

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

Speech by Mr Jean-Claude Trichet, President of the European Central Bank, Brussels, 8 December 2008.

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Madame la Présidente, Mesdames et Messieurs les membres de la Commission Economique et Monétaire, je me réjouis de cette quatrième rencontre avec votre Commission au cours de cette année. 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. Je vous fournirai ensuite de plus amples informations sur nos opérations de politique monétaire ainsi que notre dispositif de garanties. Am Schluss möchte ich auf das Management der Finanzkrise in Europa eingehen und einige der Reformvorschläge für das internationale Finanzsystem hervorheben, die ich für besonders wichtig halte. Danach beantworte ich wie immer gerne Ihre Fragen.

Economic and monetary developments

Since my previous hearing before your Committee on 10 September, euro area annual inflation has continued to decline, falling to 2.1% in November. With lower commodity prices and weakening demand, annual inflation is expected to be in line with price stability over the policy-relevant horizon.

Risks to the outlook for price stability are more balanced than in the past. Unexpected further declines in commodity prices could put downward pressure on inflation, while upside risks to price stability could materialise if the fall in commodity prices were to reverse or if domestic price pressures were to turn out stronger than assumed.

Turning to economic developments, since September, there has been an intensification and broadening of the financial turmoil, contributing in the third quarter to a contraction of 0.2% in real GDP growth compared to the previous quarter. Global economic weakness and very sluggish domestic demand can be expected to persist in the last quarter of 2008 and in the next few quarters. Subsequently, a recovery should gradually take place, supported by the fall in commodity prices and assuming that the external environment improves and financial tensions weaken. As a whole, average growth in 2009 could be between -1% and 0% according to the Eurosystem staff.

This outlook remains surrounded by exceptionally high uncertainty. Risks to economic growth lie on the downside, relating to concerns for a stronger impact on the real economy of the ongoing financial turmoil, protectionism and possible disorderly developments owing to global imbalances.

All parties concerned should make their contribution to lay sound foundations for a sustainable recovery. The measures announced by governments to address the financial turmoil should be implemented swiftly so as to support trust in the financial system and prevent constraints on credit supply.

Estimates of underlying broad money growth point to a sustained but moderating rate of expansion. This supports the view that inflationary pressures are diminishing further, with some risks remaining on the upside in the medium to longer term.

On 4 December we decided to reduce the key ECB interest rates by 75 bps, putting the overall reduction of our key interest rates at 175 bps in less than two months. We will continue to keep inflation expectations firmly anchored in line with price stability, thereby supporting sustainable growth and employment, and contributing to financial stability.

Overview of recent monetary policy operations and the Eurosystem's collateral framework

Ladies and gentlemen, I would now like to say a few words about our recent monetary policy operations and the collateral eligible in the ECB's operational framework.

The widening and deepening of the financial turmoil over the last three months triggered an unprecedented rise in risk aversion, which was felt particularly on the money markets. In view of this intensification of money markets tensions, the Eurosystem stepped up its efforts to ensure that solvent banks continued to have access to liquidity. Most notably, we decided to supply liquidity on an unlimited basis and at a fixed rate. In addition we intensified our close cooperation with other central banks, in particular with the Federal Reserve.

These measures have enhanced the capability of euro area banks to refinance themselves with the Eurosystem and have helped to ease liquidity tensions in the money markets. Yet I should like to stress that these measures are very exceptional and we very much look forward to the reactivation of inter-bank lending and to banks resuming their traditional intermediation activity.

The Eurosystem's operational framework has proved to be "fit for purpose". Three features of our operational framework have served us particularly well in dealing with the money market tensions. First, the broad set of eligible counterparties, which ensures that our operations have a sufficient scope. Second, the large scale of our operations, which ensures that our operations allow for an effective redistribution of liquidity across banks. And third, the wide range of eligible collateral.

Since its inception, the Eurosystem has always accepted a wide range of assets as collateral, including public but also private assets. This has proved to be a stabilising factor in the current turmoil, as it ensured that banks had a wide array of collateral at their disposal to access the Eurosystem's operations. In view of the difficult situation on the money markets, we decided to temporarily expand the list of eligible collateral until the end of 2009. At the same time, in order to protect the Eurosystem against financial risks, we have made refinements to our risk control framework. We are confident that these changes will help to ensure the functioning of the money markets whilst keeping in place adequate safeguards for the Eurosystem's financial interests.

EU financial crisis management

Let me now turn to the second issue on which the panel of experts prepared studies, namely financial crisis management in the EU. The market turmoil has heightened the importance of addressing financial challenges in a comprehensive and coordinated manner, both globally and at the European level. In the context of the increasing cross-border activities of financial institutions, coordination is particularly important, given that the institutional setting for financial stability remains predominantly based on national competences.

The events during the last three months have shown once again that – in times of crisis – Europe can rise to the challenge. In particular, by agreeing on a common European Action Plan in October, the responsible EU and national authorities demonstrated their ability to live up to their responsibilities and to act in a swift and concerted manner. In addition, relevant authorities coordinated closely in managing individual banks' strains. The ECB contributed to the European Action Plan through its liquidity operations as well as by issuing recommendations on recapitalisations and on the pricing of government guarantees.

I would like to stress that the support measures decided by central banks and governments for the financial sector were designed to preserve the real economy as a whole, the employees, the small businesses and all the productive sector against the potential systemic consequences of a financial meltdown.

As for the measures to render the financial system in the future more resilient, I commend the work which is being pursued at the global level by the FSF and the G-20, and at the European level by the Ecofin Council. I would like to emphasise five strands of work which I consider particularly important.

First, financial institutions must improve their risk management systems in all areas, particularly in those – such as securitisation or liquidity risk – where the crisis has highlighted grave shortcomings. In this context, we welcome the strengthening of the prudential framework as envisaged in the current revision of the Capital Requirements Directive.

Second, financial institutions should avoid excessive short-termism in their behaviour which tends to place undue emphasis on returns over risks. To that end a number of improvements are necessary, including specific guidance by supervisors on internal compensation schemes.

Third, transparency should be enhanced in all respects, including all financial institutions, opaque financial instruments and markets, such as OTC derivatives markets. With regard to the latter, I welcome the initiatives to establish a central counterparty clearing for the CDS markets.

Fourth, all the potential procyclical effects of the present functioning of the financial system, including the current regulatory framework – the implications of the present prudential rules and accounting standards – need to be mitigated.

Finally, the supervision of cross-border financial institutions needs to be enhanced. To that end, the recent measures in the EU including the compulsory establishment of colleges of supervisors for all cross-border banks are particularly important. As regards the future I am sure that substantial improvements could be envisaged, in particular by the High-Level Group set up by the Commission and which is gathering eminent personalities. Whatever proposals are made to enhance banking surveillance at a pan-European level I would stress the importance of a very close relationship between central banks and banking surveillance authority. This has always been the sentiment of the Governing Council of the ECB, and the most recent events have confirmed the pertinence of this view.

Thank you for your attention.