Jean-Claude Trichet: The process of economic, monetary and financial integration in Europe

Text of the Jean Monnet Memorial Lecture by Mr Jean-Claude Trichet, President of the European Central Bank, at the European Business School, London, 29 November 2006.

*   *   *

Ladies and Gentlemen,

It is a great privilege and pleasure to be invited to deliver this lecture here at the European Business School in London and to be among such a distinguished audience.

I am particularly moved to be here under the “invocation” of Jean Monnet: one of the founding fathers of the European Union, a visionary who realised that peace, prosperity and stability in Europe called for practical and close cooperation between European nations. He is the man who conceived the “méthode communautaire”. In his Mémoires he recalls his early years working for the family’s cognac business in London; it formed part of the global education that the provincial business required. He says in his Mémoires that it was perhaps his innate French imagination and enthusiasm tempered by an acquired British pragmatism that enabled him to be so active and successful on many historic occasions. We need Monnet’s spirit and vision more than ever. Two quotations by him illustrate just how visionary and practical he was:

“We are here to accomplish a common endeavour, not to negotiate advantages but to realise that our advantage depends on the success of our **common** advantage.”

He also said: “Let us make our present endeavour a success and let us not be guided by the opinion of others or by what others would like us to do.”

Not to forget the biblical quotation (from Proverbs) which ends one of his memoranda: “Where there is no vision, the people perish.”

Let me also pay homage here to my predecessor, Willem F. Duisenberg, who delivered the Jean Monnet Memorial Lecture here at the EBS in 2000. On that occasion, he observed that “While remarkable success has been achieved, one should not forget that many challenges, as well as opportunities, lie ahead.”

It is about this success, these opportunities and these challenges that I would like to talk now.

I intend to draw five provisional lessons from the process of economic, monetary and financial integration in Europe:

- **First**, our monetary policy concept has proved effective and credible;
- **Second**, the single currency has done much to foster economic and financial integration;
- **Third**, I will present some additional reasons to stress particularly financial integration;
- **Fourth**, large continent-wide economies like the euro area or the US always show a multidimensional diversity as regards growth, inflation and unit labour costs; and
- **Fifth**, an appropriate monitoring of the evolution of various competitiveness indicators is necessarily part of the good governance of the euro area.

The **first lesson** reflects the fact that we now benefit from the highly credible monetary integration of the euro area. Our monetary policy strategy is based on a clear price stability objective and on an economic and a monetary analysis – the two pillars of our strategy. What this means is that we undertake a very thorough and ongoing economic analysis of short and medium-term price developments based on a host of price and wage indices, and indicators of economic activity. Over this horizon, price developments are largely due to the interplay of supply and demand in the goods, services and factors markets. We cross-check the results of this analysis with the analysis of monetary developments, of M3, of components and counterparts of M3, which are oriented towards the medium and longer term. This approach has served us well and has, in particular, provided a strong support to the anchoring of long-term inflation expectations. We have also been innovative and transparent from the start. The ECB was the first major central bank to publish a detailed explanation of its diagnosis and of the reasons for its decisions immediately after its meetings. In addition, it was the first major

central bank, and is still the only one, to convene a monthly press conference on the decisions of the Governing Council immediately after they are taken.

Indeed, we devote a lot of time to explaining and discussing our framework and actions. The monthly Press Conference is a case in point. We also engage in a continuing dialogue with communities such as academics, European institutions and other policy-makers[1], ECB-watchers, journalists and the public. The high degree of transparency and credibility that we have achieved has in turn helped us to successfully anchor inflation expectations in the euro area and to make monetary policy more effective.

The ECB inherited the high level of credibility of the most stable legacy currencies, itself the achievement of many years of successful monetary policy. From the outset, the ECB has managed to fully consolidate that inheritance. This was clearly demonstrated when the euro was launched, when market interest rates on instruments denominated in euro became aligned with the lowest – and not with the average – rates prevailing prior to the euro. And this happened all along the yield curve. This was an important improvement of their financial environment for the countries which had experienced high risk premia and higher interest rates in the past. The euro also removed the nominal exchange rate volatility and periodical realignments among euro area countries which used to significantly distort their relative competitiveness.

