M. Trichet presents the monetary policy guidelines of the Bank of France for 1997 BANK OF FRANCE, PRESS RELEASE, 17/12/96.

1. The ultimate goal of monetary policy is to ensure price stability, as required by legislation. The objective of the Monetary Policy Council is that the increase in prices, as measured by the consumer price index, should not exceed 2% in 1997, as in the medium term.

2. To meet this ultimate goal, the Banque de France uses two intermediate objectives, one of which is external and the other internal:

- The objective of a stable external value of the currency: as it has been for ten years, the stability of the franc will be maintained against the group of the most credible currencies in the European Exchange Rate Mechanism.

- An intermediate internal growth target for the money supply as assessed by the development of the narrow and broad monetary aggregates: in 1997, the money supply should be able to show a medium-term growth trend of 5%. This figure is consistent with price inflation of no more than 2% and non-inflationary real GDP growth of about 2.5%, which could be exceeded, in view of the potential for growth to catch up in the medium term. The Monetary Policy Council has decided to simultaneously monitor the main narrow and broad money aggregates in order to obtain a concise estimate of all monetary developments.

3. Total domestic debt is an important indicator. It helps the Banque de France make sure that the economy is supplied with enough financing to grow, and it enables us to track developments in financing for businesses, households and general government simultaneously.

The Monetary Policy Council will keep a close eye on other indicators, including all leading indicators of changes in prices, such as capacity utilization rates, production costs, developments in incomes and commodity prices. The Monetary Policy Council will also monitor long-term interest rates and the current account balance.

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Before announcing the Council's monetary policy decisions for 1997, I would like to discuss the results achieved in 1996.

1. The 1996 results are in line with the targets we set.

The ultimate monetary policy goal, which is price stability, was met. Businesses delayed passing on part of the August 1995 two-point increase in the standard rate of VAT until the beginning of 1996. The twelve-month rise in consumer prices was equal to and then above 2% during the first seven months of 1996, but subsequently fell back to 1.ó% in August and September, once the VAT effect had disappeared. The twelve-month increase stood at 1.5% to 1.ó% in November and the latest forecasts predict a price rise of close to 1.5% for the end of 1996. The twelve-month price increase thus resumed its pre-August 1995 trend and will be less than 2% at the end of 1996, in line with the objective set by the Monetary Policy Council.

The objective of a stable external value of the French franc vis-à-vis the most credible currencies in the European Exchange Rate Mechanism was met.

Since the beginning of 1996, the franc has continued to move gradually closer to its central rates against the other currencies in the European Exchange Rate Mechanism. This firmness of the franc has gone hand in hand with the continuing overall competitiveness of the French economy. The real effective exchange rate of the French franc has improved and exports, as in previous years, helped to boost activity. The seasonally-adjusted current account surplus for the first nine months of 1996 stood at almost FRF 84 billion. This was much greater than the FRF 64 billion surplus posted for the same period of 1995. On the basis of current forecasts, France will record the third largest current account surplus in the world for 1996.

Growth in the M3 reference aggregate, which is the reference for our internal intermediate objective, showed a reversal in its trend. The expansion of M3 at the end of the third quarter of 1995 was close to its medium-term growth target path of 5%, but subsequently slowed sharply. The twelve-month increase of 4% in December 1995 gave way to a contraction of 0.4% in October 1996, the last month for which figures are available. This reversal in the growth of M3 was to a very great extent the result of a large-scale reallocation of investment flows stemming from the fall in short-term interest rates since autumn 1995, which has been of unprecedented magnitude and rapidity.

The M3-M2 aggregate, which includes assets paying money market rates of interest, posted a twelve-month fall of 10.1 % at the end of October 1996. In response to the fall in short-term interest rates and also a heavier tax burden on money market mutual funds, economic agents reallocated their portfolios towards assets covered by the investment aggregates, and particularly the Pl aggregate covering contractual savings products, including housing saving plans. Year-on-year growth in P1 accelerated from 12.3% in December l995 to 18.5% in October 1996.

The rate of interest paid on housing savings plans has remained unchanged at 5.25% since February 1994, whereas comparable market rates have fallen sharply. This gave a strong boost to the reallocation of investment flows. Year-on-year growth in housing savings plans accelerated significantly, rising from 14.1% at the end of 1995 to almost 26% in October 1996.

In addition, twelve-month growth in the P2 aggregate covering investment in bonds and life insurance products remained buoyant. It stood at 12.3% in June 1996, with new investment accounting for 9%.

