European Central Bank: Press conference – introductory statement

Introductory statement by Mr Jean-Claude Trichet, President of the European Central Bank and Mr Lucas Papademos, Vice-President of the European Central Bank, Frankfurt am Main, 6 August 2009.

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Ladies and gentlemen, the Vice-President and I are very pleased to welcome you to today's press conference. We will now report on the outcome of today's meeting of the Governing Council.

On the basis of its regular economic and monetary analyses, the Governing Council decided to leave the **key ECB interest rates** unchanged. The information and analyses that have become available since our meeting on 2 July 2009 confirm our view that the current rates remain appropriate. As anticipated, annual HICP inflation in July fell further into negative territory, reflecting mainly temporary effects. After a return to positive inflation rates during the second half of the year, we continue to expect price developments to remain subdued over the policy-relevant horizon. Recent data releases and survey information still suggest that economic activity over the remainder of this year is likely to remain weak, although the pace of contraction is clearly slowing down. This assessment takes into account adverse lagged effects, such as a further deterioration in labour markets, which are likely to materialise over the coming months. Looking ahead into next year, after a phase of stabilisation, a gradual recovery with positive quarterly growth rates is expected. Available indicators of inflation expectations over the medium to longer term remain firmly anchored in line with the Governing Council's aim of keeping inflation rates below, but close to, 2% over the medium term. The outcome of the monetary analysis confirms the assessment of low inflationary pressure, as money and credit expansion continues to decelerate. Against this background, we expect the current episode of extremely low or negative inflation rates to be short-lived and price stability to be maintained over the medium term, thereby continuing to support the purchasing power of euro area households.

Let me now explain our assessment in further detail, starting with the **economic analysis**. The data and survey information that have become available since our meeting on 2 July 2009 have broadly confirmed our previous expectations. While uncertainty is still high, there are increasingly signs that the global recession is bottoming out. As regards the euro area, recent surveys suggest that the pace of contraction is clearly slowing down. However, economic activity over the remainder of this year is expected to remain weak. Looking ahead into next year, after a phase of stabilisation, a gradual recovery with positive quarterly growth rates is expected. The significant policy stimuli in all major economic areas should support growth globally, including in the euro area.

In the view of the Governing Council, uncertainty remains high and we have to be prepared for ongoing volatility in incoming data. Overall, the risks to this outlook remain balanced. On the upside, there may be stronger than anticipated effects stemming from the extensive macroeconomic stimulus being provided and from other policy measures taken. Confidence may also improve more quickly than currently expected. On the downside, concerns remain relating to a stronger or more protracted negative feedback loop between the real economy and the turmoil in financial markets, renewed increases in oil and other commodity prices, the intensification of protectionist pressures, more unfavourable than expected labour market conditions and, lastly, adverse developments in the world economy stemming from a disorderly correction of global imbalances.

With regard to price developments, annual HICP inflation was, according to Eurostat's flash estimate, -0.6 % in July, compared with -0.1% in June. This further decline in annual rates of inflation was anticipated and reflects primarily base effects resulting from the peaks observed in global commodity prices a year ago.

Looking ahead, owing to these base effects, annual inflation rates are projected to remain temporarily in negative territory, before turning positive again later this year. However, such short-term movements are not relevant from a monetary policy perspective. Consistent with available forecasts and projections, looking further ahead, inflation is expected to remain in positive territory, while price and cost developments are expected to remain subdued in the wake of ongoing sluggish demand in the euro area and elsewhere. In this respect, indicators of inflation expectations over the medium to longer term remain firmly anchored in line with the Governing Council's aim of keeping inflation rates below, but close to, 2% over the medium term.

Risks to the outlook for inflation are broadly balanced. They relate, in particular, to the outlook for economic activity and to higher than expected commodity prices. Furthermore, increases in indirect taxation and administered prices may be stronger than currently expected owing to the need for fiscal consolidation in the coming years.

Turning to the **monetary analysis**, the latest data confirm the ongoing deceleration in broad money and credit growth. The annual growth rates of M3 and of loans to the private sector recorded in June – 3.5% and 1.5% respectively – are the lowest since the start of Stage Three of EMU. These developments support the assessment of a slower underlying pace of monetary expansion and low inflationary pressures over the medium term.

