Vítor Constâncio: Challenges to monetary policy in 2012

Speech by Mr Vítor Constâncio, Vice-President of the European Central Bank, at the 26th International Conference on Interest Rates, Frankfurt am Main, 8 December 2011.

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Ladies and Gentlemen,

Since the introduction of the euro, our common currency, times have never been as challenging as at present. Despite ongoing efforts by policy makers, the sovereign debt crisis is still ongoing, putting growth and welfare of our citizens at risk. In this context the Governing Council of the ECB met this morning and, as you know, decided to reduce the monetary policy rate by 25 basis points and take a series of measures to improve liquidity provision to the banking sector, thereby enhancing the operation of the credit channel.

I was asked to focus my address to you on challenges to monetary policy for next year, 2012. I decided to fulfil this request by covering three related areas. First, I will review the current conjuncture and outlook for 2012, as the Governing Council sees it at present. I will also take the opportunity to recall the fundamental principles that guide our monetary policy in general. Second, I will discuss how we can use separately standard and non-standard monetary policy measures in order to fulfil our price stability mandate in a context of continued high uncertainty as regards economic growth, fiscal sustainability and the stability of the financial sector. Third, I will describe some non-standard monetary policy measures we took in greater detail, elaborating on how they help correcting distortions in the monetary transmission mechanism induced by financial contagion.

1. The quest for price stability and the outlook for 2012

Let me start with the conjunctural situation and the outlook for 2012 in the context of general key principles of sound central banking that are of particular importance at the current juncture. The ECB has the clear and unambiguous mandate to maintain price stability in the euro area. More precisely, we aim at maintaining inflation rates in the euro area below, but close to, 2% over the medium term. Having a clear and overriding objective of maintaining price stability is one of the key principles of "sound" central banking. This principle has been supported by a growing and ever more refined wealth of research.[1] Overall, although not the exclusive objective of central banks, maintaining price stability is ultimately the responsibility of monetary policy. It is therefore the necessary and central contribution that monetary policy can make to the economic welfare of our citizens. This is why the Treaty enshrines it as the ECB's primary objective.

With inflation averaging about 2% in the euro area since 1999, and thus better than what was achieved in individual euro area countries before the introduction of the euro, we have witnessed a period of relatively stable prices since the start of monetary union. Inflation expectations have been, and remain, well anchored at levels in line with our quantitative

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[1] For a broad review, please see Herrero, A, Gaspar, V. Hoogduin, L Morgan, J. and Winkler, B. (eds.) (2001), "Why price stability", first ECB Central Banking Conference, June. The importance of price stability has long been clear to economists: see e.g. Le Blanc, F. (1690), *Traité Historique des Monnaies de France*, Paris, and Keynes, J.M. (1919), *The economic consequences of peace*, London, chapter 6. On the costs of inflation, see Fischer, S. (1995), "Modern central banking", in F. Capie, C. Goodhart, N. Schnadt and S. Fischer, eds., *The future of central banking*, Cambridge: Cambridge University Press, pp. 262–308; Fischer, S (1996), "Why are central banks pursuing long-run price stability", Jackson Hole Symposium.

definition of price stability, despite several shocks that euro area economies have been confronted with over this period – most notably the current financial and economic crisis. This is first of all so because the ECB has – from its start – credibly delivered upon its primary mandate, price stability.

In fact, by anchoring inflation expectations, a kind of "automatic stabiliser" is implemented. Changes in nominal yields induced by monetary policy decisions are reflected into changes in real yields, so as to dampen the destabilising effects of excessive uncertainty, both on financial markets and the real economy. This is true also in normal circumstances, but it is especially important when there are risks of deflation. During the crisis, well anchored inflation expectations helped to avoid deflationary spirals and allowed the ECB to effectively reduce short-term real interest rates by acting on the nominal, policy rate.

