

Mr. Duisenberg's opening statement at the press conference covering the latest meeting of the Governing Council of the European Central Bank Introductory statement by the President of the European Central Bank, Dr. W.F. Duisenberg, at the press conference held in Frankfurt on 13/10/98.

Ladies and gentlemen, in line with our stated intention, the Vice-President and I are here today to report on the outcome of today's meeting of the Governing Council of the European Central Bank. The length of my introductory statement reflects the importance of the matters dealt with today.

As usual, the Governing Council devoted part of its meeting to an exchange of views on recent economic, monetary and financial developments. This discussion took place against the background of conflicting messages. Clearly, on the one hand, the data on the economic situation in the United States and Europe, especially in the euro area, mainly indicate a continuation of real GDP growth, though possibly at a somewhat slower pace. On the other hand, however, the global macroeconomic environment has deteriorated. In particular, the number of signs suggesting that the world economy will slow down in 1999 is increasing. At the same time, uncertainty in the financial markets has been heightened by news of the near-collapse of a large hedge fund, losses by individual financial institutions, and the large movements in world equity, bond and foreign exchange markets.

In the view of the Governing Council, in responding to recent economic developments and current market conditions it is of the utmost importance that proposals inspired by policy activism that do not take due account of the complexity of the issues at stake are avoided. This would only contribute to compounding the uncertainties which underlie the prevailing global financial market volatility. Against this background, the Governing Council is of the view that proposals for a reassessment of capital controls as an acceptable policy option, or recent calls for world-wide, uniform interest rate reductions, are inappropriate as they do not address the very nature of the problems. At the same time, the Governing Council considers structural improvements at the global level to be warranted. These should focus, in particular, first on enhancing the transparency of both the public and private sectors; second, on strengthening domestic banking systems, primarily in emerging markets and economies in transition; and, third, on improving financial crisis prevention and management, in particular through the increased involvement of the private sector. A number of proposals have already been developed on these issues, which should now be finalised with a view to their early and forceful implementation.

In addition, the Governing Council stressed that such structural improvements at the global level would have to be accompanied by sound policies at home. In this respect, given the size of the euro area and its global role, it is of crucial importance that price stability - and hence a climate conducive to growth and employment - should be maintained in the euro area. Achieving this will also be of vital importance for the world economy as a whole.

With this in mind, the Governing Council reviewed the monetary, financial and macroeconomic situation in the euro area.

First, the Council discussed the monetary situation with reference to preliminary data on the basis of the new harmonised reporting system for money and banking statistics. Once internal work has been completed, these monetary statistics will be made available to the public. When looking at various definitions of broad money, our preliminary data show broadly similar

and stable annual growth rates of between 3 and 5% in 1997 and the first half of 1998. According to our initial analysis, these data do not appear to signal inflationary pressures arising from money at this juncture. However, given the preliminary nature of the new data, caution should be exercised with regard to their interpretation.

Second, as regards other financial indicators, although long-term interest rates have risen recently, they are still at low levels by historical standards and the yield curve has levelled off relative to the situation some months ago. A substantial part of developments in bond markets during recent months reflects a "flight into quality".

Third, the Governing Council discussed the broad outlook for prices in the context of the overall macroeconomic environment. With respect to price developments, international factors continued to exert downward pressure. HICP rates in the euro area fell to 1.2% in August after having remained unchanged at 1.4% from April to July. This mainly reflected a decline in energy prices, which were almost 4% lower in August than a year earlier, and in other commodity prices. For the euro area as a whole, price pressure as indicated by industrial output prices and labour costs also remained modest. In 1999 average inflation in the euro area is expected to remain subdued, according to the projections available.

Fourth, considerable difficulties are encountered in precisely assessing and quantifying the impact of recent international developments on prices and, equally, on activity. Recent data seem to suggest that real GDP growth in the euro area, which reached 0.6% in the first quarter of 1998, has slowed down somewhat in the second quarter. We need to await the release of more complete and thereby more reliable data for the euro area as a whole before a final view can be taken. Other recently released data on industrial production, the volume of retail sales and passenger car registrations appear to point to continued growth. This view is also supported by EC survey data, although some indicators have remained constant or have fallen back slightly in recent months; nonetheless, all these indicators remain well above their long-term averages.

The Governing Council welcomed recent interest rate reductions by a number of euro area national central banks. As a result, euro area-wide three-month interest rates have now reached a level of 3.8%, which implies a decrease of around 15 basis points since the end of August. These changes underline the fact that the process of convergence of central bank interest rates in the euro area, which is to be concluded by the end of this year, is clearly under way. The Governing Council considered further interest rate convergence towards the lower end of the current range prevailing in the euro area as being appropriate, given our current knowledge of monetary trends and the prospects for price developments and taking account of an environment characterised by risks of downward pressures. The Governing Council will continue to monitor closely monetary, financial and economic developments within the euro area with a view to determining the appropriate level of money market interest rates for the euro area.

