

## **Willem F Duisenberg: Presentation of the ECB's Annual Report 2002 to the European Parliament**

Introductory statement by Dr Willem F Duisenberg, President of the European Central Bank, at the presentation of the ECB's Annual Report 2002 to the European Parliament, Strasbourg, 3 July 2003.

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It is my pleasure to present to you today the ECB's Annual Report for 2002, a year that was marked by significant progress on our path towards a more integrated Europe. In particular, 2002 saw the successful introduction of the euro in its tangible form, as euro banknotes and coins have been swiftly accepted and embraced by the citizens of the euro area. Moreover, Heads of State or Government, at their summit meeting in December last year, took the historic decision to invite ten countries to join the European Union (EU) as of 1 May 2004.

### **Economic and monetary developments**

At the same time, the environment in which monetary policy was conducted in 2002 was one of considerable uncertainty.

Following the slowdown in economic activity throughout 2001, a moderate recovery of real GDP growth in the euro area was recorded at the beginning of 2002. However, as the year progressed, the recovery lost momentum, affected by renewed turbulence in financial markets and geopolitical tensions, which had consequences for oil prices and confidence. Overall, annual real GDP growth in the euro area is estimated to have been only 0.8% in 2002, compared with 1.4% in 2001.

Despite the subdued pace of real economic growth, HICP inflation remained at 2.3% on average in 2002, unchanged from 2001, and slightly above the ECB's definition of price stability. This was partly due to a number of temporary or one-off factors, including higher oil prices, indirect tax increases and adverse weather conditions. On top of this, there were some effects from the cash changeover. While the overall impact of the cash changeover on inflation was small, its perceived impact was much greater than its actual impact, probably due to comparatively strong price increases in some specific sectors. Of greater concern for the medium-term outlook for price stability was the fact that nominal wage growth remained relatively strong despite the weakening of economic activity and a rise in unemployment, while productivity growth remained low. This development points to persistent structural rigidities in the labour markets of the euro area.

Monetary growth was strong in 2002. While this development was partly the result of high volatility in financial markets, which heightened investors' preference for short-term liquid and less risky financial assets, it also reflected the relatively low interest rates in the euro area in 2002. Overall, however, the excess liquidity was not seen to indicate risks to price stability in an environment of subdued economic activity and moderate credit growth.

While some factors pointed to possible upward inflationary pressures at the beginning of 2002, later in the year the worsening outlook for economic activity and the sizeable and protracted appreciation of the euro increasingly pointed towards lower inflationary pressures over the medium term. Against this background, the Governing Council decided to reduce the key ECB interest rates by 50 basis points in December 2002.

This was followed in March 2003 by a reduction of 25 basis points and by a further 50 basis point reduction in June 2003. These rate cuts provided some counterweight to the various factors having an adverse effect on economic activity and thereby improved the prospects for price stability in the medium term.

With these decisions, the minimum bid rate on the main refinancing operations reached 2% in June 2003. Interest rates in the euro area are now at record low levels by historical standards, both in nominal and real terms.

As regards the current outlook for price stability, Eurostat's flash estimate of annual HICP inflation in the euro area was 2.0% for June 2003. The appreciation of the euro, which has brought exchange rates to levels close to long-term averages and more in line with economic fundamentals, should contribute to keeping inflationary pressures low. In addition, in a context of moderate economic

recovery, wage growth is expected to remain compatible with the maintenance of price stability. The strong monetary growth also should not, for the time being, adversely affect the outlook for price stability. While the outlook for price stability has remained broadly unchanged since our last decision on 5 June, the Governing Council will continue to monitor carefully all factors which are relevant to its assessment.

Although the outlook for price stability is favourable, having allowed interest rates to fall to historically low levels, monetary policy cannot by itself generate lasting and sustainable growth and employment in the euro area. Other policy-makers also have to take up their responsibilities. Part of the weakness in economic growth in the euro area can be linked to a lack of ambition in the areas of both fiscal and structural reforms to further improve the conditions for investment and employment in the euro area. I probably cannot emphasise sufficiently the need to speed up the pace of structural reforms in the labour and product markets, given their positive impact on the euro area's ability to better withstand external shocks, as well as to increase its growth potential. Fiscal policies should also strive to establish a well designed consolidation strategy in those countries struggling with increasing fiscal imbalances. A medium-term, stability-oriented approach for economic policies would eliminate a great deal of the uncertainty currently overshadowing long-term planning and perspectives which would also have positive effects over the shorter term. In fact, at present, the situation of subdued economic growth and the stronger external value of the euro make the structural reforms even more necessary.