Our robust and medium-term oriented monetary policy strategy has been crucial in credibly anchoring inflation expectations. Using the same framework for internal analysis and external communication has helped the ECB to conduct its monetary policy in a credible, consistent and effective manner.

This brings me to today's monetary policy decision. The Governing Council decided to lower the key ECB interest rates by 25 basis points, following the 25 basis point decrease on 3 November 2011. Inflation is likely to stay above 2% for several months to come, but it will decline to below 2% during 2012. The intensified financial market tensions are continuing to dampen economic activity in the euro area and the outlook remains subject to high uncertainty and substantial downside risks. In such an environment, cost, wage and price pressures in the euro area should remain modest over the policy-relevant horizon. At the same time, the underlying pace of monetary expansion remains moderate. Overall, it is essential for monetary policy to maintain price stability over the medium term, thereby ensuring a firm anchoring of inflation expectations in the euro area in line with our aim of maintaining inflation rates below, but close to, 2% over the medium term. Such anchoring is a prerequisite for monetary policy to make its contribution towards supporting economic growth and job creation in the euro area. This assessment is also reflected in the December 2011 Eurosystem staff macroeconomic projections for the euro area, which foresee annual real GDP growth in a range between 1.5% and 1.7% in 2011, between –0.4% and 1.0% in 2012 and between 0.3% and 2.3% in 2013. Compared with the September 2011 ECB staff macroeconomic projections, there is a narrowing of the range of the real GDP growth projection for 2011 and a significant downward revision of the range for 2012.

The Governing Council continues to view the risks to the medium-term outlook for price developments as broadly balanced. On the upside, the main risks relate to further increases in indirect taxes and administered prices, owing to the need for fiscal consolidation in the coming years. The main downside risks relate to the impact of weaker than expected growth in the euro area and globally. In our assessment, substantial downside risks for the economic outlook for the euro area exist in an environment of high uncertainty. Nevertheless, the modelled probability of a deflationary episode is still very small indeed, even if it has recently slightly increased.

The ECB's institutional and operational independence[2] is fundamental when designing the appropriate responses to the challenges posed by the crisis. The implications for the risk to

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[2] The issue of central bank independence has been the subject of important academic work, following the seminal paper by Kenneth Rogoff(1985) on "The Optimal Degree of Commitment to an Intermediate Monetary Target", Quarterly Journal of Economics, vol. 100 (4), 1169–89. See for example Waller, Christopher J., and Carl E. Walsh (1996). "Central-Bank Independence, Economic Behavior, and Optimal Term Lengths", American Economic Review, vol. 86 (5), 1139–53. Some academics have even proposed quantitative indicators to measure central bank independence; see for example Grilli, Masciandaro and Tabellini (1991): "Political and Monetary Institutions and Public Financial Policies in the Industrial Countries", Economic Policy, 13, 341–92; and Cukierman, Webb and Neyapti (1992): "Measuring the Independence of Central Banks and its Effect on Policy Outcomes", World Bank Economic Review 6(3) : 358–98.

price stability of the turbulent gyrations in financial markets' sentiment led central banks – including the ECB – to bring interest rates down to unprecedented levels and to engage in a number of non-standard monetary policy measures. When entering these "uncharted waters" it was and very much remains of paramount importance for the central bank's measures to be effective that market participants never doubt about their consistency with the overall policy framework. It is precisely because measures were taken in such consistency and in full independence that market participants have never come to doubt the ECB commitment to maintain price stability over the medium-term. Ultimately, independence reinforces credibility, maximising the effectiveness of the measures implemented during the crisis. Let me therefore dedicate most of the remainder of this speech to our non-standard monetary policy and how it relates to standard interest rate policy.

2. Monetary policy, financial stability and the separation principle

The ECB was one of the first central banks to react with large liquidity injections, when the financial market turmoil erupted in August 2007. This "prelude" was followed by a series of non-standard monetary policy measures spanning our Enhanced Credit Support that started after the demise of Lehman Brothers in September 2008 and our Securities Markets Programme when the financial crisis turned into a sovereign debt crisis in May 2010. I wish to discuss two fundamental issues related to such non-standard monetary policy before I give a more detailed account of several of the adopted measures.

