

Jean-Claude Trichet: Hearing at the Economic and Monetary Affairs Committee of the European Parliament

Introductory statement by Mr Jean-Claude Trichet, President of the European Central Bank, at the Hearing at the Economic and Monetary Affairs Committee of the European Parliament, Brussels, 25 June 2008.

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Madame la Présidente, Mesdames et Messieurs les membres de la Commission Economique et Monétaire, je me réjouis d'apparaître devant votre commission aujourd'hui. Je commencerai mon intervention par une évaluation de la situation économique et monétaire, en expliquant les raisons sous-jacentes à nos récentes décisions de taux. Ensuite, je vous fournirai de plus amples informations sur les opérations de politique monétaire de la BCE en réaction aux tensions enregistrées sur le marché monétaire. Anschließend möchte ich näher auf die ersten zehn Jahre der Europäischen Wirtschafts- und Währungsunion eingehen. Außerdem werde ich die wichtigsten Elemente des neuen Strukturberichts des Eurosystems über Arbeitsangebot und Beschäftigung präsentieren.

Economic and monetary developments

Since my previous appearance before the European Parliament at the end of March, annual HICP inflation has remained high, at levels significantly above 3%. This mainly owes to strong increases in energy and food prices. Moreover, upside risks to price stability over the medium term have intensified further over the past few months, in a context of very vigorous money and credit growth. Looking ahead, the Governing Council expects inflation in the euro area to remain high for some time to come, before moderating only gradually in 2009.

In line with this view, the latest Eurosystem staff projections foresee average annual inflation between 3.2% and 3.6% in 2008 and between 1.8% and 3.0% in 2009. Compared with previous staff projections, this represents a significant upward revision, reflecting higher oil and food prices as well as increasing inflationary pressures in the services sector.

The Governing Council remains particularly concerned that current elevated inflation rates, which have proved higher and more persistent than previously foreseen, may become entrenched in private inflation expectations and lead to second-round effects in price and wage setting. The increased relevance of such considerations reflects the strengthening of upside risks to price stability over the medium term. In particular, wage growth may be stronger than anticipated, given high rates of capacity utilisation and a tight labour market. In this context, the risk of triggering an inflationary wage-price spiral is particularly acute, especially where nominal wage indexation schemes exist. Moreover, price increases in particular in parts of the services sector that lack competition may be higher than currently expected.

Against this background, it is imperative that all parties concerned contribute to avoiding the emergence of broadly-based second-round effects. This is essential to secure that longer-term inflation expectations remain firmly anchored in line with price stability.

Turning to economic activity, in the first quarter of 2008, real GDP grew strongly, by 0.8% quarter-on-quarter. In part, this unexpected positive outcome reflects temporary factors, notably a boost in construction activity, given the very mild winter in many parts of Europe. That being said, the strong growth in the first quarter has to be seen against the usual volatility of quarterly data: in coming to an assessment, it will be more appropriate to view the first two quarters of 2008 together. Looking forward, domestic and foreign demand are expected to support ongoing economic expansion, albeit to a lesser extent than during 2007.

The euro area economy has sound fundamentals and does not suffer from major imbalances.

This outlook is also reflected in the latest Eurosystem staff projections, which foresee annual real GDP growth in the range of between 1.5% to 2.1% in 2008 and of between 1.0% and 2.0% in 2009. However, it is important to put these figures into perspective: the annual rates mask the fact that on a quarterly basis real growth is projected to reach its trough already in mid 2008, before gradually recovering thereafter.

In the view of the Governing Council, uncertainty surrounding growth prospects remains high, with downside risks mainly relating to a potentially more negative impact of financial market developments than anticipated and further unanticipated increases in energy and food prices.

The monetary analysis confirms the prevailing upside risks to price stability at medium to longer-term horizons. Available data suggest that the underlying rate of money and credit expansion remains strong and that the ongoing financial turmoil has, as yet, not significantly affected bank loan supply to the non-financial corporate sector.

In line with its mandate, the Governing Council is strongly determined to secure the firm anchoring of longer-term inflation expectations in line with price stability. Such an anchoring is a prerequisite for monetary policy to make an ongoing contribution towards supporting sustainable economic growth and job creation in the euro area. In particular, the Governing Council remains committed to preventing second-round effects and the materialisation of upside risks to price stability over the medium term. Against this background, on 5 June, we decided to leave the key ECB interest rates unchanged. At the same time, we signalled that we are in a state of heightened alertness. Indeed, the Governing Council will continue to monitor very closely all developments.

Recent monetary policy operations of the ECB

Turning to our liquidity management, since March, the ECB has continued to apply basically four liquidity measures to alleviate ongoing tensions in the euro money market.

