Hearing before the European Parliament's
Committee on Economic and Monetary Affairs

Introductory statement
delivered by Dr. Willem F. Duisenberg,
President of the European Central Bank,
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It is my pleasure to meet you once again, in order to present the ECB's analysis of current economic and monetary developments and to inform you about recent monetary policy decisions taken by the Governing Council of the ECB. I should like to start my address by reviewing the main economic developments that contributed to the recent decision of the Governing Council of the ECB to adjust its monetary policy stance. In addition, I should like to give you an overview of some other issues which have been addressed by the ECB since our last meeting.

1. Current economic developments and prospects

As you will be aware, on 4 November 1999 the Governing Council of the ECB decided to raise the interest rate on the main refinancing operations of the Eurosystem, which will continue to be conducted as fixed rate tenders, by 50 basis points to 3.0% with effect from the operation which was settled on 10 November 1999. The interest rate on the marginal lending facility was also raised by 50 basis points to 4.0% and that on the deposit facility to 2.0% from 1.5%, both with effect from 5 November 1999.

The decision to increase interest rates was based on information related to both the first pillar of the monetary policy strategy of the Eurosystem, namely a prominent role for money, and the second pillar, a broadly based assessment of the outlook for future price developments and risks to price stability.

Starting with the analysis of monetary aggregates, monetary data up to September 1999 reinforced the view that M3 growth had been on a rising trend. The three-month average of the annual growth rates of M3, covering the period from July to September 1999, stood around 1½ percentage points above the reference value of 4½% set by the Governing Council of the ECB. The deviation from the reference value, which has to be monitored and interpreted with caution, has been growing steadily in 1999. The strong growth of the most liquid components of M3 is particularly noteworthy, and this seemed to be linked to the relatively low level of the opportunity costs of holding these assets which bear either no interest or only a low rate. However, over recent months in particular, the upturn in economic activity

probably also contributed to the acceleration of M3. Credit to the private sector also continued to expand rapidly during September 1999, at a rate in excess of 10%. The demand for loans remained very strong throughout the first three quarters of 1999, supported in particular by the low level of bank lending rates and the ongoing economic recovery. Overall, these monetary developments implied the existence of a generous liquidity situation in the euro area which could generate upward risks for price stability in the medium term.

At the same time, the prospects for economic growth in the euro area improved significantly. This is confirmed by the latest data from Eurostat on real GDP growth over the first half of 1999 as well as by data on industrial production, which indicated that the recovery in economic activity progressed in the third quarter of 1999. Various surveys available indicated that a further strengthening of economic activity could be expected in the near future. The external environment supports the positive outlook for the euro area. The most recent economic figures for the United States continued to point to robust output growth while the prospects for output growth in the United Kingdom also improved. The countries which were most affected by the financial crisis in Asia showed stronger signs of recovery, while in Latin America the consequences of the Brazilian exchange rate crisis were contained, although some risks still remain.

HICP increases were slightly over 1% at the time of the decision to raise interest rates. However, I should like to stress that the decision of the Governing Council was taken in a forward-looking manner, taking account of the prospects for inflation over the medium term. In this respect, the upward trend evidenced by monetary growth and the outlook for the development of economic activity provided clear indications of upward risks to price stability over the medium term. Finally, we had to take into account the fact that the downside risks to price stability which motivated the cut in ECB interest rates in April 1999 were no longer apparent at the time of the meeting of the Governing Council on 4 November.

To summarise, the rising trend in M3 growth in excess of the reference value in conjunction with the strong growth of credit indicated that the liquidity situation in the euro area had been generous thus far in 1999. Together with the broad assessment of the prospects for economic developments in the euro area, this reinforced the view that the balance of risks to future price stability had gradually been moving towards the upside. Therefore, there was a need to adjust the stance of monetary policy with a view to maintaining price stability over the medium term. This decision should not be seen as endangering economic activity. On the contrary, by aiming to nip inflation risks in the bud, it will contribute to a long-lasting phase of sustained economic growth.

Indeed, the financial markets have received our decision favourably. The analysis of several indicators from the money, bond and stock markets on the days around the decision suggests that financial markets

delivered a positive assessment of the appropriateness and timeliness of the interest rate decision. The increase in short-term interest rates was accompanied by a decline in euro area bond yields. This suggests that the move contributed to containing long-term inflation expectations and to the reduction in risk premia. As a matter of fact, the expected volatility of bond yields in the euro area declined considerably from around 4 November, which can be seen as further confirmation that the move was perceived as reducing the uncertainty regarding the course of monetary policy. While an increase in ECB interest rates was to a large extent anticipated at the time of the decision, the announcement and the explanation of the decision were associated with a sharp reduction in the expected volatility in short-term interest rates.

Overall, our assessment of the move and its implications is positive. We regard the change as an early move which was necessary in order to fulfil our primary objective. Furthermore, a timely rise in interest rates will prevent the need for larger increases in interest rates at a later date and, hence, will contribute to stronger growth over an extended period of time.

Finally, let me mention the monetary data for October 1999 which were released this morning. The three-month average of the annual growth rates of M3, covering the period from August to October 1999, stood at 6.0% and thus remained 1½ percentage points above the reference value. In addition, the annual growth rate of credit to the private sector continued to exceed 10% in October. This data does not yet alter the picture of a generous liquidity situation in the euro area.

