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 December 2003.

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

Following a comprehensive economic and monetary analysis, we concluded that the monetary policy stance remains appropriate to preserve price stability over the medium term. Accordingly, we left the **key ECB interest rates** unchanged at their low levels. While annual inflation rates are likely to fluctuate around 2% over the coming months, a gradual and limited decline should take place later on. We also noted that the economic recovery in the euro area has started and that confidence has strengthened further. We will continue to carefully monitor all developments that might affect our medium-term assessment of risks to price stability.

We also discussed the potential implications of the deeply regrettable developments at the ECOFIN Council meeting on 25 November. As we already stressed in our statement on the same day, these developments risk undermining the credibility of the institutional framework and the confidence in sound public finances of Member States across the euro area. Let me add that a credible fiscal framework is key not only to stability but also to growth, and is a precondition for low risk premia in financial markets to be preserved.

I shall now explain our assessment in more detail.

In the context of our **economic analysis**, the latest data releases confirmed that economic activity in the euro area has picked up. Real GDP growth in the third quarter reflects the strong momentum of the world economy, which we assume will continue next year.

We expect that domestic demand will start improving. Private consumption should be supported by positive terms-of-trade effects due to the past appreciation of the euro. With the usual lag, it should also profit from an increase in employment growth. Business investment is expected to recover gradually, mainly helped by an expansion of external demand, the low level of interest rates and generally favourable financing conditions. Moreover, it should increasingly benefit from the adjustment efforts of the corporate sector to enhance productivity and profitability.

Taken together, we look forward to a gradual recovery in euro area economic growth over the next quarters, leading to a broader and stronger upswing in the course of next year and the year after. The risks to this scenario appear to be balanced. Over a longer horizon, we remain concerned about the sustainability of global economic growth being undermined by external imbalances in some parts of the world economy.

Concerning prices, the latest information is in line with earlier expectations. According to Eurostat's flash estimate, annual HICP inflation was 2.2% in November, following a rate of 2.0% in October. Similar rates have prevailed for most of this year and this inertia of inflation rates at around 2% is likely to continue in the coming months. Due to adverse food price developments, the evolution of oil prices and planned increases in indirect taxes and administered prices, inflation rates will fall neither as quickly nor as strongly as was expected earlier in the year.

However, when assessing price trends over the medium term, a number of factors should dampen inflationary pressures. First, given the past appreciation of the euro, import prices should contribute to this effect. Second, domestic cost pressures should remain moderate. In particular, wage growth should be contained in the context of a recovery which, for the time being, is expected to remain gradual. Provided that wage moderation can be preserved, which is indispensable for fostering employment, a cyclical recovery in productivity tends to dampen growth in unit labour costs, which has thus far been relatively high when judged against the weakness of the economy.

Overall, these views are also reflected in recently released forecasts and seem to be in line with survey data and financial market expectations. Accordingly, there is a rather broad consensus on the main scenario. At the same time, this outlook for price stability is conditional on quite a number of assumptions, such as those on global developments, oil prices, exchange rates, wage developments and fiscal measures. Therefore, elements of risk to the outlook for price stability need to be kept in mind. In this respect, we noted that financial market indicators for inflation expectations have shown some upward momentum over recent months. While technical factors might also have played a role in the movement of these indicators, and other indicators have remained broadly unchanged, inflation expectations warrant close monitoring.

Turning to the **monetary analysis**, M3 growth has been very strong over the past two years, reflecting portfolio shifts, precautionary savings and the low level of interest rates. The low level of interest rates has also supported the growth of credit demand. In our assessment, the accumulation of excess liquidity is not of concern for price stability at the current juncture, given that, for the time being, the economic recovery is only gradual. However, should high excess liquidity continue to prevail once there is a significant strengthening of economic activity, it could lead to inflationary pressures in the medium term. We will therefore continue to carefully examine monetary developments.

In summary, the economic analysis indicates that the main scenario for price developments in the medium term continues to be in line with our definition of price stability. This picture is confirmed by **cross-checking** with the monetary analysis.

Turning to **fiscal policies**, I have already mentioned that we expressed deep regret following the ECOFIN Council meeting on 25 November. Furthermore, we stressed our support of the Commission's views on the ECOFIN Council's Conclusions. We also took note of the commitments made by France and Germany to correct their excessive deficits as rapidly as possible and at the latest by 2005. Moreover, we noted that the ECOFIN Council stands ready to take a decision under Article 104(9), on the basis of the Commission recommendation, should the two governments fail to act in accordance with their own commitments. We strongly urge the governments concerned to live up to their responsibilities. Confidence in the soundness of public finances is essential for sustainable growth in consumption and investment.

The overall fiscal framework of the Stability and Growth Pact remains of central importance and should be fully respected. The same applies to the requirement to avoid excessive deficits, laid down in Article 104 of the Treaty, and to the reference values of 3% and 60% for the deficit and debt-to-GDP ratios respectively, specified in the Protocol on the excessive deficit procedure annexed to the Treaty. These are the foundations for trust and confidence in EMU.

Trust and confidence are also crucial in the context of **structural reform**. Enhancing the competitiveness of the euro area, in particular in labour and product markets, increasing the efficiency of the tax systems and ensuring the sustainability of social security schemes all foster a better allocation and utilisation of capital and human resources. There is no doubt that measures in these respects improve the growth perspectives of the euro area. However, in order to foster confidence in the shorter term, convincing assurance must be given that these challenges are indeed being tackled in a decisive manner and that clear action is being taken. While some progress has been made, the Governing Council strongly encourages governments to accelerate the implementation of structural reforms and also calls upon social partners to fully commit themselves to the objective of making the euro area a more dynamic and innovative economy.

We are now at your disposal for questions.