

The Riksbank, EMU and the ECB

*Address by Mr. Stefan Ingves,
Deputy Governor, Sveriges Riksbank,
to IIR's conference on the euro,
23rd October 1996*

First a word of thanks for the invitation to talk about the Riksbank and the EMU process. Matters to do with EMU have become increasingly prominent, not just on the Riksbank's agenda but in the community in general. I find myself devoting more and more of my working hours, internally and increasingly, as today, outside the Riksbank, to talking about the preparations for EMU. I also note that in the past six months alone, people have become markedly more knowledgeable about EMU, which I find encouraging.

More and more people are now getting acquainted with the main features of the process leading up to the single currency. But there is still widespread uncertainty about matters of detail and, above all, about how the changeover as a whole will be arranged. Today, I shall therefore try to be specific about what lies ahead in work on the changeover and the **role of the Riksbank in this work**.

Before going any further, I also want to point out that time passes and we shall soon be approaching the point where the work on practical preparations can no longer be postponed. If we want to be in a position to participate in the monetary union from the start in 1999, the time has come to prepare for this.

It will soon be 1997, which is when, for instance, the new European payment system, TARGET, is to be tested and run in. In 1997, moreover, the Riksdag, Sweden's parliament, is due to decide whether or not Sweden

is to participate in EMU. Again, economic performance in 1997 is particularly important in that it is that year's statistics which are to be the basis for decisions about which countries fulfil the convergence criteria. At the same time, numerous technical preparations will have to be made in the financial sector.

People often ask whether there is really any need to make preparations and whether a union will actually be established. My answer is that the single currency did seem rather remote just a year ago and scarcely any country had an economy in line with the convergence criteria. Most of the major decisions were still pending in Frankfurt and most countries had made limited progress in their domestic preparations.

Today the situation is different. The member states are vying to fulfil the convergence criteria, last week our eastern neighbour, Finland, decided in favour of ERM participation, and even in their domestic spheres, most countries have initiated comprehensive work on the planning and implementation of the changeover to a single currency. The governments in most member states, Sweden included, have also become more and more engaged in work on the changeover. This summer the Swedish government decided to appoint an EU coordinator and concentrated work has been devoted since then to a ministerial memorandum on the changeover issues. Last but not least, the markets have begun to believe that Stage Three of EMU will begin on time; convergence dealing has started in Europe's financial markets. All this convinces me that we will have a monetary union in Europe in 1999.

The debate in Sweden should therefore concentrate to a greater extent on how we are to prepare for this new situation, regardless of whether or not Sweden participates from the start.

Before talking about the work that lies ahead, I want to refer briefly to fulfilment of the convergence criteria on Sweden's part. This is, after all, what determines whether or not we can qualify from the start in 1991.

The convergence criteria must be fulfilled if the option of participating is to be ours in 1998 when the heads of state or of government decide which member states are to be included in the euro area. The convergence criteria do not entail a new direction for Sweden's economic policy. Three of the criteria relate directly to the Riksbank's domain, namely those for inflation, the long-term interest rate and the exchange rate. It is up to the Riksbank to keep inflation down and this gives the market an incentive to hold the long interest rate at a low level,

which is partly dependent on general expectations about the future rate of price increases. At present Sweden has the lowest rate of inflation in Europe and we expect that Sweden will continue to fulfil the price stability criterion in 1997. The recent downward tendency in interest rates indicates that we will probably also fulfil the interest rate criterion. The exchange rate criterion has been the subject of much discussion. Some consider that to qualify, a country must have participated in the ERM for at least two years prior to the examination for EMU, while others argue that what matters in practice is the national currency's stability. Sweden adheres to the latter view. As regards the remaining criteria, the budget deficit for 1997 is forecast to be close to 3 per cent. The Government has declared that it is prepared to implement measures if the deficit moves in an unfavourable direction. On the other hand, it is probably not feasible to reduce the government debt-to-GDP ratio, currently around 80 per cent, to the stipulated 60 per cent as early as 1997. However, the Maastricht Treaty provides for a flexible interpretation here; a debt ratio above 60 per cent would be acceptable if, for example, "the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace", to quote the Treaty. All in all, it therefore looks as though we will fulfil the convergence criteria, which naturally makes it still more relevant, even for those who hesitated earlier, to begin the preparations.

