

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, Venice, 8 October 2009.

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Ladies and gentlemen, the Vice-President and I are very pleased to welcome you to our press conference here in Venice. I would like to thank Governor Draghi for his kind hospitality and to express our special gratitude to his staff for the excellent organisation of the meeting of the Governing Council. We will now report on the outcome of today's meeting of the Governing Council, which was also attended by Commissioner Almunia.

On the basis of its regular economic and monetary analyses, the Governing Council decided to leave the **key ECB interest rates** unchanged. The current rates remain appropriate. The incoming information and analyses since our last meeting in early September have confirmed our previous assessment. While annual HICP inflation was still slightly negative in September, according to Eurostat's flash estimate, it is expected to turn positive again in the coming months and to remain at moderately positive rates over the policy-relevant horizon. At the same time, the latest information further supports our view that the euro area economy is stabilising and is expected to recover at a gradual pace. However, uncertainty remains high. As regards medium to longer-term inflation expectations, they 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 over the medium term, as money and credit expansion continues to moderate. Against this background, we expect price stability to be maintained over the medium term, thereby supporting the purchasing power of euro area households.

Let me now explain our assessment in further detail, starting with the **economic analysis**. Available survey indicators continue to signal an ongoing stabilisation of economic activity. In particular, the euro area should benefit from a recovery in exports, the significant macroeconomic stimulus under way and the measures taken to restore the functioning of the financial system. In addition, following the substantial negative contributions in the first half of 2009, the inventory cycle is expected to contribute positively to real GDP growth in the second half of the year. However, uncertainty remains high and the volatility in incoming data warrants a cautious interpretation of the available information. Overall, the recovery is expected to remain rather uneven. It will be supported in the short term by a number of temporary factors but is likely to be affected over the medium term by the process of ongoing balance sheet correction in the financial and the non-financial sector of the economy, both inside and outside the euro area.

In the view of the Governing Council, the risks to this outlook remain broadly 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, the labour market deterioration may be less marked than previously expected and foreign demand may prove to be stronger than projected. On the downside, concerns remain relating to a stronger or more protracted negative feedback loop between the real economy and the financial sector, renewed increases in oil and other commodity prices, the intensification of protectionist pressures and the possibility of a disorderly correction of global imbalances.

With regard to price developments, annual HICP inflation stood at -0.3% in September, according to Eurostat's flash estimate, compared with -0.2% in August. The current negative inflation rates are in line with previous expectations and reflect largely base effects resulting from the movements in global commodity prices a year ago. Also owing to base effects,

annual inflation rates are projected to turn positive again in the coming months. Thereafter, over the policy-relevant horizon, inflation is expected to remain in positive territory, with overall price and cost developments staying subdued reflecting ongoing sluggish demand in the euro area and elsewhere. In this context, it is important to re-emphasise that 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 this outlook remain broadly balanced. They relate, in particular, to the outlook for economic activity and to the evolution of 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 that developments in broad money and credit growth remain subdued. In August, the annual growth of M3 and loans to the private sector declined further to historically low rates of 2.5% and 0.1% respectively. This parallel deceleration in money and credit growth confirms our previous assessment of a moderate underlying pace of monetary expansion and low inflationary pressures over the medium term.

The ongoing deceleration in annual M3 growth has continued to be accompanied by a strengthening in annual M1 growth, which in August rose further to 13.6%. The strength of M1 reflects the fact that narrower spreads between the rates on different short-term deposits have fostered shifts in the allocation of funds from, in particular, short-term time deposits to overnight deposits. At the same time, the steep slope of the yield curve may have supported shifts from M3 to longer-term deposits and securities outside M3.

The overall flow of bank loans to the non-financial private sector remained subdued in August. In the case of households, the latest data suggest that the decline in loan growth has been levelling off at low rates of expansion. In the case of non-financial corporations, following a few months of negative flows, the flow of loans was again slightly positive in August. Looking through the volatility in monthly data, loan growth continues to be very subdued. This is in line with the lag that normally prevails between trends in economic activity and developments in loans to enterprises. In this respect, given the subdued levels of production and trade, as well as the ongoing uncertainty with regard to the business outlook, further weak developments in loans to non-financial corporations in the coming months appear likely. At the same time, the ongoing improvement in financing conditions should support the demand for credit in the period ahead. Against the background of highly demanding challenges, 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 current rates remain appropriate. The incoming information and analyses since our last meeting in early September have confirmed our previous assessment. While annual HICP inflation was still slightly negative in September, according to Eurostat's flash estimate, it is expected to turn positive again in the coming months and to remain at moderately positive rates over the policy-relevant horizon. At the same time, the latest information further supports our view that the euro area economy is stabilising and is expected to recover at a gradual pace. However, uncertainty remains high. As regards medium to longer-term inflation expectations, they remain firmly anchored in line with the Governing Council's aim of keeping inflation rates below, but close to, 2% over the medium term. **Cross-checking** the outcome of the economic analysis with that of the monetary analysis confirms the assessment of low inflationary pressure over the medium term, as money and credit expansion continues to moderate. Against this background, we expect price stability to be maintained over the medium term, thereby supporting the purchasing power of euro area households.

As the transmission of monetary policy works with lags, we expect that our policy action will progressively feed through to the economy in full. Hence, with all the measures taken, including our latest 12-month longer-term refinancing operation of 30 September, monetary policy is providing strong ongoing support to the economy. Once the macroeconomic environment improves, the Governing Council will make sure that the measures taken are unwound in a timely fashion and that the liquidity provided is absorbed in order to counter effectively any threat to price stability over the medium to longer term. By so doing, 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 contributing to financial stability. Accordingly, we will continue to monitor very closely all developments over the period ahead.

As regards **fiscal policies**, the need for ambitious and realistic fiscal exit and consolidation strategies is becoming increasingly pressing. It is vital that governments put in place concrete structural measures and convincingly communicate that they are committed to ensuring the sustainability of public finances. Governments should design their consolidation plans in line with the provisions of the Stability and Growth Pact, ensuring that consolidation starts as soon as possible and at the latest when the recovery takes hold. These plans should also be accompanied by a strengthening of national budgetary frameworks. Consolidation efforts should be stepped up in 2011 and 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 deficit and/or debt ratios, the annual structural adjustment should reach at least 1% of GDP. In view of the rapidly increasing public expenditure ratios, as well as projected further expenditure pressures owing to higher interest burdens and ageing-related costs, countries' structural measures should focus on the expenditure side.

Turning to **structural reforms**, in all countries more efforts are crucial to support sustainable growth and employment as it is likely that the financial crisis has affected the productive capacity of our economies. In particular, appropriate wage-setting, sufficient labour market flexibility and effective incentives to work are required. At the same time, policies that enhance competition and innovation are urgently needed to speed up restructuring and investment and to create the business opportunities and productivity gains needed to ensure a sustained recovery. An appropriate restructuring and consolidation of the banking sector should also play an important role. Sound balance sheets, sound risk management, and transparent as well as robust business models are key to strengthening the financial soundness of banks and their resilience to shocks, thereby laying the foundations for sustainable economic growth and financial stability.

We are now at your disposal for questions.