### **Other issues raised in the draft European Parliament resolution on the ECB's Annual Report 2002**

Let me now turn to some other issues raised in the draft resolution on the ECB's Annual Report. I have noted - and welcome - that in several important aspects the views expressed in the draft resolution are very similar to those held by the ECB, for instance as regards the need for Member States to respect the Stability and Growth Pact and the importance of honouring their commitments under the Broad Economic Policy Guidelines, in particular with respect to structural reforms. I also appreciate the fact that your draft resolution welcomes the clarifications of the ECB's monetary policy strategy which we made public in May of this year. These clarifications, while reflecting the overall successful experience with the ECB's monetary policy strategy since its inception, will further foster understanding of the monetary policy of the ECB.

While the European Parliament and the ECB hold similar views on many important issues, some differences in views remain, such as regarding the draft resolution's suggestion that the ECB should publish the summary minutes and the balance of votes of Governing Council meetings. For a number of reasons, which I have pointed out on previous occasions before Parliament, we believe that the tools chosen by the ECB to communicate and explain its decisions ensure transparency, are more readily available and better reflect the institutional environment in which the ECB operates. You will also not be surprised that I cannot share the view that the ECB's decision-making process might have been delayed by the fact that most Governing Council decisions have so far been taken by consensus. Indeed, the Governing Council has taken its decisions in a timely manner, responding appropriately to changing economic conditions whenever required.

The draft resolution also refers to the Beige Book of the Federal Reserve System as being a benchmark for country-by-country reviews to be conducted by the Eurosystem. Let me point out that the national central banks within the Eurosystem regularly monitor and analyse macroeconomic, fiscal as well as structural developments in their respective countries, publishing their findings in their monthly, quarterly or annual reports. These analyses clearly enhance our understanding of euro area developments. However, given its euro area focus, it is natural for the ECB to pay greater attention to the euro area perspective in its explanations of the single monetary policy.

As mentioned at the beginning of my remarks, we are currently experiencing truly historic developments. The dream of a united Europe stretching beyond former post-war rifts is about to become reality. Although major challenges lie ahead, as many of the acceding countries are still developing into fully-fledged market economies, I believe that the signing of the Accession Treaty at the Athens summit in April testified to our joint belief in an integrated Europe. The clear endorsement of the Treaty in the national referendums that have already taken place in a number of acceding countries provides evidence of this commitment.

It goes without saying that an enlarged European Union will require a number of adaptations in the working procedures and the internal functioning of European institutions and bodies, including a

reform of the voting modalities of the Governing Council. I am well aware of the views that the European Parliament has expressed in this regard, but let me again point out that the Nice Treaty set clear conditions and limits within which our reform proposal had to be formulated. While the adopted changes in the voting modalities are, admittedly, complex, the tried-and-tested principles of the Eurosystem constitution, in particular the *ad personam* participation of governors and the “one member, one vote” principle for the members exercising a voting right, have been kept fully intact. This will ensure that, also in a significantly enlarged euro area in the future, the Governing Council will maintain its capacity for timely and efficient decision-making.

Upon accession, the new Member States will join Economic and Monetary Union with the status of “countries with a derogation”, and their central banks will become part of the ESCB. At a later stage, these central banks will become part of the Eurosystem, once their respective countries have fulfilled the convergence criteria for adopting the euro. A key priority of the ECB is to have in place the necessary technical and institutional infrastructure to ensure an orderly enlargement of the ESCB and, later on, of the Eurosystem. An interesting foretaste of the new, larger ESCB was provided by the last General Council meeting on 26 June. For the first time, the governors of the acceding country central banks participated as observers in a meeting of the General Council of the ECB.

With this look towards the future, I should like to conclude my statement. This will be the last time that I have the opportunity to present to you the Annual Report of the European Central Bank, which I have had the honour to preside over for the last five years. I would like to thank you for the co-operation and cordial relations that we have maintained during these years.