The euro area was created only eight years ago. We are now gaining a better understanding of the effects that it is having on the euro area economies: in a nutshell, the euro is significantly helping to bring euro area economies closer together. We are now ranking higher in terms of the Optimum Currency Area criteria.

Cast your mind back to the end of 1996, two years before the euro was launched. You might remember what the common wisdom was on this side of the channel at the time … What would one have thought if somebody had said: look, in ten years' time the President of the ECB will come and tell you that on the 1 January 2007, a 13th country will enter the euro area; that the euro area will have a total population of 315 million people; that the euro is a credible currency which has kept inflation in line with its definition of price stability; and that the anchoring of inflation expectations fully reflects this credibility. Also telling you that the promise made to the investors and savers as well as to the people of Europe had been kept, that the new currency is as credible, as confidence-inspiring, as solid as a store of value as were the previous most credible national currencies. What would have been the reaction of the audience ? Well, considering how cautious a number of analyses were at that time, one would most probably have thought that it was a fairy tale.

The **second lesson** is that monetary integration is accompanied, and supported, by an increasing degree of economic and financial integration. We have often heard the question: what's so special about a monetary union among countries that are ready for it? Will it bring something that was not there before?[2]

We know that by moving from several currencies to a single currency many costs are reduced or in some cases may disappear altogether. The euro has therefore contributed to reducing trading costs both directly and indirectly, e.g. by removing exchange rate risks and the cost of currency hedging among the legacy currencies. Information costs have been reduced as well. The euro is also enhancing price transparency and discouraging price discrimination: this is helping to reduce market segmentation, and is also fostering competition. Hence, the euro is acting as a catalyst for the single market programme while providing a positive impetus to the euro area economy.

---

[1] See for example the agenda and documentations of the following recent events that we hosted: 4th ECB Central Banking Conference on "The role of money: money and monetary policy in the twenty-first century", at http://www.ecb.int/events/conferences/html/cbc4.en.html; "Monetary policy, asset markets and learning", at http://www.ecb.int/events/conferences/html/mopo_asset-markets.en.html; "Corporate Finance and Monetary Policy", at http://www.ecb.int/events/conferences/html/cfmp.en.html; and "Monetary policy: a journey from theory to practice – an ECB colloquium held in honour of Otmar Issing", at http://www.ecb.int/events/conferences/html/mopo_issing.en.html.

[2] I am referring to the debate on the endogenous effects of monetary integration that was pioneered by Andrew Rose and Jeffrey Frankel. For a discussion of the diverse possible sources of endogeneity see Rose (2001) and De Grauwe and Mongelli (2005).

Many studies and analyses are now substantiating some of the important effects of the euro. The euro area economies are becoming more interdependent.[3] We have clear evidence of a significant increase in both intra and extra-euro area trade in goods since the launch of the euro.[4] Exports and imports of goods *within* the euro area increased from about 26.5% of GDP in 1998 to around 31% in 2005. This rise in cross-border trade may be partly related to the introduction of the single currency and the increased price and cost transparency. Over the same period, exports and imports of goods with trading partners *outside* the euro area rose from about 24% of GDP to almost 30%. This is mainly due to more sustained growth in world GDP, an increase in global trade integration, and a very sizeable increase in trade with the ten new Member States of the European Union. All in all, these developments are particularly noteworthy given the already high degree of openness of the euro area countries.

Trade in services with partners inside and outside the euro area has also increased as a percentage of GDP in recent years. Intra-euro area exports and imports of services increased from about 5% of GDP in 1998 to around 6.5% in 2005, which represents a substantial increase even vis-à-vis extra-euro area exports and imports of services, which rose from about 7.5% to around 9.5% of GDP in the same period. And this trend could increase still further with the emergence of a single market for services.