I have just emphasised that inflation expectations have remained well anchored over the crisis period, in line with our objective of price stability. At the same time, we expect inflation to return below 2% in the course of 2012. The first question is then, how do non-standard monetary policy measure help fulfil this objective?

The second general issue that I wish to discuss is related to the unprecedented nature of non-standard policies. The novelty of these tools implies that we have no track record on their broader economic effects. Could non-standard measures have unintended consequences on the monetary policy stance – consequences which may ultimately endanger the ECB's ability to maintain price stability?

Regarding the first issue, it is straightforward to recognise that non-standard measures ultimately serve our primary objective, once the medium term orientation of our strategy is recognised. The medium-term orientation acknowledges the futility of attempting to fine-tune price developments over very short periods of time This is due to long and variable lags in monetary policy transmission and to inevitable price shocks. From the very outset, the ECB's monetary policy strategy acknowledged that it is neither feasible nor desirable for inflation to be targeted on a short term basis. While anchoring longer-term inflation expectations at levels consistent with price stability, it explicitly recognised the need to avoid excess volatility in other variables – notably output and nominal interest rates.[3]

The desire to avoid excess macroeconomic volatility, however, is not limited to output and nominal interest rates. For example, it can be used to contain imbalances in financial markets and asset prices, if their slow accumulation poses a threat to macroeconomic and price stability over the longer term.

Along these lines, financial stability enters the horizon of the central bank, naturally and on a permanent basis. When the accumulation of financial imbalances that are accompanied by excessive monetary and credit growth endangers our ability to maintain stable prices over the medium term, we have the obligation to take appropriate action. When, as is clearly the case at present, financial instability in some market segments prevents a normal functioning

[3] ECB (1999), "The stability-oriented monetary policy strategy of the Eurosystem", Monthly Bulletin (January).

of the economy and of the monetary policy transmission mechanism, we must intervene to restore our capacity to ensure price stability over the medium term.

The ECB interventions during the crisis have therefore been entirely consistent with the principles of our monetary policy strategy and its medium-term orientation. The provision of liquidity to prevent a collapse of sound financial institutions during a liquidity crisis is also consistent with the broader ESCB's responsibility to contribute to financial stability. This is in line with the provisions in the Treaty, which gives the ESCB the competence, without prejudice to the primary objective of price stability and to the ECB independence, to support the general policies of the European Union and notably to contribute to the smooth conduct of policies pursued by the competent authorities relating to the stability of the financial system.[4] Most central banks have performed such a role as financial lender of last resort to the banking sector in history when severe crises struck.[5]

Nevertheless, the second fundamental issue comes to the fore, raising the question about the possible risk that the non-standard monetary policy measures may produce unintended consequences for the monetary policy stance.

This concern has been in the mind of the Governing Council from the outset of the crisis. It has led to the adoption of a clear guiding principle in the implementation of non-standard measures: the separation principle.

The separation principle is the acknowledgement that standard and non-standard monetary policy instruments have different purposes. A decision by the Governing Council on the interest rates aims to signal to financial market participants its assessment of the monetary policy stance. Changes in the key ECB rates ultimately affect inflation trough changes in bank lending rates, credit conditions and aggregate demand. Under normal financial market conditions, this transmission mechanism from standard policy decisions to prices is effective. An appropriate setting of the rate on the main refinancing operations, or MRO rate, allows us to signal the policy intentions of the Governing Council and thereby maintain price stability over the medium term and ensure a firm anchoring of inflation expectations. Under normal financial market conditions, non-standard monetary policy measures are unnecessary.

