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, Brussels, 28 September 2009.

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Dear Madam Chair,

Dear Members of the Committee on Economic and Monetary Affairs,

I very much appreciate the opportunity provided by this regular hearing to exchange views with you today, early in the new legislature. This is the 22nd time that I have appeared before this Committee: looking back, such frequent hearings have been instrumental in developing a very close relationship between the European Central Bank and the European Parliament. I hope to continue and to further deepen this relationship, especially in times that are particularly demanding.

Heute möchte ich mich auf zwei Themen konzentrieren. Zunächst möchte ich Ihnen unsere aktuelle Einschätzung der wirtschaftlichen Lage im Eurogebiet mitteilen. Ich möchte dabei auch auf die geldpolitischen Maßnahmen der EZB und ihre Wirkung eingehen.

Dans un second temps, je souhaiterais aborder un sujet important et actuel : la réforme de la supervision financière en Europe et plus particulièrement la mise en place du Conseil européen du risque systémique. Je m'efforcerai d'être le plus concis possible mais, étant donné que la dernière audition remonte à mars et que l'actualité a été très chargée ces derniers mois, la matière est aujourd'hui particulièrement riche. Je serai ensuite à votre disposition pour répondre à vos questions.

Economic and monetary developments

The economic situation and outlook have improved since the previous hearing before Parliament on 30 March 2009. Inflation and inflationary pressures have remained low over recent months. As expected, inflation turned into negative territory over the summer period, due to the large decline in oil prices since last year. In August, annual inflation was still slightly negative, at -0.2%, after a reading of -0.7% in July. Looking ahead, inflation is expected to turn positive again within the coming months and to remain subdued, within positive territory, over the policy-relevant horizon. This also reflects the fact that economic activity is expected to recover at a very gradual pace. The risks to the inflation outlook are broadly balanced. 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 below, but close to, 2% over the medium term.

Following the "free fall" in economic activity that we witnessed around the turn of the year, the euro area economy shows signs of stabilisation. After the strongly negative readings recorded earlier, economic activity in the second quarter of 2009 is estimated to have declined by 0.1%, compared with the previous quarter. In the period ahead, we expect to see a very gradual recovery. This expectation remains surrounded by high uncertainty, while risks to the outlook remain broadly balanced. On the upside, the impact of macroeconomic stimulus packages and other policy measures may be stronger than expected, confidence may improve more quickly, and foreign demand may prove to be stronger than currently foreseen. On the downside, the negative feedback between the real economy and the still strained financial sector may be stronger or more protracted than expected. Concerns also relate to potential renewed commodity price rises, further protectionist pressures and persistent global imbalances.

The assessment of low inflationary pressures over the medium term is also confirmed by our monetary analysis. In this context, we note in particular that money and credit expansion continues to decelerate. The annual growth rate of the broad monetary aggregate M3 declined to 2.5% in August, the lowest reading since the launch of the euro. As regards lending to the private sector, the annual growth rate of loans virtually stalled in August (at 0.1%). To a large extent, this development reflects the fall in production and trade and the ongoing uncertainty regarding the business outlook which has affected demand for financing. Given that the pick-up in loans to enterprises typically lags the recovery in economic activity, further weak developments in loans to enterprises in the coming months appear likely. At the same time, lower market interest rates continue to be passed on in lower bank lending rates. This has led to a gradual improvement in financing conditions, which in turn is expected to support the demand for credit in the period ahead.

It is against this background that the Governing Council views the current level of key ECB interest rates as appropriate.

In addition, we have implemented five "non-standard" measures to enhance credit support, taking into account the major role played by banks in funding the euro area economy.

1. First, we have fully accommodated banks' liquidity needs at fixed interest rates.
2. Second, we have further expanded the list of assets eligible as collateral.
3. Third, we have further lengthened the maturities of our refinancing operations.
4. Fourth, we have provided liquidity in foreign currencies, notably the US dollar, to address the need of euro area banks to fund their dollar assets.
5. Fifth, and finally, we have launched a direct covered bonds purchase programme to support financial markets.

Overall, these non-standard measures support the flow of credit to firms and households above and beyond what could be achieved through policy interest rate reductions alone.

Let me emphasise two important points in this respect.

First, the strong intervention of the Eurosystem in the euro area money market cannot be maintained for ever. We have introduced exceptional measures under exceptional circumstances. We will have to phase them out once the rationale for these measures fades away and the situation normalises. The Governing Council of the ECB considers that it would be premature to declare the crisis over. Now is not the time to exit. However, at some point in time exit strategies will have to be implemented. The ECB has an exit strategy and stands ready to put it into action when the appropriate time comes. Our exit strategy is an integral part of our overall monetary policy strategy. This means, in particular, that if we judge that the non-standard measures trigger risks to price stability, we will unwind them. As in the past, the ECB is determined and able to act decisively whenever the need arises. It has both the operational flexibility and the institutional independence to implement the desirable course of action.

