EUROPEAN CENTRAL BANK

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HEARING BEFORE THE COMMITTEE ON ECONOMIC AND MONETARY AFFAIRS OF THE EUROPEAN PARLIAMENT

INTRODUCTORY STATEMENT

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Check against delivery

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Today we shall continue our regular exchange of views on monetary policy and other activities of the Eurosystem. I am glad to see that since our last meeting on 20 June the prospects for economic growth in the euro area have remained very favourable. At the same time, upward pressures on prices had emerged which needed to be addressed by the ECB in a timely manner and led to the decision on 31 August to increase the ECB interest rates by 25 basis points. I shall start my remarks by commenting in detail on this step and on our assessment of the monetary and economic developments in the euro area which underpinned our decision. Subsequently I shall address some other issues of topical interest, namely the preparation of the euro cash changeover, the current efforts to improve the availability of statistical data in the EU and the role of the ECB in the oversight of payment systems. I shall then be happy to answer your questions.

1. Economic and monetary developments

Turning to the ECB's decision to increase the ECB interest rates by 25 basis points on 31 August, I should like to start my explanations by pointing out that, prior to the interest rate hike, upside risks to price stability were evident from both pillars of the ECB's monetary policy strategy.

Starting with the first pillar, some moderation in the evolution of monetary aggregates has been gradually detectable over recent months. This could be related to the increase in short-term interest rates in the euro area over the course of this year, which has had a dampening effect on the demand for the most liquid components of M3, namely those included in M1 (currency in circulation and overnight deposits, both of which bear little or no remuneration). However, in spite of the deceleration observed recently, M3 growth has remained above the reference value. This, in part, reflects the relatively strong increase in nominal GDP in the euro area. Furthermore, in order to assess the overall liquidity situation in the euro area, we have to acknowledge that, owing to the protracted deviation of M3 growth from the reference value which has occurred since the start of Stage Three of EMU, the actual level of the stock of M3 is much higher than the level implied by the reference value. Therefore, as also evidenced by the continued strong demand for credit in the private sector, liquidity in the euro area continued to be ample until the early summer. Particularly in a phase of robust economic growth, the continuation of ample liquidity conditions would constitute a risk to price stability.

As regards the information provided under the second pillar, the favourable picture of the economic outlook of the euro area which we saw in June has been confirmed over the past few months. This applies in particular to the prospects for strong growth.

On the basis of available short-term indicators, euro area real GDP growth in the first half of this year, compared to the second half of 1999, can be expected to amount to around 3½% on an annualised basis. This underpins the projections of strong growth of above 3% for this year and the coming two years as contained in currently available forecasts. If anything, projections have been revised upwards slightly in the past few months, reflecting the favourable conditions for domestic and external demand. On the domestic side, growth should continue to benefit from the high overall level of confidence, with indicators being close to their respective record highs. Investment growth can be expected to remain strong on account of moderate wage developments and a high degree of capacity utilisation. Growth of private consumption should also remain robust, supported in particular by ongoing strong employment growth and a concomitant steady fall in unemployment. On the external side, the factors supporting growth are the ongoing strong expansion of the global economy and the past gains in competitiveness of the euro area, reflecting the decline in the exchange rate of the euro. Given the strength of the conjunctural indicators for domestic demand and exports, euro area growth this year could turn out to be even stronger than anticipated in June.

Bond markets also continued to point to favourable prospects for economic growth in the euro area in the period ahead. While the yield curve has flattened somewhat during the course of this year, this has been a consequence of the increase in ECB interest rates. By contrast, long-term bond yields have been broadly stable this year, indicating continued financial market expectations of robust economic growth in the future.

Turning to other indicators related to the second pillar, developments in import prices have clearly been less favourable than expected in June 2000. As a consequence, July 2000 annual consumer price inflation, as measured by HICP increases, stood at 2.4%. This was above the level which the ECB regards as being compatible with price stability. At this juncture, the upward movement of consumer price inflation mainly reflects the impact of oil prices on the energy price component of the HICP and the growing pressures on prices stemming from the depreciation of the exchange rate of the euro. Overall, due to both oil prices and the exchange

rate, consumer price inflation in the euro area is likely to remain above 2% for some months to come.

Monetary policy cannot offset such short-term pressures on the HICP. However, it needs to make sure that temporary deviations from the ECB's definition of price stability do not spill over into long-term inflation expectations, and to ensure that they do indeed remain temporary. In this sense, it is crucial to make sure that short-term upward pressures from import prices do not lead to a more protracted increase in the HICP in a period of strong economic growth.

In view of this situation, in which both pillars of the monetary policy strategy of the ECB were pointing to upward risks to price stability, the Governing Council of the ECB decided on 31 August to increase the minimum bid rate on the main refinancing operations of the Eurosystem by 25 basis points, to 4.50%. The interest rates on the marginal lending and deposit facilities were also increased by 25 basis points, to 5.50% and 3.50% respectively.

