European Central Bank: Press conference – introductory statement

Introductory statement by Mr Jean-Claude Trichet, President of the European Central Bank, Frankfurt am Main, 12 April 2007.

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Ladies and gentlemen, the Vice-President and I are very pleased to welcome you to today's press conference. Let me report on the outcome of our meeting, which was also attended by the President of the Eurogroup, Prime Minister Juncker, and Commissioner Almunia.

On the basis of our regular economic and monetary analyses, we decided at today's meeting to leave the **key ECB interest rates** unchanged. The information that has become available since our last meeting has further underpinned the reasoning behind our decision to increase interest rates in March. It has also confirmed that the medium-term outlook for price stability remains subject to upside risks, so that very close monitoring of all developments is warranted. Indeed, it is essential to ensure that risks to price stability over the medium term do not materialise. This will contribute to ensuring that medium to longer-term inflation expectations in the euro area remain solidly anchored at levels consistent with price stability. Such anchoring is a prerequisite for monetary policy to make an ongoing contribution towards supporting sustainable economic growth and job creation in the euro area. Given the favourable economic environment, our monetary policy continues to be on the accommodative side, with the key ECB interest rates moderate, money and credit growth vigorous, and liquidity in the euro area ample by all plausible measures. Therefore, looking ahead, acting in a firm and timely manner to ensure price stability in the medium term is warranted.

Turning first to the **economic analysis**, recent information has underpinned our assessment of ongoing robust economic growth dynamics in the euro area. Eurostat's second estimate has confirmed quarter-on-quarter real GDP growth in the fourth quarter of 2006 at 0.9%. Over the whole year 2006, real GDP grew by 2.7% in the euro area, unadjusted for the number of working days. On the basis of the latest data, survey releases and various indicator-based estimates, it appears that robust growth is continuing in the first half of 2007.

Looking further ahead, the conditions are in place for the euro area economy to grow solidly. As regards the external environment, global economic growth has become more balanced across regions and, while moderating somewhat, remains strong. External conditions thus continue to provide support for euro area exports. Domestic demand in the euro area is also expected to maintain its relatively strong momentum. Investment should remain dynamic, benefiting from an extended period of favourable financing conditions, balance sheet restructuring, accumulated and ongoing strong corporate earnings, and gains in business efficiency. Consumption should also strengthen further over time, in line with developments in real disposable income, increasingly supported by employment growth and improving labour market conditions.

The risks surrounding this favourable outlook for economic growth are broadly balanced over the shorter term. At longer horizons, downside risks remain, stemming mainly from the external side. They relate to fears of a rise in protectionist pressures, the possibility of further increases in oil prices and concerns about possible disorderly developments owing to global imbalances.

As regards price developments, according to Eurostat's flash estimate, annual HICP inflation was 1.9% in March 2007, compared with 1.8% in the first two months of the year. A detailed breakdown of the March HICP data is not yet available. Looking ahead, barring further increases in oil prices, last year's volatility in energy prices will lead to significant base effects, thereby affecting the profile of annual inflation rates this year. On the basis of the current level of oil prices and oil price futures, annual inflation rates are likely to fall in the months to come, before rising towards the end of the year to hover again at around 2%.

Over the policy-relevant medium-term horizon, the outlook for price developments remains subject to upside risks. These relate to the possibility of further oil price rises and additional increases in administered prices and indirect taxes beyond those announced and decided thus far. More fundamentally, stronger than currently expected wage developments could pose significant upward risks to price stability, not least in view of the favourable momentum in labour markets observed over the past few quarters. It is therefore crucial that the social partners continue to meet their responsibilities. In this context, wage agreements should take into account price competitiveness positions, the still high level of unemployment in many economies, as well as productivity developments. The Governing Council monitors the wage negotiations in euro area countries with particular attention.

The **monetary analysis** confirms the prevailing upside risks to price stability at medium to longer horizons. Annual M3 growth increased further to 10.0% in February, from 9.9% in January. At the same time, the annual growth rate of loans to the private sector, while remaining very strong at 10.3% in February, showed some further signs of moderation. Whereas in previous months this moderation reflected a decline in the growth rate of household borrowing in an environment of rising mortgage lending rates throughout the euro area and a slowing increase in house prices in some regions, in February it was due to a moderation in the growth of loans to non-financial corporations. When assessing such developments, it should be borne in mind that monthly figures can be influenced by temporary factors and should thus not be overstated. Indeed, the strong growth in private sector credit reflects the continuation of the strong trend in the growth of borrowing by non-financial corporations seen since mid-2004.

When put in perspective, the latest data continue to point to vigorous dynamics in the underlying rate of broad money expansion in the euro area. The continued robust expansion of money and credit reflects the low levels of interest rates over a prolonged period of time and the strengthening of economic activity in the euro area. Rising short-term interest rates, in combination with low long-term interest rates, have had an impact on developments in the individual components of monetary and credit aggregates, but have thus far had only a limited influence on the overall strength of monetary developments. Following several years of robust monetary growth, the liquidity situation in the euro area is ample by all plausible measures. In this environment of ample liquidity, the continued vigorous expansion of money and credit points to upside risks to price stability over the medium to longer term. Monetary developments therefore continue to require very careful monitoring, particularly against the background of a solid expansion in economic activity and continued strong property market developments in many parts of the euro area.

To sum up, in assessing price trends it is important to look through any short-term volatility in inflation rates. The relevant horizon for monetary policy is the medium term. Risks to the medium-term outlook for price stability remain on the upside, relating in particular to stronger than currently expected wage developments in a context of ongoing robust growth in employment and economic activity. Given the vigorous monetary and credit growth in an environment of already ample liquidity, a **cross-check** of the outcome of the economic analysis with that of the monetary analysis supports the assessment that upside risks to price stability prevail over the medium to longer term. Accordingly, the Governing Council will continue to monitor very closely all developments. Indeed, it is essential to ensure that risks to price stability over the medium term do not materialise. This will support the solid anchoring of medium to longer-term inflation expectations in the euro area at levels consistent with price stability. Therefore, looking ahead, acting in a firm and timely manner to ensure price stability in the medium term remains warranted.

Concerning other policy areas, the Governing Council welcomed the recommendations addressed to the euro area countries in the 2007 update of the Integrated Guidelines, which was endorsed by the European Council at its meeting on 8 and 9 March, particularly to speed up fiscal consolidation, to improve the quality of public finances, to foster competition and integration, and to promote labour market reforms. Indeed, as regards **fiscal policy**, it is of the utmost importance to use the momentum of the improved economic situation and to press ahead vigorously with budgetary consolidation. Government deficit and debt-to-GDP ratios in euro area countries in 2006 have turned out to be significantly better than anticipated. But this positive outcome largely reflects buoyant tax revenues in the context of a favourable macroeconomic environment, offsetting in some cases higher than planned public expenditure. The better than expected fiscal outcomes in 2006 should lead to more ambitious targets for 2007 and beyond, allowing revenue windfalls to be fully allocated to deficit and debt reduction. Furthermore, procyclical fiscal policies should be avoided in all countries. This is of vital importance to ensure fiscal sustainability in preparation for the impact of ageing populations and is fully in line with the revised Stability and Growth Pact. Reviewing public expenditure and taxation so as to improve the quality of public finances would additionally foster economic growth and fiscal sustainability. We also support ambitious **structural reforms**, which would further contribute to the smooth functioning of Monetary Union and support growth potential and job creation. In particular, improving labour market flexibility to better align wage and productivity developments and facilitating labour mobility would further strengthen the resilience of countries to shocks and ensure their competitiveness. We are now at your disposal for questions.