# 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, Brussels, 14 March 2005.

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Madame la Présidente, Mesdames et Messieurs les 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. Comme vous le savez, j'attache beaucoup d'importance à nos rencontres trimestrielles qui permettent à la Banque Centrale Européenne d'expliquer ses décisions et de répondre à toutes les questions que se posent les Parlementaires. Mes collègues et moi-même considérons ces rencontres fréquentes comme essentielles au bon fonctionnement de l'Union Economique et Monétaire. Ich möchte meine Ausführungen mit einer Beurteilung der aktuellen wirtschaftlichen und monetären Entwicklung beginnen. Sodann werde ich zu fiskalpolitischen und strukturpolitischen Fragen Stellung nehmen. Abschließend möchte ich Ihnen einige Überlegungen hinsichtlich der Folgeaktivitäten zum EU Aktionsplan für Finanzdienstleistungen vorstellen.

## Economic and monetary developments

After the positive developments in the first half of 2004, only modest growth rates of economic activity were observed in the second half. Real GDP in the euro area is estimated to have grown at a quarter-on-quarter rate of 0.2% in both the third and fourth quarter. Taking the year as a whole, real GDP growth – on a working-day adjusted basis – was +1.8% in 2004, marking a significant improvement from the 0.5% seen in 2003. The composition of demand growth in the fourth quarter offered some positive signs with regard to the outlook for economic activity.

In the coming quarters consumption growth could benefit from anticipated developments in real disposable income. Investment is expected to continue to benefit from very favourable financing conditions, robust earnings and greater business efficiency. Euro area exports should continue to benefit from strong world economic growth. Accordingly, we expect continued relatively moderate economic growth in the euro area in 2005 and 2006, as reflected in the ECB staff projections published earlier this month, which are broadly in line with available forecasts from international and private sector organisations.

Nevertheless, the outlook for economic activity continues to be surrounded by uncertainties. On the external side, high and volatile oil prices and persistent global imbalances pose downside risks to growth. As regards exchange rates, we confirm our position – expressed when the euro rose sharply – that such moves are unwelcome and undesirable for economic growth. On the domestic side, there are uncertainties surrounding the evolution of private consumption, while the favourable financing conditions and the recovery in corporate earnings could lead to higher investment growth than is currently projected.

Turning to price developments, the evolution of oil prices and increases in indirect taxes and administered prices have had a significant impact on consumer price inflation in the course of last year. For 2004 as a whole, annual HICP inflation was 2.1%. More recently, the annual inflation rate declined quite substantially, falling to 1.9% in January from 2.4% in December, largely a result of base effects from developments in indirect taxes and administered prices in some countries. Eurostat's flash estimate of annual HICP inflation in February was 2.0%.

In the coming months, annual inflation rates are likely to fluctuate around 2%. Looking further ahead, there is still little evidence that stronger underlying domestic inflationary pressures are building up in the euro area. Wage increases have remained moderate over recent quarters and this trend should continue in the context of moderate economic growth. Accordingly, the ECB staff projections put average annual HICP inflation between 1.6% and 2.2% in 2005 and between 1.0% and 2.2% in 2006, broadly unchanged from the Eurosystem staff projections published in December. This is consistent with forecasts recently released by international and private sector organisations.

However, risks to price stability over the medium term remain on the upside, requiring continued vigilance. Such risks continue to be associated mainly with oil price developments, uncertainty regarding future increases in indirect taxes and administered prices, and potential second-round effects stemming from wage and price-setting behaviour. In this respect, developments in long-term inflation expectations need to be monitored closely.

Our monetary analysis also calls for vigilance regarding upside risks to price stability over the medium term and long term. After moderating in the first half of 2004, M3 growth has strengthened significantly since mid-2004, reflecting the stimulative effect on monetary dynamics of the historically very low level of interest rates in the euro area. As a result of the persistently strong growth in M3 over the past few years, substantially more liquidity exists in the euro area than is needed to finance non-inflationary economic growth. The exceptionally low level of real interest rates is also stimulating private sector demand for credit.

In the context of relatively contained underlying inflationary pressures, the ECB has left its key interest rates unchanged since June 2003. The low level of nominal and real interest rates has provided significant and continued support to the economic recovery. At the same time, upside risks to price stability remain. Cross-checking with the indications from monetary analysis supports the case for continued vigilance with regard to those risks.

## Fiscal policies and the Stability and Growth Pact

I would now like to make a few remarks on fiscal policies. While some progress on fiscal consolidation and the correction of excessive deficits is envisaged in euro area countries' updated stability programmes, further consolidation in a number of countries is needed.

