INTRODUCTORY STATEMENT

Delivered by

Dr. Willem F. Duisenberg
President of the European Central Bank

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Once more it is my pleasure to appear before your Committee in order to report on the recent monetary policy decisions taken by the ECB and on the reasoning underlying these decisions. To this end, I shall also present the ECB's analysis of current economic developments and comment briefly on the outlook for the euro area. I should also like to add a few words on the change in the procedures for the allotment of liquidity in the main refinancing operations of the Eurosystem, beginning with the operation to be settled on 28 June 2000. Moreover, I should like to inform you of other important decisions taken by the ECB, particularly in the area of transparency, which is an issue that has frequently been raised in the framework of our regular dialogue, and to which the ECB attaches great importance.

1. Current economic developments and prospects

Over the past few months both pillars of the monetary policy strategy of the Eurosystem have indicated that upward risks to price stability have increased. The developments in monetary and credit aggregates over the first few months of 2000 clearly indicated that liquidity conditions in the euro area were generous. The three-month average of the annual growth rates of M3 (covering the period from February to April 2000) was 6.3%. This followed an increase of 5.9% in the period from January to March 2000. There has, therefore, been a further deviation of M3 growth from the reference value of 4½%. Annual M3 growth, as measured by the three-month moving average, has been almost 1½ percentage points above the reference value since the end of the summer of 1999. It was almost two percentage points above the reference value in April 2000. Growth of credit to the private sector, which was already high throughout 1999, increased during the first four months of 2000, reaching, on an annual basis, 11.4% in April 2000. Developments in the first pillar thus indicated that upward risks to price stability had increased over the past few months. They needed to be counteracted in time.

Looking at the information provided under the second pillar, the outlook for growth in the euro area has improved further since our last meeting in March,

while upward risks to consumer price inflation have continued to increase. There is widespread consensus among the forecasts from major international organisations and private institutions that real GDP growth will exceed 3% this year and next year. This is significantly higher than projected at the end of last year or earlier this year. On the domestic side, this positive outlook reflects expectations that growth in domestic demand will benefit, in particular, from ongoing employment growth and higher rates of capacity utilisation. On the external side, the upturn of growth in the world economy appears to be more robust and broadly based than was anticipated earlier. This suggests that the growth of euro area exports should remain strong. Information from recently released short-term indicators, such as the surveys of the European Commission on consumer and industrial confidence, largely confirm these forecasts. They indicate continued strong growth in the first half of 2000, following the upturn in real GDP growth in the second half of 1999.

With regard to consumer price developments, inflation has recently risen above the level expected by most forecasters at the end of last year. At the same time, according to currently available forecasts, consumer price inflation will exceed, this year and next year, the levels forecast at the end of last year. The level and the pattern of overall HICP inflation observed over the past few months largely reflect the impact of oil price developments on the energy component of the HICP. In March, annual headline inflation was 2.1%. While it came down to 1.9% in April and May, the rise in oil prices in May 2000 points to renewed short-term upward pressures. It should also be considered that, in the context of the favourable prospects for strong economic growth in the euro area, the pass-through of exchange rate changes via import prices is normally facilitated. Overall, for these reasons, HICP inflation is not expected to fall significantly in the near future. In the context of robust economic growth, these short-term upward pressures were considered to potentially increase the risks of second-round effects, implying that they could have longer-lasting effects on consumer price inflation, if monetary policy did not counteract these in a timely manner.

Therefore, in response to these upward risks to price stability, as they emerged from the analysis under both pillars of the monetary policy of the Eurosystem, the Governing Council of the ECB decided to increase ECB interest rates by 25 basis points on 27 April 2000, and by 50 basis points on 8 June. The rate on the main refinancing operations has thus reached 4.25%. The rates on the marginal lending facility and on the deposit facilities have now been set at 5.25% and 3.25% respectively. The Governing Council also decided on 8 June to switch to a new tender procedure for the allotment of liquidity in the main refinancing operations of the Eurosystem. I will discuss this issue later.

The decisions taken by the Governing Council of the ECB reflected the forward-looking character of the monetary policy of the Eurosystem. I should like to stress that the decisions of the Eurosystem should be interpreted as responses to risks to price stability in the medium term before they materialise, rather than as reactions to a situation whereby price stability has already been jeopardised. In this respect, the recent increases in ECB rates have been motivated by a desire to avoid being compelled to take stronger measures at a later stage. I believe this is the best way to fulfil our mandate, as it is defined by the Treaty, and thereby to contribute to sustained economic growth in the euro area. The sounder the growth process is, the longer will it normally last. The sounder the growth process is, the more permanent and sustained will the creation of new jobs tend to be.

