EUROPEAN CENTRAL BANK

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

INTRODUCTORY STATEMENT

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It is my pleasure to continue today our regular exchange of views on monetary policy and other activities of the ECB and the Eurosystem. As usual, I shall first present the ECB's analysis on recent economic developments and its assessment of the prospects in the euro area, focusing on how to foster the continuation of non-inflationary growth in the euro area. Then, I shall report to you on several important decisions taken by the Governing Council of the ECB with regard to the introduction of euro banknotes and coins.

Before beginning my speech, I should once again like to take this opportunity to welcome the newest member of the euro area. By adopting the single currency on 1 January 2001, Greece has become the twelfth member of the euro area, sharing the rights and obligations of the other Member States which have already adopted the single currency.

1. Economic and monetary developments

Since the last hearing before this Committee on 23 November 2000 the Governing Council of the ECB has decided to keep the ECB's main interest rates unchanged. This was because, overall, recent developments have pointed towards more balanced risks to price stability than the ones prevailing at the time of our last meeting. However, some factors still argue for caution. Allow me to comment in more detail on the Governing Council's assessment of the current economic situation in the euro area.

I should like to start with the first pillar of the monetary policy strategy of the ECB. On 14 December 2000, the Governing Council decided to confirm the

existing reference value for monetary growth, namely an annual growth rate of 4½% for the broad monetary aggregate M3. This decision was taken on the grounds that the evidence continues to support the assumptions underlying the derivation of the first reference value in December 1998 (and confirmed in December 1999), namely those for trend potential output growth and the trend decline in M3 income velocity in the euro area.

Turning to recent monetary developments, there were already indications in November 2000 that a moderation in monetary growth had been under way for some months. In late 2000 and early 2001, these signs of moderation became stronger. According to the latest available data, the three-month average of the annual growth rates of M3 in the months from November 2000 to January 2001 was 5%, gradually moving into the direction of the reference value of 4½%. All in all, the risks to price stability from the monetary side have become increasingly balanced.

As regards the second pillar, since my last appearance before this Committee, several developments have changed somewhat the prospects of economic growth in the euro area. On the one hand, the slowdown in the US economy and developments in Japan have increased the uncertainty surrounding the prospects for world growth. On the other hand, the fall in oil prices should have positive income effects in the euro area.

All the information available shows that euro area real GDP growth declined slightly in the second half of last year compared with the strong growth recorded in the first half. However, the general outlook for this year and the next remains positive. Economic activity in the euro area is mainly determined

by domestic factors such as long-term financing costs and disposable income developments, which have remained favourable. In addition, the euro area's high rates of capacity utilisation, the ongoing growth in employment and continued declines in unemployment should help to maintain solid growth in private investment and consumption. All in all, the overall level of confidence in the euro area has remained high. Economic indicators relating to developments around the turn of the year support the view that economic growth will remain fairly robust for the period ahead. Although the more moderate prospects for world growth might end up being associated with a certain slowdown in euro area exports, at present there are no convincing signs that the slowdown in the US economy is having significant and lasting spill-over effects on the euro area economy as a whole. Nevertheless, a close monitoring of global developments is warranted.

As regards recent price developments, the annual rate of increase in the Harmonised Index of Consumer Prices (HICP) in January 2001 was 2.4%, as published by Eurostat, 0.2 percentage points lower than in December 2000. Since November 2000, developments in oil prices and the exchange rate of the euro have contributed to lower short-term inflationary pressures. In January, the rate of increase in energy prices continued to decline, but other HICP components, notably unprocessed food and services prices, rose significantly.

As developments in oil prices and the foreign exchange rate in January and February 2001 have been subject to some volatility, caution should be exercised when assessing their likely impact on HICP inflation in the short-term. Moreover, indirect effects of past oil price increases and euro

depreciation are still coming through as witnessed by the continued rise in producer price increases for consumer goods. Other short-term factors, such as increases in indirect taxation or in administered prices, may also prevent consumer price inflation from falling rapidly below 2% over the next few months.

I should also like to emphasise that market participants consider the current level of consumer price inflation as temporary. Bond yields in the euro area indicate that the general expectation is for inflation to be within the ECB's definition of price stability in the medium term. The ECB is committed to fulfil this expectation.

The current uncertainty regarding the prospects for world economic growth heightens the need to maintain the foundations for strong non-inflationary growth in the euro area as well as to strengthen the potential of the economy. The ECB shares the objective of the governments and citizens of the euro area of a growing prosperity in the euro area. By focusing on the maintenance of price stability over the medium term, the ECB is making an essential contribution to the achievement of this objective.

At the same time, it is of paramount importance that all policy actors help to maintain the current favourable outlook for growth and inflation in the euro area.

