Christian Noyer: Presentation of the European Central Bank's Annual Report for 2001

Introductory statement by Mr Christian Noyer, Vice-President of the European Central Bank, to the Committee on Economic and Monetary Affairs of the European Parliament, Brussels, 23 April 2002.

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It is my pleasure to present today the fourth Annual Report of the ECB, covering the year 2001, which, for the Eurosystem, was notably marked by the finalisation of the preparations for the euro cash changeover.

The introduction of the euro banknotes and coins

The introduction of the euro banknotes and coins on 1 January 2002 concluded the process of establishing a Monetary Union in Europe, which had been launched some ten years ago. This event can undeniably be regarded as a milestone in European monetary integration and, indeed, in European integration as a whole, as the single currency, which had already been used successfully for non-cash operations since 1999, became a tangible reality for more than 300 million citizens in the euro area.

The preparations for the cash changeover were complex and required from the outset close cooperation between the Eurosystem and EU institutions, national authorities as well as a broad range of economic and financial agents, in particular the banking sector, security carriers, the cash-operated machine industry and, of course, retailers. The ultimate testament to the euro's success, however, was the response of the European citizens, who accepted their new currency rapidly and with enthusiasm, as shown by the swift withdrawal of legacy currencies in the first weeks following the cash changeover.

Indeed, the introduction of the euro banknotes and coins proceeded far more smoothly than we had dared to expect, and I should like to take the opportunity today, on behalf of the ECB, to express once again my gratitude to the citizens of Europe and all the other parties involved for their contribution to making the cash changeover a success and for their fruitful collaboration with the Eurosystem over the past years.

Review of economic and monetary developments

Let me now turn to the review of economic and monetary developments. In the light of the central role of maintaining price stability that the Treaty assigns to monetary policy, I shall start by reporting that annual average HICP inflation in the euro area was 2.5% in 2001. The lagged effects of the increase in import prices in 2000, together with the impact of livestock diseases on unprocessed food prices in 2001, contributed to the increase in annual HICP inflation rates, which peaked at 3.4% in May 2001. Since then, the effects of these factors on the annual inflation rates have gradually disappeared.

We are obviously not satisfied with HICP developments in the course of last year. However, monetary policy only affects the level of prices with a lag and cannot aim to control it in the short term. Rather, monetary policy needs to be geared to the maintenance of price stability over the medium term, also in order to avoid introducing undue volatility in economic activity. In this respect, the level of long-term interest rates in the euro area, as well as various other indicators of the inflation expectations of economic agents, point to continued confidence throughout 2001 in the ECB's determination to maintain price stability in the medium term.

Indeed, there were already some signs in 2001 that medium-term inflation pressures were gradually starting to decline. At the start of the year, M3 growth moderated. This, together with a decline in the growth rates of loans to the private sector, indicated that the risks to price stability from the monetary side were becoming more balanced than they had been in 2000. In addition to this, the quantification of the upward distortions to the official monetary growth figures provided evidence in early 2001 that the growth of M3 appeared to be less pronounced than originally thought.

At the same time, the global economy showed some indications of weakness in early 2001, which gradually affected economic activity in the euro area through declining investment and export growth.

As a consequence, real GDP growth in the euro area was expected to moderate. In this environment, the concern over second-round effects via wages arising from the high annual rates of increase in the HICP dissipated gradually. As information stemming from both pillars of the monetary policy strategy indicated lower inflationary pressures over the medium term, the Governing Council decided on 10 May and 30 August 2001 respectively to lower the key ECB interest rates by 25 basis points.

The terrorist attacks in the United States on 11 September 2001 were a major shock to the world economy. Immediately after the attacks, the Eurosystem took measures to ensure the normal functioning of the financial markets. At the same time, the attacks created an exceptional degree of economic uncertainty, undermining confidence. This weakened economic growth further, thereby also lowering inflationary pressures.

This general assessment of lower upward pressure on inflation was not contradicted by the analysis based on monetary data. Although M3 growth increased significantly in the second half of 2001, this rise was not interpreted as implying risks to inflation. In fact, it was related to portfolio shifts from long-term to liquid short-term assets included in M3, which were initially linked to a relatively flat yield curve and a continued decline in stock prices and subsequently reinforced by the high financial market uncertainty caused by the terrorist attacks of 11 September. The continuous decline in the annual credit growth to the private sector also supported this assessment.

