# 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, 12 September 2002.

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Ladies and gentlemen, the Vice-President and I will report on the outcome of today's meeting of the Governing Council of the ECB, which was also attended by the President of the Eurogroup, Mr. Christodoulakis, and Commissioner Solbes.

At today's meeting, the Governing Council continued its comprehensive examination of ***monetary, financial and economic developments*** and assessed new evidence that has become available over the past few weeks. Our conclusion is that risks to price stability appear rather balanced. Against this background, the current level of key ECB interest rates is appropriate.

As regards the analysis under the ***first pillar*** of our monetary policy strategy, the three-month average of the annual growth rates of M3 was 7.3% in the period from May to July 2002, compared with 7.4% in the period from April to June 2002. Hence, there is no indication of a significant reduction in monetary growth over the last few months. The recent strength in M3 growth partly reflects both the low opportunity cost of holding money and renewed portfolio shifts into M3 in an environment of financial market uncertainty. In this context, monetary trends need to be assessed with caution. From a longer-term perspective, there is concern that more liquidity is available in the euro area than would be needed to finance sustainable, non-inflationary economic growth. However, at this juncture, there is less risk that excess liquidity will translate into inflationary pressure, given the environment of subdued demand. The trend in the growth of loans to the private sector also seems to point in this direction.

Concerning the ***second pillar***, the latest data confirm a modest recovery in real GDP growth in the euro area in the first half of this year. In the second quarter of this year real GDP growth is estimated to have grown by 0.3% quarter on quarter, following upwardly revised growth of 0.4% in the first quarter. In contrast to the first quarter, developments in demand appear to have been more broadly based, as activity was supported by private consumption, export growth and inventories. However, overall domestic demand growth remained subdued as a result of the protracted weakness of investment.

Looking ahead, the most likely scenario is that of ongoing, albeit modest, growth in real GDP in the second half of this year, with growth rates in line with potential growth in 2003. This delay in the acceleration of economic activity in the euro area broadly corresponds with the world economic outlook, given that the expected pace of the recovery has been scaled down over recent months. Sharp declines in stock prices are having negative effects on consumer and investor confidence. Consequently, the strength of the upturn in economic activity has become more uncertain, both inside and outside the euro area. At the same time, however, the conditions for a stronger economic recovery in the euro area remain in place. On the domestic side, private consumption should particularly benefit from lower inflation and improved real disposable income, while investment should be supported by low nominal and real market interest rates. Finally, the gradual recovery of the global economy is also expected to continue. Nevertheless, risks to the economic outlook, both inside and outside the euro area, need to be monitored closely.

Turning to price developments, in July annual HICP inflation was 1.9%, while the inflation rate excluding unprocessed food and energy fell slightly to 2.5%, its first decline in 2002. Eurostat's flash estimate for August, which indicates that annual HICP inflation increased to 2.1%, is fully in line with previous expectations that inflation rates were likely to fluctuate at around 2% for the remainder of the year. However, the short-term trend is also dependent on oil price developments, which have increased significantly over recent months.

Looking further ahead, the recent appreciation of the euro exchange rate, as well as the overall economic environment, should contribute to a reduction in consumer price inflation. Moreover, services price inflation is expected to moderate somewhat, following particularly strong increases in 2002. However, for inflation rates to come down to levels below 2% in 2003, as currently projected by most forecasts, it is crucial that oil prices do not escalate and that wage moderation prevails. With respect to nominal wage growth, we have already noted an upward trend over recent years, which continued even when the economy started to slow down. While the information from the latest wage indicators does not signal a further acceleration, wage developments remain a cause for concern, despite the weak cyclical situation.

With regard to the devastating floods which have hit three member countries in particular, we deeply regret the substantial loss of life. The overall macroeconomic impact of these floods should be limited and have no lasting effects. Certain food prices could temporarily rise as a result, also due to bad weather conditions in other euro area countries, and while real GDP growth could initially be dampened slightly it may subsequently be stimulated by reconstruction.

Overall, subdued aggregate demand and the strengthening of the euro should contribute to lower inflationary pressure. At the same time, other factors - in particular monetary developments, but also wage trends and oil price developments - might pose risks to price stability in the medium term and therefore need to be monitored closely.

Regarding ***fiscal policies*** in the euro area, flood-related costs should lead to a review of priorities and a reallocation of expenditure. In addition, against the background of recent developments, it seems to be more warranted than ever to call on member countries to remain committed to the Stability and Growth Pact. Countries with sound fiscal positions should safeguard their achievements, while countries with remaining imbalances must avoid deficits in excess of 3% of GDP and implement determined policies in order to progress towards budgets close to balance or in surplus. This is essential for maintaining and further strengthening confidence in the policy framework in the euro area and for establishing fiscal positions in all countries that allow automatic stabilisers to work efficiently without endangering sound fiscal positions in the longer term.

In the field of ***structural reforms*** we continue to urge governments to implement, in a determined way, the agenda set in the Broad Economic Policy Guidelines. Structural reforms will contribute to expanding the euro area’s potential for non-inflationary growth and to reducing its high level of unemployment. At the same time, they will help to foster confidence among consumers and investors in long-term growth and employment opportunities in the euro area, thereby having a positive effect on spending and investment decisions in the short and medium term. Such confidence is fostered by a determined and broadly based implementation of the reform agenda, focusing, in particular, on labour and product markets.

We are now at your disposal for questions.