First, it is crucial that social partners continue the process of wage moderation seen in the past. This will not only facilitate the task of monetary policy, but will

also contribute to continuing the process of reducing unemployment in the euro area.

In addition, long-term growth perspectives for the euro area will benefit if governments intensify their efforts to progress along the path of fiscal consolidation. I consider that budgetary plans recently expressed in countries' updated stability programmes are not very ambitious as tax cuts are not accompanied by appropriate expenditure restraints. If the macroeconomic environment remains as favourable as expected, the envisaged fiscal policy stance could add to demand pressures. Fiscal policy could, thus, become an additional source of upward risks to price stability. In addition, the stability programmes do not make the necessary progress in addressing long-term fiscal challenges. These challenges include, inter alia, the budgetary adjustments needed in many countries to cope with population ageing.

More efforts are also needed in the ongoing process of implementing structural reforms to foster the growth potential of the euro area. This is of crucial importance to promote the supply of labour and capital and to innovate and disseminate new technologies and production methods. More flexibility in labour markets and reforms aimed at enhancing labour force participation are needed to offset the low growth in the working age population. Additional measures that are needed are the removal of barriers to investment and the creation of the institutional structures needed for a rapid and efficient adoption of new technologies. In this respect, the Governing Council considers that there is no clear indication yet that these structural factors have led to a measurable and lasting increase in productivity growth in the euro area. This

notwithstanding, the uncertainties surrounding estimates of the medium-term development of potential output growth in the euro area have become skewed to the upside. This being the case the Governing Council will carefully monitor further evidence of an acceleration of productivity growth in the euro area. The ECB's monetary policy would naturally take such changes appropriately into account, if and when they occur.

2. Issues relating to the introduction of euro banknotes and coins

I should now like to report on several decisions that have been taken by the Governing Council of the ECB with regard to the euro cash changeover on 1 January 2002.

Given the crucial importance of this matter and the responsibility of the Eurosystem as a whole to achieve a smooth cash changeover, the Governing Council has adopted an ECB Guideline on the 2002 cash changeover. The aim of this Guideline is to ensure that the framework of the changeover is consistently implemented, such as the provisions for frontloading and sub-frontloading and the financial modalities for credit institutions, as well as to provide a level playing-field for all credit institutions, their agents and sub-frontloaded entities. The ECB Guideline can be viewed on the ECB’s website and has also been published in the Official Journal of the European Communities.

Moreover, the Governing Council considered measures which should help to ensure the availability of euro banknotes in non-euro area countries, so that customers demanding euro banknotes are able to obtain them in a timely and

efficient manner. This is particularly relevant for countries in eastern and south-eastern Europe. For example, a significant amount of Deutsche Mark-denominated banknotes are estimated to be held in these countries, and also some other euro area currencies are held outside their national borders. Therefore, the Governing Council agreed on the following principles regarding the distribution of frontloaded euro banknotes outside the euro area:

- credit institutions which are counterparties for monetary policy operations within the Eurosystem will be allowed to distribute frontloaded euro banknotes to their branches, or headquarters, as appropriate, located outside the euro area;
- credit institutions with their main place of business inside the euro area will be allowed to sub-frontload euro banknotes to their subsidiaries that are also credit institutions and are located outside the euro area or to other credit institutions which have neither their registered nor their head office inside the euro area; and
- branches, headquarters and subsidiaries of euro area-based credit institutions, as well as other credit institutions, located outside the euro area, to which euro banknotes would be distributed or sub-frontloaded, are not allowed to further sub-frontload euro banknotes to any third party (e.g. retailers) whatsoever.

In contrast to the euro area, where frontloading and sub-frontloading may start as from 1 September 2001, the distribution and sub-frontloading outside the euro area will only be permitted as from 1 December 2001.

Regarding the Euro 2002 Information Campaign, I should like to report to you that a detailed outline has been agreed and presented to the media, including the principal slogan to be used throughout the whole information campaign: "*the* EURO. OUR *money*".

Moreover, a website dedicated to the campaign was launched in all 11 official languages of the European Community, and can be visited at www.euro.ecb.int. The website contains a number of sections providing a broad range of information which should help specialist groups and the general public to prepare for the introduction of the euro banknotes and coins.

The Governing Council also agreed to organise a series of conferences on euro changeover issues – the "Euro 2002 Information Campaign conferences" – which will bring together the key parties involved in the euro cash changeover process at both national and European level. These events will be organised in the course of 2001 in all euro area Member States, hosted by the respective national central bank. The conferences will support the visibility of the Euro 2002 Information Campaign and prepare the ground for the mass media part of the campaign, which will begin in earnest in the last quarter of the year. The first conference of this series, to be hosted by the National Bank of Belgium, will take place tomorrow here in Brussels.