

John Hurley: The Central Bank and the Eurosystem

Introductory remarks by Mr John Hurley, Governor of the Central Bank and Financial Services Authority of Ireland, at the Seminar for Irish Media, Dublin, 6 December 2005.

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Introduction

I would like to begin by thanking you all for making time to come here this morning. This promises to be a busy news week and I am sure there are many other demands on your time, so I am very grateful that so many of you have turned up this morning.

The aim of the session is to give an overview on the role of the Central Bank as a member of the Eurosystem. The main focus is on monetary policy, looking at the strategy, the experience to date and communication. The session will also include the launch of some new euro area statistics.

Experience and achievements

For almost seven years now the euro area has had a single currency and a single monetary policy conducted by the Governing Council of the ECB. The introduction of the single currency has been an historical landmark. In twelve countries, the euro has replaced the national currency and rapidly become part of everyday life. For the business community, intra-euro area exchange rate volatility and the uncertainty it caused for trade and investment have been eliminated. In the financial area, the role of the euro in global markets and the growth in the use of the new currency outside the euro area have also been impressive. The euro has very quickly become an important part of the global financial system and the evidence of the past seven years is that its role can continue to grow.

Within the euro area, the key challenge has been to formulate and implement the single monetary policy. As you are well aware, it has not all been plain sailing. Since coming into being, the single monetary policy has been conducted in a very testing environment, characterised by a series of shocks. At various times, especially in the early years, there were periods of exceptional economic, financial and geopolitical uncertainty. The first 18 months witnessed a very strong increase in oil prices, the peak of the dotcom boom and a significant fall in the value of the euro. The subsequent correction following the collapse of the dotcom boom, allied to heightened geopolitical tensions, then triggered the most critical and sustained period of economic and financial uncertainty witnessed in decades. This persisted until early 2003, and while uncertainty has unwound considerably since, the sharp rise in oil prices has led to uncertainty returning periodically in the interim. On top of all this, we have also seen a sizeable appreciation of the euro since 2002, particularly against the dollar, taking it back to the level prevailing at its initial launch. From that short outline, it is clear that the economic and financial environment of the past seven years has provided a stiff test of the single monetary policy.

Given this background, what has been the outcome? Over the past seven years, the evidence indicates that both inflation and inflation expectations have remained firmly under control. Since the beginning of 1999, indicators of long-term inflation expectations in the euro area have remained below but close to 2 per cent. This suggests that the single monetary policy has been successful in anchoring long-term inflation expectations and that the public and the markets are convinced about the determination to maintain price stability over the medium-term. This has been a very significant achievement in a relatively short period of time and has been an important factor in permitting euro area interest rates to remain accommodative, even after last week's interest rate rise.

I would like to comment briefly on last week's move and to emphasise its consistency with the monetary policy strategy we have in place. The decision to increase interest rates was taken against the background of the risks to price stability that have been identified. The decision will help to keep medium to long-term inflation anchored at levels consistent with price stability. Even after this increase, interest rates remain low and continue to lend considerable support to growth. As to the future, I would emphasise that the Governing Council has not taken any 'ex ante' decision to engage in a series of interest rate increases. Our mandate is to maintain price stability and we will continue to monitor all developments closely. We will examine the data, make our assessment and act as appropriate to deliver price stability.

The institutional framework

The Eurosystem institutional set-up involves centralised decision-making on monetary policy issues and decentralised implementation of those decisions. I can assure you that the Central Bank of Ireland plays an important role in both areas. One of the features of the Governing Council is the democratic way in which it goes about its business. In a sense one should not be surprised by this: the Statute of the ESCB provides for each member to have one vote and specifically restricts weighted voting to financial matters. I am impressed by the manner in which these principles are observed in practice. Certainly, there is no sense of Governors operating in a representative capacity when addressing euro area policies. Equally, it is the force of an argument, rather than who makes it, that commands respect. I can assure you that we have a very comprehensive monetary policy preparation process in place in the Central Bank, which ensures that we play a full part in the formulation of euro area monetary policy.

We also play a full part in the monetary policy implementation process. At the operational level, Central Bank staff carry out the Eurosystem's money market management operations with Dublin based banks. The banking system in Ireland actually takes a disproportionately high share of funding in ECB operations. This reflects the importance of Dublin as a financial centre, as testified by the still growing number of financial institutions choosing Ireland as a location for their operations. Thus, in terms of our interaction with the market, it may be surprising but it is nonetheless true that membership of monetary union has actually brought the Central Bank in contact with a wider range of domestic counterparties than was the case before 1999.

The Eurosystem is also responsible for the smooth operation of payment systems. The main instrument for carrying out this task is the provision of payment and securities settlement facilities. To this end, the Eurosystem has created TARGET for large-value payments in euro. At present, TARGET is a 'system of systems' made up of interlinked national payment systems, and again here the Central Bank plays a full part. In excess of one million transactions, amounting to almost EUR5 trillion, were processed through the Irish system in 2004. This represented 1.5 per cent by volume of the total transactions processed by the TARGET system last year.

While I have focussed on the Central Bank's responsibilities in relation to Eurosystem monetary policy, I would like to emphasise that this is only one part of what we do. Additional responsibilities, among other things, include contributing to the maintenance of financial stability and providing banknotes and coin; our full set of responsibilities are set out in the Three Year Strategic Plan which we published in 2004. This gives you a flavour of some of our activities and I feel I should now stop and hand over to Tom O'Connell and his team who will tell you a lot more about the role of the Central Bank as a member of the Eurosystem, with a particular focus on monetary policy.

Once again I would like to thank you for taking the time to come here this morning.