Intra-euro area foreign direct investment (FDI) has also grown considerably, and is catching up with extra-euro area FDI. Between 1994 and 2004 (unfortunately, in the field of FDI, statistics collected by institutions like UNCTAD, the IMF or Eurostat are always released with a two-year delay), intra-euro area FDI stocks grew robustly from almost 14% of euro area GDP to around 24%. Extra-euro area outward FDI stocks have grown somewhat less rapidly since the introduction of the euro: i.e., from 22% to 30% of euro area GDP.

The euro is having some remarkable effects as a catalyst for a single market in financial services, particularly in the market segments which are more directly affected by the single monetary policy, such as fixed income markets. Let me give you just a few examples, based on a set of indicators published by the ECB.[5]

Since the introduction of the euro in 1999, the cross-country standard deviation of interest rates in the interbank money market have fallen sharply. Back in January 1998, one year before the start of Monetary Union, this deviation stood at more than 130 basis points for overnight rates, at over 100 basis points for one-month maturities, and at around 50 basis points for 12-month rates. Yet since January 1999, these differences have rarely exceeded 1 basis point.

There is significant evidence that euro area corporations are taking advantage of the possibility to raise funds from the full range of euro area investors. The euro corporate bond market has grown significantly since 1999, and could grow even further, to judge by a comparison with the US. The outstanding volume of bonds issued by non-financial corporations of around €2.3 trillion in the US is still two and a half times larger than in the euro area (while the respective GDPs are comparable).

A rapid integration is also taking place in the euro area equity markets. Stock prices in euro area countries are increasingly affected by euro area-wide factors and news. The advantages of sectoral diversification seem to have surpassed those of geographical diversification. As a consequence of the introduction of the single currency, euro area investors have increasingly diversified their equity portfolio holdings within the euro area. According to a recent research[6], between 1997 and 2004, the share of intra-euro area allocation increased markedly, by almost 15 percentage points, for equity portfolios and by 39 percentage points for bonds. In 2004, respectively, 28% and 51% of euro area total equity and bond portfolios were invested cross-border among euro area countries.

Integration in retail banking, by contrast, has been slow so far, although it has picked up in the last two years. With some notable exceptions, much of the consolidation in the banking sector has been the

---

[3] In June 2005, the ECB held a workshop on "What effects is EMU having on the euro area and its member countries?" The workshop was organised in five areas: 1) trade integration; 2) business cycle synchronisation, economic specialisation and risk sharing; 3) financial integration; 4) structural reforms in product and labour markets; and 5) inflation persistence. All proceedings are now available in the ECB Working Paper Series: see nos 594 to 599.

[4] See Baldwin (2006) and Anderton et al. (2004).

[5] See Baele et al. (2004).

[6] De Santis and Gerard, ECB Working Paper 626

result of domestic mergers; only in the last couple of years have cross-border banking mergers started to take place. In this respect, a number of euro area banks have considerably expanded their interests outside the euro area. However, in general, cross-border activity within the euro area has remained relatively limited, even though it is gaining in importance. This trend is expected to continue, thereby increasing the level of competition and efficiency in the euro area financial system.

But further work is needed in order to achieve the goal of a single market in financial services. To this end, the ECB and the Eurosystem are actively involved in several initiatives that will help foster financial integration, five of which I would like to highlight. First, the launch of TARGET2 – the new payment platform for the financial system – is planned for the end of 2007. Second, we are participating in the Short-Term European Paper (STEP) initiative to promote the convergence of better market standards and practices in the European short-term securities markets. Third, at the end of 2005, we contributed to the European Commission’s Green Paper on Mortgage Credit in the EU. This is an important segment of the banking and retail markets, with an outstanding volume of more than €4 trillion in residential mortgage debt in the EU, corresponding to around 40% of EU GDP. Fourth, the project for a Single European Payment Area under which all banking transactions conducted across the euro area will incur the same charges as a domestic transaction. This will be a powerful engine for the further integration of financial markets. Finally, we have launched recently a new initiative – TARGET2 securities, which will offer the settlement of securities transactions in the euro area. There we are still in the process of consultation with the private sector.

