Jean-Claude Trichet: Hearing before the Economic and Monetary Affairs Committee of the European Parliament

Introductory statement by Mr Jean-Claude Trichet, President of the European Central Bank, at a hearing before the Economic and Monetary Affairs Committee of the European Parliament, Brussels, 22 March 2010.

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Dear Madam Chair,

Dear Members of the Committee on Economic and Monetary Affairs,

It is a pleasure to be with you today for the first regular hearing in 2010.

Over the last few months, since our meeting in December 2009, the euro area economy as a whole has continued to gradually recover. But there are a number of issues, related to country and financial market developments, which have led to an intense discussion about the euro area and its functioning. This makes today's discussion all the more timely.

Wir sehen, welche großen Herausforderungen sich durch die Finanzkrise für die europäische Wirtschaftspolitik ergeben. Wir sehen auch, was es heißt, mit Wirtschafts- und Währungspolitik verantwortungsvoll umzugehen. Die Stabilität der gemeinsamen Währung ist die Verantwortung aller.

Aujourd'hui, comme le veut la tradition, je commencerai mon intervention par une évaluation de la situation économique, en portant une attention particulière à l'élimination progressive des mesures non conventionnelles prises lors de la période de crise. Ensuite, j'aborderai les deux sujets sur lesquels nous nous sommes mis d'accord concernant la politique budgétaire et les déséquilibres mondiaux.

Economic and monetary developments

As mentioned, since the previous hearing last December, economic and financial conditions have continued to improve, albeit only at a moderate pace. Economic activity is estimated to have increased by 0.1% from the third to the fourth quarter of last year. Recent information confirms that we can expect a moderate recovery in the current year. This is in line with the latest ECB staff projections. Also forecasts by other institutions confirm this expectation, with an annual growth rate round 1% in 2010, gaining pace in 2011. In the assessment by the Governing Council, the risks to this outlook remain broadly balanced, but as predicted already last year, the recovery is likely to be uneven across regions and sections and over time. High uncertainty continues to prevail.

As regards price developments, we have continued to witness low inflation and low inflationary pressures over the recent months. Inflation in February 2010 stood at 0.9%. The outlook for inflation remains in line with price stability and risks to this outlook remain broadly balanced. Specifically, we expect inflation to stay around 1% in the near term, and to remain moderate over the policy-relevant horizon, in line with a relatively slow recovery in demand.

Our monetary analysis continues to confirm the expectation of low inflationary pressures over the medium term, as reflected in weak expansion of money and credit. The growth of loans to enterprises in particular is anticipated to remain weak for some time ahead, while the annual growth rate of loans to households is positive and strengthening. These developments are still in line with regularities over past business cycles. We will monitor credit developments very closely in the months to come. While there is no clear evidence of credit constraints in the euro area as a whole, the situation differs across countries, sectors and company sizes. To a large extent, the weak growth of loans is due to the unprecedented severance of the 2009 recession.

Indicators of inflation expectations over the medium to longer term remain firmly anchored in line with our aim of keeping inflation rates below, but close to, 2% over the medium term. It is against this background that the Governing Council kept the level of key ECB interest rates unchanged earlier this month, regarding the current level as appropriate.

The significant monetary impulse stemming from our interest rate reductions last year has spread to market interest rates, and the transmission to rates charged by banks to households and corporations has continued to perform well. This transmission needs to be seen in conjunction with the non-standard measures that the ECB has taken. These measures, notably the provision of full allotment of liquidity to banks with a one-year maturity against collateral, have been effective in providing funding to banks at favourable conditions, stabilising the money market, and fostering the pass-through of our interest rate reductions.

Phasing out from non-standard measures

In line with the above economic and monetary assessment, the Governing Council decided earlier this month to continue the gradual phasing out of some of the extraordinary measures. We do not wish to breed dependency. Banks are to take up their intermediation again and should have all appropriate incentives to do so. The 12-month operations have already been discontinued and the 6-month operation upcoming next week will be the last one. In addition, we now decided to re-introduce variable-rate tenders for the regular three-month operations as of late April. At the same time, we continue to provide the euro area banking system with unlimited access to central bank refinancing through shorter-term operations (with one-week and one-month maturity), for as long as needed and in any case until mid-October this year. This is to continue to support the credit provision to the euro area economy.

