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, at the European Parliament, Brussels, 14 September 2005.

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Madame la présidente, Mesdames et Messieurs les membres de la Commission économique et monétaire, j'ai l'honneur de paraître devant votre Commission aujourd'hui dans le cadre de notre dialogue régulier. À cette occasion, je voudrais rendre hommage à Wim Duisenberg, qui est décédé à la fin du mois de juillet. Le premier président de la Banque centrale européenne a apporté une contribution considérable à la construction européenne. Il a joué un rôle décisif dans la mise en place des institutions monétaires en Europe, dans le lancement réussi de la nouvelle monnaie, dans l'affirmation de la crédibilité de notre monnaie unique – l'euro – et dans l'instauration de la confiance placée en elle. Nous le regrettons profondément.

Je commencerai mon intervention aujourd'hui par une évaluation de la situation économique et monétaire actuelle. Ich möchte außerdem zu aktuellen Themen der Fiskalpolitik und zu den Fortschritten im Bereich der Strukturreformen Stellung nehmen. Abschließend möchte ich die Position der EZB zu den Folgeaktivitäten hinsichtlich des EU-Aktionsplans für Finanzdienstleistungen erläutern.

Economic and monetary issues

At the time of my last appearance before the European Parliament in July the underlying trend in real economic growth in the euro area remained modest. Looking ahead, we expected that positive fundamental factors – notably strong global demand and robust earnings in the euro area – would contribute to a certain pick up and a broadening of economic activity.

The latest data and indicators have not changed this assessment. According to Eurostat's flash estimate, real GDP grew at a quarter-on-quarter rate of 0.3% in the second quarter of this year, compared with 0.4% in the first quarter of 2005, confirming that the underlying growth dynamics remained subdued in the first half of 2005. At the same time, the most recent survey indicators have, on balance, supported the view that economic growth could improve in the second half of this year. Looking further ahead, conditions continue to be in place for positive fundamental factors to influence the outlook and for economic activity to pick up beyond the short term. On the external side, ongoing growth in global demand and improvements in euro area price competitiveness should support euro area exports. On the domestic side, investment should benefit from the exceptionally low level of both nominal and real market interest rates prevailing across the entire maturity spectrum, as well as from the robust growth of corporate earnings and ongoing improvements in corporate efficiency. Consumption growth should gradually rise, broadly in line with expected developments in disposable income.

This picture is consistent with the most recent ECB staff projections, which envisage euro area real GDP growing at rates of between 1.0% and 1.6% in 2005 and between 1.3% and 2.3% in 2006. Compared with the June projections, the ranges projected for real GDP growth have been adjusted slightly downwards. For 2005, this mainly reflects slight downward revisions of past data, while for 2006 this reflects the projected effects on disposable income of increases in oil prices.

This outlook for economic activity is subject to a number of downward risks, relating mainly to higher oil prices, low consumer confidence and concerns about global imbalances. In particular, the potential further dampening impact of oil prices on the outlook for growth is being monitored very closely. Oil prices have continued to rise, increasing considerably since the beginning of the year, and developments in futures prices suggest that market participants expect the current tightness in oil markets to persist. Obviously, the situation has been further complicated by the tragic effects of Hurricane Katrina. All our thoughts are with the people of the city of New Orleans and all affected neighbouring areas and we are touched by the wave of global solidarity helping them to cope with their immediate needs. At the same time, it remains difficult to assess the full extent of the damage and the period of time necessary for its repair. Normally, despite the significant wealth destruction resulting from such storms, the economic impact at the national level is limited to the short term and is increasingly offset by the positive impacts of rebuilding activity. At the moment, we consider that the global impact will most likely remain limited and temporary, but we will of course continue to monitor very closely any available further evidence.

Turning to price developments, recent increases in oil prices have pushed headline inflation rates to levels in excess of 2% over the last months. According to Eurostat's flash estimate, annual HICP inflation was 2.1% in August, compared with 2.2% in July, and inflation rates are expected to fluctuate around current levels over the next few months, with some further increases towards year-end. At the same time, when analysing underlying domestic inflationary trends, there continues to be no significant evidence of upside pressures building up in the euro area. In particular, wage increases have remained contained over recent quarters and this trend should prevail for the time being, given the current labour market situation.

This picture is broadly in line with the new ECB staff projections. ECB staff project average annual HICP inflation to lie between 2.1% and 2.3% in 2005 and between 1.4% and 2.4% in 2006. These projections constitute significant upward revisions to the Eurosystem staff inflation projections published in June, mainly reflecting the fact that oil prices have once again increased by more than was suggested earlier by forward rates.

Upside risks to this new baseline inflation scenario remain, relating to potential further rises in oil prices, administered prices and indirect taxes. More fundamentally, the main risks to the inflation outlook stem from potential second-round effects in wage and price-setting behaviour triggered by ongoing oil price rises. In this respect, it is essential that the social partners continue to meet their responsibilities. Against this background, we will continue to monitor inflation expectations very closely. Particular vigilance is required in order to ensure that longer-term inflation expectations remain well-anchored in the euro area.

