Mr. Duisenberg's opening statement at the meeting of the Governing Council of the European Central Bank Introductory statement by the President of the European Central Bank, Dr. W. F. Duisenberg, at the press conference held in Frankfurt on 11/9/98.

Ladies and gentlemen, the Vice-President and I are here today to report not only on the outcome of today's meeting of the Governing Council of the European Central Bank, but also - as you are already aware - on the outcome of the meetings of the Governing Council and the General Council that took place on 1 September 1998. It was in view of the short time span between the two sets of meetings that we decided that it would be more efficient to hold only one press conference to provide you with a summary of our deliberations.

It is my intention to continue this practice for the remaining meetings of this year. In this regard, the Governing Council will meet, not only as scheduled on 13 October, 3 November and 1 December 1998, but there will also be an additional meeting on Tuesday, 22 December 1998. By this time, the bulk of nearly five years of preparatory work - including the "EMI years" - will be behind us and I envisage that the Governing Council's final meeting before the start of Stage Three of Economic and Monetary Union (EMU) will be devoted to fine-tuning its last-minute preparations. You will recall that monetary policy decisions remain a national competence until 31 December 1998. Looking ahead to next year, the Governing Council will hold fortnightly meetings and I intend to hold a press conference, normally, once a month. For the first quarter of 1999, I envisage holding a press conference immediately after the first meeting of each month. Further details of the meetings schedule are provided in the separate press release that will be issued to you this evening.

Let me, however, return to the present. The Governing Council and the General Council devoted part of their September meetings to an extended exchange of views on recent economic, monetary and financial developments. In particular, much attention was paid to the global economic and financial environment of the future euro area, which has clearly worsened. Two major factors are currently affecting capital markets. First, the "flight into quality". Second - and related - the tendency to switch from equities to bonds. As evidenced once again over the past few days by large swings in investor sentiment, the monetary policy environment has become more uncertain.

One focal aspect of the discussion has been a close monitoring of the financial crisis in Russia. As we all know, the Russian crisis has added to concerns regarding the state of the world economy at a time when the crisis in Asia is still ongoing and growth in Japan is negative. These concerns have been fuelled by renewed strains in international financial markets as well as sharp fluctuations and downward corrections in major stock markets. There is no doubt that these developments will have a dampening effect on the world economy. However, their precise impact is difficult to measure at the current juncture.

On the one hand, economic and model-based analysis still suggests only moderate effects on prices and output in the euro area. This is due to the fact that, first, most of the crisis regions are quite small in economic terms, i.e. when compared with world GDP or their contribution to world trade. Second, trade links between these countries and the euro area are also of limited size. Third, the euro area itself is a very large economy, which is only directly exposed to variations in global trade to a certain degree. However, on the other hand, this analysis should not mislead us. We are perfectly aware that the risks associated with current global developments go beyond those effects which we can measure directly. In this respect one may think of indirect influences resulting from changes in confidence, saving and expenditure within the euro area. We have to take these risks seriously and analyse the situation soberly, but we should also not dramatise.

Let me now turn to the latest available data. These seem to indicate that economic expansion within the euro area has remained broadly on track, despite the worsening of the external environment. Domestic demand remains strong, while the contribution to growth from net exports has declined. Both private consumption and investment provided an important stimulus to the growth rate in the first quarter of this year. More up-to-date indicators point towards continued expansion in the second quarter, albeit at a possibly more moderate pace than in the first quarter.

The outlook on consumption is supported by higher real earnings growth and declining unemployment, and is reflected in consumer confidence. The evidence for the corporate sector is perhaps more mixed. As compared to the first quarter of 1998, industrial production figures show a somewhat slower rate of increase in the period from April to May, but capacity utilisation has continued to increase and this, combined with low interest rates, should underpin investment. European Commission survey data, such as confidence indicators and the assessment of order books, bear witness to relatively high levels, both with respect to their long-term averages and recent peaks. This can also be taken as a favourable indicator for continued growth in the short term, although some indicators have not improved further since the spring. Unemployment has also been declining, but at a modest pace, and from a high level. In discussing the cyclical uncertainties, one should not forget that work on badly needed structural reforms has not so far made much progress.

Considering recent price developments, HICP inflation for the euro area as a whole remained stable at 1.4% between May and July. Both domestic and external factors still appear to be favourable, suggesting that euro area inflation may be expected to remain subdued in the future. An important external factor underlying the favourable prospects for inflation is the sharp decline in oil and commodity prices, which is partly associated with developments in Asia. Moreover, domestic sources of inflation, such as those arising from the labour market situation and capacity utilisation, are also relatively moderate at the present juncture. In my opinion, taking a euro area wide perspective, these views are also broadly compatible with current monetary and financial developments. In this connection, please take note that we should soon have new information on monetary developments on the basis of the new statistical reporting framework for money and banking.

The environment of significant volatility in international financial markets, particularly stock markets, appears to account for much of the recent decline in long-term interest rates in the euro area to historically low levels, as investors have sought to protect themselves against heightened global risk. Nonetheless, it is notable that the euro area yield curve shifted downwards at all maturities, which to some extent would tend to indicate a further decline in long-term inflation expectations for the euro area as a whole.