The change in the procedure for the allotment of liquidity in the main refinancing operations of the Eurosystem, which I mentioned at our last meeting on 20 June, has proven to be very satisfactory. As you may recall, the Governing Council decided on 8 June that, starting with the operation to be settled on 28 June, the main refinancing operations of the Eurosystem would be conducted as variable rate tenders with a minimum bid rate. In this procedure, the minimum bid rate took over the role previously performed by the rate in fixed rate tenders in signalling the monetary policy stance of the Governing Council. Our current assessment is that market participants adapted smoothly to the new procedure, and that the procedure has served its purpose very well.

The Governing Council will remain alert to all emerging risks to price stability. The maintenance of price stability will continue to contribute to a favourable environment for growth. However, it cannot increase the growth potential of the euro area. It is the responsibility of other actors to create the necessary conditions for sustained high growth in the euro area.

First, favourable wage developments will be one key factor to ensure the continuation of robust economic growth and the reduction in unemployment in the medium term. In this respect, it is

crucial that forthcoming wage settlements be based on the ECB's definition of price stability. Any attempt to increase wages in reaction to recent oil price increases would be highly detrimental to the current favourable growth process, since monetary policy would need to react to the resulting upward pressure on prices. It is a matter of fact that recent oil price increases have deteriorated the terms of trade of the euro area, and thus also reduced real income. This fact needs to be accepted by all parties concerned.

Second, some of the main challenges for the governments of the euro area countries relate to the conduct of fiscal policy. At present, one major impediment to an increase in the long-term growth potential in the euro area is the high level of social contributions and of taxation on labour and corporate income. While a reduction in taxes and social contributions would certainly be beneficial from an economic point of view, it is essential that such a course of action remain compatible with the long-term sustainability of public finances. Therefore, reforms on the taxation side, which we very much welcome, should be accompanied, or even preceded, by a reduction in the level of expenditure at present and in the future.

Taking into account the gradual ageing of the population in the euro area, reforms of pension systems should not be delayed. Such reforms are necessary in order to achieve long-term sustainable fiscal positions and, at the same time, avoid the risk of having to impose an excessive burden on workers and enterprises in the future. While some progress has been made by governments over the past few years, further efforts will be essential in order to support the long-term growth prospects in the euro area.

Moreover, fiscal reforms should be accompanied by further progress in other areas. In particular, reforms in the field of labour and product market regulations are essential for the economy of the euro area to take full advantage of the opportunities created by the introduction of the single currency, the process of globalisation and the availability of new technologies. Enhanced labour market flexibility and increased competition in product markets will be key factors in contributing to a higher growth potential in the euro area. In several countries notable progress has been achieved in some respects. However, there is still much to be done when looking at the area as a whole.

Finally, let me also say a few words about recent exchange rate developments. From a monetary policy point of view, they are clearly a cause for concern as they add to upward

pressure on consumer prices in the euro area. Furthermore, they do not appear to be appropriate when looking at fundamentals.

As you are aware, we already expressed this concern for some time. In the meantime, we have witnessed a considerable improvement in the economic growth prospects for the euro area. At the same time, as a result of measures taken by the Governing Council of the ECB, the outlook for price stability in the euro area remained intact. At present, inflation in the euro area is among the lowest in the world. The fact that the euro has continued to depreciate in recent months is not in line with these strong economic fundamentals of the euro area. Recent global exchange rate developments are also not in line with international balance of payment positions.

2. Other activities of the Eurosystem

Let me now turn to other activities of the Eurosystem, starting with several decisions which were taken with regard to the introduction of the euro banknotes and coins on 1 January 2002. The ECB, together with the other European institutions and the Member States, is paying closest attention to this crucial event, which will mark the final step in the completion of Economic and Monetary Union. As you are aware, the ECB has launched an information campaign on the 2002 cash changeover, on which my colleague, Mr. Domingo Solans, reported to you in May. I should like to recall that the ECB shares the Parliament's view that a co-ordination of the various information campaigns conducted at the European and national levels is essential in order to provide clear and consistent information to markets and the general public.

Moreover, several measures have recently been taken by the ECB in order to facilitate further the changeover process for market participants and the general public. In July the Governing Council defined the general principles of the framework for the euro cash changeover, including the financial modalities for credit institutions. Moreover, 1 September 2001 was fixed as the starting date for the frontloading of euro cash to credit institutions in the euro area. This implies that credit institutions may also commence the sub-frontloading of euro cash to retailers, the vending machine industry and cash-in-transit companies in September 2001.