To return to the issue of planning, I usually kick off by saying that **everything has to be done three times**.

Firstly at the EMI in Frankfurt, where we and the other fourteen member states have to reach agreements and make decisions.

Secondly there are the changes to be made in each central bank. In that monetary policy will be directed from Frankfurt, the central banks also face major changes. Moreover, as a bank we must be capable of handling TARGET, for example.

Thirdly, we must implement the changes on a national basis. At the Riksbank we are doing everything to manage the first two items on time. On the third I can promise that we will do all we can to assist, but the responsibility here is not ours; instead it is actually up to each and everyone in society to be prepared.

How to know what to do

In order to coordinate the preparations for the introduction of the single currency, the EMI (the forerunner of the European Central Bank, ECB) is conducting work on numerous projects in various areas. The work of the EMI is monitored at monthly meetings of the EMI Council. They confirm the timetable and guidelines and formally confirm the decisions. The meetings are prepared by sub-committees and working groups that include representatives of the Riksbank and the other central banks. The activities of the EMI cover many areas and each area gives rise to numerous projects. According to the latest list, work is currently in progress on about 90 different projects for EMU. Other projects have already been completed and there will no doubt be new ones further on. Many matters will have been fully discussed and decided by the turn of this year; others can wait until 1999 or even later.

Which areas are discussed in the Master Plan?

To give you some idea of the current issues, I shall now outline some of the areas in which we are working at the EMI.

Monetary policy. Monetary policy will be conducted centrally from the ECB in Frankfurt. A single monetary policy is one of a monetary union's basic components. There are many indications, however, that the actual execution of monetary policy operations will be decentralised, at least initially, to the national central banks. As you will have learnt from the media, a discussion is in progress on the appropriate strategy for attaining the ultimate objective, which is price stability. Should there be an explicit inflation target, like the one currently implemented by the Riksbank, or should inflation be tackled indirectly by managing liquidity in relation to an intermediate goal? The Swedish view is that the difference is not as great as it sometimes appears to be. In both cases the objective is to safeguard a stable value of money.

It is also necessary to harmonise monetary policy's instruments. Besides repos, other direct market operations by the central banks and standing credit facilities, some countries use reserve requirements. The

single monetary policy will probably have such instruments at its disposal. This issue is to be decided as soon as 1997. Another major matter where the question of centralisation versus decentralisation has still to be decided is the management of exchange reserves.

Payment system. The implementation of a single monetary policy throughout the EMU calls for an ability to undertake euro operations promptly across the entire area. This calls for a network to handle cross-border payments. The project for this is called TARGET. In practice it involves harmonising the national systems for large-value payments - in Sweden's case the Riksbank's RIX system - so that they can communicate with each other. All the national systems are to be based - as the Swedish system has been for several years - on the principle of real time gross settlement, or RTGS, which means that payment orders entering the system are settled one by one on a continuous basis during the system's operating hours. This network of national RTGS systems, which has been named the TARGET system, will make it possible to initiate and settle cross-border euro payments in a matter of seconds.

The specification of the TARGET system was decided by the EMI Council this summer. It is now up to the central banks and the banking and clearing institutions to adapt their own payment systems so that these can handle euro and fulfil the other requirements for participation in TARGET. The euro function is necessary so that payments can be sent and received via the RIX system, which will be the Riksbank's entrance to TARGET. The TARGET system is to be supplemented with separate systems for handling securities as loan collateral in the payment system and for the implementation of monetary policy. In many EU countries, the settlement system for securities is wholly or partially owned by the central bank. This is not the case in Sweden but the frequent and close consultations between the Riksbank and the Securities Register Centre ensure that the mutual exchange of information functions well.

The construction of the RIX system will differ according to whether or not Sweden participates in the euro area. This means that the banking and clearing institutions must also prepare alternative solutions. Regardless of whether we participate or not, Sweden will be able to use TARGET for sending and receiving euro payments. Moreover, if Sweden remains outside, the Riksbank intends to provide euro accounts alongside the krona accounts.