Meanwhile, the Governing Council will continue to monitor closely fiscal intentions in the euro area Member States. The structural budgetary positions in several Member States are still far from being close to balance or in surplus as required by the Stability and Growth Pact. Therefore, these Member States are not yet sufficiently prepared to enable automatic stabilisers to function in the event of a slowdown in real GDP growth, while still respecting the 3% reference value set out in the Treaty and ensuring a decline of debt ratios at an appropriate pace. Moreover, in a number of Member States, against the background of a still

favourable and partly better than expected growth performance, short-term budgetary targets appear not to represent structural improvements.

In addition to the review of economic developments, a number of decisions were taken with regard to various aspects of the preparatory work for Stage Three.

(a) Monetary policy issues

First and foremost, let me turn to the issue of the monetary policy strategy. I can inform you that at today's meeting the Governing Council reached agreement on the main features of the stability-oriented monetary policy strategy that the ESCB will pursue in Stage Three of Monetary Union.

Before explaining our decision on the strategy, let me emphasise certain important characteristics of the environment in which the single monetary policy will operate as of next January. Of most concern to the ESCB are some uncertainties which will inevitably arise as a result of the move to Stage Three. These relate, in particular, to the way in which the transition to Stage Three of Monetary Union will affect economic behaviour and institutional and financial structures in the euro area. They also relate to statistical issues.

Against this background, the Governing Council has chosen a distinct monetary policy strategy, one that reflects the special circumstances it faces at present. This strategy will ensure continuity with the successful strategies pursued by participating national central banks in recent years, while taking into account - to the extent needed - the unique situation created by the transition to Monetary Union.

With this context in mind, the Governing Council today agreed on the main elements of the stability-oriented monetary policy strategy of the ESCB. These elements concern:

- the quantitative definition of the primary objective of the single monetary policy, price stability;
- a prominent role for money with a reference value for the growth of a monetary aggregate; and
- a broadly-based assessment of the outlook for future price developments.

First, let me stress that, as mandated by the Treaty establishing the European Community, the maintenance of price stability will be the primary objective of the ESCB. Therefore, the ESCB's monetary policy strategy will focus strictly on this objective.

In the interest of transparency and in order to give clear guidance with regard to expectations regarding future price developments, the Governing Council of the ECB has agreed to announce a quantitative definition of price stability. In this context, the Governing Council of the ECB has adopted the following definition: "Price stability shall be defined as a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below 2%".

Let me emphasise the fact that price stability is an objective which is to be maintained over the medium term. The current rate of HICP inflation in the euro area is in line with this objective.

Three features of this definition should be highlighted:

- First, the HICP is the most appropriate price measure for the ESCB's definition of price stability. It is the only price index that will be sufficiently harmonised across the euro area at the start of Stage Three.
- Second, by defining price stability using the HICP "for the euro area", the Governing Council of the ECB makes it clear that it will base its decisions on monetary, economic and financial developments in the euro area as a whole. I should like to emphasise the fact that the single monetary policy will adopt a euro area-wide perspective; it will not react to specific regional or national developments.
- Third, this definition is very much in line with most current definitions adopted by national central banks in the euro area.

Furthermore, the statement that "price stability is to be maintained over the medium term" reflects the need for monetary policy to have a forward-looking, medium-term orientation. It also acknowledges the existence of short-term volatility in prices which cannot be controlled by monetary policy.

In order to maintain price stability, the Governing Council of the ECB agreed to adopt a monetary policy strategy which will consist of two key elements.

- First, money will be assigned a prominent role. This role will be signalled by the announcement of a quantitative reference value for the growth of a broad monetary aggregate. The reference value will be derived in a manner which is consistent with - and will serve to achieve - price stability.

Deviations of current monetary growth from the reference value would, under normal circumstances, signal risks to price stability. The ESCB will assess how best to counter these risks. However, the concept of a reference value does not imply a commitment on the part of the ESCB to mechanically correct deviations of monetary growth from the reference value over the short term.

The relationship between actual monetary growth and the pre-announced reference value will be regularly and thoroughly analysed by the Governing Council of the ECB; the result of this analysis and its impact on monetary policy decisions will be explained to the public. The precise definition of the reference aggregate and the specific value of the quantitative reference value for monetary growth will be announced by the Governing Council of the ECB in December 1998.

However, while the monetary aggregates contain important and relevant information for monetary policy-making, monetary developments will not constitute a complete summary of all the information about the economy that needs to be known for an appropriate monetary policy to be set.

- Second, there is also a clear need to look at other indicators. Consequently, in parallel with the analysis of monetary growth in relation to the reference value, a broadly-based assessment of the outlook for price developments and the risks to price stability in the euro area will play a major role in the ESCB's strategy. This assessment will be made using a wide range of economic and financial variables as indicators for future price developments.

Thus the Governing Council will systematically analyse all the information available regarding the prospects for, and the risks to, price stability in the euro area as a whole.

