Christian Noyer: Success factors of the euro and the ECB

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Introduction

Ladies and gentlemen,

I should like to begin by expressing what a pleasure and great honour it is for me to have been invited to speak to you here today. I already participated in this symposium in 1999, and I very much appreciate this opportunity to discuss with you the factors driving the success of the euro by looking back with you at the first three years of Stage Three of European Economic and Monetary Union (EMU).

In my brief remarks, I should like, first, to talk about the very recent event that was of particular significance, namely the euro cash changeover, i.e. the introduction of the new euro notes and coins, and discuss the international role of the euro. Second, I should like to elaborate on the institutional set-up of the European Central Bank (ECB) and its objectives. Finally, I will share with you some views on the experience we have gained with the single monetary policy so far and on the challenges ahead.

The euro cash changeover and the role of the euro

Since 1 January this year, more than 300 million citizens in Europe have shared the same tangible currency. Now that the new euro banknotes and coins have become the legal tender in 12 of the 15 Member States of the European Union (EU) – Denmark, the United Kingdom and Sweden have not yet adopted the euro – the process of monetary integration laid down in the Maastricht Treaty in 1991 has found its visible expression in the daily life of the residents of the euro area. It should be noted that the euro has already been in existence since 1 January 1999, when the exchange rates of the currencies of the euro area countries were irrevocably fixed. Until 1 January 2002, however, the euro was the currency of the financial and foreign exchange markets. For cash payments, the old national banknotes and coins had to be used in the last three years. Although the national currencies were officially regarded as mere expressions of the single currency, the euro – in the eyes of many people – only arrived with the introduction of the new euro banknotes and coins.

The exchange of the old national banknotes and coins of the 12 countries of the euro area for the euro has been a massive operation requiring enormous organisational, logistical, technical and economic efforts. Its success has far exceeded our own expectations. In almost all its aspects, the euro cash changeover has progressed well and rapidly, without any major hitches. This was a crucial factor for acceptance of the new currency by the European public. The completion of the changeover has been a challenge of unprecedented dimensions that involved the banking sector, security carriers, retailers and the cash-operated machine industry. In order to guarantee a gradual and smooth supply of euro to the economy, euro banknotes and coins started to be distributed to the banking and retail sectors as from 1 September last year. 6.4 billion banknotes worth some EUR 133 billion, and more than 37.5 billion coins with a total value of around EUR 12.4 billion, had already been frontloaded to the banking sector by the end of 2001. The adaptation of more than 200,000 automated teller machines (ATMs), which supplied around 70% of the new banknotes utilised for transactions within less than one week, was another key factor in the euro cash changeover.

From the outset, European citizens showed a great deal of enthusiasm and have been very fast in adopting their new money. Two weeks after the introduction of the euro banknotes and coins, the value of euro banknotes in circulation was higher than that of national banknotes, and the vast majority of cash transactions in the euro area were being conducted in euro.

In the last few months, the Eurosystem, i.e. the ECB and the national central banks (NCBs) of the 12 EU Member States participating in the euro area, and a number of other parties, such as retailers, educational institutions, the tourism industry and the media, were heavily involved in the information campaign which acquainted the general public with the new money. The euro banknotes are endowed with distinctive characteristics and state-of-the-art security features which not only enable the public and professional cash handlers to recognise and check them quickly, but also make them some of the world's safest.

The transition to the new banknotes and coins was facilitated by the fact that the financial markets were already fully accustomed to the euro. The introduction of the single currency three years ago was another exceptional success that opened the way to fundamental changes in the conditions in which governments, financial institutions and the private sector operate in financial markets of the euro area and in the rest of the world.

Within the euro area, the elimination of exchange rate risks and the lower transaction costs which followed, together with the far more transparent markets the euro brought with it, have created new opportunities for businesses and forced firms to attain higher levels of efficiency and competitiveness.

A further success factor for the euro has been and still is its role as a catalyst in the process of financial integration, thereby enhancing the widening and deepening of the euro area financial markets. A large, liquid and integrated money market was rapidly created after 1 January 1999. This, in turn, triggered a significant growth of interest-bearing instruments denominated in euro. On the unsecured money market, the EONIA (euro overnight index average) reference rate, an interbank overnight interest rate index compiled by the ECB, has established itself as one of the most important, perhaps even the most important, reference rate. The EONIA swap market is now considered the largest overnight swap market in the world. In the bond market, too, the euro played a crucial role in fostering the deeper and more liquid euro area bond market that we see today. As early as in 1999, the total amount outstanding of euro-denominated debt securities made the euro bond market the second largest bond market in the world, and the international issuance of the euro-denominated bonds has even outpaced that of US dollar-denominated bonds for a few months at a time.

At the international level, the euro has become the second most widely used currency as a result of the overall weight of the euro area economy in the world and the legacy of the national currencies which were replaced by the euro.

Looking at official international uses, the euro is second only to the US dollar among the world's official reserve currencies. The gap between the two currencies, however, is wide. According to the latest available data, the euro accounted for around 13% of the world's official foreign currency holdings at the end of 1999, compared with a US dollar share of around 70%. Experience has shown, however, that there is a considerable time lag before the importance of a currency, as indicated by the economic weight of the country issuing that currency, is reflected in its use as an official reserve currency.

As an anchor currency, the euro plays a role in the exchange rate regimes of more than 50 countries outside the euro area. The solutions adopted by these countries range from very close, or even full, links to the euro, such as the unilateral entitlement to use the euro as legal tender – euroisation – to looser types of anchoring, such as peg arrangements and crawling fluctuation bands.

