

Launch of the Euro

Corsetti & Pesenti

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Launch of the Euro

- ✦ Dec. 31, 1998, based on ECU and bilateral parities as announced May 1998
- ✦ TARGET payments system for large transfers (Trans-Europe Real-time Gross Settlement Express Transfer)
- ✦ ECB, established June 1998, coordinated monetary policy in advance of euro
- ✦ Continuity with Bundesbank policy strategy

The Strategy of Monetary Policy

- ✦ HICP price increase of < 2% over medium term
- ✦ Two “pillars” for monitoring inflation:
 - 4.5% “reference” growth rate of M3
 - Economic factors influencing price inflation
 - Dual targeting of money and inflation raises questions
- ✦ Reports and analysis to Press and EP monthly
 - No forecast of inflation
 - No minutes of meetings

Implementation of the Strategy

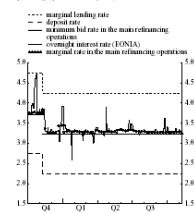
- ✦ Focus on Price Stability at expense of output?
 - April 1999 interest rate cut as evidence against
 - Lack of concern over external value of euro
- ✦ Bias in favor of weaker countries?
 - In response to fiscal constraints from SGP
 - National Central Bank representatives on Monetary Policy Committee
- ✦ Role of monetary aggregates in “Two Pillar” Strategy
 - Depends on stability of euro money demand
 - Continuity with Bundesbank policy rules
- ✦ Accountability vs. Secrecy in voting and minutes

Instruments of Monetary Policy

- ✿ Open Market Operations
 - NCB repo purchases/sales via auction at fixed (refi) rate, switched to variable rate in mid-2000
 - Volume averaging € 3 trillion per year
 - Problems in forecasting impact of national Treasury operations on bank liquidity
- ✿ Deposit and Lending Facilities
- ✿ Excess Reserves remunerated at refi rate

Euro Interest Rates

Chart 1
ECB interest rates and money market rates
(percentages per annum, daily rates)



Source: ECB and Reuters

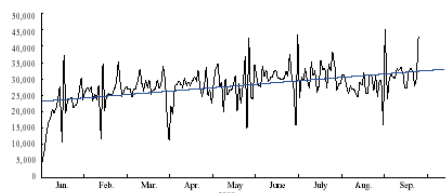
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Liquidity Management

- ✿ TARGET (Trans-Europe Real Gross Settlement Express Transfer) System
 - for large inter-country payments
 - Competes with private systems in France, Germany, etc.
 - Domestic volume exceeds cross-border volume
- ✿ Interbank market for overnight reserves

Target System Volume

Chart 1
Volume of TARGET cross-border payments
(billion Euros)

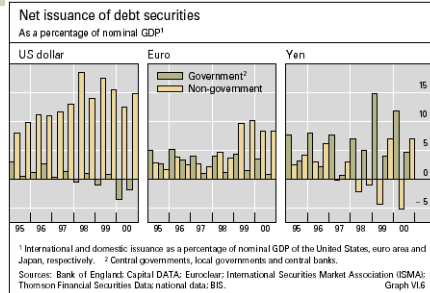


Source: ECB Monthly Report, October 1999

Bond Market, Public Debt, & Equities

- ✦ Rapid growth of corporate bond market, especially on issuing side
- ✦ Shift from bank financing via bonds to direct corporate borrowing
- ✦ Government bonds reflect credit quality of different governments, relative to SGP goals
- ✦ European equity markets boomed in 2000, slumped in 2001-2002
 - Need for Euro company law, common prospectus
 - Lamfalussy Committee Report

Debt Securities Market

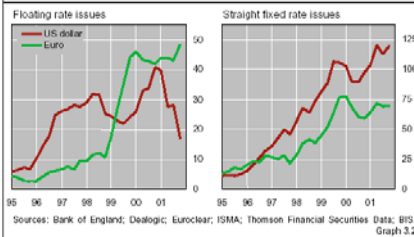


Source: BIS Annual Report 2001

Euro-bonds

Net issuance of international bonds and notes

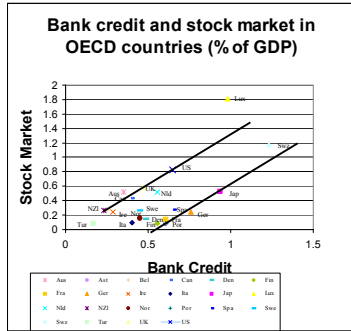
Four-quarter moving averages, in billions of US dollars



Banks, Mergers & Acquisitions

- ✦ Bank-dominated vs. market-oriented finance (German vs. Anglo-Saxon model)
- ✦ Within country consolidation – “national champions”
 - Reduced competition in segmented national markets
 - National supervision of banks may lack rigor
- ✦ Future development of Eurozone-wide banks
- ✦ Mergers up from 300/yr in 1980s to 400-800/yr 86-92.

