

# Speech

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## Sweden and EMU

Swedish Bankers' Association  
Annual meeting

First I should like to express my thanks for being invited to attend your annual meeting and talk about the European Monetary Union. We have listened to our Finance Minister's account of the political situation in Sweden and heard Finland's Central Bank Governor present the situation for a country that intends to participate in the currency cooperation from the start. My talk focuses on the situation for the Riksbank, a situation that can be described as being both out and in. This is because there are a number of respects in which, as a central bank, we will have to "join in" even though Sweden as a nation has chosen not to participate fully in Stage Three from its inception.

An outside position will obviously exclude us from EMU's major step - the introduction of the single currency. Neither will our monetary policy be handed over to the ECB. But regardless of this, Sweden is a member of the European Union and has full access to the inner market. We are, moreover, already participating in Stage Two of EMU and will be a member of the European System of Central Banks. The Riksbank also has to maintain a state of readiness for the possibility of participating later on. My remarks today will concern the Riksbank's future handling of this situation.

### **Sweden - EU member but euro outsider**

EMU will entail major changes for every EU member state. All in all, I believe Sweden is well equipped to cope with these changes. Our economic foundation is becoming increasingly strong. The economic crisis in the early 1990s and the

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marked setbacks from an inflationary situation have been converted into the current situation with low inflation and favourable growth. The efforts to consolidate government finance and regain a balanced budget by 1998 have helped strengthen confidence in Swedish policy. This is evident from the krona's appreciation in recent years and the tendency for bond rates to converge onto the European level, though in both these respects we still have some way to go. In this tremendous task, however, one aspect remains to be tackled - the labour market. Unemployment is still very high.

I should also like to say something about Sweden's role in Europe. We have been a member of the European Union since 1995. For us in Sweden, this participation together with fourteen other EU countries in many economic and political fields is a new situation. The EU-related work has grown continuously; for most of us it has been a constructive experience to be involved in and influence European developments more clearly than would have been possible if we had not joined. Even if we are outside the euro area, this cooperation will continue. We will be obliged, for example, to treat our economic and exchange rate policy as a matter of common concern. Our economic situation will be under surveillance and a convergence programme is to be presented annually.

But the future is not just Europe. An extensive process of globalisation is in progress and markets are being integrated worldwide. In the past decade the course of events has been particularly dramatic in financial markets as regards integration, harmonisation and technical innovations. Competition in the new open world market for financial services will demand a great deal of Sweden's financial sector and banking system. We can already see how the Stockholm Stock Exchange is preparing to quote shares in currencies other than the Swedish krona; mergers and acquisitions are reducing the number but increasing the size of the major banks with traditional operations, and the number of niche banks is growing. These are some of the signs that the financial sector in Sweden is adapting to meet a new situation.

The Riksbank, too, is affected by the new trends. In recent years the need for monetary policy credibility and discipline has become much greater, as has the need for financial stability. We are also adapting in more practical matters. As a step towards increased payment system efficiency, for example, the Riksbank has decided to accept certain foreign securities as collateral in the RIX system.

## **The Riksbank and the ESCB**

As I mentioned earlier, even with Sweden as an outsider, the Riksbank will be included in the European System of Central Banks. We will not have a seat on the principal decision-making body, the ECB Governing Council, but we will be a member of the ECB General Council, which is to include the central bank governors of all EU member states together with the ECB's president and vice-president. The General Council does not have a say in monetary policy in the euro area but will still have many important functions.

The General Council's primary purpose is to take over the EMI's functions, which must continue to be performed as long as there are EU member states outside the euro area. Among other things, this involves surveilling the convergence process in the outsider countries. Other tasks are monetary policy

coordination between the euro area and the outside member states and the administration of the new exchange rate system, ERM2. The preparations for countries that adopt the single currency later on are another matter for the General Council. Our participation will also provide insights into the work of the ECB Governing Council because the president of the ECB is to keep the General Council informed of decisions by the Governing Council.

Today the EMI has around thirty committees and working groups in which we participate. Just what the ECB's committee structure will be is not yet known. Some groups may be disbanded and new ones formed. Neither do we know to what extent we as an outside country will be represented. Participation is likely to be restricted to certain areas. But as most issues will continue to affect outside countries, our representation in the future committee work will probably be extensive. For the Riksbank this will continue to be an important activity.

Besides our continued work at the European level, there are matters at home that also have to be covered.

## **Continued preparations**

At the Riksbank, the prospect of Sweden being outside the euro area initially has naturally raised the question of what our attitude to euro preparations should be. A decision to continue actively entails a considerable amount of work. Even though the conduct of monetary policy basically resembles what the Riksbank does today, all the economists, lawyers, data technicians and statisticians involved have to acquire detailed knowledge and an understanding of how the planned systems are intended to work.

We have concluded that even if Sweden does not join the euro area from the start, the Riksbank must maintain a high state of readiness for participation at a later date. We do not want to risk being in a situation where a decision about participation is changed and the Riksbank does not have time to make the necessary adjustments. To avoid misunderstandings, we have said that the Riksbank is to handle entry to the monetary union in the course of a year. In other words, from the time when it is clear that Sweden will be joining, the Riksbank will need not more than one year to cope with the changes that participation in the single monetary policy requires.

In order to comply with this time limit, as well as for other reasons to which I shall be returning, the Riksbank's preparations for the euro are continuing. This applies to our work on consulting with and informing Sweden's financial sector as well as to the internal preparations.

