Mr Trichet presents the Annual Report of the Bank of France

Address by Jean-Claude Trichet, Governor of the Bank of France before the President of the French Republic, Senate and National Assembly on the occasion of the presentation of the Annual Report, in Paris on 21/5/99.

I am honoured to present you with the report on the operations of the Banque de France, monetary policy and the prospects for it, as required by law. As is the custom, I also submit herewith the Monetary Policy Council's comments on the events of the past year, which was marked by the choice of the European Union Member States authorized to participate in Monetary Union and by the creation on 1 June 1998 of the European System of Central Banks.

The upturn in growth that started in 1997 accelerated in 1998. Annual average GDP growth stood at 3.2%, after 2.3% in 1997 and 1.6% in 1996. In 1998, the expansion was fuelled by vigorous domestic demand, particularly household consumption. Furthermore, total investment, which had stagnated in 1997, posted a dynamic increase in 1998. By contrast, foreign trade made a negative contribution to GDP growth owing to the deterioration in the international environment. Although France was comparatively less severely hit by the spread of the emerging country crisis, the economy was affected by weaker demand from our main European trading partners.

Thanks to faster growth, the French economy created 300,000 jobs in the non-farm market sector in 1998, compared with 196,000 in 1997. The unemployment rate fell from 12.2% to 11.5% from the end of one year to the next.

Against the backdrop of quickening growth, inflation was brought further under control. The year-on-year rise in consumer prices stood at 0.3% in December 1998, after 1.1% in 1997, and thus met the objective of less than 2% set by the Monetary Policy Council. This was the lowest rate of inflation recorded since 1954. One of the main factors in the slowdown in price rises was the fall in the price of oil and other commodities. "Underlying" inflation, which reflects the fundamental trends in the economy, showed a slightly more sustained progression than the consumer price index. According to France's National Institute of Statistics and Economic Studies, INSEE, it posted a year-on-year rise of 1.1% in December 1998, the same as in December 1997.

According to the harmonized index of consumer prices (HICP), which is the measure of inflation in the euro area, France is one of the three best-performing countries in terms of inflation: French inflation stood at 0.7% as an annual average in 1998, compared with 1.1% for the euro area.

In the course of 1998, the franc remained constantly above its central rates vis-à-vis the other most credible currencies of the European Exchange Rate Mechanism. The goal of a stable external value for the franc—which was the external intermediate objective of French monetary policy over the last five years—was thus achieved.

This went hand in hand with the maintenance of the competitiveness of the French economy. The current account surplus totalled FRF 236 billion in 1998, or 2.8% of GDP, comparable to the level recorded in 1997.

With regard to monetary and financial developments, and particularly growth in monetary aggregates—which constitutes the internal intermediate objective of French monetary policy—, the means of payment covered by M1 posted a year-on-year rise of 3.1% in December 1998, after 6.5% in December 1997. Sight deposits paying regulated rates of interest included in M2 –M1 showed a year-on-year increase of 5.7% in December 1998, sharply down on the 9.2% recorded at the end of the previous year. Similarly, M2 progressed by 4.3%, less than the 7.8% rise recorded in 1997. The aggregate M3–M2, which covers liquid investments paying market rates of interest, stabilized in 1998 with a 0.6% decline after the 8.2% drop recorded in 1997. This was mainly due to growth in money market UCITS, which rose by 4.1% after declining by 11.3% the previous year. The year-on-year increase in M3 was 2.7%, compared with 2.0% in December 1997. Growth in investment in contractual savings products recorded in the P1 investment aggregate maintained a sustained pace in 1998, and in all M3+P1 showed a year-on-year progression of 4.0%, against 5.1% in December 1997.

Total domestic debt posted a year-on-year rise of 3.4% at the end of December. It had shown an increase of 3.7% in December 1997. Financing raised on the domestic markets progressed vigorously, with the year-on-year advance standing at 9.2% in December 1998, after 6.6% a year earlier.

Against a background marked by uncertainty surrounding the international environment and by prospects of a euro area-wide slowdown in activity, on 3 December 1998 the Monetary Policy Council of the Banque de France, in close dialogue with the other members of the European System of Central Banks (ESCB), decided to cut its main key rate, which had been set at 3.30% since October 1997, to 3.0%.

This decision was inspired by three considerations:

– the need to ensure the cohesion of the euro area in the best possible conditions;
– the need to organize the convergence of short-term rates towards the lowest rates in the area, i.e. in particular French rates;
– the need to choose the level of key rates that was most appropriate at the time of entry into the euro.

This decision constituted a further stage in the process leading to the transfer of responsibility for monetary policy to the European System of Central Banks as of 1 January 1999. In fact, the rate applying to the first main refinancing operations of the ESCB was set at 3% on 22 December 1998 by the Governing Council of the ECB.

After five years of independent conduct of monetary policy, the Banque de France has earned a high degree of confidence, as witnessed by the solidity of the franc and the relative level of French long-term interest rates. The Bank is proud to have been able to transmit this confidence to the euro, along with other central banks forming the core of the European Exchange Rate Mechanism.

Nineteen ninety eight was a successful year for European integration: the remarkable convergence of European economies enabled the historic decision by heads of state and government to commit eleven countries to the road to the euro. The date of 4 January 1999 marked a first technical success in the changeover from national currencies to the euro. The major challenge now facing the euro area as a whole is to permanently guarantee good economic and financial performances. It is no longer a question of victoriously overcoming an obstacle, but of efficiently managing the monetary, fiscal and structural areas over the long term. This is naturally indispensable in order to ensure cohesion, stability, prosperity and consequently a reduction in unemployment in the euro area, i.e. in an area with 291 million inhabitants. And this is also a contribution necessary for the stability and prosperity of the world economy, within which Europe will play a central role, like the United States.