German vs. Anglo-Saxon Financial Markets



Exchange Rate of the Euro

- ✿ Euro weakness since 1999 introduction a surprise
- ✿ Business cycle differences the main reason
- ✿ Increased supply of euro assets > increased demand, especially given strong US stock market
- ✿ Discussion of “target zone” for \$/€ rejected in 1999

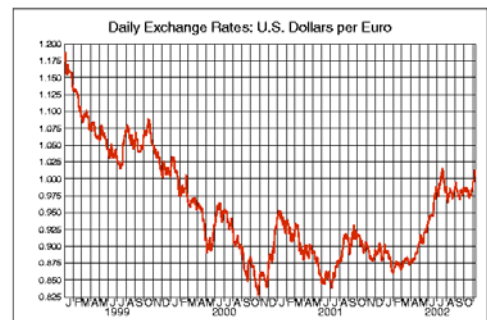
Impact of Business Cycle on Euro

Figure 3. Revisions to 1999 GDP Growth Forecasts and the \$/Euro Exchange Rate



PACIFIC Exchange Rate Service

Euro Exchange Rate

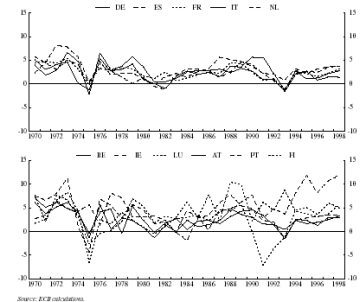


Asymmetries in the Eurozone

- ✿ Disparities in Growth Trends – Periphery vs. Core
- ✿ Synchronization of cycles
- ✿ Endogenous currency union optimality
- ✿ Asymmetries in transmission of monetary policy
 - Reliance on consumer credit
 - Importance of variable rate mortgages
 - Role of bank credit vs. credit market
- ✿ Inflation disparities due to catch-up of faster-growing laggards
- ✿ Price *level* disparities due to market segmentation

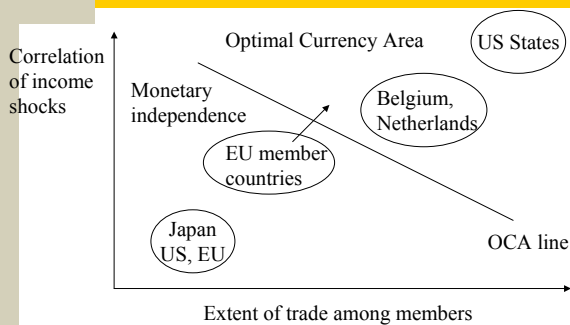
EU Growth & Cycles

Chart 1
Real GDP growth in euro area countries
(annual percentage change against 2000)



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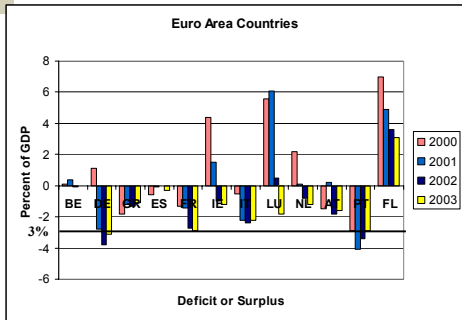
Correlation of Shocks vs. Trade Shares



The Stability & Growth Pact

- ✿ To enforce Maastricht Criteria on members:
 - Target Budget Balance, to allow deficits in recessions
 - Convergence Programs required, with monitoring
 - Excess Deficit > 3% of GDP only if “unusual event” or “serious downturn” (-2% of GDP or “further supporting evidence”)
 - Action Plan to remove deficit required
 - Sanctions after 10 months of non-compliance, sooner if deliberate
 - Non-interest-bearing deposit [0.2% of GDP + 10% of excess deficit, up to 0.5% of GDP], converts to fine after 2 years of non-compliance

Euro Zone Fiscal Deficits



Source: European Commission Forecasts, Autumn 2002