However, exceptional circumstances require extraordinary measures. The scope of non-standard measures that the ECB has used so far has to be explained as they are clearly delimited: they aim to ensure that dysfunctions in some financial market segments do not lead to severe disruptions in the monetary policy transmission mechanism, which could compromise our capacity to ultimately affect prices through our interest rate decisions. From this perspective, non-standard measures are a complement, rather than a substitute, of standard interest rate decisions: they help ensure that standard policy produces its intended effects, rather than aiming to impart additional relaxation to the overall monetary policy stance.

This feature distinguishes the non-standard monetary policy measures the ECB used so far from quantitative easing policies as pursued by other major central banks, because quantitative easing is designed as a substitute for standard interest rate policy when central bank rates have reached levels close to their zero lower bound and cannot be lowered further. This feature also illustrates that the introduction of non-standard measures does not imply the need for the ECB to manage a trade-off between short run inflation volatility and price stability in the longer run. The non-standard monetary policy measures that we have

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4 See article 127(5) TFEU.

5 See, for example, Thornton, H. (1802), An Enquiry into the Nature and Effects of Paper Credit of Great Britain, Bordo, M.D. (1990), The lender of last resort: Alternative views and historical experience, Federal Reserve Bank of Richmond Economic Review, January/February, or Freixas, X., C. Giannini, G. Hoggarth and F. Soussa (2002), Lender of last resort: A review of the literature, in Goodhart, C.A.E., and G. Illing (eds.), Financial Contagion, Crises and the Lender of Last Resort – A Reader, Oxford University Press.

used so far are rather the means to ensure that standard ECB decisions can be effective at all horizons.

There should therefore be no concern that our non-standard measures may produce spillovers on the ECB's ability to maintain price stability. Thanks to the possibility to separate standard and non-standard monetary policy actions, our non-standard measures do not restrict in any way our capacity to tighten the monetary policy stance when necessary. This has been clearly demonstrated by the Governing Council's repeated decisions to change interest rates over the course of this year, while maintaining its non-standard monetary policy measures. In turn, our non-standard measures are temporary in both their nature and scope. Once the impairments to the transmission process disappear they can be phased out, whereas the standard interest rate policy remains. In fact, many of our non-standard monetary policy measures phase out automatically, for example long-term refinancing operations at fixed rates at extended maturities, if they are not explicitly renewed.

In spite of the separation principle, however, some commentators have raised concerns that the large amount of liquidity currently available to euro area banks will turn into broad money and credit, and eventually into a source of inflationary pressure. Non-standard measures have indeed resulted in a sizable expansion of the ECB balance sheet. In the more of four years between mid-2007 and end 2011, the Eurosystem balance sheet relating to monetary policy assets[6] grew from 438 EUR billion euros to a temporary peak on 25 June 2010 of 985 billion euros, and has decreased since then to currently 923 billion euros. This corresponds to a rate of growth of close to 110%.

However, it should also be noted that the rate of growth of total Eurosystem balance sheet between end-November 2007 and end-November 2011 was 88%, whereas for the Federal Reserve's was 219% and for the Bank of England was 191%.

Central bank reserves are held by banks and are not part of money held by the non-financial sector, hence not, per se, an inflationary type of liquidity. There is no acceptable theory linking in a necessary way the monetary base created by central banks to inflation. Nevertheless, it is argued by some that financial institutions would be free to instantly transform their loans from the central bank into credit to the non-financial sector. This fits into the old theoretical view about the credit multiplier according to which the sequence of money creation goes from the primary liquidity created by central banks to total money supply created by banks via their credit decisions. In reality the sequence works more in the opposite direction with banks taking first their credit decisions and then looking for the necessary funding and reserves of central bank money. As Claudio Borio and Disyatat from the BIS put it: "In fact, the level of reserves hardly figures in banks' lending decisions. The amount of credit outstanding is determined by banks' willingness to supply loans, based on perceived risk-return trade-offs and by the demand for those loans."[7] In modern banking sectors, credit decisions precede the availability of reserves in the central bank. As Charles Goodhart pointedly argued, it would be more appropriate talking about a "Credit divisor" than about a "Credit multiplier".[8]

One can obviously monitor developments in monetary and credit aggregates to check if the concern regarding inflationary risks is justified. The ECB does this on a regular basis through its monetary analysis, so we are well positioned to react to any signs of excessive money and credit growth which may pose risk to price stability over the medium term.