Hence, as I am sure you agree, the economic and financial environment of the euro area is clearly changing for the better. We are certainly not witnessing the creation of a “fortress Europe” – rather, I would prefer to emphasise how European integration complements global integration. At the same time, euro area countries have become more interlinked than they were at the start of Economic and Monetary Union (EMU). Simply put, we all have a larger stake in each other.

My **third lesson** is that monetary and financial integration are playing an important role in the smooth functioning of our vast continental economy with a single currency. There are numerous well-known economic benefits arising from financial integration in the euro area. By making markets deeper and more liquid, financial integration creates economies of scale and increases the supply of funds for investment opportunities. The integration process fosters competition, the expansion of markets and intermediation, thereby complementing and leading to further financial development. Financial development, in turn, leads to lower intermediation costs and a more efficient allocation of capital. Allocating resources to the most productive investment opportunities ultimately increases the potential for greater and more sustainable non-inflationary economic growth. Also economic agents can invest more easily in any part of the euro area and thereby spread the risk of potential local shocks having an impact on income and consumption.[7]

In 1973 Robert Mundell made a second seminal contribution to the debate on currency areas. He explicitly discussed the role of financial integration, in the form of cross-country asset holding, in international risk sharing. Countries sharing a single currency can mitigate the effects of asymmetric shocks in particular by diversifying their income sources and by adjusting their wealth portfolio. At the time, this contribution received very little attention as it was published in a little-known volume containing the proceedings of a topical conference that had taken place years earlier. It was Robert McKinnon, himself a co-founder of the OCA theory, who “rediscovered” this contribution in 2001 and pointed out its relevance in the current policy debate.[8]

A corollary of the argument raised by Mundell and McKinnon is that a similarity of shocks is not a strict prerequisite for sharing a single currency if all members of the currency area are financially integrated and hold claims on each other’s output. This point has important implications on the debate about the composition of a single currency area. A common currency could be shared by countries subject to idiosyncratic shocks as long as they “insure” one another through private financial markets.

On this subject there is a very interesting study which considers the US. According to this study, US capital markets smoothe out 39% of the shocks to gross state product (that is equivalent to our GDP),

[7] See Cappiello et al. (2006) and an analysis based on an international portfolio choice model in De Santis and Gérard (2006).

[8] See McKinnon (2001) and Mundell (1973).

the credit channel smoothes out 23% of such shocks, and the federal government 13%.[9] 25% of the shock is not smoothed out. Hence, in the United States, financial markets and financial institutions would contribute 62% to the absorption of state idiosyncratic shocks. The effect is very substantially higher than the effect of the federal budget.

This is a very important result which puts into perspective the argument against the single currency based upon the absence of a significant federal budget and therefore the absence of a significant role for the fiscal channel to absorb asymmetric shocks at the level of the different states. We see in the case of the US that the fiscal channel is in fact modest. Much more important is the financial channel, and it is an additional reason for the ECB to speed up financial integration.

My **fourth lesson** is that the observations about the divergences within the euro area should also be put in perspective. The existence of a degree of diversity is a natural phenomenon in any vast continental currency area. And understanding what lies behind the diversity is an important aspect of economic management. I will provide you with three main snapshots of this diversity.

