Mr Noyer considers the role of the central bank in encouraging and safeguarding savings

Speech given by Mr Christian Noyer, Vice-President of the European Central Bank, at the EUROFONDS colloquium in Paris, held on 21 January 2000.

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Ladies and gentlemen,

It is a great pleasure to be taking part in this EUROFONDS colloquium on savings. I should like to take this opportunity to share with you some thoughts on the role of a central bank in encouraging and safeguarding savings. This is indeed a crucial matter, since the level of savings largely determines the long-term level of productive investment, which provides the basis for solid and stable growth. Moreover, the level and structure of savings affects, in various ways, the cost and means of financing enterprises, the profitability of the financial sector and the distribution of income between generations in view of the central issue of financing retirement.

I should like to focus my presentation, as I am sure you will understand, not on the central bank in theory but on the role of the Eurosystem in this field, that is, the European Central Bank and the 11 national central banks of the euro area. In addition, I shall say a few words on the impact of the launch of the euro on the development and safeguarding of savings in Europe. I shall therefore develop two points:

- By safeguarding price stability, the Eurosystem contributes to the safeguarding and consolidation of savings.
- The creation of the euro is leading to larger and more integrated financial markets, improving the allocation of financial savings.

1. By safeguarding price stability, the Eurosystem contributes to the safeguarding and consolidation of savings.

The primary objective of the monetary policy of the Eurosystem, as laid down in the Treaty, is price stability. This objective is founded on the conviction that price stability makes it possible to ensure the full efficiency of the price mechanism and to avoid both arbitrary redistribution of wealth as a result of inflation as well as the costs and distortions caused by uncertainty and periodical adjustments of nominal values.

These positive effects of price stability obviously benefit savings. I personally see three aspects to this: an effect on the protection of the value of savings, an effect on their structure and allocation, and finally an effect on the distribution of saving within society.

First, by aiming at price stability, monetary policy directly preserves the real value of a large proportion of financial savings. This is immediately obvious in the case of fiduciary money or sight deposits which are remunerated only a little or not at all (which accounted for 39% of the monetary aggregate M3 in 1999). However, fixed-term deposits are not totally safeguarded from inflation where their remuneration is fixed over a specified period or where they only adjust to market rates after a time lag. In the same way, the remuneration of fixed rate debt securities such as bonds only includes expected inflation and is thus vulnerable to any unexpected change in inflation. It has been empirically established that, as intuition suggests, the volatility of inflation increases as it rises, which implies that risk premia are generally not in line with the real level of inflation. I should add that inflation creates a well known fiscal bias when flows of interest to creditors include an inflation premium to cover the depreciation in the value of financial capital during a period of inflation, and this premium, which is not real income, is charged.

In fact, in a situation where inflation rises unexpectedly a transfer of wealth occurs from the creditors to the debtors. This interferes with the optimal allocation of savings (I shall return to this issue) when the transfers of wealth do not correspond to the provision of a service or a real economic cost, but have all the characteristics of a “windfall profit” or an exceptional loss. It can also result in a reduction in the amount of savings in two ways: by discouraging agents’ propensity to save amounts subject to the monetary hazard; and (because of the bias resulting from the depreciation in the nominal value of debt and the fiscal distortion to which I referred) by transferring inflationary income from the private to the public sector, which has a lower saving ratio.

Second, inflation not only affects the system of measurement of prices for goods and services, it also affects the quality of indicators of profitability and of interest rates. By way of an example, the profits of a firm can be artificially affected by differences between the posting dates of payments and receipts or by the incorporation of inflation premia into flows of interest. Of course, these profits could possibly include a real gain linked to the reduction in real interest charges, but this does not correspond to the intrinsic profitability of the firm. In the same way, the comparability and thus the best selection of different investments is affected by the inclusion of higher inflation premia in reported rates of return.

In addition, inflation discourages a long-term approach to efforts to save, as shown a contrario by the developments in long-term investments following the shift of monetary policies in Europe towards price stability in the last few years. The substantial share of life insurance investments of non-financial agents in the euro area serves to illustrate the point. This has risen from 18% of investment flows of non-financial agents in the euro area at the beginning of the last decade to 26% on average in 1997 and 1998. In the same way, bond issuance in Europe intensified notably in 1999, although this is also explained by the disappearance of exchange risk within the euro area and the greater depth of the market. Another indication of this trend towards the consolidation of savings is that the long-term financial liabilities of monetary financial institutions in the euro area increased notably in 1999 (by 7.2% in the year to the end of November 1999).

Furthermore, the primacy of price stability contributes to improving macroeconomic stability, thus encouraging long-term investment. The reduction in real interest rates following the reduction in the inflation premium works in the same way. I should like to note here that investment and saving are two sides of the same coin (as shown in the national accounts, which include investment within gross savings), i.e. the accumulation of physical or financial capital with a view to a future return.

