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 Rome, 3 April 2003.

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Ladies and gentlemen, the Governing Council of the European Central Bank today met for the seventh time outside Frankfurt. Let me therefore thank both Governor Fazio for his invitation and generous hospitality, and the staff of the Banca d'Italia for an excellently organised meeting.

At our meeting today, which took place in the exceptional circumstances associated with the conflict in Iraq, we comprehensively reviewed **monetary, financial and economic developments**. We discussed at some length the potential economic implications of the military operations. In the Governing Council's view, it is not possible at this juncture to assess what effect they will have on the global economy, and on economic developments and the medium-term outlook for price stability in the euro area. Overall, the basic elements of our assessment of 6 March on the outlook for price stability remain in place and accordingly we decided to keep interest rates unchanged.

We also noted that the outbreak of the war has not affected the functioning of the financial system. As indicated in our press release of 20 March, the Governing Council will act to ensure the proper functioning of financial markets, providing sufficient liquidity in the euro area as needed.

Let me now explain our assessment of economic developments in more detail.

As regards the analysis under the **first pillar** of our monetary policy strategy, the three-month average of the annual growth rate of M3 was 7.4% in the period from December 2002 to February 2003, up from 7.0% in the period from November 2002 to January 2003. Given the continued high volatility in financial markets, mainly related to the geopolitical uncertainty, M3 growth continued to be fostered by portfolio shifts away from more risky assets. However, M3 growth appears also to have been affected by the low level of short-term interest rates prevailing in the euro area, as indicated by the strong growth in its most liquid components. At the same time, credit growth showed signs of stabilisation in early 2003, after the moderation observed throughout last year.

Turning to the analysis under the **second pillar**, recent data and surveys continue to confirm that real GDP growth in the euro area remained weak in early 2003. In particular, the persistence of geopolitical tensions continued to negatively affect sentiment and dampen economic activity, thereby adding to the forces which had already depressed the outlook for the euro area before the escalation of tensions in the Middle East. As a result, we should only expect a modest rate of economic growth for 2003. However, the evolution of economic growth for the rest of this year is particularly difficult to foresee at the moment, given the exceptional degree of uncertainty arising from the military conflict. Our baseline scenario continues to be one of a moderate recovery associated with diminishing uncertainty, starting in the second half of 2003. However, we will need to review the economic implications of the war as soon as a clearer picture emerges. A number of scenarios, implying widely different outcomes for economic activity, are conceivable at present. Yet it would be premature to assign specific probabilities to any such exercises, which are mainly of an illustrative nature.

Looking at price developments, annual HICP inflation is estimated by Eurostat to have been 2.4% in March 2003, unchanged from February. The recent drop in oil prices is not likely to be reflected in the price statistics until April.

As for the outlook for price stability over the medium term, it is particularly important to clearly distinguish between short-term volatility and more fundamental factors. While oil price developments may very much influence the pattern of inflation rates over the coming months, other factors should dominate beyond the short term. The lagged effects of the appreciation of the euro exchange rate since mid-2002 will continue to dampen upward pressure on prices, as will the modest economic growth. If the recent significant reduction in oil prices is sustained, inflation rates will in all likelihood fall below 2% in the course of 2003 and remain in line with price stability thereafter; evidently, this presupposes that wage moderation prevails.

Overall, the present policy stance is consistent with the preservation of price stability over the medium term. It maintains a monetary environment that is in itself favourable to economic growth in a situation in which other factors are having an adverse effect on economic activity. Exceptional circumstances are complicating the assessment of economic trends. We will therefore continue to monitor events carefully and evaluate them in the light of our mandate.

Regarding **fiscal policies**, the Stability and Growth Pact provides a robust and flexible framework for addressing any strains on public finances without undermining the principle of budgetary discipline. While letting, where possible, automatic stabilisers operate in reaction to changing economic circumstances, there is no reason to pursue fiscal activism. It remains essential that both the commitments made in the stability programmes and the requests to further improve fiscal positions, as subsequently agreed in the ECOFIN Council, are implemented in full. This will help to build confidence in the fiscal framework and anchor expectations about the future macroeconomic environment.

In a highly uncertain environment, it is all the more essential that governments help to boost investor and consumer confidence by taking decisive action to implement **structural reforms** in labour and product markets and in public finance. On the one hand, there appears to be a broad consensus among policymakers and the public that such reforms are important to ultimately raise the euro area's production potential, improve the flexibility of the economy and make the euro area more resilient to external shocks. On the other hand, notwithstanding some progress in individual countries, the effective pace of reform has so far remained slow and clearly insufficient to meet the Lisbon objectives. Over the past few years this has given rise to an implementation gap. Efforts to overcome structural inefficiencies in the functioning of markets must be stepped up. This would promote confidence in the medium-term production capacity of the euro area and therefore counteract to some extent the current high degree of uncertainty.

We are now at your disposal for questions.