My first snapshot is that inflation dispersion declined considerably in the run-up to the euro and, since the setting-up of the euro, it has been on a par with inflation dispersion in the US. Impressive progress has been made, and inflation dispersion among euro area countries has broadly stabilised at a relatively low level since the launch of the single currency. To give you an example: the unweighted standard deviation of annual inflation rates stood at around 6 percentage points in the 1990s, and has broadly stabilised at around 1 percentage point since 1999. This dispersion level is similar to that of the 14 US Metropolitan Statistical Areas (MSAs) which also stood at 1 % on average over the same period, but somewhat higher than for the four US census regions. Although such comparisons are subject to some well-known caveats, I would argue that inflation dispersion in the euro area has not been high by international standards.[10]

A feature of euro area inflation differentials is their persistence over long periods, and in this respect the euro area differs from the US.[11] Inflation in most Member States displays significant inertia, with many countries that have had inflation rates above the euro area average in recent years remaining on average in this position for long periods. This is mirrored in a similar persistence for the low-inflation countries. However, the good news is that we are now seeing signs of limited reversals of this trend, with some euro area countries with relatively high inflation rates having moved down to, or even below, the euro area average. Overall, these corrections are welcome, but the point is that they have been quite slow in coming. Whereas some wage or inflation differentials are fully justified – and prove that Monetary Union promotes adjustments – we still need to improve our understanding of the reasons for this somewhat sluggish adjustment process.

If we look at the cost side, inflation differentials in most countries are more generated by domestic factors than external ones. In particular, we have witnessed a sustained divergence of wage developments across the euro area, and narrower differences in labour productivity growth.

If we look at product groups, there has been a relatively higher degree of price dispersion in the area of services, probably mostly owing to the dispersion in wage developments in the services sector.

Hence, there is a certain degree of structural diversity in inflation and cost developments among euro area economies. It often reflects structural rigidities and/or a lack of competition and calls for resolute action in these domains.

My second snapshot concerns growth dispersion in the euro area. The average dispersion of annual real GDP growth (measured as the unweighted standard deviation) since the creation of the euro has been around 2 percentage points. This figure is, by the way, very close to the average dispersion of real growth rates since the 1980s. By comparison, the dispersion of real growth across the 50 US States has fluctuated at around an average of 2.5 percentage points over the last 15 years, while the average dispersion of the real growth rates was around 1.5 percentage points across the eight US

---

[9] Asdrubali et al. (1996).

[10] ECB (2003), ECB (2005).

[11] Recently the ECB organised an Inflation Persistence Network to examine in details all aspects of this relevant issue for us. All proceedings of the IPN have been issued in our working paper series. For some selected references see Dhyne et al. (2005), Altissimo et al. (2006) and Bils and Klenow (2004).

statistical regions. Again, as in the case of inflation, we observe approximately the same order of dispersion in the euro area and in the US.

There is also a relatively high degree of persistence regarding output growth differentials within the euro area which is to a certain extent also found in the US. However, taking the US as a benchmark is only useful up to a certain point. On the one hand, the US economy is known to be more flexible than the euro area, which means that the effects of asymmetric shocks can be more easily and quickly absorbed. On the other hand, the US exhibits stronger regional specialisation than the euro area, making its regions more subject to specific asymmetric shocks.

Two main drivers of dispersion in real GDP growth rates across the euro area countries can be distinguished: dispersion of cycles, and dispersion of trends.

The first of these drivers, the dispersion of cycles, has steadily declined since the early 1990s from about 2 percentage points to 1 percentage point. In this regard, the degree of synchronisation of business cycles across euro area countries seems to have increased and currently appears to be at a historical high.

The second driver of dispersion, trend growth, shows more lasting differences since the early 1990s. Trend growth dispersion rose from about 1.2 percentage points at the start of the decade to about 1.7 percentage points in the late 1990s before starting to decline. The picture also differs across euro area countries, some of which persistently exhibit trend output growth either above or below the euro area average.[12]

These differences among euro area countries can be explained by various factors, including structural differences in demographic trends, long-term catching-up in terms of living standards, differences in the implementation of structural reforms and therefore in the degree of economic flexibility inducing differences in long-term growth potential, and differences in terms of relative cost competitiveness.

