

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

Introductory remarks by Mr Jean-Claude Trichet, President of the European Central Bank, Brussels, 30 March 2009.

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Madame la Présidente, Mesdames et Messieurs les membres de la Commission économique et monétaire, je me réjouis d'être entendu pour la troisième fois par le Parlement européen depuis le début de cette année, et pour la deuxième fois par votre commission. Je n'oublie pas non plus la rencontre conjointe du Parlement européen et des parlements nationaux en février. La rencontre d'aujourd'hui est la dernière prévue au cours de cette mandature. Elle revêt donc une importance particulière. Permettez-moi dès à présent de vous remercier pour les échanges de vues stimulants et riches que nous avons eus au cours des cinq dernières années. Il ne s'agit pas moins de ma vingt-et-unième audition devant votre commission, ce qui atteste de l'intensité des relations entre la BCE et les représentants élus des citoyens européens.

Heute möchte ich mich auf vier Themen konzentrieren: die aktuelle wirtschaftliche Lage, die Struktur der Finanzierung privater Immobilien im Eurogebiet, die Auswirkungen der Krise auf eine zukünftige Einführung des Euro in den Mitgliedstaaten in Mittel- und Osteuropa und schließlich die Vorschläge zur Reform der Bankenaufsicht in Europa. Ich hoffe, dass ich damit auf einige der wichtigsten Themen eingehe, bevor ich mich wie üblich Ihren Fragen stelle.

Economic and monetary developments

Let me begin with the economic situation and our recent monetary policy decisions. Please note that, with only three days before our next monetary policy meeting this Thursday, I am in the so-called "purdah" period and will therefore duly remain with what I said at my last press conference. Since my appearance before the European Parliament on 21 January the economic situation and outlook have weakened further. Inflationary pressures have diminished further, as confirmed by monetary and credit trends. In February the inflation rate remained low, at 1.2%. As you know, the decline in inflation since last summer primarily reflects the sharp falls in global commodity prices over this period. Looking ahead, we expect inflation rates well below 2% for this year and 2010. The risks to this outlook are broadly balanced, but surrounded by a high degree of uncertainty.

Following the substantial weakening of the world economy in the wake of the financial turmoil, real GDP growth in the euro area contracted markedly, by 1.5% on a quarterly basis, in the fourth quarter of 2008. The latest information suggests that economic activity has deteriorated further in the first quarter of 2009. Looking ahead, we expect demand to remain very weak throughout 2009, both at the global level and in the euro area, before gradually recovering in the course of 2010. As is the case for inflation, this outlook remains surrounded by uncertainty. Risks to this outlook seem to be more balanced. On the one hand, the positive impact of governments' recent rescue packages for the banking sector and the macroeconomic stimulus that is now under way may be stronger than anticipated. On the other hand, the impact that the ongoing financial turmoil has on the real economy could be stronger than expected. In addition, protectionist tendencies are giving rise to considerable concern.

It was against this background that the Governing Council reduced the key ECB interest rates by another 50 basis points in early March. This took the overall reduction in our key rates to 275 basis points since October of last year. Overall, we expect price stability to be

maintained over the medium term. We will continue to deliver on our mandate and ensure the firm anchoring of inflation expectations over longer-term horizons. Such anchoring supports sustainable growth and employment and also contributes to financial stability.

Let me also recall that the ECB has adjusted its liquidity management framework in order to counter the dysfunctional nature of the euro area money market. The most important measures decided upon in October 2008 were the use of fixed rate tender procedures with full allotment for both main and longer-term refinancing operations and the extension until end-2009 of the list of assets eligible for use as collateral in Eurosystem credit operations. We have thereby provided the banking system with unlimited liquidity support, at fixed rates, with maturities of up to six months. We have just decided to maintain this procedure for as long as needed, and in any case beyond the end of 2009. As a result of all of these measures, most of which are highly non-standard, banks have continued to have broad access to euro liquidity.

Structural Issues Report on housing finance in the euro area

Let me now turn to the second topic, namely housing finance, which is covered in this year's ECB Structural Issues Report. As in previous years, I will present to you the general thrust of our report, which will be published later today.

The report analyses trends and differences in the characteristics of housing loans, in the funding of bank loans, and in the spread between mortgage interest rates and the funding costs of banks.

