European Central Bank: Press conference - introductory statement

Introductory statement by Mr Willem F Duisenberg, President of the European Central Bank and Mr Lucas Papademos, Vice-President of the European Central Bank, Luxembourg, 4 July 2002.

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Ladies and gentlemen, the Governing Council of the European Central Bank met today for the sixth time outside Frankfurt. First of all I would like to thank our host, Governor Mersch, and the staff of the Banque centrale du Luxembourg, for the invitation and for the generous hospitality offered to us. Allow me also to add that the Governing Council today held its 100th meeting since the establishment of the ECB on 1 June 1998. We have not celebrated this event in any specific way, but we are pleased to draw your attention to this fact. Finally, let me, on behalf of the entire Governing Council, pay tribute to Pierre Werner, who passed away a few days ago. He was one of the founding fathers of the single currency and for this we will always be grateful to him.

At today's meeting, the Governing Council continued its comprehensive examination of **monetary, financial and economic developments** and assessed new evidence that has become available over the past few weeks. Our conclusion was that while risks to price stability over the medium term remain tilted to the upside, recent evidence sends mixed signals. Against this background, the Governing Council decided to leave the key ECB interest rates unchanged.

As regards the analysis under the **first pillar** of our monetary policy strategy, the three-month average of the annual growth rates of M3 increased to 7.5% in the period from March to May 2002, from 7.4% in the period from February to April. While there was some normalisation of M3 growth in early 2002, M3 dynamics have strengthened again recently. This development may partly reflect renewed portfolio shifts into M3 instruments, related to the recent increase in overall financial market uncertainty. However, more fundamental factors, such as the low opportunity cost of holding money and the economic recovery in the euro area have also driven monetary expansion in recent months. In addition, the rate of growth of loans to the private sector has been recovering. While due caution in interpreting recent short-term monetary developments is warranted, it is a matter of concern that there is significantly more liquidity available in the euro area than would be needed to finance sustainable, non-inflationary economic growth.

Concerning the **second pillar**, the latest data confirm that a gradual recovery in real GDP growth in the euro area is under way. Information from several surveys and leading indicators for the second quarter of this year point to somewhat higher real GDP growth rates than in the first quarter. Looking ahead, an ongoing strengthening in both domestic and foreign demand continues to be the most likely scenario. The conditions for further recovery in the euro area remain in place. There are no major imbalances in the euro area and financing conditions are very favourable. At the same time, there is continued economic growth outside the euro area. However, in view of recent financial market developments, the uncertainty surrounding the strength of the economic upturn – both outside and inside the euro area – has not diminished over recent weeks.

Turning to price developments, Eurostat's flash estimate indicates that annual HICP inflation fell from 2.0% in May to 1.7% in June. However, it is too early to interpret this fall as a sign of receding upward pressure on prices, given that HICP inflation excluding the more volatile items of energy and unprocessed food prices has remained high throughout the first half of this year, reflecting in particular trends in services prices. Moreover, it is to be expected that overall HICP inflation rates will fluctuate around 2% in the coming months.

The strengthening of the euro exchange rate should have a moderating effect on inflation. However, it is difficult to quantify the size and establish the timing of this effect. For price stability to be maintained on a sustainable basis it is crucial that the high wage increases resulting from recent negotiations in some regions do not spread across the euro area, not least because this would have negative consequences for competitiveness, employment growth and consumption.

Overall, the strengthening of the euro exchange rate is a new factor suggesting a potential for lower inflation rates. However, other factors – in particular monetary developments and wage trends – do not indicate a moderation in price pressures. Monetary policy therefore needs to remain vigilant as regards the key factors determining the outlook for price stability over the medium term.

Regarding **fiscal policies** in the euro area, we have seen some worrying developments in the past few months. Against this background we call upon all member countries to honour the commitments made to achieve budgets that are close to balance or in surplus by 2003-04, in compliance with the framework of the Stability and Growth Pact. This is necessary in order to maintain and further strengthen confidence in the policy framework of the euro area and to establish fiscal positions in all countries that allow automatic stabilisers to operate efficiently without endangering sound fiscal positions in the longer term. Moreover, governments are encouraged to push ahead with reforms relating to the size and structure of public expenditure and revenue, which will also create room for tax cuts and absorb the fiscal costs of population ageing.

In the field of **structural reforms** allow me to refer briefly to the adoption of the Broad Economic Policy Guidelines. If implemented in a determined manner, structural reforms will contribute to expanding the euro area's potential for non-inflationary growth and to reducing its high level of unemployment.

We are now at your disposal for questions.