With respect to the Stability and Growth Pact, discussions now need to be brought to a convincing conclusion with an outcome that safeguards fiscal discipline. The fiscal framework enshrined in the Treaty and in the Stability and Growth Pact is a cornerstone of Economic and Monetary Union, crucial for the economic rationale and the overall cohesion of EMU.

As the Committee on Economic and Monetary Affairs of the European Parliament knows, since the beginning of these discussions the ECB has made its views clear. Improvements in the implementation of the Stability and Growth Pact, and in particular its preventive arm, would be welcome. But the corrective arm should not be weakened. The credibility of the excessive deficit procedure as a means to deter and correct excessive deficits needs to be fully preserved. This is necessary in order to anchor expectations of fiscal discipline, which is fundamental not only for macroeconomic stability and cohesion in the euro area but also for enhancing confidence and fostering growth prospects in all Member States.

## The Lisbon strategy

Let me now turn to the forthcoming mid-term review of the Lisbon strategy. The Lisbon strategy was designed in 2000 to push forward structural reforms, which Europe so urgently needs in order to maintain its high level of prosperity. Structural reforms raise European economies' growth potential. They also enable countries to face the challenges of technological change, globalisation and ageing populations. In addition, structural reforms increase countries' resilience to economic shocks, contribute to improving the management of public spending and make it easier to maintain price stability. Five years after Lisbon, however, there is broad agreement that progress on structural reforms, particularly at the national level, has been unsatisfactory. This is not to deny that there has been notable and in some areas impressive progress on the implementation of structural reforms across Europe. However, much remains to be done to meet the challenges most European countries still face. In particular, the EU needs to increase employment and labour utilisation, especially in the context of ageing populations. At the same time, productivity needs to be raised. Against this background, the ECB supports the Commission's proposals to push forward the Lisbon strategy by focusing reform efforts at the national and European level on "delivering stronger, lasting growth and creating more and better jobs". Such an economic environment would facilitate the achievement of the Lisbon agenda's social and environmental objectives. Through the maintenance of price stability, the ECB will continue to support the Lisbon process by providing a vital element for fostering sustainable output growth as well as for supporting employment and social cohesion.

The ECB also supports national governments when they are determined to close the existing implementation gap, which must be done in order to reap the full benefits of reforms. This should also improve consumer and business confidence in the short run. In this regard, the ECB sees the use of benchmarking as an important instrument for fostering the implementation of reforms by surveying best practices across Member States. Benchmarking, based on sensibly defined quantitative indicators, should be regarded as a welcome driver of public debate, raising public awareness that structural reforms can be implemented successfully in EU countries and that they have important benefits.

### The post-Financial Services Action Plan strategy

Let me now turn to the ongoing structural reform process in the field of financial services. Since the introduction of the single currency, financial integration at the level of institutions, markets and market infrastructures has been making significant progress. This is especially the case in wholesale markets, such as the unsecured money market, the government bond market and the related derivatives markets. This development is also the result of the impetus provided by the public measures taken in the context of the Financial Services Action Plan (FSAP), which is about to be completed. At the same time, integration in retail markets is not yet sufficiently advanced.

As regards the post-FSAP strategy, although the ECB is still in the process of formulating its views on the matter, we have already identified at least three important elements.

First, the focus should be on the effective and consistent implementation of the FSAP at the national level. New legislative initiatives at the Community level should be kept to a minimum and only introduced if strictly necessary. In this respect, the implementation of the Lamfalussy framework represents a unique opportunity to achieve a consistent regulatory and supervisory framework for financial services. Indeed, the experience so far gained with the implementation of the framework in the securities field is broadly positive. It should be recognised, however, that there is still scope for improvement, for instance with regard to striking the right balance between the two levels of Community legislation (core principles and technical details).

Second, the policies relating to the regulatory and supervisory framework should be complemented by and closely coordinated with other relevant policies for financial services, for instance competition policy.

Third, incentives should be provided for the private sector to play its role in exploiting the opportunities offered by public action. Where appropriate, mechanisms should be provided to facilitate coordinated approaches among market participants.

Moreover, the Eurosystem has requested that a Single Euro Payments Area (SEPA) be created for the euro area from 1 January 2008, meaning that citizens and enterprises could make payments throughout the euro area from a single bank account, using a single set of payment instruments, as easily and safely as in the national context today. In addition, national infrastructures should migrate to a pan-European payments infrastructure by the end of 2010. We appreciate the Commission’s support for the SEPA project. The ECB is also in a regular dialogue with the banking industry to seek market participants’ support for these objectives.

I am now ready to answer your questions.