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6 The balance sheet items related to monetary policy operations include: Main refinancing operations, Longer-term refinancing operations, Fine-tuning reverse operations, Structural reverse operations, Marginal lending facility, Credits related to margin calls and Securities held for monetary policy purposes.

7 Borio, Claudio and P. Disyatat 2009) "Unconventional monetary policies: an appraisal" BIS Working Paper no. 292.

8 Goodhart, Charles (1995) "Central Banks and the financial system" Mit Press.

If we look at broad money, however, it becomes clear that the underlying pace of monetary expansion remains moderate. At the end of 2008 – the period of the maximum rate of increase in the ECB balance sheet – the rate of M3 growth fell rapidly. From a peak of over 10% over 2007, the annual growth rate in M3 slowed down to zero at the end of 2009, before turning positive again, though around moderate levels, during 2010 and 2011. From January to October 2011 in relation to the same period last year M3 has increased just by 2.2% and in the month of October M3 has even decreased by 59 billion euros in absolute terms. Hence, while close scrutiny of future developments remains warranted, the evolution of M3 is not suggestive of any undesirable spillovers from non-standard monetary policy measures on the prospects for price stability. This confirms that the availability of central bank liquidity worked mainly, as intended, as a means to offset underlying funding tensions for banks. The large expansion of the ECB balance sheet was therefore instrumental in preventing a larger decline in M3. It is conceivable that, in the absence of non-standard measures, broad money growth could have fallen much further – possibly to the large, negative levels observed during the 1930´s Great Depression in the United States.[9]

3. Contagion, the monetary transmission mechanism and non-standard monetary policy

Let me now turn to a more detailed discussion of the non-standard measures implemented by the ECB. These measures must be tailored to the specific market segment, and to the specific disruption, which may prevail at a certain point in time. Therefore, there cannot be a single non-standard policy tool: different tools must be activated depending on the particular impediment to the transmission of changes in the standard policy rate to the economy. Two months ago I argued that financial contagion – both between debt markets of different sovereigns and between sovereigns and banks – is one major force at work that impairs the functioning of the monetary policy transmission mechanism.[10] This is still the case today; if anything contagion dynamics have worsened rather than eased.

Contagion already played an important role at the beginning of the financial crisis, then in terms of the propagation of illiquidity in interbank markets. The measures implemented starting in September 2008 had the specific objective of addressing the evaporation of liquidity in the money market, which seriously impaired a key source of funding for banks and thus their ability to continue lending to households and businesses. The money market “freeze” and liquidity contagion was, at least in large part, due to asymmetric information on other banks’ creditworthiness – in turn related to their exposure to toxic asset backed securities. As such, it could not have been cured by a reduction in key ECB rates. The latter could have dealt with a possible increase in interbank rates due to larger counterparty risk premia, but not to a situation of liquidity hoarding and market breakdown.[11] Moreover, a sharp reduction in key ECB rates aimed at reducing banks’ cost of funding would also have had unwarranted repercussions on the overall monetary policy stance.

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[9] See Friedman, M., and A.J. Schwartz (1963), A Monetary History of the United States, 1867–1960, Princeton University Press or, more recently, Christiano, L., R. Motto and M. Rostagno (2003), “The Great Depression and the Friedman-Schwartz hypothesis”, Journal of Money, Credit and Banking 35, pp. 1119–1197.

[10] Keynote lecture on “Contagion and the European debt crisis” at the Bocconi University/Intesa Sanpaolo conference on “Bank Competitiveness in the Post-crisis World”, Milan, 10 October 2011.