A specific detail concerns the payment and accounting procedures in the period when the krona is still being used but the euro is being adopted more and more as a unit of value by government, business and others. For example, the banks must be prepared to accept incoming payments in kronor while making the equivalent outgoing payments in euro. Somewhere in the system there will have to be a conversion mechanism - popularly known as "the black box" - for translating kronor into euro at the fixed rate. This procedure may even be able to provide the recipient with a payment notice that offers the choice of being paid in either kronor or euro. Prior to 2002, of course, the absence of physical notes and coins means that euro payments can only take the form of transactions on account

The plan is for public authorities gradually to adopt the euro as the unit of value from 1999 onwards. Right from the start, for example, all monetary policy transactions are to be conducted and expressed in euro and new government loans are to be issued in the single currency. One purpose of this is to demonstrate that the new currency has official backing. Private sector agents may change to euro as the unit of value when they find this appropriate (though by the end of 2001 at the latest). The central banks will, however, provide incentives for an early changeover, for example by using euro in their transactions with the banks and in the money and foreign exchange markets. (This does not preclude the use of kronor for inter-bank transactions.) The Riksbank will be making this changeover right from 1st January 1999, from which date the euro will be its unit of account.

Banknotes and coins. The interval between the initial planning for a new banknote and the printing and issue of the first series is rather long. Although it is possible that euro banknotes will not be issued before around 2002 - the final decision by the ECB is due in 1998 - work on them has been in progress for some time. A design competition has been launched and a number of enterprises in Europe have drafted proposals for the appearance of the banknotes, featuring two themes: ages and styles of Europe, in the form of architecture, art or other subjects; and abstract designs.

The coins are to have a national face and a European face. For the Riksbank there is also the task of planning this huge replacement project. All krona coins are to find their way to the Riksbank and be exchanged for euro. In view of the practical problems of using coins in two currencies

side by side, it is important that the changeover is completed as quickly as possible. Among other things, this will require a lot of transportation and storage facilities.

The banknotes will have a wide circulation that will probably include non-EU areas. The opportunity is being taken to incorporate the latest safeguards against counterfeiting. These include watermarks, security threads and other traditional components, as well as more advanced optical features.

Statistics. A great deal of the EMI's statistical preparations were completed this summer. You are no doubt aware that EMU will involve changes as well as additions to reporting requirements. More reporters will result, by definition, from a larger number of Monetary Financial Institutions (MFIs), which will be under an obligation to report. The primary purpose of the statistics in the banking area is to provide a foundation for the single monetary policy. In order to measure liquidity in the financial sector, the ECB needs information about bank balances and other financial transactions. There must also be access to other balance-sheet figures of relevance for the general stability of the payment system and the possibility of tensions there. For the statistics to be compiled in the EMU and serve as a basis for monetary policy, they need to be harmonised so that every country reports the same things in accordance with uniform principles. Extensive work on this harmonisation is now in progress and the reporters are in the process of absorbing detailed information about the changes with a view to taking the necessary measures.

Ins and Outs. The preparations in Sweden are being made so that we are in a position to join the euro area right from 1st January 1999. But Sweden may, of course, be one of those countries that, voluntarily or otherwise, remains outside this area. The outs will fall into different categories: some will have to wait because they do not fulfil the requirements, other will meet the requirements but choose to wait. For the United Kingdom and Denmark, unlike Sweden, the latter option is incorporated in the Maastricht Treaty.

A major question to solve before 1999 is the nature of the relationship between the ins and the outs. The outsiders will continue to be members of the European Union and participate in the single market, which must not be prevented from functioning. It is therefore in the interest of all the

member states that monetary stability is also achieved between insiders and outsiders. For example, a devaluation of an outsider's currency would lead to problems for the insiders, for which the only way of achieving a compensatory writedown would lie in a depreciation of the euro and that might jeopardise price stability. Intense discussions are in progress to decide arrangements, affecting both ins and outs, that can safeguard this stability. This is clearly in the outsiders' own interest, particularly those that are striving to stabilise their own economy with a view to participation at a later date. The construction of the arrangement, which is called ERM2, is to be finalised this autumn. It seems likely that the euro will be the anchor of this new exchange rate mechanism; that the margins for fluctuations will be wide, perhaps ± 15 per cent as at present; that interventions will be obligatory; that any country may, if it wishes, negotiate a narrower band; and that participation will be voluntary, though this will be "expected" of outs.

