

## **Jean-Claude Trichet: Presentation of the ECB's Annual Report 2007 to the European Parliament**

Introductory statement by Mr Jean-Claude Trichet, President of the European Central Bank, to the European Parliament, Strasbourg, 9 July 2008.

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Monsieur le Président, mesdames et messieurs les membres du Parlement Européen, c'est pour moi un grand honneur de vous présenter – comme le prévoit le Traité – le Rapport annuel 2007 de la BCE. Mais comme vous le savez, les relations entre le Parlement et la BCE vont bien au-delà des obligations imposées par le Traité. De fait, nous avons établi, au fil des années, un dialogue très étroit. C'est la quatrième fois cette année que j'interviens devant vous. De même, mes collègues au sein du Directoire de la BCE ont été en contact étroit avec le Parlement Européen concernant diverses questions, telles que l'élargissement de la zone euro, les systèmes de paiement et le dixième anniversaire de l'Union monétaire et économique. Je constate avec plaisir que, selon la proposition de résolution, le dialogue entre le Parlement et la BCE a porté ses fruits.

Ich werde Ihnen zunächst einen kurzen Überblick über die wirtschaftlichen Entwicklungen in den Jahren 2007/2008 geben und die geldpolitischen Maßnahmen der EZB erläutern. Danach möchte ich einige Anmerkungen zu Punkten und Vorschlägen machen, die Sie in Ihrem Entwurf einer Entschließung zum Jahresbericht 2007 der EZB vorgebracht haben.

### **Economic and monetary developments**

In 2007, the ECB operated in a challenging environment, with rising and volatile commodity prices and, since the second half of 2007, heightened uncertainty stemming from the ongoing correction in financial markets across the world. Despite these developments, the euro area economy continued to expand at solid rates in 2007, with annual real GDP growing by 2.7%.

In the first half of 2008, moderate ongoing growth in real GDP has continued, although the quarter-on-quarter profile is likely to show significant volatility, owing to temporary, in part weather-related, factors. It is thus important to focus on the medium-term trend when assessing growth developments.

Looking ahead, on the external side, growth in emerging countries should remain robust, supporting euro area foreign demand. On the domestic side, the economic fundamentals of the euro area remain sound and the euro area does not suffer from major imbalances. Moreover, employment rates and labour force participation have increased significantly in recent years, and unemployment rates have fallen to levels not seen for 25 years.

That being said, the uncertainty surrounding this outlook for growth remains high, with downside risks mainly relating to further unanticipated increases in commodity prices, possible further spillovers from continuing tensions in financial market to the real economy and increasing protectionist tendencies.

Turning to price developments, in 2007 average annual HICP inflation in the euro area was 2.1%, slightly above the ECB's definition of price stability. However, towards the end of the year, substantial increases in international oil and food prices brought inflation to levels well above 2%. Since then inflation in the euro area has risen further and, in the wake of renewed sharp commodity price increases, arrived at the worrying levels of around 4% in mid 2008. Looking ahead, the annual HICP inflation rate is likely to remain well above the level consistent with price stability for some time, moderating only gradually in 2009.

Risks to price stability over the medium term remained clearly on the upside in 2007 and have intensified over recent months. These risks include possible further rises in commodity prices and unanticipated increases in indirect taxes and administered prices. In addition, the Governing Council is strongly concerned that price and wage-setting behaviour could add to inflationary pressures through broadly-based second-round effects. First signs are already emerging in some regions of the euro area. In this context, indexation schemes for nominal wages are of particular concern and should be avoided.

As in 2007, the monetary analysis in the first half of 2008 has continued to confirm the prevailing upside risks to price stability at medium to longer horizons. In line with our monetary policy strategy, we take the view that the sustained underlying strength of monetary and credit expansion in the euro area over the past few years has created upside risks to price stability. Over recent quarters, these risks appear to have become manifest as inflation has trended upwards. Against this background, the continued strength of monetary dynamics represents an important signal of the risks to price stability over the medium term that we have been addressing through our actions since end-2005. Moreover, a thorough assessment of available data suggests that the ongoing financial market correction has, as yet, not significantly affected the availability of bank credit.

To contain prevailing upside risks to price stability over the medium term the Governing Council further adjusted the monetary policy stance in March and June 2007. After a period of unusually high uncertainty in the context of the financial market correction, in July 2008 the Governing Council has brought the minimum bid rate in the Eurosystem's main refinancing operations to 4.25%. This action underlines the Governing Council's strong determination to prevent second-round effects and maintain longer-term inflation expectations firmly anchored in line with price stability. This is the contribution of the ECB's monetary policy to preserving purchasing power over the medium term and supporting sustainable growth and employment in the euro area.

Following last week's decision to raise rates, in the Governing Council's current assessment the monetary policy stance will contribute to achieving price stability over the medium term. We will continue to monitor very closely all developments over the period ahead.

### **Other issues raised in the European Parliament's draft resolution on the ECB's Annual Report 2007**

Mister President, honourable members of the European Parliament, in your draft resolution you raise a large number of issues of relevance to the ECB. I would like to assure you that we will consider your remarks and requests with great care and report back to you accordingly. I will now briefly elaborate on some of these points.