Given that the euro banknotes and coins will become legal tender only as of 1 January 2002, the Eurosystem will retain the ownership of all frontloaded euro cash until then. Credit institutions

will be obliged to arrange appropriate coverage of the risks of anticipated public use, as well as of destruction or theft. In addition, sub-frontloading shall be performed by credit institutions against the delivery of appropriate collateral to the national central banks.

As regards the cross-border exchange of national banknotes within the euro area, you may recall that the ECB decided, back in 1998, that each national central bank of the euro area has to provide for at least one location where an exchange of such national banknotes can be effected at the official conversion rates. Originally, it was envisaged that this exchange facility would expire on 31 December 2001. Now the Governing Council of the ECB has decided to extend this period until 31 March 2002 in order to expedite the changeover process. For the sake of completeness, I should like to add that the exchange of national banknotes at the respective national central bank after 1 January 2002 will be possible for a much longer period (at least ten years). However, according to current planning in Member States, the time span for the exchange of national coins will, at least in some countries, be considerably shorter, ranging from one year after the coins have ceased to be legal tender up to an indefinite period.

The Governing Council also reviewed the number of euro banknotes which will have to be printed before the end of 2001, and decided to increase the launch stock of euro banknotes from 13 to 14.5 billion. In doing so, the Governing Council took into account the participation of Greece, a higher than expected increase in banknotes in circulation within the euro area, an anticipated strong demand for low-denomination banknotes and the slower than anticipated progress in the use of electronic money. The total nominal value of euro banknotes will amount to EUR 616 billion.

Another important issue to which the ECB continued to pay considerable attention relates to improvements needed in the field of EU statistics. In conducting monetary policy, the ECB uses a wide range of statistics – broadly speaking: those published in the 60 pages of tables in our Monthly Bulletin. Two sets of statistics of particular importance to us, namely the monthly monetary data and the HICP (Harmonised Index of Consumer Prices) covering the euro area, compare well in quality and timeliness with corresponding data elsewhere. This is also true for some other areas, such as balance of payments and securities issues. However, in some areas the timeliness and quality of data available for the euro area is still disappointing.

In August the ECB published a report entitled "Statistical requirements of the ECB in the field of general economic statistics", which outlines the requirements in this area. In broad terms, the areas where improvements have the highest priority relate to quarterly national accounts, harmonised quarterly public finance statistics, labour market statistics, conjunctural statistics and the quicker availability of data on trade outside the euro area.

The European Commission, in co-ordination with the ECB, is currently preparing an action plan covering priorities for rapid improvement. According to current planning, the action plan is to be endorsed by ECOFIN ministers at the end of this month, giving the work the highest possible level of political support.

I should now like to refer briefly to issues concerning the area of payment systems. As already stated on several occasions, efficient euro payment and settlement systems are essential for the smooth implementation of monetary policy and for the stability of financial markets. This close relationship is reflected by the fact that the Treaty has assigned to the ESCB the responsibility to promote the smooth operation of payment systems, which implies an oversight function and includes the possibility for the ECB to issue regulations in this area. Moreover, the ECB is also concerned with the security of payment instruments, which is crucial for public confidence in the single currency. As part of its communication policy and in order to give guidance to markets and the public at large, the ECB issued a statement in June which explains in detail the objectives and activities of the Eurosystem in this area, especially as regards the execution of its oversight function.

The focus of the ECB, however, is not restricted to the efficient processing of large-value transactions. The ECB also has a clear interest in the smooth functioning of cross-border retail payment systems. This interest, which the ECB shares with the European Parliament, is reflected by its initiative of September last year concerning the improvement of cross-border retail payment systems. Since then, the ECB has been in close contact with the European banking industry in order to explore practical ways and means of enhancing the efficiency of cross-border retail payments systems. You may be interested to know that a progress report, providing an assessment and recommendations of the ECB in this area, is close to being finalised and will be published soon.

As concerns retail payments, I should also like to draw your attention to one particular issue, namely the costs caused by balance of payments reporting requirements. The ECB shares this concern and has, together with the Commission, national central banks and other statistical authorities, undertaken efforts to reduce such costs, in particular by establishing a common exemption threshold of EUR 12,500, which will come into effect as from 1 January 2002. This means that banks will not have to report their customers' cross-border payments and receipts if the amount is below the threshold. The implementation of a uniform exemption threshold constitutes a major breakthrough in reducing an administrative burden which is specific to cross-border payments. As a consequence, reporting requirements can no longer serve as a justification for high customer fees for cross-border payments below the threshold. Furthermore, a list of harmonised economic codes is being prepared, which should further facilitate the automation of reporting.

To conclude my remarks, let me briefly mention the ECB Occasional Papers, a new series of publications which was launched in July as a further refinement of the ECB's communication tools. The ECB Occasional Papers will be drafted by ECB staff members and published under their own responsibility. They will address various policy-relevant issues and make available to the public data and analyses used within the ECB and the Eurosystem.