2. The EU accession process and the Helsinki seminar

I should now like to turn to several other issues that may be of interest to you. The Governing Council held a preliminary discussion on EU accession countries and the accession process. Indeed, the accession of new members to the European Union is an area of development in which the Eurosystem will be increasingly involved within its fields of competence. During its first year of existence, the ECB already had a certain amount of bilateral contact with central banks of accession countries, including official visits to some of them and receiving a large number of delegations at the ECB. Drawing on these experiences, the ECB organised, in co-operation with the Bank of Finland, a high-level seminar gathering together the Eurosystem and the central banks of the 12 accession countries, which was held on 10-12 November in Helsinki.

The seminar was, with only one exception, attended by all governors of the central banks of the candidate countries. The principal purpose of the seminar was to review the central banking issues involved – both in the pre-accession process and, later, during EU membership – in the different steps which will ultimately lead to the adoption of the euro, in order to identify the main problem areas and to enhance co-

operation between the Eurosystem and central banks of candidate countries. I should like to give you a brief overview of some of the conclusions that emerged from the discussion.

First, there was a clear understanding that the timely adoption and implementation of the Community "acquis" is essential, in particular in the area of central bank independence and other legislation related to the monetary field and to banking and financial markets.

Second, as regards the convergence process, the seminar concluded that accession countries should pursue both "real" and "nominal" convergence in parallel. "Real" convergence means the process through which the living standards of accession countries will be "catching up", progressively evolving towards levels closer to those of the current EU Member States. It implies the adaptation of economic structures in line with those prevailing within the EU and the implementation of appropriate structural reforms. This process should be accompanied by nominal convergence, i.e. price stability and sound public finances. Progress towards nominal convergence should indeed go hand in hand with structural reform. Accession countries need to continue to implement monetary policies geared to achieving and maintaining price stability, and to support this process with prudent fiscal policies and adequate structural reforms.

Third, given the different starting points for the economic reform process and the difficulties involved in ascertaining, at this stage, the lead time for further progress towards nominal and real convergence, no common path should be prescribed for all 12 accession countries. It seems that a plurality of approaches with regard to the orientation of their exchange rate policies prior to accession, the inclusion of their currencies in ERM II or the later adoption of the euro would be more appropriate and would be feasible without compromising the principle of equal treatment.

Fourth, and lastly, the smooth functioning of banking and financial markets is of the utmost importance for the successful integration of the applicant countries into the Single Market and, at a later stage, into the euro area. The financial sector in the accession countries has been characterised in recent years by intense restructuring in the form of mergers, acquisitions and privatisation. Central banks will contribute to ensuring that such developments occur within a general framework of stability.

Finally, I should like to mention that in Helsinki the Eurosystem confirmed its readiness to provide technical assistance to the central banks of the accession countries in its fields of competence. The working relationships between the Eurosystem and the central banks of the accession countries will be further developed in order to prepare successfully the steps which will have to be taken, in the Eurosystem's areas of competence, in view of EU accession and, at a later stage, the adoption of the euro.

3. Euro banknotes and coins

To conclude, I should now like to turn to another important issue, namely the introduction of the euro banknotes and coins on 1 January 2002, which will constitute the final milestone on the path to the completion of Economic and Monetary Union. Indeed, the introduction of the euro banknotes and coins will imply a major change in the everyday life of 300 million European citizens. It is therefore crucial to gradually prepare the general public in euro area countries for this event, in order to ensure that the new banknotes and coins will be favourably received.

To this end, the ECB is preparing, in close co-operation with the European Commission and the euro area Member States, an information campaign – called the "EURO 2002 campaign" – which aims at making the public familiar with the design and security features of the new euro banknotes and coins. Particular emphasis will be put on the anti-counterfeiting features of the banknotes, which will reflect the state of the art. Since public confidence in the new banknotes will essentially depend on the public's perception of the banknotes as a secure means of payment, the EURO 2002 campaign will explain to the general public and, more specifically, to cashiers in shops and banks how to examine the new banknotes in a quick and efficient way so as to detect possible counterfeits. Particular attention will also be given to the vulnerable groups in our society, such as the blind and partially sighted.

You may recall that in February the ECB published a tender notice in the Official Journal of the European Communities regarding a contract to prepare and implement the EURO 2002 campaign. On the basis of the resulting applications, the Governing Council of the ECB took a final decision, selecting the company which is now assisting the ECB with the information campaign. The ECB looks forward to continuing its co-operation with the Community institutions and the Member States on our common efforts to ensure broad and comprehensive information for European citizens on the introduction of the euro banknotes and coins.

Let me also briefly mention that the ECB recently published a report on the legal protection of banknotes in the EU Member States, which covers various aspects, such as the legal protection of euro banknotes against counterfeiting, copyright protection of euro banknotes, anti-banknote copying devices for reproduction equipment, the adoption and publication of euro banknote designs, the exchange of damaged or worn euro banknotes, the withdrawal of euro banknotes, the legal regime applicable to banknotes issued by entities other than the ECB and the national central banks, and the issuance of non-legal tender tokens and banknotes denominated in euro. The report presents the views of the ECB on the ways and means of ensuring the legal protection of euro banknotes and is thus part of our efforts to ensure a smooth introduction and widespread acceptance of the euro banknotes and coins.