Jean-Claude Trichet: Presentation of the ECB's Annual Report 2003 to the European Parliament

Introductory statement by Mr Jean-Claude Trichet, President of the European Central Bank, to the European Parliament, Strasbourg, 25 October 2004.

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Permettez-moi de souligner tout d'abord que je partage entièrement votre désir de maintenir les relations étroites et fructueuses que nos institutions ont développées au cours des dernières années, et que je me réjouis à la perspective de poursuivre notre dialogue dans cet esprit franc et coopératif.

J'ai l'honneur de vous présenter aujourd'hui le rapport annuel de la BCE pour l'année 2003, lequel constitue, en conformité avec les dispositions du Traité, un des outils principaux de la BCE pour rendre compte aux citoyens de l'Europe et à ses représentants de la politique monétaire et des activités de la BCE dans les autres domaines de sa compétence.

Die EZB ist sich der grundlegenden Bedeutung ihrer Rechenschaftspflicht bewusst und hat stets betont, dass das sehr hohe Maß an Unabhängigkeit der EZB mit strengen Berichtspflichten, wie sie im EG-Vertrag festgelegt sind, einhergehen muss. Die EZB misst daher dem regelmäßigen Dialog mit den Bürgern Europas und ihren gewählten Vertretern höchste Bedeutung bei.

Economic and monetary issues

The ECB's monetary policy operated in a rather uncertain and challenging environment in 2003. In the first half of the year, real GDP growth stagnated amid considerable uncertainty related to geopolitical tensions and the turbulences in oil prices and financial markets. Following the easing of economic and geopolitical uncertainties, prospects for economic activity gradually brightened after the summer of 2003. Nevertheless, overall, real GDP in the euro area increased by only 0.5% in 2003.

Annual HICP inflation slowed down slightly in 2003 to 2.1% on average, from 2.3% on average in both 2001 and 2002. The persistence of inflation above 2% was mainly caused by increases in a number of volatile components of the HICP, in particular oil prices, and, in the second half of 2003, food prices. Rises in indirect taxes and administrative prices also added to inflation in 2003. From a medium-term perspective, however, we expected price developments to remain in line with price stability after the progressive elimination of the influences of those volatile components of the HICP.

This expectation resulting from our economic analysis was in line with our monetary analysis. Much of the strength of monetary growth in early 2003 was due to the high level of economic and financial market uncertainty prevailing at that time, which prompted portfolio shifts into safer, short-term liquid assets included in M3. In the Governing Council's assessment, the accumulation of excess liquidity was less of a concern for price stability as long as the economic recovery in the euro area remained gradual.

In view of the moderation of medium-term inflationary pressures in the first half of 2003, the ECB's key interest rates were reduced by 25 basis points in March 2003 and by 50 basis points in June of the same year. Thus, in June 2003, the interest rate on the main refinancing operations reached the level of 2.0%. Since then, this interest rate has remained unchanged at this historically very low level, whilst the preservation of inflationary expectations in line with our definition of price stability has contributed significantly to the very low level of medium and long term nominal and real interest rates. The resulting yield curve has delivered a financial environment which is lending very significant support to the economic recovery.

Turning now to more recent economic developments, the economic recovery which started in the second half of 2003 has continued in 2004. In terms of year-on-year growth rates, we reached 2% in the second quarter of this year. Quarterly growth rates since mid-2003 have been in the order of 0.4% to 0.7%. By and large, output growth in the last 12 months was close to present estimates of the potential growth rate in the euro area.

We expect a continuation of this growth trend in the coming quarters. On the external side, the world economy is, according to the IMF, currently recording its strongest growth in 30 years. Some moderation is expected next year, but euro area exports should nevertheless continue to benefit from favourable global demand conditions in 2005. On the domestic side, investment should normally benefit from the positive global environment, the very favourable financing conditions in the euro area and the improvements in corporate efficiency, and there is scope in the euro area as a whole for a strengthening of private consumption.

Naturally, some uncertainties to this outlook exist. One of the risks stems from developments in oil markets. If oil prices were to remain high, or even to increase further, they could dampen the strength of the recovery, both inside and outside the euro area, despite the fact that the oil intensity of the euro area is significantly lower than it was in the 1970s. We also need to keep in mind that part of the oil price increases is due to strong global demand, which was not the case in the first and second oil shocks. But it remains true that the oil price increase constitutes an adverse supply shock for the euro area economy as a whole. For the oil price shock to be absorbed smoothly, the policy mistakes of the past must not be repeated. In particular, "second-round" effects must be avoided.

