining the outlook for prices.

Regarding **fiscal policies** in the euro area, it is vital that all Member States maintain a medium-term perspective in compliance with the framework of the Stability and Growth Pact. Maintaining such a perspective will lead to a successful transition to budgetary positions close to balance or in surplus and to a smooth functioning of automatic stabilisers in all member countries. Let me therefore reiterate that the Member States concerned must honour the commitments made to achieve balanced budgets by 2003-4. Moreover, governments are encouraged to push ahead with reforms relating to the size and structure of public expenditure and revenue, which will also create room for further tax cuts and absorb the fiscal costs of population ageing.

This reform agenda, as well as the urgent **structural reforms** relating to product, labour and financial markets, will be addressed in the forthcoming Broad Economic Policy Guidelines. Overall, such reforms reflect the key challenge for the euro area to expand its potential for non-inflationary growth and to reduce its high level of unemployment. The Governing Council calls upon Member States to make faster progress in accelerating and deepening structural reforms in order to provide economic agents with the proper incentives to enhance efficiency and entrepreneurship and to progress towards a knowledge-based economy as proclaimed in the Lisbon agenda and confirmed in Barcelona.

We are now at your disposal for questions.