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, at the press conference held in Frankfurt, 10 October 2002.

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Ladies and gentlemen, the Vice-President and I will report on the outcome of today's meeting of the Governing Council of the ECB.

Today, the Governing Council continued its in-depth examination of **monetary, financial and economic developments,** incorporating in its assessment the new evidence that has become available over recent weeks. Our conclusion is that risks to price stability are at present balanced. Based on our overall assessment, we have kept 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 was 7.1% in the period from June to August 2002, compared with 7.3% in the period from May to July 2002. Hence, monetary growth remained strong and liquidity in the euro area ample. Recent monetary developments, however, should be interpreted with care. On the one hand, monetary trends have been influenced by considerable uncertainty in financial markets and therefore partly reflect strong liquidity preferences among investors. On the other hand, the low level of short-term interest rates has tended to stimulate monetary expansion, reflected particularly in the increase in the narrow aggregate M1. At the same time, loans to the private sector appear to be stabilising at growth rates above 5%, a rate of expansion which, in real terms, is in line with the long-term average. Considering all the evidence relating to the first pillar, from a medium-term perspective, more liquidity is available than would be needed to finance sustainable, non-inflationary growth. However, given the current environment, we do not see the risk of this translating into inflationary pressure in the near future.

Concerning the **second pillar**, the latest data and survey results confirm that economic activity in the euro area remains subdued. These data and results also suggest that real GDP growth in the third quarter of 2002 may turn out to be similar to that of the first two quarters, when quarter-on-quarter expansion reached 0.4%. Against this background, previous expectations of an acceleration in economic growth in 2002 will not materialise. At the same time, a significant degree of uncertainty has been building up over recent months owing, in particular, to the sharp decline in stock prices and their potential detrimental effects on the economy, as well as to geopolitical tensions as reflected in surging oil prices.

Nevertheless, the main scenario for the euro area is a return, in the course of 2003, to economic growth rates in line with those of potential, as also reflected in forecasts by international organisations. However, the uncertainty surrounding the economic outlook is high. Sources of downside risks - including oil prices, imbalances in the global economy, financial market uncertainties and their impact on consumption, investment, and thus on employment – will be monitored closely. At this juncture, it is particularly difficult to offer a precise assessment of the timing and strength of the economic upswing, both in the euro area and globally.

Turning to price developments, in August annual HICP inflation was 2.1%. Eurostat's flash estimate for September indicates an annual HICP inflation rate of 2.2%. While no detailed information is as yet available for individual HICP sub-components, the recent increase is likely to reflect the rise in energy prices. These developments generally remain in line with previous expectations of inflation rates hovering at around 2% for the remainder of the year, but short-term trends could be affected by future oil price developments.

Looking further ahead, the euro exchange rate, which has strengthened since early this year, and the overall economic environment should contribute towards reducing inflationary pressure. In addition, we expect rates of perceived inflation, which are currently high, to move closer to actual rates. However, the assessment that inflation rates will fall and remain below 2%, depends on the development of oil prices and the prevalence of wage moderation. In this respect, earlier this year we pointed to an upward trend in wage growth which, according to preliminary indications, may have come to a halt only recently. In the same vein we have noted the inertia of consumer price developments in the euro area, as reflected in the stubbornness of the annual rate of inflation excluding unprocessed food and energy. This rate was 2.5% in August, only marginally lower than early this year; therefore, vigilance is warranted.

Overall, monetary policy will remain geared towards maintaining price stability and will continue to focus on the medium-term, thereby providing a reliable anchor for consumers and investors. At the current juncture, aggregate demand and exchange rate developments should contribute towards easing inflationary pressure, while monetary developments, wage trends and oil price developments could point to risks in the opposite direction. Consequently, all factors which could influence the balance of risk to price stability will be monitored closely.

Regarding **fiscal policies** in the euro area, the Governing Council notes with concern that there is still insufficient ambition in some countries to bring budgets to positions close to balance or in surplus over the medium term. The current fiscal problems in some countries arise from the fact that these countries did not take the opportunity to improve substantially on their fiscal positions when economic growth rates were considerably higher than is currently the case. Given that this opportunity was missed, there is now no alternative but for all countries with remaining imbalances to make firm commitments to avoid excessive deficits, in keeping with the Treaty provisions, and to attain budgetary positions close to balance or in surplus, as required under the Stability and Growth Pact. Swift, decisive action is necessary in order to set up credible adjustment paths based both on realistic assumptions on the economic environment and on well-specified consolidation measures. Such adjustment paths must entail significant yearly improvements in the cyclically adjusted budget balance, and must be followed strictly and be completed within the shortest possible time-frame. To underpin this process, the ECB calls for strict monitoring procedures for the implementation of the consolidation strategies, the full use of the excessive deficit procedure and the application of rigorous accounting rules.

Fiscal consolidation is not detrimental to the outlook for economic growth. The attainment of budgetary positions in line with the Stability and Growth Pact will gradually create scope for dealing with age-related issues and their impact on public finances. In any case, in the short term, the Pact does not place constraints on those member countries already in compliance, although it does call for the transition to be completed in the few remaining countries. Direct effects on short-term demand are to be counteracted by higher credibility of the conduct of fiscal policy – boosting confidence and thus private spending.

We also urge governments to overcome the inertia in implementing **structural reforms**, both within the area of fiscal expenditures and revenues and in labour and product markets. Any further delay in tackling, with greater determination, the underlying reasons for limited growth in potential output over the medium term, and for only partially exploiting the current potential, is costly. It would also make it increasingly difficult to reach the objectives set in the Lisbon Agenda. Structural reforms take time to unfold fully their benefits and should therefore be frontloaded. Under the current circumstances, frontloading is particularly needed as it would support confidence.

We are now at your disposal for questions.