Precisely my third and final snapshot of diversity concerns the rapidity with which relative changes in cost and price competitiveness are occurring. These movements mainly reflect changes in relative unit labour costs and inflation differentials. They demonstrate that there is more flexibility in terms of changes of relative cost competitiveness between euro area countries than was suspected ex ante for an area which totally excludes any nominal exchange rate adjustment. According to present figures, the difference in the cumulated growth of unit labour costs for the total economy between the “highest increase” and “lowest increase” countries was about 20% to 25% for the period 1999-2005.

This is an important phenomenon and its underlying factors require close examination. In general, unit labour costs are increasing at a relatively faster pace in those euro area economies which started at a significantly lower level of GDP per capita. In most if not all cases, this phenomenon is driven by the Balassa-Samuelson effect, which occurs when there is a catching-up to higher living standards, and is thus justified, as it reflects movement towards a new equilibrium.

Another situation is highlighted by countries that might have adopted the euro with their respective exchange rates within the euro area well above their historical effective real parities and therefore with a low level of competitiveness : they needed to correct this situation. This was probably the case for Germany, which has posted very moderate growth in unit labour costs over an extended period since the inception of the euro, leading to a correction of its previous low level of competitiveness. This correction and the related sustained period of relatively low inflation is justified and perfectly welcome. It also shows that adjustment mechanisms in the single currency area do work. To a certain extent, the opposite has been observed for a certain period of time in some mature economies that entered the euro with a relatively high level of competitiveness, for example, the Netherlands.

There is yet another case that does not present the economic justifications that were present in the previous cases. In some economies, the combination of relatively weak labour productivity growth and significant increases in nominal wages and salaries for a sustained period might drive unit labour costs up to levels persistently higher than the average for the euro area. This risks hampering growth and job creation at the time of the market adjustment to come in particular through the competitiveness channel.

---

[12] See Giannone and Reichlin (2006), Benalal et al. (2006) and ECB (2004).

Summing up, I would say that the level of dispersion of inflation and growth in the euro area is in line with the main features of a vast continental economy. But we need to investigate further some of the factors underlying the level of persistence that we observe in the dispersion of growth, of inflation and of unit labour costs in some cases where such persistence cannot be convincingly justified. In these cases, a particular speeding-up of structural reforms to reinforce the flexibility of the economy would help to consolidate the long-term cohesion of the euro area in three ways: by increasing the long-term growth potential of the economies concerned, by reinforcing the synchronisation of the cycle throughout the area and by accelerating the necessary market adjustments. The role of structural reforms is decisive in this domain.

My **fifth, and last, observation** is that the interplay of country specific situations as regards, in particular, the level of GDP per capita, of country specific features such as, in particular, the degree of implementation of structural reforms, and of country specific shocks triggering transitory episodes calls – in any vast continental economy with a single currency – for appropriate policy actions in order to make as efficient as possible market adjustment processes which rely very much on the competitiveness channel.

The policy recommendations would encompass, amongst other factors, the following four elements – first a rigorous implementation of the Stability and Growth Pact, second the full completion of the single market including in the domain of services and financial services, third the implementation of the structural reforms in all markets, and fourth the need to monitor carefully at country levels the evolution of unit labour costs and more generally competitiveness indicators.

a. Concerning the first element, I would like to stress how important sound fiscal policies are. They contribute to enhancing the degree of flexibility and cushioning the effects of the economic cycle – or of adverse shocks – through the working of automatic stabilisers ; this is the philosophy of the Stability and Growth Pact : by calling Member States to have a fiscal situation close to balance or in surplus over the medium term, it allows automatic stabilisers to fully play their role in period of downturn without exceeding the deficit limit of 3 % of GDP. Additionally, sound fiscal policies create room for domestic economic management to pursue, say, the desired tax and spending policies. Inside the euro area we have a very clear example of such a virtuous process: Ireland.[13] I would stress in particular the decisive importance for the best functioning of the adjustment dynamics in the euro area of consolidating resolutely fiscal positions in good times. This would not only permit to respect the Pact in bad times, not only create the room for letting automatic stabilisers function in the bust episode of the cycle, but it would also dampen the couterproductive effect of the boom episode of the cycle in helping moderate inflation and unit labour cost overshooting in particular.