In addition to the exchange rate mechanism, the proper functioning of EMU requires that fiscal policies are conducted satisfactorily. The national economies must remain more or less convergent even after the third stage has begun. Government finance must be sound and the balance of payments stable. To ensure this, there will be a stability pact. Its construction has not been finalised but we do know that sanctions in some form would be imposed on a country that allows its deficit to get out of hand. Discussions are in progress on the severity of these sanctions and when they would be triggered. The structure should be completed by the Council meeting in Dublin this December.

From this it can be concluded that if Sweden were to remain outside the euro area, our economic policy could scarcely be less directed towards stability. It is not just that the rest of the world would react by withdrawing from krona investments, leading to higher interest rates in Sweden; we would also be included in the monitoring of all EU countries' economic policies.

Other areas. As I indicated earlier, the Master Plan covers a great many areas. In addition to those I have reviewed specifically, there is the establishment of the European Central Bank (ECB) and its relationship with the national central banks (NCBs). In this context it should be noted that the independent status of NCBs, for instance in relation to the national government, is a requirement that applies to outsiders as well as insiders.

Another aspect is all the legal issues in every area. A group of legal experts from the central banks has been formed to tackle these issues. An important example is the continuity of contracts. As of 2002, current contracts which stipulate that payments or other transactions are to be completed in the national currency will be performable (for the insiders) only in euro because the national currency will have ceased to be legal tender. The lawyers are now considering how to pave the way so that law courts, at least in the EU area, recognise euro payments as a completion of contractual undertakings to pay in a national currency. The legal status of the euro will be clarified in an ordinance that is due for completion this autumn.

Another legal issue with considerably less weight in principle but of great practical importance for us all is the rounding rules for translating national currencies into euro. Conversions are to be made at fixed rates, so it is highly important that the rounding rules are exact and uniform, regardless of the currency or currencies involved in a particular transaction.

There is also the issue of the Riksbank Act - must it be amended? Does the Riksbank already have the independent status which the Treaty stipulates? The governor of the Riksbank is, in principle, to be irremovable and be prohibited, in the context of decisions in the ECB, from either seeking or taking instructions from, for example, the Riksbank's governing board. Another knotty problem is whether members of Sweden's Riksdag will be eligible for membership of the Riksbank's governing board. The other EU countries consider that they should be debarred but our position is that this should be allowed.

Other areas where rules need to be reasonably similar are accounting and information technology (IT). Uniform accounting rules are required for comparisons of the central banks' activities and the IT issue calls for solutions to numerous practical problems. For example, how is the exchange of information between NCBs to be arranged for the implementation of monetary and exchange rate policy transactions? And how in practice are the payment systems to be linked together?

After this brief account of what is being done in Frankfurt, my message to those who are still in doubt is that the Master Plan is being implemented and the work will be completed on time.

If we join, what will happen to the Riksbank?

Monetary policy will be decided by the ECB in Frankfurt but the Riksbank will still have virtually all its operative functions. Banknotes and coins must continue to be distributed, regardless of whether they are denominated in euro instead of kronor. The RIX system will still be operating. We will continue to formulate opinions about monetary policy and the governor of the Riksbank will participate in the ECB's monetary policy decisions. Moreover, the implementation of monetary policy will be in the hands of the NCBs. It is also likely that we will want to continue our analytical activities, for example the regional analyses or analyses of particular relevance for Sweden.

Another matter that is being discussed is whether the pool of foreign reserve assets is to be managed centrally in Frankfurt or be decentralised to the NCBs. Furthermore, the Riksbank will continue to be responsible for the national payment system, as well as for the distribution of banknotes and coins. Ensuring that physical means of payment are available throughout the country is a task that accounts for a very large part of the Riksbank's activities and this will continue to be the case even if we change to euro. Another continuing function will be the close oversight of the financial sector with a view to promoting a reliable and efficient payment system.

All this means that much will continue to be required of the Riksbank's work, at the same time as we, just like many others, will carry out changes and adapt our resources and functions to the new requirements inherent in the establishment of the European Monetary Union.

Now that I have outlined what is being done in Frankfurt and how EMU will affect the Riksbank, I should like to return to the ongoing preparations in Sweden. How are we doing and where is it being done?