As we approach the start of Stage Three, we shall need to continue to monitor closely economic, monetary and financial developments within the euro area and in the world economy. This will allow us eventually to set the interest rate for the euro area as a whole. At the same time, we shall also need to monitor fiscal intentions in the euro area Member States, as they will become more transparent over the autumn. If governments merely adhere to previous deficit targets for 1999, the structural position of budgets in quite a number of countries would effectively deteriorate. This would entail that they would move farther away from, rather than approach, the requirements of the Stability and Growth Pact, which calls for the achievement of a budget close to balance or even in surplus.

In addition to the review of economic developments, a number of organisational issues were settled.

(i) The General Council adopted its Rules of Procedure, which will be published in the Official Journal of the European Communities. You will recall that I informed you that the Governing Council's Rules of Procedure were adopted in July.

(ii) The General Council also decided that the non-euro area national central banks shall pay up 5% of their subscriptions to the capital of the European Central Bank (ECB). However, the four national central banks concerned will not be asked actually to pay in their share as the amount due is less than they can expect to receive as their share in the proceeds of the liquidation of the European Monetary Institute (EMI). Further details on the actual amounts involved are provided in the separate handout that will be issued to you this evening.

(iii) For its part, the Governing Council completed the list of committees which will assist in the work of the European System of Central Banks (ESCB). In addition to the eleven ESCB Committees agreed upon at the meeting in July, the Governing Council decided to establish an International Relations Committee and a Budget Committee. The latter was set up in order to provide transparency to the shareholders of the ECB - the national central banks - on matters relating to the budget of the ECB.

(iv) Finally, the Governing Council endorsed the draft Headquarters Agreement between the German Federal Government and the ECB, which will be signed here in Frankfurt on 18 September 1998.

A number of decisions were also taken with regard to various aspects of the preparatory work for Stage Three.

(a) Exchange rate policy co-operation between the euro area and other EU countries

The General Council endorsed the text of an Agreement between the ECB and the non-euro area national central banks, laying down the operating procedures for an exchange rate mechanism in Stage Three (the so-called ERM II). You will recall that the European Council in Amsterdam in June last year agreed to set up an exchange rate mechanism in Stage Three to replace the present European Monetary System (EMS). For this reason, the EMI had, on behalf of the ECB, prepared a draft Central Bank Agreement to replace the current exchange rate mechanism (ERM I, if you like) by a new one in Stage Three. It is this Agreement which has now been signed by the President of the ECB and the Governors of the four non-euro area national central banks. The signature by the latter implies their agreement to the operating procedures. It does not, however, imply their participation in ERM II.

Further details on the conventions and procedures for ERM II are provided in the separate press release that is being issued to you this evening. The Agreement itself will be published in the Official Journal of the European Communities.

(b) Monetary policy issues

The Governing Council agreed on several issues relating to the monetary policy framework in Stage Three. At the centre of this framework is the report entitled “The single monetary policy in Stage Three: General documentation on ESCB monetary policy instruments and procedures”, which contains a detailed description of the monetary policy instruments and procedures to be applied by the ESCB in Stage Three. The report expands on and updates the material included in an earlier version of the report that was published by the EMI in September 1997. I should like to limit my remarks in this regard to the announcement that a copy of this comprehensive report will be released very shortly, at which time a separate press release explaining the nature and purpose of the documentation will be issued.

The Governing Council also agreed upon a guideline for the management of the foreign exchange assets by the national central banks and for the Member States’ transactions with their foreign exchange working balances. These are now being formalised in official legal documentation.

(c) Statistics

The Governing Council endorsed the statistical framework on the basis of a number of reports that had been prepared by the EMI - many of which had been published in the past - thereby confirming the ECB’s statistical requirements for Stage Three. I should perhaps point out that the reporting framework for the money and banking statistics of the ECB will appear in the “General Documentation” that will be released next Wednesday.

(d) Euro banknotes

With regard to the euro banknotes, the Governing Council confirmed (in line with previous recommendations by the EMI) that seven banknote denominations would be issued: 5, 10, 20, 50, 100, 200 and 500. Furthermore, it decided that there would not be any national features on the euro banknotes. As you know, the euro banknotes will be put into circulation on 1 January 2002. Thus there are fewer than 800 working days to go before their launch. The Governing Council took note that the technical preparations for the euro banknotes are proceeding according to schedule. The origination phase (i.e. the process of converting the designs into proof-prints) has now been successfully concluded and a zero-production run will be conducted in the autumn before mass production starts in early 1999.

(e) Payment systems

The Governing Council endorsed a list of eligible securities settlement systems following an assessment of such systems against standards that had previously been laid down for their use in the credit operations of the ESCB. The list, which indicates those securities settlement systems that will be used by the ESCB and the conditions for their use, will be set out in the “General Documentation”, to which I have already referred. In addition, the Governing Council approved a report on the “Assessment of EU securities settlement systems against the standards for their use in ESCB credit operations”. It is intended to release this report during the next couple of weeks.