b. I would mention the full completion of the single market as a major element for the best functioning of the adjustment dynamics. We still have significant progress to make in this domain even if the single market was the goal of the founding fathers of the Treaty of Rome and even if this fifty years endeavour has been very strongly reaffirmed twenty years ago with the Single Act. Still we have a lot of work to do in many domains. According to the OECD, product market regulations are still high in a number of euro area countries and the euro area as a whole is rated at a significantly higher level than the United States. Let me also mention the service sector which represents 70 % of the GDP of the euro area and is far from being fully integrated in an effective single market. We attach enormous importance to the full integration of financial market as I have already said in particular because they play a decisive role in shock absorption and adjustment dynamics in a vast single currency area. Let me give you a last example of a domain where it is essential to proceed. Slovenia will enter in a month time in the euro area, raising the number of fellow citizens having the same currency at the level of 315 million. But a number of countries inside the euro area have till now maintained obstacles to the free circulation of workers vis-à-vis Slovenia. These obstacles are contrary to the essence of a single market with a single currency.

c. A third element which is decisive to increase the effectiveness of adjustment dynamics is the resolute implementation of structural reforms according to the LISBON strategy reaffirmed by the Council. Structural reforms would permit to elevate the growth potential of the euro area

[13] See also Trichet (2006a).

and of each particular economy and help contain relative unit labour costs through increased labour productivity. They would facilitate price adjustments all over the euro area where we observe a level of price stickiness significantly superior to what characterizes the US economy. They would permit to improve further very significantly the functioning of the labour markets, increasing flexibility and facilitating the attainment of full employment at a high level of participation rate. All these effects would both facilitate adjustments between economies inside the euro area and contribute to an efficient functioning of the euro area as a whole in the context of increased global trade and global financial integration.[14]

The relatively modest implementation of the agenda thus far has clearly shown how difficult it is to achieve reforms in practice. Governments realise this and recently, the Lisbon agenda has been refocused towards reforms targeted at raising growth and employment.

d. The fourth element that would support sound economic management is the need to monitor closely unit labour costs and national competitiveness indicators. We know that in the interplay of the market adjustment dynamics the competitiveness channel is of the essence. We also know that the longer and more accute the period of "boom" would be, or, more simply, the longer the period during which relative competitiveness inside the euro area would deteriorate under the pressure of costs, unit labour costs and prices, the longer will be the period of the market-led adjustment. This calls for executive branches and social partners to be fully aware of the overall consequences of the dynamics of present and past competitiveness indicators. In this respect the nature of the economic issue is quite close to the fiscal policy issue. As previously observed there is a very strong economic underpinning for fiscal consolidation in good tiemes, in particular in order to smoothe the boom episode of the cycle and diminish the degree of relative loss of cost and price competitiveness of the productive sector. It is the same as regards the wage formation. To the extent that it depends on the lucidity of the social partners as well as on the "role model" played in a number of countries by governments and local authorities in handling wages in the civil service, reducing the degree of loss of relative unit labour cost competitiveness in good times would smoothe the necessary biting of the market adjustment competitiveness channel in more difficult periods of times.

I thank you for your attention.

References

Altissimo, F., M. Ehrmann and F. Smets (2006), "Inflation Persistence in the Euro Area: A Summary of the Inflation Persistence Network Evidence", National Bank of Belgium Working Paper No 95.

Anderton, R., F. di Mauro and F. Moneta (2004), "Understanding the impact of the external dimension of the euro area: trade, capital flows and other macroeconomic linkages," ECB Occasional Paper No 12.