An important question in this context relates to the sustainability of the expansion of economic activity at current growth rates. The answer to this question has important implications for our assessment of the monetary policy stance, as it potentially affects the interpretation of some of the analysis conducted under both pillars of the monetary policy strategy of the Eurosystem.

At our last meeting in March, I already addressed the issue of the reference value for monetary growth. This reference value is compiled from the estimated trend growth of real GDP, the estimated trend decline in the velocity of

circulation of M3 and the quantitative definition of price stability. In the light of the prospects for strong economic growth and upside risks to price stability which I have already mentioned, the question has been raised as to whether these developments would require a revision of the reference value for monetary growth. In this context, I should like to recall the Governing Council's decision to review the reference value on an annual basis, and that the next review will take place in December 2000. I should also like to emphasise that the reference value is a medium-term concept and does not constitute a monetary target. What we aim to capture by trend growth is the rate of growth, which is sustainable in the medium term, which, according to our analysis, has been estimated as falling in the range of 2-2½%.

Let me also emphasise the fact that estimates of potential output (and thus of the output gap) are surrounded by considerable uncertainty. Therefore, these indicators should be treated with great caution. We are currently observing a strong cyclical expansion supported by strong productivity growth. However, we need more compelling evidence before it can be concluded that this upturn will be followed by higher growth potential, which is above trend growth, as it has been estimated so far. It is too early to tell, but we are monitoring and analysing developments closely. We will take our findings into account when reviewing the reference value and taking monetary policy decisions. Nevertheless, I should like to stress that it is hard to imagine that the current growth in M3 could be justified by an upward revision of potential growth. I should also like to point out that the analysis of monetary and credit developments conducted under the first pillar of our strategy is more complex than simply comparing actual M3 growth with the reference value.

The challenge to turn the current expansion into a prolonged period of non-inflationary growth clearly requires further efforts in all policy areas. Reforms in the labour market will be a major factor contributing to sustained non-inflationary growth in the euro area. The current level of unemployment in the euro area, despite some decline, is still too high. In this respect, both appropriate

wage settlements and structural reforms will be important contributions to continued employment growth and to maintaining low inflation. With a view to fiscal policies in the euro area, it is important that the opportunity of the current economic environment is seized to improve the soundness of public finances. Member States should take advantage of the current cyclical position in order to achieve and maintain budgetary positions, which meet the requirements of the Stability and Growth Pact. More ambitious fiscal positions than those targeted in Member States' updated stability programmes should be achieved, particularly in countries with high debt ratios and especially if economic growth develops more favourably than expected. In addition, we welcome initiatives to implement tax cuts in a number of countries, provided that these measures are consistent with the progress to be achieved in the area of fiscal consolidation. At the same time, more emphasis should be placed on structural reforms on the expenditure side of budgets leading to stricter expenditure restraint. At the current juncture, a pro-cyclical bias in fiscal policies should be avoided.

Let me now turn to the decision of the Governing Council to modify the procedure for the allotment of liquidity in the main refinancing operations of the Eurosystem. This change was motivated by purely technical reasons, namely by the need to address the problem of overbidding, which has become increasingly severe in the course of recent months. As a matter of fact, since early 2000, the bids submitted in the main refinancing operations of the Eurosystem have been following a steady upward trend, leading ultimately to allotment ratios of less than 1% of the bids. For this reason, we decided that the main refinancing operations would be conducted as variable rate tenders using the multiple rate auction procedure, beginning with the operation to be conducted in one week from now. Contrary to the fixed rate tender procedure, whereby the counterparties of the Eurosystem submit bids for a specified amount of liquidity, the new procedure implies that the counterparties will also indicate in their bids the interest rate they are prepared to pay for the requested amount of liquidity. This should eliminate the incentive to overbid, for in the new

format of the auction the bidding behaviour of counterparties should be constrained by interest rate cost considerations.

I should like to stress that the switch to variable rate tenders is in no way intended to further modify the stance of the monetary policy of the Eurosystem. In order to underline this intention, and to be able to continue to send a clear signal concerning the monetary policy stance, we decided to introduce a minimum bid rate, below which no valid bid may be submitted. This rate will signal the monetary policy stance of the Eurosystem, and thereby assume the role that has, so far, been performed by the main refinancing rate in the fixed rate tender procedure.