[11] For a formal analysis of the possible breakdown of the interbank market in the presence of counterparty risk, see Heider, Hoerova and Holthausen, “Liquidity hoarding and interbank market spreads: the role of counterparty risk”, ECB Working paper No. 1126. See also Allen, F., E. Carletti, and D. Gale (2009), “Interbank Market Liquidity and Central Bank Intervention”, Journal of Monetary Economics 56, 639–652; Bruche, M. and J. Suarez (2010), “Deposit Insurance and Money Market Freezes”, Journal of Monetary Economics 57, 45–61.

In contrast, the ECB decision addressed banks' funding problems directly. In the aftermath of the failure of Lehman Brothers, the ECB launched its policy of "enhanced credit support", a series of measures to enhance the flow of credit above and beyond what could be achieved through policy interest rate reductions alone. These measures include the unlimited provision of liquidity through "fixed rate tenders with full allotment"; the provision of liquidity at lengthened maturities of up to one year; and the provision of more liquidity in foreign currencies to euro area banks and of euro liquidity to other central banks for them to provide to their local banks; and a programme of purchases of covered bonds. As banks can only make use of the ECB liquidity-providing facilities if they have sufficient collateral, the ECB also extended the list of assets it accepts as collateral, subject to appropriate haircuts. As it had been the case in the years before the crisis, we also adjusted collateral eligibility criteria in view of market developments in order to remedy evolving inconsistencies and avoid possible abuses. The total value of eligible marketable collateral is very large. It equals about EUR 13 trillion,[12] which amounts to about 140 percent of euro area GDP. From this total, the euro area banks have in their balance sheets about EUR 4 trillion with EUR 1.8 trillion already approved for utilisation and creates the necessary room for manoeuvre in our liquidity provision that right now amounts to just EUR 650 million.

Thanks to the enhanced credit support, banks with funding needs could simply obtain liquidity from the ECB and continue operating almost "as if" the money market freeze had never occurred. Clearly, the full allotment decision could have been taken, and would have been equally effective, even in the absence of any changes in key ECB rates. The fact that interest rates were also cut rapidly over the period after September 2008 is due to the contemporaneous deterioration of the outlook for price stability. The non-standard measure implemented in 2008, however, prevented at source any severe disruption in the monetary policy transmission mechanism and thus ensured that the policy easing could produce its intended effects.

This example illustrates that, as I have argued before, once non-standard measures are appropriately implemented, they can be thought of as being independent from the process of interest rate setting. There is however a prerequisite for such independence: an appropriate operational framework involving the remuneration of banks' reserves. This feature ensures that banks can hold increasingly large amounts of liquidity without suffering an increasingly hefty opportunity cost. A full allotment procedure such as that applied by the ECB could thus completely offset the effects of the money market freeze. If reserves had not been remunerated, however, banks under financial distress would have had to go above the minimum reserves to build appropriate liquidity buffers with the ensuing increase in their opportunity cost. The ECB could have induced banks to satisfy their demand for liquidity only through a contemporaneous reduction of the opportunity cost of reserves, which is the policy interest rate. The separation principle would have been broken.[13]

A similar application of the separation principle has been made with the more recent SMP, which the ECB introduced in response to the repercussions of the euro area government debt crisis. Under the SMP the Eurosystem buys securities in dysfunctional debt market segments in order to safeguard the transmission of monetary policy.

This framework has enabled the ECB to quickly respond to the market tensions resurfacing over the summer of 2011. Let me briefly recapitulate the most recent measures. On 10 August, the ECB has again provided liquidity at a maturity of six months. On 15 September, the ECB has announced three additional US dollar operations with a maturity of about three months, which cover the end of the year. Importantly, the ECB has, in

[12] ECB (2010), Annual Report.