Let me also say something on longer-term monetary policy issues , that I know is of interest to you, namely the relationship between monetary policy and asset prices. The financial crisis has revived the long-standing debate on the relationship between monetary policy and asset price bubbles. This debate is centred on a straightforward question: Should monetary policy aim to prevent the emergence of asset price bubbles? While this question has no simple answer, the ECB's monetary policy strategy is an approach that is well suited to cope with the challenges brought about by unsustainable asset price developments.

Our mandate is to maintain price stability over the medium term. Protracted, unsustainable financial trends or atypical swings in risk pricing in financial markets can pose risks to price stability down the road. The close link between monetary developments and evolving imbalances in asset and credit markets implies that our monetary policy needs to detect such imbalances at an early stage and to respond to the implied, longer-term, risks to price stability in a timely and forward-looking manner, thereby contributing to financial stability. Our monetary analysis, which concentrates on the monitoring of money and credit, does just that. It is a strategic framework that embeds a degree of implicit "leaning against the wind" of excessive money, credit and asset price growth. Judgement is of course necessary in addressing asset price dynamics. The ECB has developed considerable expertise in the analysis of monetary and credit developments and their implications for risks to price stability, which has proved an invaluable asset also throughout the financial crisis.

Fiscal policies in the euro area

I would like to turn to fiscal policies now. As you know, financial sector support and the budgetary loosening in the context of the financial and economic crisis has – in most euro area countries – caused sizable fiscal imbalances. Meanwhile, most countries in the euro area have exceeded the 3% reference value for the deficit ratio. Under these circumstances, the Stability and Growth Pact, which has been put in place to safeguard sound and sustainable fiscal positions, should be rigorously applied. The ECB calls to strengthen the governments' commitment to strictly adhere to its provisions.

National policy makers should give fiscal consolidation top priority in the context of ongoing economic recovery, and bring the deficit ratio to below 3% of GDP in line with the Ecofin recommendations. Based on the Stability Programme updates, governments appear to be on track this year, but further measures will be necessary in the coming years to correct excessive deficits within the set time horizon.

As regards the composition of the fiscal adjustment, we welcome a focus on the expenditure side, because the size of the public sector has significantly increased in the crisis and because expenditure-based consolidation has proven to be more effective in the past.

Governments can enhance the credibility of fiscal consolidation by strengthening national budgetary frameworks and implementing structural reforms to increase potential growth. In this context, I welcome the European Commission's initiative for a Europe 2020 strategy and the stronger role of the Eurogroup in multilateral country surveillance which is overdue. At the same time, it is important that fiscal surveillance under the Pact remains a process of its own right and that the fundamental principles of the Treaty and the Pact are fully preserved.

A successful exit from the strong fiscal expansion in the wake of the recent crisis will require ambitious measures and a strong political will regarding implementation. I am confident that European fiscal policy makers will succeed in restoring the sustainability of public finances. The adjustment efforts undertaken by the Irish government and more recently by the Greek government can be seen as promising first steps in the upcoming consolidation process.

Policy responses to imbalances

One of the main drivers of the financial crisis were the large global external imbalances. These imbalances implied massive capital inflows into deficit countries. Those inflows had partly been financed by the issuance of financial instruments, whose value was shattered in the turmoil. The imbalances reflected a lack of medium-term orientation towards stability and sustainability of macroeconomic policies in key deficit and surplus economies. The euro area did not contribute to the build-up in global imbalances. Its current account has remained close to balance over the years.

The crisis has induced a partial reduction in global imbalances, but this correction appears to be largely cyclical. Some important structural factors that led to unsustainable imbalances remain largely in place. A risk that unsustainable global imbalances might re-emerge in the period ahead can therefore not be ruled out. Ruling it out would require rigorous policy adjustments in key deficit and surplus economies.

The G20's decision to create a process of mutual assessment of its members' macroeconomic and structural policies is fundamental in this respect. To be successful, this process requires that peer surveillance is executed fairly and without complacency, and that the countries and economies concerned have the will and the operational capacity to change their domestic policies accordingly. These are necessary conditions to pave the way for a better functioning of the global economy. The euro area can enter this process from a positive standing, given its medium-term orientation in monetary, fiscal and macroeconomic policies.

Let me conclude by recalling that macroeconomic imbalances are not only confined to the global level but also appear within the euro area. These imbalances remain a challenge, largely reflecting a lack of adjustment in a number of Member States. It remains indispensable that the countries concerned bring their monitoring of cost competitiveness indicators, their structural reforms, and their fiscal consolidation efforts more into line with the principles and rules underlying the functioning of monetary union. This would allow euro area economies to reap fully the macroeconomic benefits of EMU.