With regard to consumer prices, oil market developments have had a direct impact on the euro area HICP. Following an annual rate of 1.7% in the first quarter of 2004, inflation reached 2.3% in the second quarter and 2.2% in the third quarter. Inflation rates over the past year have also been driven up by exceptionally strong rises in indirect taxes and administered prices. Nevertheless, looking ahead, the available information does not indicate that stronger underlying inflationary pressures are building up domestically as yet. Wage developments have remained moderate since the last quarter of 2003, and this trend should continue. Provided that there are no further significant shocks to prices, annual inflation rates should drop below 2% in the course of 2005.

However, I should also stress that, over recent quarters, several upward risks to the outlook for price stability have emerged which call for ongoing vigilance. These again relate to oil price developments, in particular if second-round effects stemming from wage and price-setting behaviour materialise. Other concerns relate to long-term inflation expectations and monetary trends.

Indeed, the downward trend in annual M3 growth since mid-2003 appears to have halted over the summer of 2004, and the shorter-term dynamics of M3 have strengthened. This reflects the fact that the historically low level of interest rates in the euro area continues to support monetary expansion. The low level of interest rates is also fuelling the growth of credit to the private sector and we have witnessed continued strong growth in loans for house purchase. Given the strength of M3 growth over the past few years, there is substantially more liquidity in the euro area than is needed to finance non-inflationary growth. This could pose inflationary risks in the future if this excess liquidity is not progressively reduced as a result of reverse portfolio shifts accompanying the recovery. Moreover, persistently high excess liquidity and strong credit growth could become a source of unsustainable asset price increases.

A sound and credible monetary policy is a necessary condition for sustainable growth and job creation but is not in itself a sufficient condition. Other conditions must be met, in particular, sound fiscal policies and appropriate structural reforms. In this respect, in the area of fiscal policy the year 2003 proved disappointing. The average fiscal deficit in the euro area increased from 2.4% to 2.7%. Moreover, the fiscal situation remained of great concern in countries that had already recorded significant imbalances in 2002. The aggregate euro area fiscal deficit-to-GDP ratio is not expected to improve in 2004 and the average debt-to-GDP ratio is expected to further deteriorate. This is a source of concern - all the more so in view of the important challenges for the consolidation of public finances which will have to be faced in the coming years, such as the fiscal burden of an ageing population.

Last year fiscal policy in the EMU faced a number of serious challenges. On 25 November 2003 the EU Council decided not to act on the basis of the Commission's recommendation and agreed to hold the excessive deficit procedure for the countries concerned in abeyance. The Governing Council of the ECB has, the very same day, supported the view of the Commission. The Stability and Growth Pact is a cornerstone of EMU. It is key to providing an economic rationale to a single currency area which has no federal government and to ensuring macroeconomic stability on a sustainable basis. The Governing Council of the ECB is of the opinion that substantial improvements in the Pact's implementation are needed, particularly as regards the preventive arm of the Pact. At the same time, it is not in favour of making changes to the text of the Treaty or of the Regulations which form the basis of the Pact and we insist on the importance of preserving the full integrity of the nominal anchor of 3% in the corrective arm of the Pact. I would also stress the vital importance of a reliable and timely reporting of government finance statistics which would not be subject, in any respect, to political interference and electoral cycles.

On a more positive note, both 2003 and 2004 have seen some progress towards structural reforms in several euro area countries. While implementing these reforms has not always been easy, I am confident that we will be able to see their positive effects in the next years. I have said clearly that the ECB was backing governments, parliaments and social partners that had embarked on those necessary reforms in the euro area. However, we should not become complacent. In many areas further reforms are needed. The continuing reform process is key to enhancing the euro area's production potential and ensuring future growth and employment opportunities. Let me also stress here that I am particularly concerned about the very abnormally high level of youth unemployment in many of our member countries.

The year 2003 was also marked by the final preparations for the enlargement of the European Union by ten new Member States with effect from 1 May 2004. For the ECB's part, the integration of the central banks of the ten new Member States into the European System of Central Banks proceeded very smoothly. The governors of the central banks of these countries are now members of the ESCB's General Council. In addition, the currencies of three of the ten countries have joined the exchange rate mechanism II (ERM II).