First, the ECB has continued to “frontload” the supply of liquidity over the reserve maintenance period. This means that we have provided more liquidity at the beginning of the maintenance period, while compensating for this by providing less liquidity towards the end of the period. The average supply of liquidity has thus remained unchanged over the entire maintenance period.

Second, around the end of the first quarter of 2008, when money market tensions were intensifying, the ECB conducted two liquidity-providing fine-tuning operations to address these tensions. The ECB has recently announced that it stands ready, if needed, to contribute to smoothing the market conditions around the end-of-semester.

Third, the ECB has continued its policy of providing a higher share of liquidity on a longer-term basis by renewing our supplementary three-month longer-term refinancing operations. Moreover, in April 2008 the Eurosystem conducted a supplementary longer-term refinancing operation with a six-month maturity and announced another one for July 2008. It is to be noted that the total amount of outstanding refinancing remained unchanged, as we reduced the share provided via the one-week main refinancing operations.

Fourth, to ensure the availability of funding denominated in US dollars, the ECB has continued the conduct of term auction facilities in cooperation with the US Federal Reserve. Accordingly, it provided liquidity in US dollars to euro area banks, secured with Eurosystem eligible collateral.

Ten years of EMU

Let me take the opportunity to say a few words on the tenth anniversary of the ECB and the European System of Central Banks, which we celebrated on 1 June. The creation of the euro has been an historic policy decision for Europe. The ECB has been successful in delivering what it is expected to deliver under its mandate, namely price stability. Importantly, longer-term inflation expectations have been at levels consistent with price stability. This is a great achievement against the backdrop of a series of substantial oil and food price shocks as well as increases in indirect taxes and administered prices over the past decade.

Price stability is essential not only because it protects the income of all our fellow citizens – and particularly the most vulnerable and poorest groups in society – but also because it is a necessary condition for sustainable economic growth and job creation.

As regards fiscal consolidation and structural reforms, a number of euro area countries have made good progress over the past decade, while others are still lagging behind. Notably, some countries have still to achieve and maintain sound fiscal positions and reduce government debt ratios to more sustainable levels. The ECB is concerned about recent signs of a slowdown or even back-tracking in terms of structural reforms and fiscal consolidation. Ill-designed structural policies, economic rigidities and undisciplined fiscal policies may contribute to increased inflationary pressures or higher inflation persistence, which monetary policy would need to take into account. In this respect, the steady pursuit of prudent and efficient fiscal policies along with reforms that enhance competition and market flexibility is crucial to ensure the smooth functioning of Monetary Union.

Labour supply and employment in the euro area

Within this context, let me draw your attention to the latest Eurosystem's Structural Issues Report, which will be posted this morning on our website. The report this year focuses on the main developments in labour supply and employment in the euro area countries since the early 1980s.

Let me briefly mention some key developments.

Since the start of Monetary Union, the euro area has witnessed an increase of 15.7 million in the number of people employed. This compares to around 5 million in the preceding period 1990-98. The total labour market participation rate rose to nearly 71%, and the employment rate rose to over 65%.

The period since 1999 is also characterised by a change in labour supply composition. Women have entered the labour market in increasing numbers. In addition, older workers have tended to remain in the labour market for longer, which is welcome in view of population ageing. Immigrants have contributed positively to labour supply, helping to fill skills shortages. The share of workers with tertiary level education has increased.

These are encouraging developments, resulting from the implementation of structural reforms in product and labour markets, increased immigration and wage moderation. Nevertheless, progress has been quite uneven across countries and significant challenges remain.

From a monetary policy perspective, four conclusions can be drawn.

First, there is a need to further increase the labour market participation and employment rate of all groups of society. We have not yet reached the Lisbon employment rate target of 70%. Lower labour taxes, stricter work availability requirements and reduced incentives to retire early would contribute to stimulating labour supply. Reduced restrictions on labour contracts and well-designed “work/family reconciliation” policies would among others support participation further. Increasing product market competition would also help support employment creation.

Second, there is a need for making labour market institutions more flexible to facilitate a better matching of the skills of those who seek a job with the characteristics of labour demand. To help match demand and supply, wage developments should reflect local labour market conditions.

Third, there is a need to increase knowledge and the transferability of skills. Bringing unemployed or inactive people into jobs will, over time, enhance individuals' labour productivity and thus real wages. Good quality education is of the utmost importance and the recognition and incentives for young people, workers and firms to invest in education and training must be enhanced. The efficiency and service orientation of education institutions should be improved. In addition, the labour market should play a stronger role in signalling to education systems and workers which skills are in short supply.

Finally, the euro area should make better use of skills from outside the euro area. Immigration policy should be closely aligned with the skills needed by the labour market, and ensure the successful integration of immigrants into the active workforce and society as a whole.