

Christian Noyer: Is the euro a success story?

Speech by Mr Christian Noyer, Governor of the Bank of France, at the Paris EUROPLACE International Forum, Tokyo, 29 November 2006.

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It is a great pleasure for me to be here today and to have the opportunity to address such a distinguished audience. I want to talk to you about a success story: the euro. As you well know, there have been difficult times for European integration. The Treaty creating a Constitution for Europe was not ratified last year and the future of political integration is fraught with uncertainties. Also, much remains to be done, in terms of structural reform, if the European countries want to achieve the same level of long term growth as other developed economies.

Nevertheless, I feel very optimistic. And the reason for this optimism is the euro. The single currency has the potential to bring enormous benefits to European nations, which they can use to achieve a high degree of stability and prosperity.

1) What are those benefits?

The first, and most obvious, is price stability. Over the last five years, inflation has stayed broadly in line with the price stability objective set by the European Central Bank, i.e. inflation below but close to 2% over the medium-term. Gone are the days when European citizens had to worry about the purchasing power of their savings. This stability goes beyond the behaviour of prices. Inflation expectations themselves have been remarkably stable, including during the recent period when oil prices jumped to levels no one could have expected only a year ago. This, by itself, illustrates the credibility achieved by the Eurosystem, after only six years of existence.

Second, European households and companies are reaping the benefits of that credibility. Long term interest rates stand at an historically low level, around 100 basis points below the level in the United States. So, even after the recent increases in short term rates, monetary and financial conditions remain extremely favourable for investment and growth. And indeed, we might be witnessing in Europe the start of period of sustained and stable growth, at least if current projections and surveys prove to be right in the coming months.

A third benefit of the Euro is the boost it gives to financial integration in Europe. In many segments, European financial markets have reached the depth and liquidity which, up to now, were the preserve of dollar markets. This stimulates productive investment, helps in restructuring (as witnessed by the current wave of M&As) and, more generally, allows a better allocation of savings and sharing of risks.

As a consequence, the euro is becoming extremely attractive, as a vehicle, a transaction, an investment and a reserve currency. As you may know, as central bankers, we remain neutral as far as the internationalisation of the euro is concerned. We are neither encouraging, nor discouraging the process. But, as a citizen, I cannot help and feel proud of having one the two main currencies in the world.

In sum, benefits of the euro include a high degree of credibility of monetary policy reflected in the level of long-term interest rates; diminished exchange rate volatility; completion of the single market and encouragement to cross-border trade.

None of this, of course, can be taken for granted. Benign conditions currently prevailing on financial markets can be reversed. External or internal shocks may be coming, which would impact negatively European economies. The American economy could for example slow down more sharply than anticipated. Fuelled by an excessive expansion of credit, some internal imbalances, although in no way comparable to those in some other developed economies, could also develop in the euro area, especially in the housing sector. But I have the strong conviction that we are fully equipped to deal with any contingency, and, provided the necessary structural reforms are undertaken, keep the economy on a path of growth and stability.

2) How have those successes been achieved?

A lot comes, in my view, from the institutional and operational framework in which monetary policy is developed and implemented.

The independence of the ECB and of the 12, very soon 13, participating NCBs is enshrined in the Treaty. They are institutionally, operationally and financially independent from European Community institutions and national governments.

We have a clear and transparent definition of price stability: inflation below but close to 2% over the medium-term.

The monetary policy framework of the Eurosystem is "medium-term" oriented. It rests on a two-pillar approach: on the one hand the economic analysis examines cyclical, economic and financial indicators related to the main determinants of short-term inflation; on the other hand the "monetary analysis" looks at the behaviour of money and credit aggregates and provides a perspective on longer-term inflation. Crosschecking the outcome of the economic analysis – broadening growth in the euro area – with the monetary analysis – ample liquidity and strong monetary growth – supports the assessment of risks over the medium to long-term horizon, which have led to the Governing Council's decisions since December 2005.

Implementation is decentralized. Monetary policy decisions taken by the Governing Council of the ECB are implemented by the NCBs.

This framework has proven its robustness and efficiency. But there are limits to what monetary policy can deliver. Its main contribution to growth is to achieve price stability. Ultimately, however, whether this will translate into higher growth in the longer run depends on reforms aimed at increasing the economy's potential. Here European countries are making progress, although at too slow a pace.

3) How can EU Member States increase their growth potential?

In 2000, the Lisbon European Council designed a new strategy in order to promote competitiveness of the EU and defined ambitious goals in that respect. The Lisbon agenda has introduced a multilateral surveillance of structural policies. In 2005, EU Heads of Government re-launched the Lisbon strategy with an enhanced focus on jobs and growth and a streamlined governance regime. The key elements are the National Reform Programs which cover, for each country, the commitments taken over a 3-years cycle as regards structural reforms.

EMU, with a single monetary policy and 12 governments responsible for budgetary policies, requires an institutional fiscal framework. It has to be simple, easy to implement, and able to ensure that fiscal policies are sound and sustainable, to avoid free-riding behaviours as well as neo-ricardian effects.

The most widely-discussed surveillance process, because it is the most binding one, is the Stability and Growth Pact (SGP). The Pact may be defined as the "users instructions" for the obligation, defined in the Treaty, for EU Member States, to achieve a medium-term budgetary position of close to balance or in surplus, while maintaining the ratio of the annual government deficit to gross domestic product (GDP) at within 3 % and the ratio of gross government debt to GDP at within 60 %. Member States which do not respect these ratios face an "excessive deficit" procedure which may lead the Ecofin Council to take a series of measures which range from simple recommendations to financial sanctions.

In 2005, the European Council agreed to reform the SGP. The important role of the SGP in terms of budgetary discipline is confirmed. The reform sets out the criteria for the implementation of the excessive deficit procedure and allows for more leeway in the time-frame for correcting excessive deficits. It does not, however, diminish the binding nature or the efficiency of the Pact.

Let me conclude by mentioning how much we have achieved in Europe over the last fifty years. The EU has reached a diversified but, broadly speaking, very ambitious level of integration: it is complex because the degree of integration is largely dependent on which areas are at stake, it is ambitious since, in some areas precisely, the system is completely integrated and relies on one single policy. The euro, in that regard, is both the symbol of our achievements and our best hope for the future of European integration.

Thank You.