Willem F Duisenberg: Assessment of the euro cash changeover and the ECB view on recent monetary and economic developments

Keynote address by Dr Willem F Duisenberg, President of the European Central Bank, at the New Year's reception of the International Club of Economic Journalists, Frankfurt, 14 January 2002.

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Thank you very much for inviting me to participate in today's New Year reception. In my speech today, I will address two issues, neither of which is likely to come as a surprise to you. First, I should like to assess the euro cash changeover, which started a fortnight ago. Second, I should like to share with you the view of the Governing Council of the European Central Bank (ECB) on recent monetary and economic developments.

A first assessment of the euro cash changeover

On 1 January 1999 the euro was established as a new currency. Two weeks ago, the euro banknotes and coins were issued and became legal tender in the countries participating in the euro area. With their arrival, the process of introducing a single European currency, as agreed in Maastricht in 1991, is complete. Paying with a single currency in daily transactions throughout the euro area can be regarded as an achievement of historic proportions and as a major step in the process of European integration.

The Eurosystem, the ECB and the 12 national central banks (NCBs) of the euro area as well as all other parties involved were quite confident – although of course not 100% certain – that the euro cash changeover would be a success, given the enormous efforts and preparations which went into this unprecedented operation. Now, two weeks after the introduction of the euro banknotes and coins, I can even say that, given the scale of the task, the operation has so far progressed very smoothly, even beyond our own expectations.

Here and there some minor mishaps have occurred and may continue to occur, but this is quite normal for such a massive operation, involving more than 300 million people in 12 countries.

The introduction of euro banknotes and coins has been a complex and ambitious undertaking which requires – in addition to understanding and co-operation on the part of the public – organisational, logistical, technical and economic efforts on the part of those sectors directly involved in the use of banknotes and coins. I should like to take this opportunity to express my gratitude to all these parties, such as retailers, the vending machine industry, cash-in-transit companies and, of course, the banking sector. But the media has also been accompanying the changeover in a very positive, informative and supportive manner, thus helping us to convey certain messages to the citizens of the euro area as to how they can contribute to a successful operation. At the end of the day, the success of the euro cash changeover depends not only on the co-operation of all professional parties directly involved, but also on a favourable attitude and quick acceptance by the citizens. Therefore, I should also like to express my gratitude to the media for their efforts.

Let me now mention some of the other factors which have contributed to the success of the euro cash changeover.

First, in March last year the Governing Council of the ECB established the Cash Changeover Co-ordination Committee (CashCo) comprising representatives from the ECB, the 12 NCBs of the euro area, the European Commission and Europol. The Committee has overall responsibility for the co-ordination of the changeover to euro banknotes and coins from the period before 1 January 2002 until the end of February 2002.

Second, measures were taken to ensure an early return of national banknotes and coins. As regards the return of legacy currency coins, most national authorities reduced the work for banks during the dual circulation period either by encouraging the public to deposit hoarded coins at banks' counters early on, or through a range of charity schemes introduced in some countries. With regard to national banknotes, there was also a return of hoarded banknotes, particularly high denominations. In total, legacy currency banknotes in circulation fell during the course of the year by EUR 110 billion to EUR 270 billion at the end of 2001.

Third, a crucial factor for the success of the euro cash changeover was the decision to allow the frontloading and sub-frontloading of banknotes and coins to the banking sector and to other target groups from 1 September 2001. This four-month lead time was required in order to ensure that sufficient euro banknotes and coins were available for widespread circulation from 1 January 2002. In fact, the scale and timing of frontloading and sub-frontloading varied considerably between different countries, depending on the national changeover scenario chosen, the national infrastructure (e.g. the extent of the central bank branch network and its role in the money supply, the storage facilities available in bank branches) as well as the size and geography of the country.

In almost all euro area countries the national authorities provided euro coins to credit institutions from September 2001 because their bulk made them more difficult to transport and their lower value meant that the risk to credit institutions was lower than for banknotes. Five countries (i.e. Austria, Finland, Germany, Luxembourg and Spain) started frontloading banknotes at the same time; the remaining seven countries postponed the distribution of banknotes until November and December 2001 in most cases.