#### ***Monetary policy strategy***

I would like to start by welcoming the positive assessment made by the Economic and Monetary Affairs Committee of the ECB's monetary policy strategy. Our two-pillar framework ensures that all information relevant for the assessment of risks to price stability is taken into account in a consistent and systematic manner when taking monetary policy decisions. In particular, the monetary analysis guarantees that the ECB's monetary policy is oriented to the medium to longer term. Given the close link between monetary developments and evolving imbalances in credit and asset markets, the monetary analysis has proven a particularly valuable asset in times of financial distress. In 2007 the Governing Council has launched within the Eurosystem a research agenda to enhance further its monetary analysis, as is also proposed in the draft resolution to continue to improve the ECB's analytical infrastructure.

## ***Transparency***

I would also like to welcome the Committee's recognition that making the minutes of the ECB Governing Council's meetings available to the public would not be advisable. Such a measure would draw attention to individual positions when in a euro area of 15 – and very soon 16 – countries, what counts is the position of the collegial decision maker, the Governing Council. It could also lead to pressures on Governing Council members to abandon their necessarily euro area perspective when taking monetary policy decisions. As already emphasised on previous occasions, I see the Introductory Statement I present on behalf of the Governing Council at the monthly press conference as an equivalent to what other central banks call "summary minutes". Together with the ensuing Q&A session, the Introductory Statement provides in real time a comprehensive overview, on the part of the Governing Council, of the current monetary policy stance. This communication instrument has served us very well in guiding financial market expectations.

## ***Fiscal policies***

As regards fiscal policies, the ECB shares the view expressed in the draft resolution that all Member States must fully respect the Stability and Growth Pact. However, after the decline of the past four years, a renewed increase in the euro area aggregate fiscal deficit ratio is projected for 2008. There is a clear risk that some countries will not comply with the provisions of the preventive arm of the Stability and Growth Pact. Achieving sound and sustainable budgetary positions and on this basis allowing the free operation of automatic stabilisers is the best contribution fiscal policy can make to macroeconomic stability.

## ***Economic differentials in the euro area and structural policies***

The draft resolution also refers to the risks posed by economic differentials across euro area countries, which to some extent reflect structural rigidities and/or inappropriate national policies. It goes without saying that economic divergences across euro area countries cannot be addressed by monetary policy.

In order to avoid a protracted period of either low growth and high unemployment or overheating, as a country responds to asymmetric shocks, reforms to enhance the resilience to such shocks should be undertaken at the national level. These include well designed structural reforms to enhance competition, increase productivity and foster labour market flexibility. Greater flexibility in euro area labour markets and wages would reduce adjustment costs and inflation pressures in the event of adverse supply shocks and would augment the economy's resilience, thus limiting employment losses and facilitating the conduct of the stability-oriented monetary policy of the ECB.

Let me emphasise again that there is a need for a lucid monitoring of national competitiveness developments, including unit labour costs, as recouping ex post a loss of competitiveness is a difficult exercise. In this regard, we support the Parliament's call for responsible wage policies.

## ***Financial stability and supervision***

Let me now turn to the issues highlighted by the financial market correction for crisis prevention and crisis management, which also figure prominently in your draft resolution.

As regards *crisis prevention*, the market correction highlighted issues for both supervisors and central banks. Supervisors should make further efforts to reinforce cooperation and exchange of information on a cross-border basis. To that end, it is of crucial importance to further exploit the potential of the Lamfalussy framework. The Ecofin Council has agreed on certain measures to that end, and attention should now shift towards implementing them. Let me mention in this context that the market correction has not provided any convincing

evidence for an overhaul of the current supervisory framework, for instance through the setting up of a new authority for EU supervision.

Central banks, including the ECB, have to a great extent been effective in identifying the weaknesses and risks to the financial system that materialised as the turmoil unfolded. Such warnings may be found, for instance, in many past issues of the ECB Financial Stability Review. In this context, the ECB also recognises the need to further enhance cooperation between central banks and supervisors which could entail the use of supervisory information to enrich financial stability assessments, and the translation of such assessments into tangible supervisory action.

Looking to lessons for *crisis management*, a main issue that emerged during the turmoil concerns the need for a smooth flow of information between central banks and supervisors during the unfolding of a crisis. Central banks may need supervisory information for the effective performance of their functions in the management of a crisis, such as money market interventions, provision of Emergency Liquidity Assistance, and financial stability monitoring. This applies to the Eurosystem as well. Supervisors from their side may benefit from central bank information, for instance as regards banks' liquidity positions. Therefore, the envisaged reinforcement of the EU legal basis for information exchange between central banks and supervisors is strongly supported by the ECB.

### ***Payment systems***

My final remarks concern the integration of Europe's payment systems. The ECB noted with satisfaction the positive assessments in the draft resolution about SEPA and TARGET2. Concerning the Eurosystem's TARGET2-Securities initiative, the Governing Council will in the coming weeks decide on the continuation of the T2S project. It is important to note that all major CSDs have responded positively to our initiative.

I thank you very much for your attention. I am now available to answer your questions.