Jean-Claude Trichet: Hearing at 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 at the Economic and Monetary Affairs Committee of the European Parliament, Brussels, 30 June 2011.

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Dear Madam Chair,

Dear Honourable Members,

It is a pleasure to be back in Parliament and your Committee for our regular exchange of views.

Once again, our meeting comes at a time when important decisions are being taken but also pending. Of particular concern is the conclusion of the legislative procedure on the economic governance package.

Je tiens tout d'abord à saluer les efforts continus du Parlement européen et du Conseil afin de rapprocher leurs positions sur le paquet de gouvernance économique. Le Conseil des Gouverneurs aurait souhaité que le Conseil européen du 24 Juin dernier fasse un geste d'ouverture envers le Parlement européen sur ce dossier. Le principal point de désaccord – l'extension de la majorité qualifiée inversée dans le volet préventif du pacte de stabilité et de croissance – est d'une importance clé. La zone euro a urgemment besoin d'un cadre de gouvernance économique renforcé et ambitieux. La crise actuelle démontre, de manière irréfutable, s'il en était encore besoin, les conséquences néfastes de politiques budgétaires et économiques malsaines.

Deshalb ist es unerlässlich, zu einer ambitionierten Einigung zu kommen. In der aktuellen Lage wäre eine Einigung besonders begrüßenswert, um deutlich zu machen, dass die richtigen Lektionen aus der Krise gezogen werden.

Let me now turn to the economic and monetary developments in the euro area since our previous meeting in March, as well as the two topics you have asked me to focus on, namely fiscal consolidation and monetary policy on the one hand, and sovereign debt developments on the other.

I. Economic and monetary developments

Let me first turn to the economic and monetary developments in the euro area since our previous meeting in March. In this context, let me also note that we are now in the purdah period, as the next Governing Council meeting will take place on 7 July. This means that nothing in what I will say is intended or should be interpreted in any respect in terms of future monetary policy.

Incoming information since I last spoke to you has confirmed a positive underlying momentum of economic activity in the euro area. We expect the continued expansion of the world economy and domestic demand from the private sector as the main driver of economic growth in the euro area. The latest Eurosystem staff macroeconomic projections are in line with this assessment. They foresee the economy to grow between 1.5% and 2.3% for 2011 and between 0.6% and 2.8% for 2012. In our view, the risks to this outlook remain broadly balanced in a context of elevated uncertainty.

As regards price developments, we are observing continued upward pressure on prices, especially in the earlier stages of the production process. Inflation in the euro area stood at 2.7% in May, after 2.8% in April. The inflation rates seen over the past few months largely reflect higher energy and commodity prices. Going forward, inflation is likely to stay clearly above 2% over the months ahead, mainly due to energy and commodity prices. The Eurosystem staff projections indicate inflation ranging between 2.5% and 2.7% for 2011, and between 1.1 and 2.3% for 2012. It is of paramount importance that the current relatively high inflation rates do not translate into second-round effects, via higher wages and price-setting, and thereby do not lead to broad-based inflationary pressures.

Risks to the medium-term outlook for price developments continue to be on the upside. Notably, energy prices could increase faster than currently expected, and indirect taxes and administered prices might be raised faster with a view to reducing budget deficits. In addition, increasing capacity utilisation may exert stronger upward pressure on domestic prices.

As regards our monetary analysis, we see the underlying pace of monetary expansion gradually recovering. At the same time, monetary liquidity remains ample. This has the potential to accommodate price pressures.

As you are aware, we are strongly determined to secure that inflation expectations remain firmly in line with our aim of keeping inflation rates below, but close to, 2% over the medium term.

Against this background the Governing Council raised the key ECB interest rates by 25 basis points in April, in order to adjust the very accommodative monetary policy stance in the light of upside risks to price stability. Since then we have kept the rates unchanged. At the same time, as I said in the press conference after the last Governing Council, we see the monetary policy stance as still accommodative and risks to price stability on the upside. Accordingly, I said that we are in a state of strong vigilance and that we stand ready to act in a firm and timely manner to avoid that recent price developments give rise to broad-based inflationary pressures over the medium term.

