European Central Bank: Press conference – introductory statement

Introductory statement by Mr Jean-Claude Trichet, President of the European Central Bank, and Mr Vítor Constâncio, Vice-President of the European Central Bank, Frankfurt am Main, 10 June 2010.

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Ladies and gentlemen, Mr Constâncio, the new Vice-President of the ECB, and I are very pleased to welcome you to our press conference. We will now report on the outcome of today's meeting, which was also attended by Commissioner Rehn.

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 new information which has become available since our meeting on 6 May 2010, we continue to expect price developments to remain moderate over the policy-relevant medium-term horizon. Global inflationary pressures may persist, while domestic price pressures are expected to remain low. The latest information has also confirmed that the economic recovery in the euro area continued in the first half of 2010, but quarterly growth rates are likely to be rather uneven. Looking ahead, we expect the euro area economy to grow at a moderate pace, in an environment of continued tensions in some financial market segments and of unusually high uncertainty. Our monetary analysis confirms that inflationary pressures over the medium term remain contained, as suggested by weak money and credit growth. Overall, we expect price stability to be maintained over the medium term, thereby supporting the purchasing power of euro area households. Inflation expectations remain firmly anchored in line with our aim of keeping inflation rates below, but close to, 2% over the medium term. The firm anchoring of inflation expectations remains of the essence.

Monetary policy will do all that is needed to maintain price stability in the euro area over the medium term. This is the necessary and central contribution that monetary policy makes to fostering sustainable economic growth, job creation and financial stability. All the non-standard measures taken during the period of strong financial market tensions, referred to as "enhanced credit support" and the Securities Markets Programme, are fully consistent with our mandate and, by construction, temporary in nature. We remain firmly committed to price stability over the medium to longer term, and the monetary policy stance and the overall provision of liquidity will be adjusted as appropriate. Accordingly, the Governing Council will continue to monitor all developments over the period ahead very closely.

Let me now explain our assessment in greater detail, starting with the ***economic analysis***. After a period of sharp decline, euro area economic activity has been expanding since mid-2009. According to Eurostat's first estimate, euro area real GDP increased, on a quarterly basis, by 0.2% in the first quarter of 2010. While adverse weather conditions, in particular, dampened growth in the early part of the year, the latest economic indicators suggest that a rebound took place during the spring. Looking ahead, the Governing Council expects real GDP to grow at a moderate and still uneven pace over time and across economies and sectors of the euro area. The ongoing recovery at the global level and its impact on the demand for euro area exports, together with the accommodative monetary policy stance and the measures adopted to restore the functioning of the financial system, should provide support to the euro area economy. However, the recovery of activity is expected to be dampened by the process of balance sheet adjustment in various sectors and weak labour market prospects.

This assessment is also reflected in the June 2010 Eurosystem staff macroeconomic projections for the euro area, according to which annual real GDP growth will range between 0.7% and 1.3% in 2010 and between 0.2% and 2.2% in 2011. Compared with the

March 2010 ECB staff macroeconomic projections, the range for real GDP growth this year has been revised slightly upwards, owing to the positive impact of stronger activity worldwide in the short run, while the range has been revised somewhat downwards for 2011, reflecting mainly domestic demand prospects. The June 2010 Eurosystem staff projections are broadly in line with forecasts by international organisations.

In the Governing Council's assessment, the risks to the economic outlook are broadly balanced, in an environment of unusually high uncertainty. On the upside, the global economy and foreign trade may recover more strongly than projected, thereby further supporting euro area exports. On the downside, concerns remain relating to renewed tensions in some financial market segments and related confidence effects. In addition, 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, and protectionist pressures, as well as the possibility of a disorderly correction of global imbalances, may weigh on the downside.

With regard to price developments, euro area annual HICP inflation was 1.6% in May 2010, according to Eurostat's flash estimate, after 1.5% in April. The rise in inflation over recent months mostly reflects higher energy prices. During the second half of this year some further slight increases in HICP inflation cannot be excluded. Looking further ahead, inflation rates should overall remain moderate. Upward pressures on commodity prices may persist, while euro area domestic price pressures are expected to remain low. Inflation expectations over the medium to longer term continue to be firmly anchored in line with the Governing Council's aim of keeping inflation rates below, but close to, 2% over the medium term.

This assessment is also reflected in the June 2010 Eurosystem staff macroeconomic projections for the euro area, which foresee annual HICP inflation in a range between 1.4% and 1.6% for 2010 and between 1.0% and 2.2% for 2011. Compared with the ECB staff projections of March 2010, the ranges have been adjusted somewhat upwards, mainly reflecting higher euro prices for commodities. Available forecasts from international organisations provide a broadly similar picture.

