EUROPEAN CENTRAL BANK

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Introductory statement

by Dr. Willem F. Duisenberg,

President of the European Central Bank,

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European Central Bank
Press and Information Division
Kaiserstrasse 29, D-60311 Frankfurt am Main
Tel.: 0049 69 1344 7455, Fax: 0049 69 1344 7404
Internet: http://www.ecb.int
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Before starting my presentation, allow me, Mrs. Randzio-Plath, to congratulate you on your re-election as chairwoman of this committee. I am looking forward indeed to continuing the co-operation with you and the Committee on Economic and Monetary Affairs in the same open and constructive spirit that has always marked our regular exchanges of views.

Just over three weeks ago, we witnessed a historic moment: the euro, first introduced on 1 January 1999 and successfully used for non-cash operations both within the euro area and on international financial markets for the past three years, became tangible reality. On 1 January 2002, the euro banknotes and coins became legal tender in the euro area and are now a visible symbol of Europe's identity. Indeed, paying with a single currency in daily transactions throughout the euro area can be regarded as an achievement of historic proportions as well as a major step forward in the process of European integration.

1. Review of the euro cash changeover

Today, some three weeks after the introduction of the euro banknotes and coins, I am pleased to report to you that the cash changeover has so far progressed very smoothly, better than we expected. Some minor mishaps have occurred here and there, and some may yet occur, but this is quite normal for such a massive operation, involving - in the 12 euro area countries alone - more than 300 million people.

The completion of the changeover has been a complex, ambitious and unprecedented undertaking. In addition to the EU institutions, the

Eurosystem and national authorities, it was essential to closely involve the banking sector and security carriers, as well as retailers and the cash-operated machine industry, in the preparations at an early stage, as a smooth changeover, in a short period of time, could only be achieved through a systematic and co-ordinated interaction on the part of all leading actors. It required organisational, logistical, technical and economic efforts by all parties involved in the use and handling of banknotes and coins. At the end of the day, however, the success of the euro cash changeover also depended on a favourable attitude of and swift acceptance by all citizens. And, indeed, the European citizens have accepted their new currency rapidly and with enthusiasm, which can be considered as a clear signal in favour of a more integrated Europe.

I should like to take the opportunity here to express my gratitude to the European citizens and all parties involved in the changeover for their efforts and their fruitful collaboration with the Eurosystem over the years.

Just to flag some of the efforts made: by the end of 2001, more than 6.5 billion euro banknotes worth some EUR 133 billion and amounting to almost 50% of national banknote circulation had been frontloaded. With regard to the euro coins, more than 37.5 billion coins with a total value of around EUR 12.4 billion had been frontloaded. Overall, citizens acquired more than 150 million coin starter kits. At the beginning of this week, around 8.1 billion euro banknotes were in circulation, which is more than 90% of the number of euro banknotes that had initially been estimated for the end of February 2002. In terms of value, this corresponds to approximately EUR 209 billion,

which is equivalent to 77% of national banknotes circulation at the end of 2001.

In total, the legacy currency banknotes in circulation declined in 2001 by EUR 110 billion to EUR 270 billion at the end of the year. Since the beginning of 2002, this figure has come down by 51% to EUR 133 billion last Monday. The euro progress ratio, which calculates the value of euro banknotes in circulation divided by the total value of euro and national banknotes in circulation, was 61% on 21 January 2002, up from 33% on 1 January 2002.

Given that, in terms of transactions, around 70% of all banknotes are put into circulation via automated teller machines (ATMs), the quick adaptation of these machines was one of the key factors for a smooth changeover. In total, more than 200,000 ATMs had to be converted. In virtually all euro area countries, 100% of the ATMs were converted within less than one week.

As a result, on average, 75% of all cash transactions were already effected in euro after only one week. Naturally, this figure varied from country to country and from sector to sector. On the whole, the euro banknotes and coins were introduced considerably faster than originally foreseen, not least because of the favourable attitude of and quick acceptance by European citizens. Today, even though the technical adaptation of the vending machines has not yet been completed, the cash changeover can be considered to have been completed from the consumers' point of view, since practically all face-to-face cash transactions are being conducted in euro.

More than 80% of the 10 million vending machines have been adapted, which indicates that this process is taking place at a slightly slower pace than the

changeover in general. This may cause some local problems whenever national coins are no longer in active circulation.

With regard to counterfeiting, all euro counterfeits reported so far have been of very poor quality. Thus far, no counterfeits have been found in central bank sorting operations.

Finally, I should like to inform you that the changeover has also been smooth and is progressing well outside the euro area. The euro banknotes were received positively, especially in the accession countries, and euro banknotes are now available in banks and "bureaux de change" outside the euro area. With regard to the frontloading of central banks outside the euro area, I should mention that 26 central banks, mainly in central and eastern Europe, the Mediterranean area and in Africa, requested to be frontloaded with euro cash. The total value of the euro banknotes provided to these central banks and to wholesale banks outside the euro area amounted to some EUR 4 billion.

2. Economic and monetary developments

Let me now turn to economic and monetary developments and our assessment of the outlook for price stability in the euro area in the medium term. Overall, there has been little change in our assessment since my last testimony to this Committee on 18 December 2001.

Starting with the analysis under the first pillar of the ECB's monetary policy strategy, we have seen continued strong growth in M3 in the period up to November. The strong short-term dynamics of M3 over the autumn of 2001

seem mainly to be related to a particularly marked preference for liquid holdings by euro area investors in the context of the worldwide economic uncertainty following the terrorist attacks of 11 September. To the extent that these developments are of a temporary nature, monetary developments can be considered not to indicate future inflationary pressures at present. However, if not reversed, the recent building up of liquidity could call for a re-assessment of monetary developments in the coming months, especially at a time when the euro area economy recovers.