At the same time, formation of liquidity was dynamic. The narrow money aggregates M1 and M2, which cover transaction balances and liquid savings, showed annual growth trends in October 1996 of around 5.8% and 7.5%, respectively. In particular, the growth of M2-M1, covering passbook savings deposits, accelerated from 7.6% in December 1995 to 9.6% in October 1996.

In such a context, it is important to monitor closely the investments which, within the P investment aggregates, constitute fairly close substitutes for monetary assets in the strictest sense. M3 + P1 posted significant annual growth of around 4%.

On the financing side, total domestic debt showed a yearly growth trend of around 3.3%. Total domestic debt incorporates the debt financing obtained by resident non-financial agents in the corporate, personal and public sectors, be it in the form of borrowing from credit institutions or debt issues on domestic or international markets, and is thus a valuable yardstick for analyzing the financing provided to the economy. Even though government debt continues to be the most dynamic component of total domestic debt, its twelve-month growth slowed sharply from 13.4% in December 1995 to ó.9% in September 1996. Outstanding lending by credit institutions to the private sector is practically stable, particularly owing to the corporate sector's sizeable cash surplus. According to the National Institute for Statistics and Economic Studies (INSEE), the self-financing rate of companies and near-companies stood at around 114% in the second quarter of 1996.

I shall now make a few comments concerning interest rates, which fell across the board in 1996.

This decline in interest rates, which began in October 1995, corresponds to a considerable increase in confidence in the French franc and in the creditworthiness of France in connection with the policies set forth by the President of the Republic and the Government for the reduction of government deficits, the stability of the franc and Monetary Union in 1999. In 1996, the Banque de France's repurchase tender rate was cut from 4.45% to 3.2% today. It is one of the lowest rates in the G7 countries in both nominal and real terms. The five-to-ten-day repo rate fell from 5.85% to 4.75%.

Short-term market rates eased substantially, with three-month rates shedding almost 400 basis points since October 1995 and currently standing at around 3.4%.

The easing in short-term rates went hand in hand with a significant decline in long-term rates, which are the reference for a large share of lending to the private sector. Ten-year rates have fallen by more than 100 basis points since October 1995.

Thanks to the credibility of every component of its economic policy, France today enjoys the lowest medium- and long-term market rates in the European Union, and the third lowest rates in the world, bettered only by Japan and Switzerland.

This brings me to the monetary policy decisions for 1997.

1. **The ultimate goal of monetary policy is to ensure price stability, as required by legislation. The objective of the Monetary Policy Council is that the increase in prices, as measured by the consumer price index, should not exceed** 2% in 1997. as in the medium term.

2. **To meet this ultimate goal, the Banque de France uses two intermediate objectives**, one of which is external and the other internal:

- The objective of a stable external value of the currency: as it has been for ten years, the stability of the franc will be maintained against the group of the most credible currencies in the European Exchange Rate Mechanism.

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3. Total domestic debt is an important indicator. It helps the Banque de France make sure that the economy is supplied with enough financing to grow, and it enables us to track developments in financing for businesses, households and general government simultaneously.

The Monetary Policy Council will keep a close eye on other indicators, including all leading indicators of changes in prices, such as capacity utilization rates, production costs, developments in incomes and commodity prices. The Monetary Policy Council will also monitor **long-term interest rates** and the **current account balance**.

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These decisions call for two remarks.

First, on a technical level, the Monetary Policy Council has decided to monitor several narrow and broad money aggregates simultaneously in order to obtain a concise estimate of all monetary developments. As we have seen, certain data, and particularly, but not exclusively, M3 data, have been severely disrupted recently by several factors, such as the very substantial fall in short-term rates and the ensuing large-scale reallocation of investment flows towards non-monetary assets, higher taxes on money market mutual funds, and the continuing very high level of interest paid on housing saving plans.

We will therefore keep a very close eye on the M1, M2, M3, and M3+P1 aggregates as expressions of the underlying growth of the money supply. Particular attention will be paid to the growth of the M3+P1 aggregate covering monetary assets and contractual savings.

A very large proportion of the outflows from M3 in the past year was directed towards investments covered by P1, and particularly housing savings plans with a residual maturity of one year or less. In fact, this type of investment at present constitutes a very close substitute for monetary assets.

Second, the Monetary Policy Council has set monetary policy against the background of potential growth for the French economy of around 2.5% per year. We consider the average growth of our economy in the medium-term, and it could be exceeded given that we have a potential to catch up in the medium term. We reckoned with a maximum price increase of 2% and potential real growth of between 2.5% and 3% in the medium term to arrive at a figure of 5% for the medium-term growth trend of the money supply.

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It is very important to bear in mind the essence of the policy implemented by the Monetary Policy Council.