[13] For a formal discussion of these different dimensions of monetary policy, see Cúrdia and Woodford, "The Central-Bank Balance Sheet as an Instrument of monetary policy", mimeo, April 2010.

response to disorderly conditions in euro area debt securities markets, resumed the active implementation of the SMP on 8 August to buy debt securities, though only in the secondary government bond market. The SMP aims to create a better functioning transmission mechanism of monetary policy to all parts of the monetary union and is in full compliance with the prohibition of monetary financing. The relative size of the programme, representing just 1.9% of the euro area GDP against 13.7% of GDP that has been bought by the Bank of England or the 11.4% purchased by the Federal Reserve, makes it easier to be fully sterilised.

Furthermore, at the recent October 6 meeting, the ECB decided to conduct two further one-year long-term refinancing operations; to continue to apply fixed rate full allotment procedures in all monetary policy liquidity-providing operations for as long as needed and at least until the middle of 2012; and to conduct a second Covered Bond Purchase Programme (CBPP2) with an intended purchase amount of EUR 40 billion and over a period of one year, which started last month. On 30 November, the ECB announced coordinated actions with other central banks to enhance the capacity to provide liquidity support to the global financial system.

Today, the Governing Council also decided to adopt further non-standard measures. They include the conduct of two longer-term refinancing operations (LTROs) with a maturity of 3 years as fixed rate tender procedures with full allotment, and with the option of early repayment after one year; to increase collateral availability by reducing the rating threshold for certain asset-backed securities (ABS); to grant eligibility for Eurosystem operations to ABS having a second best rating of at least “single A” in the Eurosystem harmonised credit scale at issuance, and at all times subsequently, and the underlying assets of which comprise residential mortgages and loans to small and medium-sized enterprises; to allow national central banks to accept as collateral additional performing credit claims (namely bank loans) that satisfy broadly revised eligibility criteria; to reduce the reserve ratio, which is currently 2%, to 1%; and to discontinue for the time being, as of the maintenance period starting on 14 December 2011, the fine-tuning operations carried out on the last day of each maintenance period.

These measures should ensure enhanced access of the banking sector to liquidity and facilitate the functioning of the euro area money market. They are expected to support the provision of credit to households and non-financial corporations. All the non-standard monetary policy measures are, by construction, temporary in nature.

If we look at the past experience, the ECB’s measures have enabled the monetary policy transmission mechanism to continue operating relatively well at the level of the euro area, containing also contagion, although it should be recognised that the transmission mechanism remains severely disrupted in some euro area countries.

In sum, our actions – standard and non-standard – were fast, targeted and decisive; and clearly within the ECB’s mandate. But the main responsibility for solving the European sovereign debt crisis and the continuing financial crisis rests with EU authorities and Member States’ governments. All these authorities have to live up to their responsibilities, comply with previous commitments and swiftly implement agreed reforms. It is now of particular importance that all parties move ahead of financial markets, rather than sticking to a purely reactive approach. Under no circumstances can authorities relax efforts under the assumption that the ECB could alone compensate for the lack of action of others.

4. Concluding remarks

Let me conclude by emphasising the key messages I wanted to convey today.

First, based on the information available today, we expect to see inflation to stay above 2% for several months to come, but it will decline to below 2% during 2012.

Second, our determination to maintain price stability for the euro area as a whole over the medium term has made it necessary for us to intervene in dysfunctional market segments, thereby also contributing to the stability of the euro. We have already done a lot in this regard and we are ready to continue doing so, while remaining completely committed to our primary objective. The ECB is also open-minded to extending its non-standard monetary policy within its mandate, when circumstances require, as we have shown today. Overall, we have the available tools.

Third, in setting our monetary policy for the euro area we take full advantage of the principle of separation between standard and non-standard monetary policy. This principle suggests that actions on both sides can be taken independently. Moreover, our non-standard policy measures, for example taken in order to remedy adverse effects of financial contagion on the monetary transmission mechanism, are fully aligned with the ECB's mandate and monetary policy strategy.

Fourth, the ECB is able and willing to continue fulfilling central banks' classical role as financial lender of last resort, handling liquidity problems in the financial system without endangering price stability.

I thank you for your kind attention.