The second point I would like to emphasise concerns the relationship of liquidity and price stability. Some commentators ask whether our bold programme of liquidity provision could ultimately trigger inflation in the future. Let me explain why this fear is unfounded. To start with, it should be noted that although the liquidity provided by the ECB has increased substantially, this has not led to an increase in monetary aggregates. This would have been the case in normal times when banks use an increase in our liquidity provision to create credit to households and enterprises. However, at present this does not appear to be taking place on any significant scale. As I mentioned earlier, the growth in monetary aggregates – an overall important measure of liquidity expansion in the economy – is at its lowest level for at least a decade. Furthermore, it should be noted that the ECB has all the instruments required to promptly withdraw its liquidity support if necessary, to counter the possible emergence of upside risks to price stability. It helps in this context that most non-standard measures are being phased out naturally, as the operations stop at maturity, unless we decide to extend them.

Macro-prudential supervision in Europe and the role of the ECB

Let me now turn to the second main issue, the role of macro-prudential supervision and the envisaged European Systemic Risk Board (ESRB).

The financial crisis has shown that the present, highly sophisticated globalised financial markets and interconnected financial institutions are prone to systemic risk. Systemic risk concerns the possibility that the functioning of the financial system can be threatened or materially impaired as a result of the collective behaviour of market participants, investors and financial institutions; it derives, in particular, from their interactions in financial markets and from the close links between the supply of credit and the macro-economy. Systemic risks can emerge even when financial institutions manage their risks in a way that looks appropriate from their individual perspective. Given the interconnectedness in highly developed financial systems, the behaviour of financial institutions – especially systemically important ones – can have an impact on other financial institutions and the financial system as a whole. Macro-prudential supervision has to take account of these externalities and focus on the interconnectedness of financial institutions, markets and infrastructures. Therefore it contributes to an important public good – namely systemic financial stability.

Coping with systemic risks will continue to be of the essence, especially in view of the increasing sophistication of global finance that, in turn, is facilitated by the rapid technological progress. Against this background, it is the right step to set up a body specifically responsible for macro-prudential oversight at the European level in the form of a European Systemic Risk Board.

The envisaged composition of the Systemic Risk Board is appropriate. In terms of output, the Board's focus on the identification of risks and the provision of early warnings, where necessary, and of appropriate recommendations, is equally pertinent. Let me emphasise that such warnings and recommendations will have to be more than mere words. The suggested provisions requiring addressees to take remedial action or, otherwise, to justify why they have not acted, should give the necessary "traction" to the deliverables of the Systemic Risk Board. The principle of "comply or explain" is the right one.

The ESRB will have very close links with the ECB. The members of the General Council of the ECB will be voting members of the ESRB, together with the three heads of the supervisory authorities and a member of the Commission; the members of the General Council of the ECB will elect the chair and vice-chair of the ESRB; and the ECB will provide analytical, statistical, administrative and logistical support to the ESRB, as suggested by the de Larosière group, communicated by the Commission, decided by the ECOFIN Council and approved by the European Council in June this year. As I mentioned to your Committee, the ECB stands ready to place the necessary resources and expertise at the service of supporting the ESRB, in very close collaboration with the national central banks.

The new institutional set-up for the ESRB, and the ECB's role in it, must rest on solid institutional and legal foundations. The ECB is closely and constructively participating in the ongoing legislative process on the establishment of the ESRB. The ECB's contribution in this process focuses on establishing in Europe the most effective and robust set-up for macro-prudential supervision possible. Given the dramatic consequences of the current crisis, we cannot afford for Europe to be ill-equipped and powerless to prevent and mitigate systemic risks.

Let me conclude with a remark on accountability. The fact that the link between the ECB and the ESRB is very close does not mean that the reporting to your Committee and to the Parliament will be merged. The reporting will remain – and must remain – in the form of two separate accountability exercises because the mandates are clearly distinct. As for the

European Central Bank, the Treaty states in Article 105.1 that "The primary objective shall be to maintain price stability". As regards financial stability, the Treaty speaks of a "contribution", in Article 105.5, stating that the ECB shall "contribute to […] the stability of the financial system". As for the European Systemic Risk Board, the current legislative proposal foresees that "The ESRB shall be responsible for the macro-prudential oversight of the financial system within the Community in order to prevent or mitigate systemic risks within the financial system" (Article 3). The tasks include the following: "identify and prioritise such risks; issue warnings where risks are deemed to be significant; and issue recommendations for remedial action where appropriate."

Thank you very much for your attention, I am now at your disposal for questions.