Risks to the outlook for price developments are broadly balanced. Upside risks over the medium term relate, in particular, to the evolution of commodity prices. Furthermore, increases in indirect taxation and administered prices may be greater than currently expected, owing to the need for fiscal consolidation in the coming years. At the same time, risks to domestic price and cost developments are contained. Overall, the Governing Council will monitor closely the future evolution of all available price indicators.

Turning to the ***monetary analysis***, the annual growth rate of M3 was unchanged at –0.1% in April 2010. The annual growth rate of loans to the private sector increased somewhat further and turned positive, but remained weak at 0.1%. Together, these data continue to support the assessment that the underlying pace of monetary expansion is moderate and that inflationary pressures over the medium term are contained. Shorter-term developments in M3 and loans have remained volatile and, given the renewed tensions in some financial market segments, volatility in M3 and its components may well continue.

The actual growth in M3 continues to understate the underlying pace of monetary expansion, but the downward impact of the rather steep yield curve and the associated allocation of funds to longer-term deposits and securities outside M3 appear to be gradually waning. The same holds for the shifts within M3 that have been observed as a response to the narrow spreads between the interest rates paid on different M3 instruments. At 10.7%, annual M1 growth is still very strong.

The still weak annual growth rate of bank loans to the private sector conceals the fact that monthly flows have now been positive for a number of months. At the same time, these aggregate developments continue to reflect mainly an ongoing strengthening in the annual growth of loans to households, while the annual growth of loans to non-financial corporations has remained negative. A lagged response of loans to non-financial corporations to economic activity is a normal feature of the business cycle.

The latest data confirm that the reduction in the size of banks' overall balance sheets has not continued since the turn of the year. However, further adjustments cannot be ruled out and the challenge remains for banks to expand the availability of credit to the non-financial sector when demand picks up. To address this challenge, banks should turn to the market to strengthen further their capital bases and, where necessary, take full advantage of government support measures for recapitalisation.

To sum up, the current key ECB interest rates remain appropriate. Taking into account all the new information which has become available since our meeting on 6 May 2010, we continue to expect price developments to remain moderate over the policy-relevant medium-term horizon. Global inflationary pressures may persist, while domestic price pressures are expected to remain low. The latest information has also confirmed that the economic recovery in the euro area continued in the first half of 2010, but quarterly growth rates are likely to be rather uneven. Looking ahead, we expect the euro area economy to grow at a moderate pace, in an environment of continued tensions in some financial market segments and of unusually high uncertainty. A ***cross-check*** of the outcome of our economic analysis with that of the monetary analysis confirms that inflationary pressures over the medium term remain contained, as suggested by weak money and credit growth. Overall, we expect price stability to be maintained over the medium term, thereby supporting the purchasing power of euro area households. Inflation expectations remain firmly anchored in line with our aim of keeping inflation rates below, but close to, 2% over the medium term. The firm anchoring of inflation expectations remains of the essence. Accordingly, the Governing Council will continue to monitor all developments over the period ahead very closely.

As regards ***fiscal policies***, the Governing Council welcomes the recent decision by euro area countries to formally establish a European Financial Stability Facility. This needs to be accompanied by decisive action at the level of governments. It is essential that all countries stick to their commitments to correct high budget deficits and government debt and reduce fiscal vulnerability. To this end, the concrete adjustment measures needed to achieve the budgetary targets should be fully specified. All countries must ensure that confidence in the sustainability of public finances is guaranteed. The Governing Council welcomes the fact that a number of euro area governments with the highest deficits and strongly increasing debt levels have adopted additional fiscal consolidation measures and set out more ambitious fiscal targets. In this context, we took note of the spring 2010 orientations for fiscal policies in euro area countries agreed by the euro area finance ministers on 7 June, and welcome the commitment to take additional measures, where needed, in order to ensure the achievement of the budgetary targets for 2010 and beyond. It is indeed key that the new budgetary targets be achieved. The Governing Council fully agrees with the ministers on the priority of halting and reversing the increase in the debt ratio and welcomes the commitment to take immediate action to that effect.

For all euro area countries, ***structural reforms*** leading to higher growth and employment are crucial to support a sustainable recovery. Existing competitiveness problems, as well as domestic and external imbalances, need to be urgently addressed by the countries concerned. To that end, wage-bargaining should allow wages to adjust appropriately to the competitiveness and unemployment situation. Likewise, measures that increase price flexibility and non-price competitiveness are essential. 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 and to ensuring adequate access to finance, thereby laying the foundations for sustainable growth, job creation and financial stability.

We are now at your disposal for questions.