2. Other activities of the Eurosystem

Turning now to other activities of the Eurosystem, I should like to begin by informing you of further steps which have been initiated by the ECB in the area of its communications policy. In line with the ECB's principle to be as open as possible in the framework of its responsibilities as a central bank, and in order to enhance the transparency of its regulatory framework, the ECB has decided to make available to the general public, as a rule, the ECB legal instruments governing the relationship between the ECB and the national central banks (NCBs) of the euro area. So far, the publication of such documents has been decided by the Governing Council on a case-by-case basis.

Obviously, it is indispensable to exclude from this general rule all sensitive information that needs to be kept confidential in order to protect the public and economic interests underlying the activities of the Eurosystem, in particular with a view to monetary and exchange rate stability, the fight against counterfeiting and the legal protection of banknotes. Thus, confidentiality has to be maintained whenever the disclosure of such information could have significantly adverse effects on the activities of the Eurosystem or could seriously prejudice the effective conduct of its operations.

All non-confidential legal instruments of the ECB will be published both in the Official Journal of the European Communities and in the Compendium of the ECB, which is also accessible via the ECB Internet website. At the current stage, the Governing Council has approved the publication of three Guidelines addressed to the NCBs of the Eurosystem. They concern the authorisation to issue national banknotes during the transitional period, the exchange of banknotes in Community currencies according to Article 52 of the Statute of the European System of Central Banks and of the European Central Bank and the protection of confidentiality of individual statistical information collected by the Eurosystem. The publication of several other documents adopted by the ECB is currently under way.

Let me now briefly refer to two reports relating to the Eurosystem's tasks in the area of prudential supervision and financial stability, which have recently been released to the general public. Both reports were prepared by the Banking Supervision Committee of the European System of Central Banks (ESCB), which comprises high-ranking representatives of the central banks and banking supervisory authorities of the 15 EU Member States and the ECB.

The report on "Asset prices and banking stability" analyses the possible implications for the EU banking sector in the event of a significant fall in asset prices. Given the difficulties and uncertainties in measuring the "fundamental" value of an asset and the generally inconclusive results provided by the various asset price valuation models, the report does not endeavour to determine the "appropriateness" of asset price levels. Rather, its main objective is to assess the resilience of the EU banking sector to possible downward developments in asset prices.

The report concludes that stock market exposures of EU banks do not currently give any rise to concern from a macro-prudential point of view. The EU banking sector would not face major difficulties in the case of a sharp decline of stock prices. However, problems for EU banks could arise if a fall in stock prices entails

second-round effects such as a significant slowdown in economic growth leading to a further recession. Moreover, there appear to be some potential risks to EU banks as a result of a possible price fall in the real estate sector, but no major threat to systemic stability could be identified.

The report also addresses the policies pursued by the supervisory authorities in Member States in order to preserve financial stability and to ensure prudent lending practices by banks. The actions taken in the various Member States range from public communications of concerns to specific regulatory measures, such as changes in risk provisioning and/or asset valuation rules. Given the interest of the Eurosystem in these kind of issues, the Governing Council has given the Banking Supervision Committee of the ESCB a mandate to undertake periodic reviews of asset price developments from the point of view of banking stability.

The second report that I should like to bring to your attention examines the question of the extent to which factors such as technological change, financial liberalisation and internationalisation and the increasing trend towards banking disintermediation have had an impact on the activities and, consequently, on the income structure of EU banks in recent years.

The most noteworthy change that has occurred in the income structure of EU banks is the increasing importance of non-interest income, comprising, inter alia, fees and commissions, net profit on financial operations and income from variable yield securities. This trend may have had a positive effect on the overall profitability of banks in recent years, even though banks were also confronted with increased costs associated with the development of non-interest income activities, e.g. in order to attract and retain highly qualified personnel. The report also indicates that the shift towards non-interest income does not necessarily induce greater volatility in the income of banks.

The changes that have occurred within the income structures of banks, have also had an impact on the risk profiles of credit institutions. Indeed, some categories of risks, including operational and strategic risks, have become more significant compared with the risks associated with classical intermediation activities of banks, such as credit risks. Therefore, the findings of the report seem to support suggestions for determining specific capital requirements for risks other than credit risks. Such measures are currently under discussion in the relevant institutional fora, in the context of the review of the capital adequacy regime for banks.

I shall now be happy to answer any questions you may have.