Turning to the monetary analysis, money and credit have continued to grow robustly in the euro area over the last few months, mainly driven by the prevailing low level of interest rates. In particular, the growth of mortgage borrowing remains very strong. In this context, price dynamics in housing markets need to be monitored closely. The liquidity situation in the euro area remains ample by all plausible measures, indicating risks to price stability over medium to longer horizons.

In conclusion, oil price developments have again led to upward revisions of inflation projections for the year ahead. At the same time, medium-term domestic inflationary pressures still remain contained, while the balance of risks to the baseline inflation scenario is tilted to the upside. Cross-checking the economic analysis with the monetary analysis confirms the need for particular vigilance in order to keep medium-term inflation expectations firmly anchored at levels consistent with price stability. By achieving this, monetary policy is making a significant contribution towards economic growth and job creation in the euro area.

Turning to fiscal policies, the latest available information suggests that the pace of fiscal consolidation in many euro area countries remains unsatisfactory. It is of particular concern that targets for correcting excessive deficits are at risk in some cases. Moreover, countries that have recently breached the 3% deficit limit are being granted relatively long periods to correct the situation in what constitutes a very generous application of the reformed Stability and Growth Pact. Against this background, it is important to recall that the best contribution that fiscal policies can make to stability, growth and cohesion in the euro area is to effectively tackle existing fiscal imbalances as part of a determined and well-designed economic reform programme. In this context, a rigorous implementation of the new rules is needed. This would reinforce the credibility of the Stability and Growth Pact, boost expectations of sound fiscal policies and thereby help to increase confidence in economic growth prospects.

As regards structural reforms, the European Commission has recently presented the "Community Lisbon Programme", which contains a list of measures at the EU level to relaunch the Lisbon strategy. The ECB fully backs this initiative, in particular the measures to further open EU markets and to simplify the regulatory framework within which business operates. Progress at both the Community and the Member State level is crucial to addressing the economic challenges facing the EU.

Financial services policy

I would now like to say a few words about the European Commission's Green Paper on Financial Services Policy for the period 2005-2010. As already expressed in its contribution to the Commission's public consultation, the Eurosystem supports the key policy orientation of the Green Paper, which highlights the need to focus on the consolidation and consistent implementation of the legislative framework for financial services. To this end, the potential of the Lamfalussy framework should be exploited to the extent possible.

As regards the area of financial regulation, the Eurosystem concurs with the emphasis placed by the Commission on the objective of rationalising the existing framework. The proposal for "better regulation" based on open, transparent and evidence-based policy-making is fully supported. The Eurosystem also supports the suggestion by the Commission to launch a feasibility study on the development of one body of consistent law. We regard such a "financial services rulebook" as a tool to rationalise the existing set of EU rules for financial institutions and, in particular, to reduce complexity and legal uncertainties and to eliminate possible inconsistencies.

Still in the context of financial regulation, the completion of the current FSAP legislative work is also important. In that connection, I would like to mention in particular the Capital Requirements Directive, on which, I am informed, work is proceeding smoothly. Also, I would like to make a specific reference to the issue of securities clearing and settlement, to which the Eurosystem attributes great importance. An efficient securities clearing and settlement infrastructure is of fundamental importance to the integration and smooth functioning of financial markets. To this end, the Eurosystem supports the Commission's intention to put forward a proposal for a directive on securities clearing and settlement. On the question of new regulatory initiatives, we share the view that asset management and retail financial services are areas where regulatory intervention could be considered.

In the area of financial supervision, the Eurosystem fully supports the Commission's view that the current institutional set-up should be exploited to the maximum extent before any potential structural change is considered. In particular, the Eurosystem agrees that the main policy objective in the area of financial supervision is two-fold: first, to enhance the competitiveness of EU financial markets and institutions and to facilitate the development of cross-border finance both in terms of institutions and in terms of products and services – the so-called financial integration angle; and second, to ensure the effectiveness of standards for oversight and supervision in a more integrated financial system – the so-called financial stability angle. In this respect, we attach particular importance to the consistent implementation of financial services legislation and the pursuit of supervisory convergence, as well as to the effective cooperation between home and host authorities. We are of the view that it is important that home-host coordination be developed on a robust and consistent basis for the financial groups involved in a way that both ensures effective supervision and reduces compliance costs. The Level 3 Committees play a very important role in this respect. Furthermore, we see a need for the current regime for the supervision of liquidity risk to be reviewed against the background of financial market developments, including the introduction of the euro.

As regards financial stability, which represents an area of particular interest to the Eurosystem, we are of the opinion that the refinement of financial stability arrangements should remain a key priority for the EU. There are three broad areas where the Eurosystem sees room for enhancing the present arrangements, namely financial stability assessment, the management of financial stress and deposit insurance. In this respect, let me recall that the provision of Emergency Liquidity Assistance is a central banking function and that there is an agreement within the Eurosystem on how this facility operates in the euro ara. Thus, there are no specific issues relating to the provision of Emergency Liquidity Assistance that need to be addressed in the context of the post FSAP work.

Finally, let me stress again that the Governing Council of the ECB is very strongly attached to the full completion of the single market for banking services and to a level playing field making absolutely no difference between nationalities.

I am now ready to answer your questions.