Jean-Claude Trichet: Testimony before the Committee on Economic and Monetary Affairs of the European Parliament

Introductory statement by Mr Jean-Claude Trichet, President of the European Central Bank, before the Committee on Economic and Monetary Affairs of the European Parliament, Brussels, 1 December 2003.

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It is my pleasure to appear before your Committee for the first time in my capacity as President of the ECB. I would like to tell you that I was very impressed by our last encounter here and I thank your Committee and Parliament for the confidence expressed by giving your approval to my appointment. I look forward to continuing our regular dialogue in the same fruitful and constructive spirit that was dear to my predecessor Wim Duisenberg, to whose achievements I wish to again pay tribute on this occasion.

I shall begin my first report to you with our assessment of economic and monetary developments, before turning to another issue of topical importance, namely the draft EU Constitution. I should like to conclude my statement by briefly addressing the international role of the euro.

1. Economic and monetary developments

At the time of Mr Duisenberg's last testimony in September, we noted that economic activity had been very weak in the first half of 2003. At the same time, early signs of a recovery were emerging. Since then, data have confirmed our main scenario, which is one of a gradual improvement in economic activity starting in the second half of this year. Eurostat has provisionally estimated that quarterly real GDP growth was 0.4% in the third quarter of the year.

There are, increasingly, reasons to expect the gradual economic recovery in the euro area to broaden and strengthen in the course of 2004. Recent data show that the recovery of the world economy is clearly making progress. The expansion of global trade and economic activity should support euro area exports. On the domestic side, recent survey data continue to point towards a further improvement in confidence. The conditions for investment are also improving as a result of firms' continued adjustment efforts to enhance productivity and profitability. Financing conditions are generally favourable, not least due to the low level of interest rates. Finally, terms-of-trade effects stemming from the past appreciation of the euro should also positively affect real disposable income and thus facilitate a pick-up in consumption growth. Developments in financial markets are broadly consistent with the overall picture of a gradual resumption of economic growth.

As compared with a few months ago, downside risks to the main scenario of a gradual recovery have clearly receded. Overall, the risks to this scenario in the coming quarters now appear to be balanced. Over longer horizons, some risks to the sustainability of economic growth at the global level remain. This is due, primarily, to unresolved structural problems, the sustainability of public finances and to external imbalances in some parts of the world economy.

As regards prices, the annual rate of HICP inflation declined to 2.0% in October, from 2.2% in September. Looking ahead, inflation rates may not fall as quickly and strongly as was expected at the time of the last testimony of the President of the ECB. We have seen rather strong increases in some categories of food prices owing to the effects of this summer's heatwave. In addition, oil prices have remained higher than expected, owing mainly to ongoing political uncertainties in the Middle East. Furthermore, in the coming months, planned increases in indirect taxes and administered prices in some euro area countries are likely to have an upward impact on annual inflation rates.

However, there are also factors which should continue to dampen inflationary pressures. First, in the context of a gradual economic recovery, wage developments should remain moderate. In addition, the past appreciation of the euro, which is reflected in current subdued price pressures at the producer level, will continue to lower import prices and be passed on to consumer prices over time. At the same time, developments in inflation expectations need to be monitored closely.

Cross-checking this assessment with our monetary analysis, we see that liquidity in the euro area remains ample following the period of strong monetary growth over the past two years, reflecting past portfolio shifts, precautionary savings and the low level of interest rates. The latter factor also provided a counterweight to the negative impact of weak economic growth on loans to the private sector. In the view of the Governing Council, the accumulation of excess liquidity should not, at the current juncture, be of concern for price stability, given that, for the time being, the economic recovery is only gradual. However, should high excess liquidity continue to prevail once there is a significant strengthening of economic activity, this could lead to inflationary pressures in the medium term. Monetary developments therefore need to be monitored carefully.

Overall, the Governing Council of the ECB, at its meeting in November, continued to assess the outlook for price developments as in line with our definition of price stability and considered the current stance of monetary policy to be appropriate. At the same time, the Governing Council made clear that it will carefully monitor all developments that might affect its assessment of risks to price stability.

Turning to recent fiscal policy developments, you are very well aware of our serious concerns. In recent months we have seen a gradual move away from the commitments made under the Stability and Growth Pact. The Governing Council had already made clear on 6 November that the recommendations of the European Commission regarding the steps to be taken in the excessive deficit procedure had pushed the room for interpretation of the rules and procedures to the limit.

As you already know from the Governing Council's statement to the public last Tuesday afternoon following the decision of the ECOFIN Council, the Governing Council deeply regrets the ECOFIN Council's decision not to act on the basis of the Commission's recommendations regarding France and Germany. It fully shares the views made public by the Commission on the ECOFIN Council's conclusions.

The conclusions adopted by the ECOFIN Council carry serious dangers. The failure to respect the rules and procedures foreseen in the Stability and Growth Pact risks undermining the credibility of the institutional framework and confidence in the sustainability of public finances across the euro area.