As regards our non-standard measures, the Governing Council earlier this month decided to maintain its fixed rate tender procedures with full allotment in its refinancing operations up to the third quarter of 2011.

II. Fiscal consolidation and monetary policy

Let me now turn to the topic of fiscal consolidation and monetary policy.

In a monetary union, the central bank when setting interest rates has to take an area-wide perspective. In the same manner the US Federal Reserve do not and cannot tailor its interest rate to the specific economic conditions in individual US states.

Setting the policy rate with a clear focus on the euro area as a whole does not, however, mean ignoring the diversity in financial conditions. Since the financial crisis erupted, the ECB has adopted a number of non-standard measures to foster as much as possible a smooth functioning of the monetary policy transmission throughout the euro area.

- The current major challenges faced by a few euro area countries are mainly the result of some governments not conducting sound policies and not implementing reforms that would benefit their citizens and the European public as a whole. It is essential that euro area countries fully assume the responsibilities at the national level that derive from their participation in the euro area. Past experiences of fiscal consolidation episodes demonstrate the long-term benefits of reducing sizeable fiscal imbalances. There are at least three reasons why well-designed fiscal consolidation is beneficial in the current circumstances. Accompanied by appropriate structural reforms, it promotes long-term growth. For those economies with large fiscal imbalances, it is indispensable to bolster confidence. And for all economies it helps create buffers that would be essential to deal with unforeseen events.

- It is also for this reason that the ongoing negotiations on the governance package should produce an ambitious outcome. I have been emphasising time and again why we are very much in agreement with the European Parliament on this – the need for a quantum leap in economic governance through the currently discussed legislative package.
- At this stage, I would like to recall two points:
- First, we should not be content with a stronger Stability and Growth Pact only at the later stages of an excessive deficit procedure. We need to halt any fiscal excesses early on and correct them. The obvious way is a higher degree of automaticity early on in the procedures, that is, more reverse qualified majority voting in the preventive arm of the Pact; and therefore the prospect of more timely sanctions, possibly of a reputational nature.

Second, we would benefit considerably from an equally ambitious macroeconomic imbalances framework that detects imbalances early on, through a well focused and rigorously applied scoreboard; and then corrects them, again in a timely fashion. Here, we need to focus on those countries that ultimately pose a risk to other euro area countries through in particular persistent and excessive competitiveness losses.

III. Sovereign debt developments

Let me now turn to the current sovereign debt developments.

As you know, at the euro area level, we see that fiscal consolidation in many countries is ongoing, and will, according to the European Commission's Spring 2011 Forecast, bring the euro area general government deficit down to 3.5% by 2012. This is an encouraging prospect, especially by international comparison. Also for the current year the euro area fiscal deficit is somewhat less than half of that of the US and Japan. However, selected euro area countries are currently still facing high debt and deficit levels.

The ECB has always made clear that the best way to cope with the current sovereign debt positions is a determined and disciplined implementation of agreed fiscal consolidation paths and the structural reform agenda to promote medium term growth. For the euro area countries under an EU/IMF programme, a determined implementation of those programmes is of utmost importance to get back to a sound economic situation. This call has been echoed by the European Council, which at its recent meeting urged the national authorities, especially but not only in Greece, to continue implementing rigorously and with the highest resolve the necessary adjustment efforts to put the country on a sustainable path. To that end, national unity and cross-party consensus are essential.

As to the possibility of debt action, let me recall what I have said many times on this matter, on behalf of the Governing Council: We strongly advise against all concepts that are not purely voluntary or that have elements of compulsion. We call for the avoidance of any credit events and selection default or default.

Let me add that I am from time to time surprised by the narrow view of private sector involvement that is generally taken in the present debate. We should not forget that private capital is also mobilised when embarking on privatisation. Privatisation is a good way of mobilising private capital and is something that we have encouraged considerably, particularly in the case of Greece. It is an effective way of mobilising private capital and has positive consequences not only on the financing of the country, but also in terms of positive structural effects on growth and employment. Finally, the private sector involvement that everybody is aiming at is to go back as soon as possible to private sector market financing.

Thank you for your attention.