European Central Bank: Press conference – introductory statement

Introductory statement by Mr Jean-Claude Trichet, President of the European Central Bank and Mr Lucas Papademos, Vice-President of the European Central Bank, Frankfurt am Main, 2 April 2009.

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Ladies and gentlemen, the Vice-President and I are very pleased to welcome you to today's press conference. We will now report on the outcome of today's meeting of the Governing Council.

On the basis of its regular economic and monetary analyses, the Governing Council decided to reduce the **key ECB interest rates** by a further 25 basis points. This decision brings the total reduction in the interest rate on the main refinancing operations of the Eurosystem since 8 October 2008 to 300 basis points.

Today's decision takes into account the expectation that price pressures will remain subdued, reflecting the substantial past fall in commodity prices and the marked weakening of economic activity in the euro area and globally. The latest economic data and survey information confirm that the world economy, including the euro area, is undergoing a severe downturn. Both global and euro area demand are likely to remain very weak over 2009, before gradually recovering in the course of 2010. Available indicators of inflation expectations over the medium to longer term remain firmly anchored in line with the Governing Council's aim of keeping inflation rates at levels below, but close to, 2% over the medium term. A cross-check with the outcome of the monetary analysis confirms that inflationary pressure has been diminishing. After today's decision we expect price stability to be maintained over the medium term, thereby supporting the purchasing power of euro area households. The Governing Council will continue to ensure a firm anchoring of medium-term inflation expectations. Such anchoring is indispensable to supporting sustainable growth and employment and contributes to financial stability. Accordingly, we will continue to monitor very closely all developments over the period ahead.

Let me now explain our assessment in greater detail, starting with the **economic analysis**. Reflecting the impact of the financial market turmoil, economic activity has weakened markedly in the euro area, as domestic demand has contracted in parallel with the downturn in the world economy. Available data and survey indicators suggest that economic activity in the euro area has remained very weak in early 2009. It is likely to remain very subdued for the remainder of the year but is expected to gradually recover in 2010. The substantial fall in commodity prices since the summer of 2008 is supporting real disposable income and thus consumption. In addition, external as well as domestic demand should increasingly benefit from the effects of the significant macroeconomic stimulus under way as well as from measures taken to restore the functioning of the financial system both inside and outside the euro area.

Taking these effects into account, we see the risks to this outlook for economic activity as being broadly balanced. On the one hand, there may be stronger than anticipated positive effects due to the decrease in commodity prices and to policy measures taken. On the other hand, there are concerns that the turmoil in financial markets could have a stronger impact on the real economy, as well as that protectionist pressures could intensify and that there could be adverse developments in the world economy stemming from a disorderly correction of global imbalances.

Annual HICP inflation has fallen further, from 1.2% in February to 0.6% in March, according to Eurostat's flash estimate. As explained on earlier occasions, the decline in inflation since last summer primarily reflects the sharp fall in global commodity prices over this period. Moreover, signs of a more broad-based reduction in inflationary pressure are increasingly emerging. Looking ahead, base effects stemming from past energy price effects will play a significant role in the shorter-term dynamics of the HICP. Accordingly, we expect to see headline annual inflation rates declining further in the coming months and temporarily reaching negative levels around mid-year. Thereafter, annual inflation rates should increase again. Such short-term movements are, however, not relevant from a monetary policy perspective. Looking further ahead, over the policy-relevant horizon, annual HICP inflation is expected to remain below 2% in 2010, reflecting mainly ongoing sluggish demand in the euro area and elsewhere. Available indicators of inflation expectations over the medium to longer term remain firmly anchored in line with the Governing Council's aim of keeping inflation rates at levels below, but close to, 2% over the medium term.

The risks surrounding this outlook are broadly balanced. They relate in particular to the risks to the outlook for economic activity as well as to risks to commodity prices.

Turning to the **monetary analysis**, the latest data confirm the high month-to-month volatility of developments in M3 and its components observed since the intensification of the financial turmoil in September 2008. Looking through this volatility, the pace of monetary expansion in the euro area has continued to decelerate markedly and supports the assessment of diminishing risks to price stability in the medium term.

Developments within M3 clearly reflect market participants' specific investment responses to the intensification of the financial turmoil, but increasingly also the impact of the past reduction in the key ECB interest rates. As this reduction has narrowed the gaps between the interest rates paid on the different categories of short-term deposits, it has fostered shifts in the allocation of funds. For example, the demand for overnight deposits further strengthened in February and contributed to the rise in the annual growth rate of M1 to 6.3%, while the demand for short-term time deposits weakened considerably.

The flow of MFI loans to non-financial corporations and households has remained very subdued. The slightly negative flow of lending to non-financial corporations in February reflects a decline in the outstanding amount of loans with a shorter maturity, while the net flow in loans with longer maturities remained positive. The decline in short-term lending may be indicative of a reduction in loan demand related to the weakening of economic activity. However, supply effects have probably also affected loan developments. In this respect, developments over the past few months may in part reflect ongoing efforts of banks as well as the corporate and household sector to reduce the highly leveraged positions built up in past years.

To sum up, today's decision takes into account the expectation that price pressures will remain subdued, reflecting the substantial past fall in commodity prices and the marked weakening of economic activity in the euro area and globally. The latest economic data and survey information confirm that the world economy, including the euro area, is undergoing a severe downturn. Both global and euro area demand are likely to remain very weak over 2009, before gradually recovering in the course of 2010. Available indicators of inflation expectations over the medium to longer term remain firmly anchored in line with the Governing Council's aim of keeping inflation rates at levels below, but close to, 2% over the medium term. A **cross-check** with the outcome of the monetary analysis confirms that inflationary pressure has been diminishing. After today's decision we expect price stability to be maintained over the medium term, thereby supporting the purchasing power of euro area households. The Governing Council will continue to ensure a firm anchoring of medium-term inflation expectations. Such anchoring is indispensable to supporting sustainable growth and employment and contributes to financial stability. Accordingly, we will continue to monitor very closely all developments over the period ahead.

Regarding **fiscal policies**, it is necessary that countries' commitments to a path of consolidation in order to return to sound fiscal positions are credible, respecting fully the provisions of the Stability and Growth Pact. This is essential to maintain the public's trust in the sustainability of public finances, which is important both for the economy to recover and for supporting long-term growth. Countries subject to the excessive deficit procedure need to comply strictly with the ECOFIN Council recommendations for correcting their deficits. Many countries will need to specify further credible consolidation measures for 2010 and beyond. Full and consistent implementation of the EU's legal provisions for sound fiscal policies is a prerequisite for the maintenance of their credibility as one of the pillars of the institutional framework of Economic and Monetary Union.

Turning to **structural reforms**, the Governing Council welcomes the commitment of the spring European Council to make full use of the renewed Lisbon strategy for growth and jobs in the current situation. The updated recommendations for the euro area countries call for an accelerated implementation of reforms to support the economy, facilitate necessary adjustments and ensure a high level of growth potential. It remains essential that government support measures do not distort competition or delay necessary structural adjustment processes and that governments remain firmly committed to avoiding protectionism.

We are now at your disposal for questions.