All countries supplied credit institutions and the retail sector with both euro banknotes and coins prior to 1 January 2002. The participation of retailers in sub-frontloading operations varied by country, sector and region. As regards the cash-operated machine industry, and in view of the need to load machines with coins prior to €-Day, most all euro countries sub-frontloaded euro coins to this sector. By the end of 2001, more than 6.5 billion euro banknotes worth some EUR 134 billion and more than 37.5 billion euro coins with a total value of around EUR 12.4 billion had been frontloaded. This meant that around 70% of the banknotes and 80% of the coins were already distributed to banks before 1 January, which was decisive for a smooth start to the changeover. Broadly speaking, sub-frontloading was also in line with the initial forecasts and represented an overall amount of between 10% and 20% of the frontloaded amount.

According to the ECOFIN Council statement made in November 1999, euro coins were allowed to be provided to the general public from mid-December 2001 in order to ensure the citizens' familiarity with euro coins and to reduce the stocks needed by retailers to provide change at the beginning of 2002. The citizens of the euro area were very quick to buy one or more coin sets. Overall, the general public acquired more than 150 million coin starter kits comprising over 4.2 billion coins worth EUR 1.6 billion. This means that on average each individual was in possession of 14 coins at the beginning of 2002. In a number of countries (i.e. Germany, Portugal, Finland and Luxembourg), demand was such that banks were authorised to make up their own kits and even to sell some of their bulk stocks.

Fourth, given that in terms of transactions around 70% of banknotes are put into circulation via automated teller machines (ATMs), the quick adaptation of these machines was one of the key factors for a smooth changeover. In total, more than 200,000 ATMs, either on site in bank branches or off site, for example in shopping centres, had to be converted. This was already achieved within less than one week.

As a result, in all participating Member States the bulk of cash transactions could already be made in euro after 10 days. This means that the euro banknotes and coins have been introduced considerably faster than originally foreseen by the ECOFIN Council, which had set a goal of two weeks.

A fifth factor contributing to a smooth changeover was the commitment of the banking sector in almost all euro area countries to put, in particular, the low denomination euro banknotes (i.e. EUR 5 and EUR 10) into circulation on a large scale at the beginning of 2002. This considerably reduced the need for retailers to hold large amounts of cash during the first few days of 2002. In those euro area countries one or both of the low denomination euro banknotes were dispensed via at least part of the ATM network at the start of 2002. In countries where welfare payments are paid largely in cash (i.e. Belgium, France and Ireland), this was also done in low denominations. Moreover, banks paid out predominantly low denomination euro banknotes over the counter. All this resulted at the beginning of the year in a circulation of low denomination banknotes (i.e. EUR 5, EUR 10 and EUR 20) of 82.4% in terms of actual banknotes and 43% in value. This far exceeded the proportion of national banknotes of similar value previously in circulation in the individual euro area countries.

In conclusion, the Eurosystem is proud of and grateful to all those involved for their contributions to this historic moment. The enthusiasm of the citizens of the euro area to get hold of euro cash from mid-December can be seen as a clear vote for a united Europe. I am very confident that the changeover will proceed to its completion as smoothly and successfully as it has started.

Recent monetary and macroeconomic developments

Let me now turn to the macroeconomic situation in the euro area and the outlook for price stability over the medium term.

Recent information has confirmed the Governing Council's earlier assessment that economic activity in the euro area was weak in the second half of 2001 and will probably remain subdued in early 2002. However, although the outlook is still surrounded by a high degree of uncertainty, there are indications pointing to a gradual economic recovery in the euro area in the course of this year. This is signalled, inter alia, by financial market developments and by recent survey data, which indicate that the decline in confidence in the euro area may have bottomed out.

Indeed, the conditions exist for economic growth in the euro area to recover in the course of this year. There are no fundamental imbalances in the euro area that would require a prolonged correction process. In addition, financing conditions in the euro area are favourable, as real and nominal short-term and long-term interest rates are currently at very low levels. Furthermore, the expected further decline in consumer price inflation in 2002 will lead to higher growth in real disposable income that should support domestic demand.