Asdrubali, F., B. Sorensen and O. Yosha (1996), "Channels of Interstate Risk Sharing: United States 1963-1990", Quarterly Journal of Economics, CXI, November: 1081-1110.

Baele, L., A. Ferrando, P. Hördahl, E. Krylova and C. Monnet (2004), "Measuring financial integration in the euro area", ECB Occasional Paper No 14, April.

Baldwin, R. (2006), "The euro's trade effects," ECB Working Paper Series No 594.

Benalal, N., J. L. Diaz del Hoyo, B. Pierluigi and N. Vidalis (2006), "Output growth differentials across the euro area countries: some stylised facts", ECB Occasional Paper Series No 45.

Bils, M. and P. Klenow (2004), "Some Evidence on the Importance of Sticky Prices", Journal of Political Economy 112, pp. 947-985.

Blanchard, O. and F. Giavazzi (2003), "Macroeconomic effects of regulation and deregulation in goods and labor markets," Quarterly Journal of Economics, August, 118(3), pp. 879-907.

[14] See also recent speeches on the ECB website : Trichet (2006b) and Trichet (2006c).

Cappiello, L., P. Hördahl, A. Kadareja, and S. Manganelli (2006), "The impact of the euro on financial markets," ECB Working Paper No 598.

De Grauwe, P. and F. P. Mongelli (2005), "Endogeneities of Optimum Currency Areas: What Brings Countries Sharing a Single Currency Closer Together?", ECB Working Paper No 468.

De Santis, R. and B. Gérard (2006), "Financial integration, international portfolio choice and the European Monetary Union", ECB Working Paper No 626.

Dhyne, E. et al. (2005), "Price setting in the euro area: some stylized facts from individual consumer price data", ECB Working Paper No 524.

Duisenberg, W. "Jean Monnet Memorial Lecture" (2000)

Duval, R. and J. Elmeskov (2006), "The effects of EMU on structural reforms in labour and product markets," ECB Working Paper No 596.

ECB (2003), "Inflation differentials in the euro area: potential causes and policy implications," ECB report released on 16 September 2003.

ECB (2004), "Sectoral specialisation in the EU: a macroeconomic perspective", ECB Occasional Paper No 19.

ECB (2005), "Monetary policy and inflation differentials in a heterogeneous currency area", article in the ECB Monthly Bulletin of May 2005.

EU Commission (2006), "The EU Economy 2006 Review. Adjustment Dynamics in the Euro Area: Experiences and Challenges", 22 November 2006.

Giannone, D. and L. Reichlin (2006), "Trends and cycles in the euro area: how much heterogeneity and should we worry about it?", ECB Working Paper No 595.

McKinnon, R. (2001), "Optimum Currency Areas Revisited," Stanford University, mimeo.

Mundell, R. (1973), "Uncommon Arguments for Common Currencies", in H.G. Johnson and A.K. Swoboda, The Economics of Common Currencies, Allen and Unwin, pp. 114-132.

Rose, A. (2001), "Currency Unions and Trade: The Effect Is Large", Economic Policy, 33, pp. 449-461.

Trichet, J.-C. (2006a), "Further integrating euro area economies: some reflections", speech at the "57. Jahresversammlung des Ifo Instituts für Wirtschaftsforschung an der Universität München" in Munich on 29 June 2006. http://www.ecb.int/press/key/date/2006/html/sp060629.en.html

Trichet, J.-C. (2006b), "How to elevate the potential growth rate of Europe", Ludwig Erhard Lecture delivered in Berlin on 16 October 2006. http://www.ecb.int/press/key/date/2006/html/sp061016.en.html

Trichet, J.-C. (2006c), "EMU after seven years: Successes and challenges", speech delivered at the Frankfurt Chamber of Industry and Commerce on 5 May 2006. http://www.ecb.int/press/key/date/2006/html/sp060505.en.html