Monetary policy

The euro should be at least as solid and stable as the best currencies of the European Union and therefore at least as solid and stable as the French franc in the past. This is what inspires the policy of the European System of Central Banks, the European Central Bank and its Governing Council. This is what is required by the Treaty and also by our fellow citizens, who want a new currency that is at least as solid as the French franc. And it is indispensable in order to preserve the competitiveness of the European economy, ensure low medium- and long-term market interest rates on a lasting basis and therefore favour growth, job creation and the fight against unemployment.

The stability-oriented monetary policy of the European Central Bank and of the European System of Central Banks is guaranteed by their independence, which is enshrined in the Treaty. It is buttressed by the support of European public opinion which, like French public opinion, is deeply attached to the stability of the currency. In the final analysis, an independent institution is always accountable to the public.

In a world monetary and financial system characterized by totally free capital flows, confidence is the most precious asset: the confidence that we inspire in economic agents and French, European and international investors; and the confidence with which we are credited today, tomorrow and in the future. The independent Banque de France has over the last six years shown great determination in helping to ensure that the euro inherited as much confidence as possible at its birth. This legacy of confidence is in good hands.

Fiscal policy

In the field of European fiscal policy, the Monetary Policy Council draws attention to the following three points.

– First, it remains essential that the mutual surveillance by euro area governments of national fiscal policies, within the framework of strict compliance with the Stability and Growth Pact, function smoothly. The European Union does not have a significant federal budget for economic policy—the European budget only represents 1.27% of Union GDP. Therefore, all the national budgets of the Member States combined function as the Union' s budget. The preservation of confidence in the euro, and consequently the prosperity, growth and creation of jobs in the euro area, will depend on the quality of fiscal surveillance throughout the area.

– Second, by adopting the Stability and Growth Pact each individual European country, and not just the European Union, set itself the medium-term objective of achieving public finances "close to balance or in surplus". The Monetary Policy Council emphasizes this point, which is essential for the stability of the single currency and is necessary to favour growth, job creation and the fight against unemployment. One of the difficulties encountered by Europe, as by France, is that public opinion is not yet entirely convinced. However, four simple arguments form the basis of this recommendation: preserve, thanks to the confidence of investors, low medium- and long-term market interest rates, generate the financial resources necessary for productive sector investment, strengthen the confidence of the personal sector and bolster that of the corporate sector. It should be added that all Monetary Union member countries have to have budgets that are close to balance or in surplus, precisely in order to allow public finances to act, where necessary, as "automatic stabilizers" when economic conditions deteriorate. This point is essential, most particularly in the event of "asymmetric shocks", i.e. particular economic difficulties affecting one member country, but not the others.

– Last, as it has done constantly in recent years, the Monetary Policy Council calls attention to the need to gradually reduce the ratio of public expenditure to GDP. According to OECD methodology, in France public spending amounts to 54.2% of GDP, well above the euro-area average of 48.7% and the Group of Seven leading industrialized countries average of 38.1%. Bringing this ratio back below 50% is a primary objective, even though it is timid in comparison with the performances of France's partners. This greater rectitude in the management of public finances is a vital condition of competitiveness, growth and the development of employment in France. In this respect, one may note that the policy mix in the United States is based on the conviction that the resolute policy of public deficit reduction has been one of the main engines of the vigorous growth enjoyed by the US for many years.

Structural reform

The effectiveness of economic policies is not simply the result of the right mix of fiscal and monetary policy. Structural policies themselves have a major part to play. This is particularly true in France and throughout the euro area, where around three quarters of unemployment is structural.

As with the level of public expenditure, European public opinion is again not sufficiently convinced that mass unemployment is very largely the unfortunate result of structural defects. When the public is convinced, it is likely that the problem will be easier to resolve since European leaders will then more readily find the support essential for the successful completion of reforms that as a rule are hard to implement.

The enhanced coordination between economic policies, decided at the end of 1997 by the European Council meeting in Luxembourg, relates in particular to “the surveillance of the structural policies implemented by the Member States”. This coordination should make it possible to identify and promote the best measures in the fields of education and training, the labour market, welfare protection, etc.

The Monetary Policy Council readily suggests implementing three principles of action for structural reform in the euro area. These would lead all euro-area countries to introduce at home reforms experimented in another economy of the area that meet the following three criteria: first, they are the subject of a multipartisan consensus; second, they have been implemented on the basis of an agreement between the social partners; third, they have actually helped create jobs. The Council does not doubt the fact that France, like all the economies of the euro area, could benefit greatly from the extension of such consensual and effective reforms.

The competitiveness of the economy

Last, as it has done in each of the previous years, the Monetary Policy Council emphasizes the importance of cost containment in the economy and the need to provide an environment that favours the competitiveness of businesses. In Europe, before the single currency, any poorly conducted national economic policy was swiftly and severely punished by depreciation of the currency on the foreign exchange markets and rises in market interest rates. With the creation of the single currency, these indicators have disappeared along with the swiftly applied sanctions associated with them. In the new euro area, any economic policy errors leading to lost competitiveness would result, more slowly and insidiously, in weaker growth and job creation. For this reason, even more so than in the past, unit production costs and more generally the quality of the competitive environment of businesses need to be very closely monitored.

The reason why we emphasize the importance of competitiveness indicators is therefore not only that cost containment is a necessary condition for low inflation. It also, and primarily, lies in the fact that in the European economy of today, which is governed by complete freedom of choice for consumers and complete freedom for businesses to choose where to invest, jobs will be created preferentially in economies that manage to contain their unit production costs and offer an environment that is as favourable as possible to business competitiveness.