Parliament confers on the Banque de France an objective, namely the objective of price stability. Maintaining the value of the currency preserves the purchasing power of the currency, and therefore that of French citizens.

In addition, Parliament has sought to create the conditions for growth and for job creation, via the stability of the currency. This is also the goal of the Monetary Policy Council. To achieve this goal, we use two means.

First, by preserving the value of the currency, we enhance its credibility in France, in Europe and in the world and allow our economy to benefit from financing at favourable market interest rates. It is very important for future French growth, for investment and for job creation that we have the lowest medium- and long-term market rates in the European Union today and the third lowest interest rates in the world.

Second, price stability curbs cost increases in our productive sector. In doing so, the competitiveness of our economy—other things being equal—is preserved and enhanced. This is good for future French growth and for job creation. It is important to note that we currently have a dynamic export sector and, according to the latest forecasts for 1996, the third highest current account surplus in the world.

One other indicator of competitiveness is encouraging, namely the flow of foreign direct investment into France. It stood at FRF 120 billion in 1995. The latest figures for the first nine months of 1996 show inward foreign direct investment totalling FRF 74 billion. In all, since the beginning of 1995, a total of FRF 194 billion, the equivalent of USD 39 billion, has been invested directly in France, making us the third-ranking industrialized economy in terms of inward foreign direct investment, behind the United States and the United Kingdom.

Thus, when the Monetary Policy Council makes interest-rate decisions, it bears in mind first the objective of preserving the purchasing power of the currency, for and on behalf of all French people, and second, its corollary, namely the creation of monetary, financial and competitive conditions that will allow our economy to achieve its full potential for sound and sustained growth, for job creation and therefore for combating unemployment.

Central Banks cannot “command” growth. Growth is the fruit of the labour of men and women, of the efficiency of employees, workers and engineers, of the imagination and skill of business leaders, and also, more broadly, of the influence of European and international business conditions. It is stimulated, in the medium and long term, by structural reforms that liberate initiative, strengthen the dynamism of the economy, combat unemployment effectively and encourage the creation of the greatest possible number of jobs for a given level of wealth and growth.

However, it is up to Central Banks to create the best possible monetary and financial conditions, through the credibility and stability of the currency.

These conditions now exist in our country and the Monetary Policy Council is convinced that the time has come for firms and households to invest. In many sectors and firms, the financing exists. The self-financing rate of the entire French productive sector is above 100% overall. Interest rates as a whole are at historic lows. The French economy has substantial potential for growth in the medium term. In the last three years, potential growth has averaged a little more than 2% a year for the years 1994, 1995 and 1996. We can do better. We believe that our economy's potential non-inflationary growth is around 2.5% in the medium term, and this can be exceeded given the capacity for growth to catch up. The requirements for investment are financing terms, self-financing, competitiveness, and medium-term growth. We believe these requirements exist today.

If I had to sum up briefly the message of the Monetary Policy Council, I would say: “The investment plans exist. The time has come today to implement them. Let us invest. It is the surest way for us to contribute to non-inflationary growth that creates jobs and thus to help in the fight against unemployment.”

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French monetary policy is in line with the European strategy of the President of the Republic and the Government, and therefore with the creation of an economic and monetary union on 1 January 1996.

The advance towards the single currency was decisively confirmed at the European Summit in Dublin, where an agreement was reached on the legal status of the euro, on the new European Monetary System and on the stability and growth pact intended to guarantee fiscal discipline in the Monetary Union.

The Banque de France's monetary policy contributes directly to our country's success in meeting three of the five criteria for entry into Monetary Union: the criterion of price stability, which is the ultimate goal of our monetary policy; that of the stability of the franc vis-à-vis the most solid European currencies, which is an intermediate objective to which the Banque de France is steadfastly committed, and that of the level of long-term interest rates, which is a result and an important indicator of our monetary strategy.

l) Today, the Monetary Policy Council is happy to note that we fully meet these three entry criteria. The Council will continue to make sure that we abide by them throughout 1997 so that the Heads of State and Government can draw up the list of countries eligible for the euro in the best possible conditions, in accordance with the terms of the Dublin decision of the Heads of State and Government, “as soon as possible in 1998”.

The euro will be created on 1 January 1999. Our market interest rates on maturities of more than two years already incorporate the credibility and soundness of the euro, the future single currency of European citizens. The agreement on the stability and growth pact drawn up in Dublin is a decisive element in inspiring confidence in the euro in French citizens and investors from around the world that is at least equal to the confidence in the French franc. This will give us low market interest rates in the euro area, which is good for growth, job creation and the fight against unemployment.