Inflation rates have been falling significantly over recent months, from a peak of 3.4% in March 2001 to a level, according to the Eurostat flash estimate, of 2% in December. This downward path in annual inflation rates, which stems mainly from the unwinding of past increases in energy prices and from base effects related to past increases in food prices, is likely to continue for some months. However, mainly on account of base effects, the pattern of annual inflation rates may be somewhat erratic in the coming months. In this regard, the possibility of some short-lived upward movements in the annual rate of inflation cannot be ruled out, but this should not be a cause for concern. Likewise, downward shifts resulting from such base effects later in the spring should not signal a change in the longer-term outlook for price stability.

Concerning the introduction of euro banknotes and coins, which I have just talked about at length, there is a lot of talk by the public and the media about the potential inflation effects stemming from rounding towards psychologically attractive prices. But we should expect such rounding to be in both directions, up and down. In fact, although many had feared anticipatory effects on inflation rates already in 2001, there has been little evidence so far of the changeover affecting the average level of prices, and we do not expect any noticeable effect on the average price level in the future. This is largely due to strong competition in the retail sector, continued awareness on the part of consumers and the commitment of governments not to increase the average level of administered prices. However, we will of course remain vigilant with regard to the possibility, albeit remote, of an impact on inflation rates in the first months of this year as a consequence of the introduction of euro banknotes and coins.

Looking beyond short-term developments, we assume that wage moderation in the euro area will continue and that the pressure of demand on prices will remain limited, although there is some cause for concern about forthcoming wage negotiations. It is therefore particularly important to point to the indispensable role of continued wage moderation in fostering employment and maintaining a favourable outlook for price stability.

Finally, I should also emphasise that we do not regard recent monetary developments as posing a risk to price stability. Although the annual growth rates of M3 have picked up significantly in recent months, we need to keep in mind that this happened in an economic and financial environment characterised by exceptionally high uncertainty throughout the world. It can therefore be assumed that this growth to a large extent reflects the risk aversion of investors who wish to "wait and see" – and therefore hold liquid and safe assets included in M3 – before again undertaking long-term investments. In this sense, this increase in M3 should remain temporary and should not indicate future inflationary pressures. This notwithstanding, the continued acceleration of M3 and the ongoing build-up of liquidity calls for close attention and will require a thorough analysis of monetary developments in the months to come.

Overall, we do not currently see any major risks to price stability in the euro area. In fact, following a series of unexpected sectoral price shocks, the outlook for price stability significantly improved in the course of 2001. The Governing Council reacted to this in a forward-looking manner by reducing the key ECB interest rates by a total of 150 basis points in 2001. On the basis of current information, our assessment is that annual inflation rates should fall safely below 2% this year and thereafter remain at levels consistent with price stability over the foreseeable future. Against this background, the

Governing Council of the ECB concluded at its last meeting that it considers the current level of key ECB interest rates to be consistent with the maintenance of price stability over the medium term.

The best contribution monetary policy can make to sustainable and non-inflationary economic growth is to maintain price stability. In this respect, I would also like to reiterate how important it is for fiscal policies to maintain a medium-term orientation within the framework of the Stability and Growth Pact. We are well aware that the current weakness in economic growth presents a particular challenge for those countries which have not yet attained budgetary positions close to balance or in surplus or which have high public debt-to-GDP ratios. Nonetheless, it is important to realise that, rather than being detrimental to a return to sustainable economic growth, the adherence of these countries to their medium-term consolidation programmes will strengthen consumer and investor confidence. Any deviation from the medium-term orientation could thus only prove counterproductive. Countries without fiscal imbalances can, of course, allow automatic stabilisers to operate fully. However, there is no case for fiscal activism in any country.

The only way to continue to expand the rate of non-inflationary output growth of the economy in a decisive and long-lasting manner is to deepen structural reform in the labour and goods markets. Efforts have been made in this direction in many euro area countries over recent years, but there is still some way to go. In the same vein, governments should pursue determined reforms with regard to the size and structure of public expenditure and revenue, also in order to create room for further tax cuts and to absorb the fiscal costs of population ageing. Together with continued wage moderation aimed at sustaining recent labour market gains, these reforms will foster employment and investment, and ultimately contribute in a decisive manner to making the euro a resounding and long-lasting success, underpinned by a stable and dynamic economy. I am confident that the importance of this moment and the need to act resolutely is well understood by policy-makers all over Europe.