In the light of this information from the two pillars of the monetary policy strategy, the Governing Council reduced the key ECB interest rates twice by 50 basis points, first on 17 September, in the immediate aftermath of the events of 11 September, and then again on 8 November 2001. After these decisions, the minimum bid rate on the main refinancing operations stood at 3.25% and the rates on the deposit facility and the marginal lending facility stood at 2.25% and 4.25% respectively, 150 basis points lower than a year earlier.

Let me also report that at its meeting of 8 November 2001, the Governing Council decided that it would henceforth – as a rule – assess the stance of the ECB's monetary policy only at its first meeting of the month. Accordingly, since November 2001 interest rate decisions have only been taken at such meetings. In addition, I should mention that in the context of its regular review of the reference value for M3, the Governing Council confirmed in December 2001 the value of 4½% for the annual growth of the broad monetary aggregate M3.

I would now like to turn briefly to the analysis of the current economic situation. Over recent weeks we have seen a slight weakening of monetary dynamics, which might be a first indication of a gradual unwinding of the factors that led to the increase of M3 growth in the second half of last year, and a continuation of the decline in credit growth. However, owing to the strong M3 growth in 2001, there is still a lot of liquidity in the economy. We therefore have to monitor monetary dynamics closely in the coming months. The persistence of excess liquidity in the economy could become a concern once the economic recovery in the euro area gathers pace.

Turning to economic developments, the latest information has reinforced our expectation that real GDP growth in the euro area will recover in 2002 and that, later in the year, it should again be back in line with potential growth. The recovery should be supported by both domestic and external factors, in an environment in which financial conditions are favourable and where there are no major imbalances in the euro area. However, at the current juncture, some uncertainty still remains regarding the strength of the recovery.

As regards price developments, there is no evidence thus far of a significant upward impact on the overall price level from the euro cash changeover. While some shorter-term effects cannot be ruled out, there is reason to believe that the introduction of the euro banknotes and coins will strengthen competition, thereby supporting the maintenance of price stability over the medium term. This notwithstanding, HICP inflation is currently somewhat higher than was expected a few months ago, owing partly to a significant rise in oil prices. If the increase in oil prices is sustained, the expected decline in annual HICP inflation rates to below 2% later in the spring could be less pronounced – and inflation rates during 2002 could turn out to be somewhat higher – than we expected in late 2001. Beyond the shorter term, in the light of current expectations of a gradual economic recovery in the euro area, upward pressure on prices from aggregate demand should remain contained. However, this outlook for inflation is fundamentally dependent on continued wage moderation. In this respect, there is some cause for concern with regard to ongoing wage negotiations.

The economic downturn in the euro area in 2001 also presented challenges for fiscal policy. Since some countries came close to the 3% limit for the deficit to GDP ratio, the experience of 2001 clearly demonstrated the need for all countries to undertake consolidation efforts in good time to ensure a fiscal position close to balance or in surplus before the start of a downturn. In order to prevent problems like those experienced last year from recurring in the future, it is vital that the commitments made to achieving balanced budgets by 2003-04 be firmly followed up in the Member States concerned.

Finally, I would like to highlight the need for structural reforms aimed at improving the functioning of product and financial markets. If implemented vigorously, these reforms can increase euro area growth potential and employment on a sustainable basis. The improvements in the functioning of markets, together with wage moderation, have contributed to strong employment growth and a considerable reduction in unemployment over the past couple of years. This is clear proof of the benefits of committing to a rigorous implementation of the agenda agreed in Lisbon and confirmed in Barcelona. However, while a number of initiatives were taken in this direction in the course of last year, it is of the utmost importance that further progress in these areas be achieved.

To conclude my statement, I should like to express my confidence that the euro will prove a stimulus for further economic and financial integration. The introduction of the euro banknotes and coins has not only enhanced price transparency, it will also highlight the fact that the European Single Market is not yet complete and that a number of regulatory, administrative or legal impediments to the free circulation of goods, the cross-border provision of services and to labour mobility still exist. It is my belief that the euro, as a visible symbol of European identity in everyday life, will increasingly bring these obstacles to light and stimulate efforts to eliminate them. In this way, the euro will accomplish one of the pre-eminent functions of the single currency, namely to "crown" the establishment of a single market in Europe.

Finally, I should like to mention that this is my last appearance in this forum as Vice-President of the ECB. I should like to thank the members of the Committee on Economic and Monetary Affairs for the very fruitful exchange of views, both in the context of my presentation of the ECB's Annual Report and on other occasions. This Committee has indeed played an important role in bringing the euro closer to the citizens of Europe.