It also compares housing finance in the euro area, the United Kingdom and the United States. Generally, euro area banks are significantly stricter in terms of non-interest conditions on loans, partly explaining the significantly smaller sub-prime market here. On the funding side, relatively stable bank deposits continue to be the main source of funding for bank loans in the euro area, with much less emphasis on the "originate-to-distribute" function. These observations support the conclusion that housing finance in the euro area should be more resilient to shocks.

Housing finance has an impact on the transmission of monetary policy to the economy. Two observations deserve particular attention. On the one hand, a higher degree of competition among mortgage suppliers leads to a strengthening of that transmission. On the other hand, the introduction of greater flexibility in mortgage contracts via the temporary suspension of payment or maturity extensions would result in interest rate changes having a smaller immediate impact on the economy.

Finally, it is clear that we have to assume a greater amount of retention on the part of banks, both as regards the amount and the characteristics of loans granted to households and as regards their sources of funding.

Implications of the current crisis for euro area enlargement

Let me now turn to the third topic, which relates to the implications of the current crisis for euro area enlargement. The global economic situation has deteriorated significantly since September 2008 as a result of the intensification of the financial crisis. Some central and eastern European countries have also been hit hard, thus highlighting previous vulnerabilities. These weaknesses relate in particular to domestic and external imbalances, unsound fiscal policies, and domestic and external debt positions. However, it is very important to differentiate between the various countries in the region. A number of countries have shown a significant degree of resilience in these exceptionally difficult circumstances. And, not surprisingly, the countries that are most affected by the crisis are unfortunately those that had built up large imbalances and vulnerabilities in the past.

Overall, the financial crisis has highlighted the importance of avoiding macroeconomic imbalances and following a sustainable growth path supported by a sufficient degree of structural reform. This is particularly true for “catching-up” economies, which have to balance the desire for swift convergence with the need to ensure the sustainability of the convergence process.

The adoption of the euro can not be a substitute for the need of domestic policy adjustment. This would go against the economic logic which underlies the convergence process in Europe. And it is important to bear in mind that the premature adoption of the euro can make it more difficult for a country to cope with the challenges ahead. Without sustainable convergence, the monetary policy stance of the ECB would be inappropriate for the country concerned. In this case, the country in question could face the risk of excessive output and inflation volatility, as it would lack important tools to stabilise economic conditions at home. Thus, euro adoption cannot take place until major imbalances in the country have been eliminated and provided appropriate sustainable convergence has been achieved as required by the Treaty.

What role for the ECB in the area of financial market supervision?

I will now turn to the final topic, the review of the framework for financial supervision in the European Union. Already last autumn the European Parliament asked the ECB and the ESCB to play an active role in macro-prudential supervision and financial stability. Such a role is envisaged in the report by the high-level group chaired by Jacques de Larosière. I welcome its proposals on macro-prudential supervision, which relate in particular to a European Systemic Risk Council under the auspices of the ECB. Let me provide you with a few observations on this matter.

First, the output of the Systemic Risk Council will make a major contribution to financial stability in the EU. In accordance with the de Larosière report, it will identify and assess risks and vulnerabilities in the EU financial system, issue risk warnings and adopt related policy recommendations. This will substantially improve the present arrangements for risk assessment at EU level.

Second, the proposed composition of the Systemic Risk Council reflects a recognition of the role played by central banks in macro-prudential supervision.

Third, the fact that the Systemic Risk Council would be set up under the auspices of the ECB and the ESCB would allow it to benefit from the analytical capabilities and technical infrastructures developed by central banks in its analysis of monetary and financial stability. In this context, the Systemic Risk Council will have to rely on a wide range of macro- and micro-prudential data. This implies that the ECB and the ESCB should have access to the relevant micro-prudential information from supervisors.

Fourth, for the proposed macro-prudential framework to function as intended, it is crucial that risk warnings be translated into policy action as effectively as possible. In this context, the Systemic Risk Council should report its risk warnings and relevant recommendations to the ECOFIN Council.

Finally, we should provide an appropriate institutional basis for the establishment of the Systemic Risk Council and the related new macro-prudential tasks of the ECB and ESCB, in order to ensure the necessary authority, accountability and legal capabilities. The activation of Article 105(6) of the Treaty could be a very useful avenue in this context.

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I could not conclude today's introductory remarks without very warmly thanking you, Madame la Présidente, and all the honourable members of the Committee for our regular exchanges of views over the past five years. These 21 hearings have been important opportunities to

receive feedback from the members of Parliament. Thank you for your kind cooperation and thank you for your attention.