Regarding the analysis under the second pillar of our strategy, recent information has confirmed our earlier assessment that economic activity in the euro area was weak in the second half of 2001 and will probably remain so in early 2002. At the same time, there has been some evidence in late 2001 that supports the likelihood of a gradual economic recovery materialising in the course of 2002.

Starting with external developments, there have been some incipient signs of stabilisation in the outlook for growth at the global level. However, uncertainty remains high and some recently released data still provide mixed signals and do not yet point firmly to an imminent acceleration in economic activity.

In the euro area itself, recent survey data suggest that the decline in confidence may have bottomed out and that, notwithstanding the uncertainty about a turning point, economic activity may be firming. Developments in financial markets could be seen as supporting this view.

One of the main reasons for expecting a recovery in economic activity in the course of 2002 is the lack of fundamental economic imbalances in the euro area which would require a long correction process. Furthermore, financial conditions are favourable at present, and higher growth in real disposable incomes as a consequence of the expected decline in consumer price inflation should support domestic demand. Yet, while recent data have confirmed the expectation of a gradual recovery of the euro area economy this year, the timing and strength of this upturn remain uncertain. Therefore, continued close monitoring of further incoming information is warranted.

In the current economic environment, medium-term upward pressures on inflation are not likely to materialise. Annual consumer price inflation, as measured by the Harmonised Index of Consumer Prices (HICP), has declined steadily over the past few months and stood at close to 2% in December 2001. This reflects the unwinding of past increases in energy prices and, albeit to a lesser extent, in food prices. Recent information on producer prices supports the view that the decline in consumer price inflation will continue in the course of 2002. In the months to come, however, the path of HICP inflation might turn to be somewhat erratic on account of base effects related to developments in the HICP in early 2001. For this reason, the possibility of some short-lived upward movements in the annual rate of inflation cannot be ruled out. This should not, however, be a cause for concern. Likewise, downward shifts resulting from such base effects later in the spring should not signal a change in the longer-term outlook for price stability.

There has been much talk in the media and the public about whether the cash changeover will lead to higher prices in the euro area. Obviously, many prices have been rounded to new psychologically attractive prices in recent weeks. But, according to all the evidence we have so far, rounding has been in both directions, up and down. However, some uncertainty still surrounds this assessment. Although a definitive picture will only materialise in the period ahead, there are good reasons to expect that the cash changeover will not have any significant effect on the general price level in the short term, as there is strong competition in the euro area retail sector. In addition, consumers and consumer associations have been very vigilant in pointing out attempts to increase prices in the phase of the cash changeover. Furthermore, the current economic environment limits the scope for price increases at the retail level. Moreover, the governments have committed themselves not to increase the average level of administered prices in the context of the cash changeover. Finally, we should also bear in mind that the cash changeover enhances price transparency across the euro area countries, thereby strengthening price competition in the euro area. This could, over the longer term, even lead to downward price movements.

Overall, on the basis of current information, annual inflation rates should fall safely below 2% this year and remain at levels consistent with price stability in the foreseeable future. Against this background, the Governing Council concluded at its meeting on 3 January that the economic situation is developing in line with the forward-looking interest rate decisions taken last year and that it considers the current level of ECB interest rates to be appropriate for the maintenance of price stability over the medium term.

I should like to stress, however, that the expectation of a favourable outlook for inflation in the medium term is dependent on the continuation of wage moderation in the euro area. Excessive wage increases in the forthcoming wage negotiations would represent a source of concern. It is therefore of utmost importance to recall the key role played by wage moderation in fostering employment and maintaining a favourable outlook for price stability.

Turning to fiscal policies, it is important that Member States maintain a medium-term perspective in compliance with the framework of the Stability and Growth Pact. While the current weakness in economic growth presents a particular challenge for those countries which have not yet attained budgetary positions close to balance or in surplus or which have high public debt-to-GDP ratios, adherence to their medium-term objectives will strengthen consumer and investor confidence. Countries without fiscal imbalances can, of course, allow automatic stabilisers to operate in full. That said, however, there is no case for fiscal activism. There is considerable evidence showing that fiscal policy can only contribute little, if anything, to stabilising economic activity, given the lags in the decision-making process and the time needed to fully affect economic activity. Furthermore, it should be borne in mind that the possible short-term benefits resulting form the conduct of an activist fiscal policy may be outweighed by developments in long-term interest rates which might react adversely to the risks of a worsening in fiscal prospects.

At this stage, and in view of the still high level of structural unemployment in the euro area, it is important to recall that the key challenge for the euro area

remains the improvement of the conditions for further expanding the production potential. Substantial progress in the field of structural reforms is essential to strengthen the productive forces in the economy. This requires an acceleration and deepening of structural reforms in the labour and product markets in order to provide economic agents with the proper incentives, as well as fostering technological innovation. Furthermore, governments should pursue determined reforms with regard to the size and structure of public expenditure and revenue, also in order to create room for further tax cuts and to absorb the fiscal costs of population ageing.

With the introduction of euro banknotes and coins, the process of monetary integration, which started ten years ago in Maastricht, has been successfully completed. Now, the main task ahead of us is to continue with resolve the implementation of the structural reforms that are necessary to enhance the growth potential of the economy and economic welfare in the euro area.

I stand now ready to answer your questions.