I would like to conclude this brief overview of the international role of the euro by emphasising that developments in this field will be the outcome, first and foremost, of a market-driven process.

At this point, let me move the focus of my presentation from the introduction of the euro and its role in financial markets to the institutional factors behind the success of the ECB and its monetary policy.

The institutional set-up and the objectives of the ECB

The Treaty establishing the European Community assigned to the ECB the maintenance of price stability in the euro area – i.e. the internal stability of the euro – as its primary objective. It is through the credible and lasting maintenance of price stability over the medium term that the ECB can best contribute to sustained long-run economic growth, employment creation and better standards of living. In our view, the uncertainties surrounding the monetary policy transmission mechanism, part of which arises from the continuous evolution of economic behaviour and institutional structures, make the central bank ill-suited to fine-tune economic developments.

Without prejudice to its primary objective, the ECB shall also support the general economic policies of the European Community, such as the enhancement of output growth and employment. This does not, however, mean that the ECB bears responsibility for objectives other than price stability. By giving its monetary policy a medium-term orientation, the ECB does show concern for, and contribute to, smoothing output fluctuations. It is clear, however, that the instruments and the mandate to promote potential output and employment lie with structural policies, and thus primarily at the national level. The allocation of tasks and objectives to different policy-makers in the euro area is thus very clear. The budgetary provisions in the Treaty, which limit the level of government deficits and debts, and the Stability and Growth Pact, which introduced the goal of budgetary positions close to balance or in surplus as a medium-term objective for Member States, have been key to achieving sounder public finances.

For purposes of supporting and safeguarding the pursuit of price stability, the Treaty has endowed the ECB with a high degree of institutional independence. Being protected from potential political pressure is a further crucial factor for the success of the ECB in allowing it to guarantee European citizens a long-term euro area perspective in pursuing its mandate of maintaining price stability.

In order to assure transparency and accountability with respect to its policy design and implementation, the Treaty has imposed extensive reporting requirements on the ECB. The ECB has even exceeded these requirements, thereby meeting very high standards in this respect. Monetary policy decisions are regularly explained in the press conference the President and I give after the first meeting of the ECB Governing Council every month, in the Monthly Bulletin of the ECB, in the speeches given by members of the Governing Council and in the testimonies of the President at the European Parliament.

For purposes of setting out how it goes about in achieving its Treaty mandate, the ECB has announced a medium term-oriented monetary policy strategy. To enhance clarity, to anchor expectations and to offer a yardstick against which the ECB can be held accountable, the Governing Council of the ECB has, in particular, provided a numerical definition of price stability which is "a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below 2%".

Recognition of the fact that monetary policy has to contend with an ever changing and imperfectly known world has been a key consideration in the design of the ECB's monetary policy strategy. The Governing Council chose to equip itself with an internally consistent and robust framework for analysing economic developments and shocks, which we call our two-pillar strategy of monetary policy. Given the long-term monetary nature of inflation, a first pillar of our strategy assigns a prominent role to money, implying the use of monetary analyses, and of models, in which monetary aggregates play an important role. In parallel, a second pillar ensures that other forms of analysis and models, such as the investigation of the interplay between supply and demand and cost-push dynamics, are also incorporated into the policy-making process. Together, the two pillars ensure a comprehensive assessment of the economic situation, of the size and nature of the shocks hitting the euro area and of the related risks to price stability over the medium term.

The robust assessment and the cross-checking of information which characterises our strategy has proved to provide the Governing Council with the analytical support most suitable for the conduct of monetary policy in the euro area. It is widely acknowledged that the ECB's monetary policy has contributed to keeping inflation expectations in line with the ECB's definition of price stability, although short-term shocks pushed HICP inflation temporarily above 2% in the course of 2000 and 2001. The financial markets, well known for their pitiless judgement, have moreover been confirming the credibility of our monetary policy from the very outset. The development of long-term interest rates has in fact been in line with our objective of maintaining price stability. This is not an insignificant achievement, and we are committed to not putting it at risk.

Following the introduction of euro banknotes and coins, there is some concern among the public about potential inflationary effects stemming from the rounding upwards of prices. Compared with December 2001, inflation in the euro area has increased in January 2002 (year-on year). However, this increase was largely anticipated by the ECB and is due to a number of factors, including so-called base effects, bad weather (impacting prices of unprocessed food) and higher indirect taxes. The contribution of the cash changeover to the increase in inflation in January is probably limited. Indeed, we have seen rounding happen in both directions, up and down. As a matter of fact, there has been very little evidence so far of effects of the cash changeover on the average level of prices in the euro area. This is largely due to the stronger competition which the euro is fostering in the retail sector, together with continued awareness on the part of consumers and the commitment of governments not to increase the average level of administered prices. This said, we will of course remain vigilant with respect to the possibility of an impact on inflation rates in the first months of this year. Over the long run, however, downward pressures on prices should predominate in the euro area, thanks to the increased transparency and stronger price competition the physical introduction of the euro has been inducing.

Conclusion

Let me conclude my presentation by addressing the challenges that lie ahead. I am referring, in particular, to the enlargement of the European Union and, subsequently, of the euro area. Currently, 12 countries from central, eastern and southern Europe are negotiating the terms and conditions for their becoming members of the EU. Integrating such a large number of new applicants in the European Union will be an enormous task for all the parties involved, not least in view of the significant differences in economic conditions in most of these countries in relation to the current Member States. Considerable efforts will be required. The reward, we believe, will be the smoothing of the road towards the pursuit of a common European objective in the future.