Third, price stability has major implications for the social distribution of efforts to save.

Price stability is especially beneficial for the less well-off sections of society, which often lack sufficient information to protect their savings in a period of inflation. At a time when we are very preoccupied by adjusting working hours and the retirement age, it is essential that everyone should have the opportunity to save, i.e. to set aside part of their future income, relatively safely.

However, the principle of monetary stability very clearly highlights the issue of the distribution of income between generations. In a situation where the proportion of public spending has reached a very high level (in 1999 it accounted for 49% of GDP in the euro area, compared with only 39% in Japan and 34% in the United States) and where government deficits are limited by the Treaty and can no longer be covered by inflation, the role of private savings in the future financing of retirement attains a crucial dimension.

I should like to end this first part by saying that the positive effect of price stability on domestic savings naturally contributes, in the world capital market we live in, to guaranteeing the lasting attractiveness of the euro area for long-term financial investments by non-residents. This also requires that other economic policies contribute to a favourable environment, through structural measures aiming at increasing flexibility in the labour market and efficiency in the markets for goods, services and capital.

I have emphasised the effects of the Eurosystem’s monetary policy on the volume of savings and its consolidation. The creation, with the euro, of a vast currency zone also contributes to a more efficient management of savings.

2. The creation of the euro is leading to larger and more integrated financial markets, improving the allocation of financial savings.

The creation of the euro has accelerated the development and integration of the capital markets in Europe, which have been helped along in recent years by financial liberalisation and technological innovation.

In effect, the single currency has removed the exchange risk between the countries of the euro area and is facilitating the standardisation of debt instruments and their management on a much larger scale. This integrating effect of the euro has been most evident in the money market, by virtue of, in particular, the establishment of the large-value payment system TARGET, made available to the banks by the European System of Central Banks. This integration has shown itself in, for example, the rapid adoption by the market of reference rates for the euro area, such as the EONIA overnight rate or the EURIBOR rate for maturities of less than one year. Above all, we have seen a total convergence in short-term interest rates within the euro area.

In the bond markets, the integration of the markets remains incomplete, owing to: national differences relating to property rights over securities; taxation, accounting and supervisory regulations; and payment systems (which are also hindering the integration of the short-term securities markets and repo markets). The integration of the bond markets is nonetheless progressing. First, we have seen European bond indexes become standardised. Second, the differences in rates between sovereign issues within the euro area fell substantially in 1998. Furthermore, 1999 was characterised by a spectacular growth in euro bonds issued by private non-financial firms (a threefold increase, over the first ten months, compared with the same period in 1998), and an increasing share of bonds being issued by small and low-rated companies.

In addition, integration in the stock markets is progressing, although they have to overcome barriers of the same kind as those I have just mentioned. In addition to the closer links between stock market firms, a notable increase in transactions on the new European indexes has been observed. Moreover, the "new markets", with growth figures benefiting greatly from the establishment of the large European market, have expanded considerably.

The broadening of the capital markets and their greater integration are contributing to a more efficient allocation of savings. First, this development is also leading to lower transaction costs and increasing the liquidity of the traded instruments (which in turn contributes, ceteris paribus, to reducing the absolute level of interest rates). Second, it is multiplying investment opportunities and increasing the range on offer. At the same time, it is fuelling competition between issuers, investors, and even, to some extent, regulatory systems (as shown, for example, by the adoption in several countries, including France, of a legal framework for real estate bonds, modelled on the German *Pfandbriefe*). Meanwhile, the deeper market calls for restructuring and rationalisation of the finance industry, the effect of which would be to strengthen the management of savings in Europe. There are two facts which illustrate this trend: the number of monetary financial institutions (which has already been decreasing steadily for several years) fell by 5% in one year in 1999 (up to the end of November); and the total value of mergers and acquisitions involving banks in the euro area clearly exceeded (by around 35%, according to certain private databases) the already high level recorded in 1998. In 1999 it was also above the level of similar transactions reported in the United States.

Conclusion

Price stability and the creation of a large integrated financial market are therefore beneficial to the development of savings in the euro area and to their optimal allocation.

It would certainly be wise to ensure that certain financial imbalances are not allowed to jeopardise this favourable environment.

Thus, insufficient fiscal consolidation leads to a continuous eviction by the states of a significant part of the available private savings. In the same way, excessive taxation and wage increases out of line with growth in productivity sap the dynamism from investment and consequently also from savings.

Its development also requires a certain convergence in tax systems. Ultimately, the health of the financial sector is essential to the protection of savings. Although the Eurosystem has no direct authority in the field of prudential supervision, it monitors risk developments in the banking sector, as it does more generally with regard to developments in assets prices, where these could potentially affect overall monetary and financial stability.

In these areas, the role of the Eurosystem is always to uphold confidence in the currency, to contribute to the smooth functioning of the financial system and to encourage prudent macroeconomic policies, which influence the will and capacity to save.