This strategy underlines the strong commitment of the Governing Council of the ECB to its primary objective and should facilitate the achievement of this overriding goal. It will also ensure the transparency of the ESCB's decision-making and its accountability. Based on its strategy, the Governing Council of the ECB will inform the public regularly and in detail about its assessment of the monetary, economic and financial situation in the euro area and the reasoning behind its specific policy decisions.

This strategy is designed to avoid giving the impression that monetary policy responds "mechanistically" to deviations from a single target or changes to a specific variable. The monetary policy strategy that has been selected by the Governing Council of the ECB signals that monetary policy in the euro area will be determined in a manner which will maintain price stability, responding to new developments in or disturbances to the economy in an appropriate manner which is consistent with this overriding objective.

The strategy therefore offers a clear and transparent framework within which the Governing Council of the ECB will be able to assess and present monetary policy decisions.

Please note that the main features of the strategy are also summarised in a press release to be distributed to you.

Still in the context of preparing for the single monetary policy, you may recall that in July I informed you about the range of institutions subject to reserve requirements and the liabilities included in the reserve base. I also gave you indications regarding the lump-sum allowance to be deducted from an institution's reserve requirement and the reserve ratio, for which the Governing Council envisaged a range of 1.5-2.5%. Today, the Governing Council discussed the last remaining open issues regarding the ESCB's minimum reserve system and confirmed that, first, the lump-sum allowance will be set at a level of 100,000 euros and, second, the reserve ratio will be set in the middle of the indicated range, i.e. at 2%. Finally, it was agreed that a credit institution will be allowed to deduct from the reserve base 10% of its debt securities with a maturity of up to two years and of its money market paper if it cannot provide evidence of the corresponding interbank liabilities.

An ECB Regulation laying down the features of the ESCB's minimum reserve system will be published shortly. In the meantime, further details are provided in a separate press release which is to be issued to you this evening.

(b) Foreign exchange policy issues

The Governing Council agreed on a set of legal documentation setting out the respective roles of the ECB and the euro area national central banks (NCBs) in the management of the ECB's foreign reserve assets. The legal documentation specifies, inter alia, the role of the NCBs in carrying out operations involving the foreign reserve assets of the ECB and incorporates master netting agreements to be signed by the ECB and market counterparties.

(c) Payment systems issues

As you are aware, TARGET will not be the only system available for cross-border payments. For non-monetary policy transactions it will, for instance, also be possible to process payments via the EBA Euro Clearing System (currently the ECU Clearing and Settlement System). While TARGET is a real-time gross settlement system, the EBA alternative is a clearing system, i.e. the payments have to be settled at the end of the day. In this regard, the Governing Council has agreed that the ECB will be involved. The EBA Euro Clearing System will, therefore, open a central settlement account at the ECB for its settlements within the euro area and may also open settlement accounts with those NCBs which agree to do so. The ECB will also hold the account on which the EBA Euro Clearing System's liquidity pool will be maintained. Agreements between the ECB and the EBA covering the operation of these accounts are currently being finalised.

(d) The euro banknotes

With a view to increasing efficiency in combating counterfeiting, the Governing Council confirmed the agreement reached by the EMI Council that a Currency Analysis Centre and a Counterfeit Currency Database will be set up, which will store technical data relating to counterfeit euro banknotes. I should point out that the intention is to continue to deal with counterfeits of other currencies (e.g. the national currencies of participating or non-participating Member States and the US dollar) at the national level. All EU Member States will have the option of full participation in the database system. Although a decision on the location of the Currency Analysis Centre will not be taken until the early part of 1999, the Governing Council today approved the principles governing the way in which counterfeit euro banknotes will be handled. Further details are provided in a separate press release which is to be issued to you this evening.

The Governing Council has also agreed on the approach to be used for estimating the number of euro banknotes to be printed before the launch date of 1 January 2002. The quantity of euro banknotes to be printed will be determined by the number required to replace the stocks of national banknotes in circulation (launch stocks) in the participating EU Member States together with the volume of the logistical stocks needed to ensure that the banknote changeover operates smoothly. It is currently estimated that up to approximately 13 billion euro banknotes will need to be printed before the issue date for the eleven participating Member States. This estimate will be updated regularly as we approach 2002.

A separate press release on banknotes is to be issued to you this evening.

Finally, the Governing Council also addressed the following matters.

First, with regard to statistics, it was agreed to publish an Addendum to the document entitled the “Money and Banking Statistics Compilation Guide - Guidance provided to NCBs for the compilation of money and banking statistics for submission to the ECB”. The Addendum covers the treatment of both money market paper and bill-based lending within the harmonised framework for money and banking statistics. The original Compilation Guide was published by the EMI in April 1998.

Second, the Governing Council took stock of the current state of affairs with regard to the testing of critical ESCB systems and procedures in the run-up to the start of Stage Three. The ESCB has just commenced a general “dress rehearsal”, i.e. a final testing phase for all ESCB systems and procedures.

Finally, looking a little further ahead to beyond the start of Stage Three, the Governing Council also agreed that a series of tests should be conducted during the course of 1999 in order to ensure that all ESCB-wide systems and applications are Year 2000 compliant.