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, 4 February 2010.

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

Based on its regular economic and monetary analyses, the Governing Council decided to leave the ***key ECB interest rates*** unchanged. The current rates remain appropriate. Taking into account all the information and analyses that have become available since our meeting on 14 January 2010, price developments are expected to remain subdued over the policy-relevant horizon. The latest information has also confirmed that euro area economic activity continued to expand around the turn of the year. Looking ahead, the Governing Council expects the euro area economy to grow at a moderate pace in 2010. The recovery process is likely to be uneven and the outlook remains subject to uncertainty. The outcome of the monetary analysis confirms the assessment of low inflationary pressure over the medium term. All in all, we expect price stability to be maintained over the medium term, thereby supporting the purchasing power of euro area households. Medium to longer-term inflation expectations remain firmly anchored in line with the Governing Council's aim of keeping inflation rates below, but close to, 2% over the medium term.

Let me now explain our assessment in greater detail, starting with the ***economic analysis***. The latest information confirms that economic activity in the euro area continued to expand around the turn of the year. The euro area has been benefiting from a turn in the inventory cycle and a recovery in exports, as well as from the significant macroeconomic stimulus under way and the measures adopted to restore the functioning of the financial system. However, these stimuli will unwind over time, while activity is likely to be adversely affected by the ongoing process of balance sheet adjustment in the financial and non-financial sectors, both inside and outside the euro area. In addition, low capacity utilisation rates are likely to dampen investment, and unemployment in the euro area is expected to increase somewhat further, thereby lowering consumption growth. For these reasons, the euro area economy is expected to grow only at a moderate pace in 2010 and the recovery process could be uneven.

The Governing Council continues to view the risks to this outlook as broadly balanced. On the upside, confidence may improve more than expected, and both the global economy and foreign trade may recover more strongly than projected. Furthermore, there may be stronger than anticipated effects stemming from the extensive macroeconomic stimulus being provided and from other policy measures taken. On the downside, concerns remain relating to a stronger or more protracted than expected 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, euro area annual HICP inflation increased further in January 2010 to stand at 1.0%, according to Eurostat's flash estimate, after 0.9% in December 2009. Inflation is expected to be around 1% in the near term and to remain moderate over the policy-relevant horizon. In line with a slow recovery in demand in the euro area and elsewhere, overall price, cost and wage developments are expected to stay subdued. In this context, it is important to 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 further development of economic activity and 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 annual growth rate of M3 remained negative in December 2009, standing at –0.2%. In the same period, annual growth in loans to the private sector was zero. These data continue to support our assessment of a moderate underlying pace of monetary expansion and low inflationary pressures over the medium term. Actual monetary developments are likely to be weaker than the underlying pace of monetary expansion, owing to the downward impact of the rather steep yield curve. Looking ahead, M3 and credit growth is likely to remain weak for some time to come.

The prevailing interest rate constellation continues to have a strong influence on both the level and composition of annual M3 growth. On the one hand, the low rates of remuneration on short-term bank deposits foster the allocation of funds away from M3 and into longer-term deposits and securities. On the other hand, the narrow spreads between the interest rates paid on different short-term deposits imply a low opportunity cost of holding funds in the most liquid components included in M1, which continued to grow at a robust annual rate of more than 12% in December.

The zero annual growth rate of bank loans to the private sector reflects a further increase in the growth in loans to households, while the annual growth in loans to non-financial corporations moved further into negative territory. Such divergence remains in line with business cycle regularities. The ongoing contraction in the outstanding amounts of loans to non-financial corporations continues to be accounted for entirely by a strong net redemption of loans with a short maturity. For the sector as a whole, the overall contraction may be due partly to substitution with market-based financing.

Given the typical lags between turning points in economic activity and those in the demand for bank loans, growth in loans can be expected to remain weak over the months to come. In the meantime, the real cost of external financing for non-financial enterprises has declined further, while the net tightening of credit standards applied by banks has continued to diminish, as indicated by the Bank Lending Survey for the last quarter of 2009. At the same time, banks have continued to reduce the size of their overall balance sheets over the past few months. In this respect, the challenge remains for banks to adjust the size and structure of their balance sheets while ensuring the availability of credit to the non-financial sector. To address this challenge, banks should use the improved funding conditions to strengthen their capital bases further and, where necessary, take full advantage of government support measures for recapitalisation. This is important to facilitate access to finance, especially for those enterprises that do not have recourse to market-based financing.

To sum up, the current key ECB interest rates remain appropriate. Taking into account all the information and analyses that have become available since our meeting on 14 January 2010, price developments are expected to remain subdued over the policy-relevant horizon. The latest information has also confirmed that euro area economic activity continued to expand around the turn of the year. Looking ahead, the Governing Council expects the euro area economy to grow at a moderate pace in 2010. The recovery process is likely to be uneven and the outlook remains subject to uncertainty. A ***cross-check*** of the outcome of the economic analysis with that of the monetary analysis confirms the assessment of low inflationary pressure over the medium term. All in all, we expect price stability to be maintained over the medium term, thereby supporting the purchasing power of euro area households. Medium to longer-term inflation expectations remain firmly anchored in line with the Governing Council's aim of keeping inflation rates below, but close to, 2% over the medium term.

We will continue our enhanced credit support to the banking system, while taking into account the ongoing improvement in financial market conditions and avoiding distortions associated with maintaining non-standard measures for too long. The Governing Council will, in early March, take decisions on the continued implementation of the gradual phasing-out of the extraordinary liquidity measures that are not needed to the same extent as in the past. In order to counter effectively any threat to price stability over the medium to longer term, the liquidity provided will be absorbed when necessary. Accordingly, we will continue to monitor very closely all developments over the period ahead.

As regards ***fiscal policies***, many euro area countries are faced with large, sharply rising fiscal imbalances, leading to less favourable medium and long-term interest rates and lower levels of private investment. Moreover, high levels of public deficit and debt place an additional burden on monetary policy and undermine the Stability and Growth Pact as a key pillar of Economic and Monetary Union. Against this background, it is of paramount importance that the stability programme of each euro area country clearly defines the fiscal exit and consolidation strategies for the period ahead. Countries will be required to meet their commitments under the excessive deficit procedures. Consolidation of public finances should start in 2011 at the latest and will have to exceed substantially the annual adjustment of 0.5% of GDP set as a minimum requirement by the Stability and Growth Pact. A strong focus on expenditure reforms is needed.

The key challenge in order to reinforce sustainable growth and job creation is to accelerate ***structural reforms***, as the financial crisis has negatively affected the productive capacity of our economies. In the case of product markets, policies that enhance competition and innovation are urgently needed to speed up restructuring and investment and to create new business opportunities. In labour markets, moderate wage-setting, effective incentives to work and sufficient labour market flexibility are required in order to avoid significantly higher structural unemployment over the coming years. Finally, an appropriate restructuring of the banking sector should play an important role. Sound balance sheets, effective risk management and transparent, robust business models are key to strengthening banks' resilience to shocks, thereby laying the foundations for sustainable growth and financial stability.

We are now at your disposal for questions.