The declining pace of monetary expansion since the last quarter of 2008 continues to be accompanied by volatility in the short-term developments of M3 and its components. This reflects to a large extent the impact that absolute and relative changes in interest rates have had on the allocation of funds between financial investments inside and outside M3 and between the different deposit categories within M3. In this respect, the shift in allocation from short-term time deposits to overnight deposits within M3 has led to a further substantial strengthening of annual M1 growth in June.

The flow of bank loans to the non-financial private sector remained subdued in June, albeit with differences across borrowing sectors. The flow of loans to non-financial corporations turned substantially more negative owing to a sharp contraction in short-term lending. At the same time, the flow of loans to households was slightly more positive than last month. The ongoing uncertainty seems to have dampened borrowers' demand for financing. However, according to the latest euro area bank lending survey, lenders tightened their credit standards to a significantly lesser extent. Given the challenges that lie ahead, banks should take appropriate measures to strengthen further their capital bases and, where necessary, take full advantage of government measures to support the financial sector, particularly as regards recapitalisation.

To sum up, the information and analyses that have become available since our meeting on 2 July 2009 confirm the view of the Governing Council that the current key ECB interest rates remain appropriate. As anticipated, annual HICP inflation in July fell further into negative territory, reflecting mainly temporary effects. After a return to positive inflation rates during the second half of the year, we continue to expect price developments to remain subdued over the policy-relevant horizon. Recent data releases and survey information still suggest that economic activity over the remainder of this year is likely to remain weak, although the pace of contraction is clearly slowing down. This assessment takes into account adverse lagged effects, such as a further deterioration in labour markets, which are likely to materialise over the coming months. Looking ahead into next year, after a phase of stabilisation, a gradual recovery with positive quarterly growth rates is expected. Available indicators of inflation expectations over the medium to longer term remain firmly anchored in line with the Governing Council's aim of keeping inflation rates below, but close to, 2% over the medium term. A **cross-check** of the outcome of the economic analysis with that of the monetary analysis confirms the assessment of low inflationary pressure, as money and credit expansion continues to decelerate. Against this background, we expect the current episode of extremely low or negative inflation rates to be short-lived and price stability to be maintained over the medium term, thereby continuing to support the purchasing power of euro area households.

As the transmission of monetary policy works with lags, our policy action should progressively feed through to the economy in full. Hence, with all the measures taken, including our covered bond purchases, monetary policy will provide ongoing support for households and corporations. Once the macroeconomic environment improves, the Governing Council will take care that the measures taken are quickly unwound and that the ample liquidity provided is absorbed. Hence, any threat to price stability over the medium to longer term will be effectively countered in a timely fashion. The Governing Council will continue to ensure a firm anchoring of medium-term inflation expectations. Such anchoring is indispensable to supporting sustainable growth and employment and contributes to financial stability. Accordingly, we will continue to monitor very closely all developments over the period ahead.

Regarding **fiscal policy**, we welcome the position of the Eurogroup that, given the current economic outlook and projected public deficit and debt developments, further fiscal stimulus is not warranted. Budget plans for 2010, which are currently being finalised in a number of countries, and medium-term consolidation strategies must reflect a commitment to a swift return to sound and sustainable public finances. Accordingly, governments should prepare and communicate ambitious and realistic fiscal exit and consolidation strategies within the framework of the Stability and Growth Pact. The structural adjustment process should start, in any case, not later than the economic recovery and in 2011 the consolidation efforts should be stepped up. Structural consolidation efforts will need to exceed significantly the benchmark of 0.5% of GDP per annum set in the Stability and Growth Pact. In countries with high deficits and/or debt ratios the annual structural adjustment should reach at least 1% of GDP. Given the risks of lower potential economic growth in the euro area for a prolonged period of time, governments should adjust public expenditures appropriately to the new macroeconomic conditions and reverse the sharp rises in public expenditure ratios as soon as possible. This is necessary also to prepare budgets for future ageing-induced expenditure burdens.

Turning to **structural policies**, there is a need to intensify structural reform efforts in order to support sustainable growth in the euro area. Appropriate wage-setting and sufficient flexibility to get the unemployed back into work are crucial to prevent the crisis from having a lasting negative impact on labour markets. It is therefore essential to create appropriate incentives to work. At the same time, policies to speed up restructuring and investment, in line with the principle of an open market economy and free competition, will create the business opportunities and productivity gains needed to spark a sustained recovery.

We are now at your disposal for questions.