The Governing Council takes note of the commitments by France and Germany to correct their excessive deficits as rapidly as possible, and by 2005 at the latest, and strongly urges the governments concerned to live up to their responsibilities. It is now absolutely imperative that effective action be taken to limit negative effects on confidence. Moreover, we also note that the ECOFIN Council stands ready to act on the basis of the Commission's earlier recommendations to give notice to the two countries, should they fail to comply with the Council's conclusions.

The public can rest assured that the Governing Council remains staunchly committed to maintaining price stability.

We firmly believe that the need to correct the excessive deficits in some countries and to pursue sound fiscal policies in general have to be framed within a comprehensive and credible medium-term reform strategy. It is necessary for executive branches, parliaments and social partners to push ahead with structural reforms aiming at enhancing the competitiveness of the euro area, notably in labour and product markets, as well as in social security systems, in order to foster a more flexible allocation and utilisation of capital and human resources. The Governing Council very strongly supports recent and ongoing efforts by a number of governments in this direction. It also encourages social partners to fully commit themselves to the objective of making the euro area a more dynamic and innovative economy, as intended by the "Lisbon agenda".

Once there is a convincing commitment to implementing comprehensive structural reforms to foster the growth perspective of the euro area, confidence will increase among all economic actors, including consumers. The upswing that we currently foresee is a sign that confidence is returning, but for the economic recovery to be sustained it is essential that excessive deficits are corrected and that the reforms currently being discussed are carried out.

2. The draft EU Constitution

For the last two years, the EU has been engaged in intense debates on a future Constitution for the Union. These debates resulted in the draft Constitution presented by the Convention in June and are now culminating in the Intergovernmental Conference, which is seeking to finalise the Constitution before the end of this year. The ECB has followed the constitution-building process with great interest and welcomes all efforts to further the construction of a united Europe.

When the European Union re-writes its rulebook by giving itself a Constitution, does this mean that there will be profound changes to the provisions relating to the ECB and to monetary union in general?

Throughout the process of drafting the Constitution, the ECB has consistently advocated that the monetary constitution of the EU - the basic set of rules and provisions for EMU, as laid down in the Maastricht Treaty - is sound both in terms of the objectives set and the allocation of responsibilities between different actors and levels of government.

I am grateful that the Convention has followed a similar line of reasoning. Its draft Constitution takes over the provisions relating to EMU without changes in substance. The single monetary policy is, by its very nature, indivisible. Thus, it is an exclusive competence of the Union. The conduct of monetary policy has been assigned to an independent European Central Bank, which fulfils this task together with the national central banks of the euro area and with the clear primary objective of maintaining price stability. The European System of Central Banks is explicitly mentioned in the first part of the draft Constitution.

However, further refinements to the draft Constitution are possible, and the ECB has made several suggestions. For example, we strongly believe that price stability should be added to the list of the Union's objectives set out in the first part of the Constitution, as price stability is of great importance not only for the ECB but for the Union as a whole. It ensures confidence in the long-term value of the euro and translates into low and stable medium and long-term market interest rates. It also avoids an arbitrary redistribution of wealth, thereby helping to protect the weakest members of society. There can be no doubt that price stability deserves to be one of the European Union's objectives. Furthermore, we would like to see a clarification of the allocation of responsibilities with regard to the international representation of the euro. It would also be useful to formally recognise the widely used term "Eurosystem".

It is now for the Intergovernmental Conference to use the Convention's draft to finalise the Constitution. I sincerely hope that Foreign Ministers and Heads of State or Government will take decisions in full awareness of the historic nature of their task. From the ECB's point of view, the recent proposal to introduce into the Constitution an extended enabling clause which would allow the European Council to amend, by unanimity, important parts of the Statute of the ESCB and of the ECB is certainly not welcome. In a letter which I sent to the current President of the Council, Mr Frattini, last week, I stressed that the ECB is seriously concerned about this proposal. Such an expansion of the simplified amendment procedure would imply a far-reaching change to the current constitution of the ESCB, which the ECB could not support.

3. The international role of the euro

Let me conclude my statement with some observations on the international role of the euro, an issue which I know the European Parliament follows with great interest. The ECB monitors developments in this area carefully and, as in previous years, we will shortly publish its annual review of the international role of the euro. The findings of this report suggest that the use of the euro by non-euro area residents continues to increase gradually and is most prominent in regions neighbouring the euro area. In addition, the use of the euro is, to some extent, driven by the euro area itself, as euro area investors account for a significant part of demand for international euro-denominated bonds.

While these features have not changed over the past few years, a number of new developments have emerged in 2003. First, there is some evidence of rising interest in euro-denominated bonds on the part of Asian investors. Second, according to the latest data published by the IMF, which were recently revised, the share of the euro in global foreign exchange reserves also increased between 2001 and 2002, from 16.4% to 18.7%. Third, euro area countries are increasingly using the euro as a settlement or invoicing currency in trading with non-euro area residents, especially following the cash changeover. This suggests that the cash changeover may have encouraged exporters and importers to review their settlement and invoicing practices. As you know, these developments are the outcome of decisions essentially taken by market participants. They underscore the confidence of non-euro area residents in the euro.

I am now open to questions.