Jean-Claude Trichet: Testimony before the Committee on Economic and Monetary Affairs of the European Parliament

Introductory statement by Mr Jean-Claude Trichet, President of the European Central Bank, before the Committee on Economic and Monetary Affairs of the European Parliament, Brussels, 30 November 2004.

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Madame la Présidente, Membres de la Commission Economique et Monétaire, j'ai l'honneur de paraître devant votre Commission aujourd'hui dans le cadre de notre dialogue régulier. Je me réjouis beaucoup de ce dialogue qui place l'Union Economique et Monétaire européenne au premier rang parmi les économies industrialisées en ce qui concerne la fréquence et la profondeur du dialogue entre le Parlement et l'Institut d'Emission. Je commencerai mon intervention par une évaluation de la situation économique et monétaire actuelle. Ich möchte außerdem zu aktuellen Themen der Fiskalpolitik und zum Fortschritt im Bereich der Strukturreformen Stellung nehmen, insbesondere im Hinblick auf den Lissabon Prozess und jüngste Produktivitätsentwicklungen in der Wirtschaft des Euroraums.

1. Economic and monetary developments

After the positive developments in the first half of 2004, more recent data have indicated that growth dynamics moderated somewhat in the second half of the year. Real GDP growth in the third quarter of 2004 is estimated to have been 0.3% quarter on quarter, following growth rates of 0.7 % and 0.5 % in the previous two quarters. Although it is difficult to interpret with certainty the estimate for the third quarter given the lack of a breakdown by components, it appears that the contribution of net exports was negative, the inventory built up was strong and private consumption growth remained sluggish. These developments seem to be related in particular to the effects of the increase in oil prices, which has reduced real disposable income in the euro area and has also dampened global economic growth.

Despite the adverse impact of the oil prices, a number of conditions remain in place for the euro area to continue to grow in 2005, albeit at a somewhat slower pace than previously anticipated. On the external side, while global growth is moderating, it nonetheless remains robust. In this context, euro area exports should continue to benefit from favourable global demand conditions. On the domestic side, investment should be supported by the global environment, the very favourable financing conditions in the euro area, solid profits and greater corporate efficiency gained through business restructuring. Finally, there is scope for private consumption to strengthen, in particular if uncertainties surrounding the extent and pace of the implementation of structural reforms are reduced.

The outlook for economic activity, both globally and domestically, continues to be surrounded by uncertainties, in particular as a result of present and possible future developments in oil markets which can dampen the strength of the recovery both inside and outside the euro area.

In any event, it is important that second-round effects in wage and price-setting be avoided. In addition, it would be essential to refrain from taking measures which would prolong the necessary adjustment process. Finally, monetary policy must remain firmly committed to the objective of maintaining price stability over the medium term.

Over recent months, oil price developments have also had a significant impact on consumer price inflation. In November, annual HICP inflation was estimated by Eurostat to have been 2.2%, after 2.4% in October. In addition, increases in indirect taxes and administered prices earlier this year have had a notable effect on consumer prices.

Looking ahead, inflation rates are likely to remain above 2% for the coming months, but should moderate thereafter in the absence of additional upward shocks. The information available does not suggest that stronger underlying inflationary pressures are building up in the euro area. Wage increases have remained moderate over recent quarters. In the context of moderate economic growth, this trend should continue in the future.

There are a number of upward risks to price stability. Such risks are mainly associated with oil price developments, uncertainty regarding future increases in indirect taxes and administrative prices, and potential second-round effects stemming from wage and price-setting behaviour. In this respect, it is essential that long-term inflation expectations remain solidly anchored to our definition of price stability and are not affected by current upward movements in HICP inflation.

Our monetary analysis also calls for vigilance regarding upside risks to price stability over the medium term. The shorter-term dynamics of M3 growth have strengthened over recent months. This seems very much related to the low level of interest rates in the euro area.

This very low level of interest rates also fuels private sector demand for credit. In particular, the demand for loans for house purchases is strong, supported by strong house price dynamics in several euro area countries. The growth in loans to non-financial corporations has also picked up over recent months.

As a result of the persistently strong growth in M3 over the past few years, there remains substantially more liquidity in the euro area than is needed to finance non-inflationary growth. This could pose risks to price stability over the medium term. In addition, persistently high excess liquidity and strong credit growth could also become a source of unsustainable asset price increases, particularly in property markets. Such developments need to be monitored carefully.

I would now like to make a few remarks on fiscal policies. Many governments are currently in the process of finalising their 2005 budgets. While a number of countries have managed to maintain sound budgetary positions over recent years, five euro area countries are expected by the Commission to have deficits close to or above 3% of GDP during this year and next.

This is a disappointing development. It reflects an insufficient commitment to address the existing structural imbalances. The current economic environment should be utilised to embark on comprehensive budget consolidation where needed. This would send a strong and confidence-inspiring signal that the objectives of sound public finances and a growth-friendly environment are being pursued.