Important challenges remain for these countries on the road to adopting the euro. Last week the ECB, like the Commission, published the first Convergence Report dealing with these countries together with Sweden. The report, which uses the same framework as was used in the previous Convergence Reports, identified several priority areas in which individual countries will be required to make further efforts before they can adopt the euro. The picture which emerged varies significantly from country to country, but many share similar challenges with regard to price stability, fiscal sustainability, exchange rate stability and interest rate convergence, albeit to differing degrees. In addition, institutional convergence has not yet been achieved in all countries, in particular in the area of central bank independence. I cannot overemphasise the latter's importance for the successful pursuit of monetary policy. Overall, there is no uniform or preset timetable for the adoption of the euro by those member countries.

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The ECB appreciates the favourable comments contained in the European Parliament's draft resolution on the ECB's monetary policy strategy in 2003. Since its inception, the ECB has strived to demonstrate a strong commitment to achieving its primary objective of price stability. Inflation has remained subdued, despite a sequence of adverse disturbances. The draft resolution is in line with our thinking that it is by aiming at the credible pursuit of price stability as its primary objective, and by solidly anchoring medium and long-term inflation expectations, that the central bank will make the best possible contribution to creating an economic environment most conducive to sustainable growth.

Other issues raised in the European Parliament's draft resolution on the ECB's Annual Report 2003

Mr President, honourable Members of the European Parliament, let me re-emphasise that the ECB attaches the highest importance to its regular exchanges of views with the European Parliament, which is underscored in the 2003 Annual Report. I am therefore gratified to note that the draft resolution deems our dialogue a success. Indeed, the ECB is grateful for the suggestions made by Parliament. In this context, I can report to you that the ECB has decided to henceforth publish staff economic forecasts on a quarterly basis, in line with a proposal made by the European Parliament last year.

I have noted - and welcome - the fact that on most important issues the views expressed in the draft resolution are very similar to those held by the ECB, such as your statements on the ECB's policy conduct in 2003 and your diagnosis that a lack of structural reform is a major factor behind the weakness of euro area economic growth. I also welcome the fact that your draft resolution reflects the fact that there is a firm link between the credible pursuit of price stability on the one hand and the creation of an economic environment which is most conducive to growth on the other. I also fully share the view that more than five years on, EMU can be regarded as a great success.

On some issues, however, slight differences of view remain. The draft resolution asks for the publication of the minutes of the Governing Council meetings whilst accepting implicitly that individual votes of members would not be made public. We would very much appreciate that the Parliament could accept the argument that the publication of the votes of individual members of the Governing Council could trigger national public debates on whether national central bank governors have taken due account of national interests, when the Treaty calls for us to focus on the euro area as a whole. Such public discussions would have very adverse consequences for the credibility and effectiveness of the ECB's monetary policy.

As regards the minutes I have to stress that the ECB presents and explains its monetary policy decisions by means of comprehensive public statements at its press conferences which take place immediately after Governing Council meetings. By adopting this procedure in 1999, the ECB contributed to improving the global 'state of the art' in central bank transparency and became the first central bank to release a fully fledged diagnosis to explain monetary policy decisions immediately after they are taken. The information conveyed by the ECB in this way is, in essence, similar to what other central banks publish in "summary minutes", as it properly reflects the overall discussion in the Governing Council. The ECB is the only major central bank which makes possible an immediate interaction with the media. These features make the ECB one of the most transparent central banks in the world.

Let me also briefly touch upon the joint work of the ESCB and the Committee of European Securities Regulators with regard to the development of standards in the field of clearing and settlement, which is also addressed in the draft resolution. These standards are an important contribution to a safe and integrated securities infrastructure. The ECB attaches great importance to this objective, given that the current fragmentation of the infrastructure results in additional securities transaction costs and could become a source of financial instability.

However, while the ESCB-CESR standards on securities clearing and settlement have been designed in full compliance with the present regulatory framework, they are clearly not intended to pre-empt any future legislative acts in this area. Thus, should a Directive on clearing and settlement be adopted at a later stage, these standards would have to be assessed from the point of view their conformity with the provisions of such a Directive and, if necessary, amended accordingly.

I thank you for your attention.