Information and consultation in Sweden

As the work of the EMI has not been completed in every area, we have been careful to date not to influence the financial sector in a particular direction. We have been content to disseminate information about those aspects where the outlines of future decisions could be discerned. We have encountered a great need of information and been showered with questions

about the EMU process, in general as well as in its particulars. The requests have come from many different walks of life: authorities, the financial sector, trade unions, business organisations, journalists, students, the general public and so on. It is self-evident to us that the Riksbank and other authorities should do all they can, within the confines of confidentiality and the available resources, to provide information. The democratic principle implies that as much information as possible about the consequences of participating in the euro area should be spread before the Riksdag adopts a position in 1997. This will promote a serious discussion.

The Ministry of Finance and the Riksbank each have an organisation for the euro's practical introduction. I do not want to suggest that the room for flexibility in connection with EMU is particularly great. It is a fundamental principle that, as far as possible, the parties shall be free to decide just how they adapt to EMU's requirements. This may mean that, for example, the fulfilment of a goal, such as a particular statistical product, is what matters, while the technical way of doing this is left open. Even so, many of the EMU requirements probably have to be formulated in such detail - to achieve the necessary harmonisation - that in practice the degree of freedom is limited.

At the national level the Ministry of Finance is responsible (under Claes Ljung) for the work of planning and preparations in four sectors: Legislation, Public administration, the Business sector, and Citizens and the euro.

A fifth sector, the Financial sector, has been assigned to the Riksbank, which last spring set up a body for consultations. This body, SIFS (the acronym of the Swedish for Consultation and Information to the Financial Sector), is a controlling group directed by the Riksbank and it includes representatives from the Ministry of Finance, the Financial Supervisory Authority and the National Debt Office, as well as from the Swedish Bankers' Association and other affiliations of financial institutions, insurance companies, securities and finance companies, clearing and settlement institutions, etc. The group is a forum for discussing policy and reaching a consensus on important matters. It is also used for the mutual exchange of information about the organisations' own EMU preparations.

The practical work, including the day-to-day work on the preparations, is undertaken in five subordinate working groups. The activities correspond to the primary areas in the Master Plan, e.g. Monetary and

exchange rate policy, Payment system, Statistics, Banknotes and coins, and Legislation. At the earliest possible date the Riksbank provides detailed information about what is being done in the EMI. We also present our own plans for adapting to the decisions. On this basis the banks and others can then get to work. Any difficulties that may arise with the preparations can be discussed in the group. The motto for the changeover period, as well as for our consultations, is "voluntary". This requires that the financial agents play an active role and identify the issues and problems they need to solve.

The work to date has proceeded very satisfactorily and we are grateful for the response provided by the financial agents.

The work on a **Swedish plan for the changeover in the financial sector** will be a continuation of this collaboration. It will be necessary to have some kind of coordinated document that presents conceivable arrangements for the changeover to a single currency. We envisage a plan consisting of a main text and annexes.

In the **main text** we will try to describe how the changeover will be carried out in a number of areas: Statistics, Monetary policy, Means of payment, Payment system, and Legislative changes. Accounting and IT issues will also be considered.

In addition, in order to flesh out this plan with more details and bring it down to specific practical problems, we have invited 16 interested organisations and authorities to write **annexes** to the main text. We hope they will be able to present the most important details of how each organisation views the changeover and of when various changes will be made.

It is all a matter of providing as much information as possible about how a changeover might be achieved. Perhaps we can agree that the securities sector will change to the euro all at once on a particular date. Perhaps we can agree on the practical arrangements for changing to euro banknotes, etc. We hope that some time around the turn of this year we will be able to present a complete plan for the changeover in the financial sector. This we believe will assist us all in the major work that lies ahead.

Summary

Finally, here is a brief summary:

- The situation has changed in just the last six months.
- It looks as though Sweden will fulfil the convergence criteria.
- Other EU countries are doing all they can to meet the requirements and the work on preparations is now in progress all over Europe.
- Everything has to be done three times:
 - In Frankfurt
 - At the Riksbank
 - In the community
- Frankfurt is where the EMI, in which the Riksbank participates, is making its preparations; 90 projects are in progress in the various areas: monetary policy, statistics, means of payments, payment systems, legislation, etc.
- At the Riksbank we are working on an internal master plan to prepare for the changeover.
- Out in the community the Ministry of Finance is the primary coordinator and the Riksbank is working in the framework of the SIFS.
- During the autumn a Swedish plan will be completed for the changeover in the financial sector.