Christian Noyer: A founder's perspective on the euro as a global currency

Speech by Mr Christian Noyer, Governor of the Bank of France, at the joint conference "The euro at ten: the next global currency?", sponsored by the Peterson Institute for International Economics and Bruegel, Peterson Institute for International Economics, Washington DC, 10 October 2008.

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Good afternoon. It is a great pleasure to be here today with so many friends and colleagues to celebrate ten years of the Euro as a global currency. I must confess this is not exactly my idea of a quiet and peaceful anniversary. When I was privileged to be designated as ECB's first Vice President, I would never have imagined that I would be sitting now, as a member of the Governing Council, dealing with the worst financial crisis in the last eighty years. Actually, one of the main gratification of the job during the crisis has been the quality of our collective interaction and deliberation in the Governing Council, based on our willingness, in very challenging circumstances, to share judgments and exchange views in a spirit of friendship and mutual respect. I am very proud to be part of such a group. Together, we have been able to make quick decisions and adjust flexibly to fast changing environment, without ever giving up on our mandate and our mission.

Obviously, the Euro area, like the rest of the industrialised world, is going through a very rough patch. We can only imagine what would be the situation if we still had fifteen different currencies, with so many bilateral exchange rates potentially as volatile as other asset prices currently are. That single thought experiment is enough to show how much Europe benefits from having a single, truly global, currency.

Two days ago, we took two very important decisions. First, in an unprecedented move concerted with all major central banks, we decreased our policy rate by 50 basis points. Then, in a separate deliberation, we further adjusted our liquidity provision framework. I will spare you the technicalities. Suffice it to say that, as a result, banks will have regular access, against collateral, to unlimited amount of liquidity at the policy rate i.e. 3.75%; this, at least until the end of January 2009.

Let me briefly comment on those two decisions.

First, on liquidity provision. Since the crisis broke out, central banks have tried and restore an orderly functioning of money markets. Even when modalities are different, there has been a convergence in objectives and frameworks. Central Banks have stepped up their supply of funds at longer maturities. Some have broadened the range of collateral accepted in their secured lending operations. They expanded the scope of eligible counterparties so as to ensure a wider dissemination of funds. Importantly, major central banks conducted co-ordinated actions to provide longer-term funds to address dollar funding needs of non-US banks, thereby ensuring an adequate distribution of liquidity across borders.

Yet, after more than a year of crisis, credit markets remain very fragile, normal interbank relationships have not been reestablished, and those frictions could destabilize the financing of the corporate sector, thus further threatening economic growth. With our last decision, we have given financial intermediaries full assurance that their liquidity needs will be met, in an environment of total clarity and absolute predictability. We hope that this will contribute to reduce uncertainty and restore confidence between counterparties, which is a prerequisite to a functional money market. This may depend on more than simple liquidity provision. But central bank's ability – and willingness – to use their capacity are a major source of stability in the financial system, and should be seen as such, both by market participants and the general public.

Second, on monetary policy. We have participated in a concerted action by major Central Banks This is a major, and unprecedented, move to restore confidence, but one, I want to emphasize, fully and absolutely consistent with our mandate. It is obvious to all observers that the overall environment has dramatically changed in the last three weeks. Declining oil and commodity prices, together with stagnant activity have significantly altered the inflation outlook. Based on current conditions, we can expect "instant" inflation rate to come under our definition of price stability somewhere in the middle of 2009. In addition, long term inflation expectations, as measured by the "5 years in 5 years" break even (or swap) inflation rate, has dropped significantly under 2%, perhaps reflecting the credibility created by our past actions. To be sure, we must remain vigilant as regards wage developments and the still possible second round effects from past price surges. But, overall, I would asses that our new monetary stance is in line with what is necessary, in current conditions, to fulfill our mandate.

Let me now elaborate on two other set of policies, which, although not directly linked to the currency, contribute to underpin the strength and stability of the euro area.

The crisis has given a new impetus to discussions on the proper architecture of financial supervision. In Europe, with market integration moving at a quick pace, supervisory structures will have to adapt. I am a strong supporter of the Lamfalussy process and believe that current efforts to improve and develop it deserve all our attention. But I would also argue that the process must be conducted with pragmatism and a constant look at reality rather than by reference are some theoretical scheme and vision, and I would like to take this opportunity to mention two lessons that I draw personally from events of the last 12 months.

First, there are clear advantages in having banking supervision close to (or at least not too far away from) the Central Bank. I think this is now a conclusion shared by all Central Bankers in the world, whatever the regulatory environment they live in. An intimate knowledge of the banking sector and of different financial institutions is extremely helpful in managing periods of tensions and stress on money and credit markets. Central Banks have had to make almost instant judgment on the provision of liquidity in different forms and different maturities. There are circumstances where being able to assess the creditworthiness of market participants and the effective amplitude of their needs is of extreme help. More generally (and somehow academically), in times of crisis, the distinction between liquidity and solvency problems becomes both more important and much more difficult to make. Having, so to speak, all the cards in your hands, minimizes the risk of making mistakes.

Second, as concerns the supervision infrastructure, it seems to me that clear, simple, robust and pragmatic arrangements have performed better than more sophisticated and elaborate schemes. As you know, I had myself to face a situation of acute crisis and make decisisions in real time, concerning a major, and internationally active, financial institution. At no time did I have the feeling that our current arrangements were deficient and prevented me for getting the necessary information and making the necessary decisions. As you also know, seen from a public interest perspective, we could solve the situation without any significant disturbance to capital market. Nobody knows about the future. But I tend to come out from this episode with some confidence in the appropriateness of our current arrangements.

In addition to Central Banks, Governments in all countries have judged appropriate to act and try to restore financial stability through a broader set of policy actions. Initiatives have been taken first, to recapitalize banks through infusion of public money and, second, to foster confidence in deposit guarantees. In an European framework, such actions involve mainly national decisions which had to be made, in many cases, with some urgency. Hence the impression that, at least initially, the coordination may not have been perfect. But things are falling progressively into place and I am confident that any remaining issues will be quickly dealt with, according to the roadmap and joint principles recently adopted by ECOFIN Ministers.

So I would encourage all market participants to take a step back and, as Jean-Claude Trichet said “collect themselves” to look at the whole package of measures which have been publicized. True, they have been announced through a succession of public statements. But, taken together, they represent decisive steps and a coherent package towards restoring confidence. I am convinced that their impact on the real economy and future growth is going to be extremely significant.

Overall, it is fair to say that the euro has passed the test and comes strengthened out of the current difficulties. The Eurosytem will keep fulfilling its priority mandate of price stability while also contributing to the broader objective of financial stability. Governments are increasing their cooperation. So the eurozone has shown it is well equipped to live up to its responsibilities as a truly global player in the international monetary system of the 21st century.

I thank you for this opportunity to present my views.