Turning to the European fiscal framework, we remain convinced that there is no need to change the text of the Treaty and the Stability and Growth Pact. Having said that, we do see room for improvement in the way the fiscal rules are implemented. In particular, there is a need to ensure the pursuit of prudent fiscal policies in good times and for a stronger focus on public debt and sustainability. In this respect, some of the Commission’s proposals concerning the so-called “preventive arm” of the Pact are welcome and warrant further consideration. As regards the so-called “corrective arm” of the Pact, however, the ECB is concerned about proposals that could undermine the nominal anchor of 3% for the deficit-to-GDP ratio. This anchor of the fiscal framework is essential for maintaining expectations of fiscal discipline. This contributes to macroeconomic stability, economic growth and employment creation. The excessive deficit procedure and the Stability and Growth Pact remain a foundation for trust and confidence in EMU.

In this respect, reliable and timely government statistics are of vital importance to the credibility of the budgetary surveillance process. The European accounting rules must be fully respected when recording all types of expenditure and revenue. This should be done in a manner that is consistent and stable over time and homogeneous across countries. The procedures must not be vulnerable to political cycles, as stated by the ECOFIN Council. Countries should consider the quality and integrity of their statistics as a matter of priority.

2. The need for structural reform in the euro area

Let me now turn to the Lisbon agenda. The European Council intended to reinforce the process of structural reforms as from 2000 onwards. However, almost five years later, the European programme to become “the most competitive and dynamic knowledge-based economy in the world [..] by 2010” has not been implemented as promised. In this regard, the recent report by the High Level Group chaired by Wim Kok, which provides an independent assessment of the Lisbon strategy and contributes to next year’s mid-term review of the strategy, expresses an urgent call for renewed impetus. It proposes a stronger commitment of national governments and a sharpening of the Lisbon strategy’s focus by placing particular emphasis on the acceleration of employment and productivity growth “via a wide range of reform policies as well as a wider macroeconomic framework as supportive as possible of growth, demand and employment.”

The ECB welcomes the conclusions of the High Level Group as well as the subsequent ECOFIN reaction, which is also supportive. Concerning the role of macroeconomic policies in fostering the success of the Lisbon process, I would like to stress that an independent monetary policy aimed at delivering price stability and being credible in that delivery over the medium and long term, together with a fiscal policy in compliance with the Stability and Growth Pact to maintain fiscal sustainability, are the best contributions that macroeconomic policies can make to facilitate the implementation of reforms. Price stability is a necessary condition for being effective in fostering sustainable growth as well as of supporting employment and social cohesion, thus supporting the Lisbon objectives which, in turn, are another necessary condition for enhancing growth and job creation. Consequently, as was concluded by the ECOFIN Council in its first reaction to the Kok report, the macroeconomic framework needs to be supportive of stability and growth.

As for increasing the incentives to implement reforms, the ECB has in the past pointed to the supportive role of a more transparent and effective benchmarking based on sensibly defined quantitative indicators. Apart from creating peer pressure and accountability on the side of policymakers, benchmarking can be a crucial driver of public discussion in the EU, raising public awareness about the benefits all European citizens could derive in terms of growth and job creation from these necessary reforms. This is a reasonable approach to further the implementation of the Lisbon strategy in a context where structural reform is the responsibility of Member States.

In the absence of sufficient progress in structural reform, weak productivity growth has contributed to the low growth performance observed in the euro area in recent years. In the 1980s, the annual growth rate of labour productivity per hour worked was on average 2.3% in the euro area. It significantly decelerated during the 1990s to reach an average of 1.2% over the period 1996-2003.

As a consequence, the gap with the United States has widened over recent years. More specifically, since the mid-1990s, the gap in labour productivity growth between the United States and the euro area was on average 0.7 percentage point when measured per hour worked. However, it was nearly twice as large when measured per head due to considerable divergences in trends in average working hours between the two economies.

Alongside further progress on reforms directed towards higher rates of labour utilisation in the euro area, developments in recent years reinforce the need to implement policies aimed specifically at boosting labour productivity. In this respect, one of the main priorities of the Lisbon agenda is to encourage innovation and technological diffusion, which are among the key factors affecting long-term productivity growth.

First, policies should aim at easing regulations. Regulations limiting product market competition or hindering labour market adaptability have negative repercussions on innovation and technological advancements. EU countries made significant progress in product market reforms during the 1990s, but significant barriers to competition and innovation remain, in particular in the service sectors, which urgently need to be tackled. The ECB would strongly back the Commission's initiatives in that respect.

Second, policies should promote investment in research and development, which is also an important driver of innovation. Third, policies should aim at improving human capital. Technological advancements imply that labour skills change over time. Therefore, measures favouring the continuous development of human capital contribute to further innovation, facilitate the use of advanced technologies and allow technical change to translate into more jobs.

To conclude, the Lisbon agenda incorporates the relevant priorities to promote long-term productivity growth as a key condition to making Europe more competitive and dynamic. The ECB supports governments, parliaments and social partners who are courageously implementing these necessary reforms.

I am now ready to answer your questions.