I shall now turn to some important aspects of these preparations.

## **Statistics**

A concrete matter that calls for continued preparations even for outsider countries is the collection of statistics. The conduct of EMU's single monetary policy will require analytical material that is based on harmonised statistics for the whole EMU area.

*Firstly*, a harmonised balance sheet will be needed for the financial institutions that are important for in the execution of monetary policy.

*Secondly*, the ECB will need a good picture of the union's relationships with surrounding economies, for example as regards currency flows and trade in securities.

The adjustment of statistical systems so that they deliver the necessary base for the single monetary policy takes a long time. That is why statistics is one of the areas in which Sweden and the Riksbank are participating regardless of euro participation. It follows that the Riksbank will be continuing to drive the statistical adjustments even if Sweden does not adopt the euro from the start.

I should like to take this opportunity of thanking you and your banking colleagues for all the work that is being done in this respect. Even in an outside position, an improved statistical foundation is naturally of value for the Riksbank.

## **Policy instruments and procedures**

We already know the principles for monetary policy's framework in EMU. The national central banks are to take an active part in the ongoing work of adapting techniques and internal routines so that they function in practice with a single monetary policy. The EMI is coordinating and supervising the work and it is ultimately up to the national central banks to ensure that the necessary changes are implemented. The Riksbank has chosen to go on participating in these preparations together with other central banks.

Our approach involves full participation in the preparations while reserving the right, as the work proceeds and issues are raised, to assess whether the implementation of certain preparations is meaningful and whether it should be done now rather than later.

Some preparations may turn out to involve unnecessary costs if they are introduced immediately, in which case this should of course not be done. An example is computer systems that become obsolete in a couple of years and therefore have to be renewed continuously.

In some respects, moreover, there is uncertainty about how the ECB will in fact conduct the single monetary policy. In such cases it may be reasonable to postpone preparations so as to avoid unnecessary work.

It is too early, however, to arrive at a complete picture of which preparations we should abstain from. That is why we are working on preparations across the board and will not lessen our involvement until there are clear reasons for this.

## **The TARGET system**

The construction of TARGET, the European payment system, is one of the EMI's major tasks. This system links up the payment systems of the fifteen EU countries to provide a single system that is already being tested. TARGET is to ensure the timely and safe handling of payments related to the monetary policy operations but the system will also be available for commercial payments. Participation in TARGET is formally open to all EU countries, not just to those that join the euro area.

TARGET is therefore just as important for the single market as it is for the monetary union. The system accordingly has to meet the requirements for its role in the single monetary policy and also comply with the principles behind the single market, that is, fair, open competition and no discrimination. But unfortunately it looks as though these good principles will not be observed in full, which I find regrettable. As you know, there is a risk that non-euro EU countries will encounter de facto discrimination as regards access to intraday credits in the system. These credits provide the reserve liquidity that is needed to parry fluctuations in the flow of payments and thereby avoid bottlenecks and stoppages.

It is not yet clear whether any restrictions of this kind will in fact be imposed or, if they are, how they will be implemented. But it is important that both the Riksbank and the banks prepare themselves - as indeed they do - to cope with such a situation.

If intraday credits in the ESCB are not available to Swedish banks, the latter have three main alternatives:

- outsource the handling of euro payments to a branch or subsidiary in the euro area,
- borrow euro in the market, or
- find ways, if possible, of bringing euro liquidity home to Sweden.

As regards the second alternative, a market for intraday liquidity in euro is very likely to grow up. The matter is complicated by having two dimensions: besides the access problem I have just mentioned, there is the circumstance that as an outsider, even if Sweden were to be given the right to borrow in principle, problems may be encountered over the collateral for the euro credits.

This is because, to be eligible as collateral for ESCB credit operations, securities have to fulfil certain criteria. These criteria can be proposed by the national central banks and are finally approved by the ECB. The problem for us as an outside central bank is that we will not belong to the group of central banks that can propose securities as collateral; still less will we participate in these decisions. This means that, to become eligible for securing intraday euro credits, treasury and housing paper denominated in Swedish kronor have to be proposed and listed by a central bank that is *inside* the euro area. The proposal then has to be approved by the ECB. In other words, we will be heavily dependent on the goodwill of others.

The issue of intraday credit is troublesome and we are still working on it in the EMI with a view to arriving at solutions which are appropriate for Sweden. But the Riksbank has also been considering whether it could make a more concrete contribution to the banks' supply of intraday euro liquidity without this entailing some form of subsidised lending on our part.

The possibility we are looking at is the use of the euro component of the foreign exchange reserves. We believe this would be technically feasible and it may prove possible, given the approval of the ECB. But it would involve costs for the Riksbank that must be carried by the banks. It is still too early to form an exact picture of the level of such costs and whether the banks would find the solution financially attractive. But we believe the possibility is worth a close examination as an alternative to the paths and methods the banks themselves will be adopting.

In conclusion one can say that the banks will find various ways of managing the TARGET problems and the Riksbank will help as constructively as possible. But

whichever solutions are chosen, it seems inevitable that they will incur costs - an outsider position has a price and this is part of it.

The construction of the TARGET system will also affect Sweden's financial markets in other ways. One has to do with the system's operating hours. The EMI's line is that TARGET is to be open daily with the exception of Saturdays, Sundays, Christmas Day and New Year's Day.

This will not force a particular country to stay open on all other public holidays - if Sweden chooses to shut up shop on, say, Midsummer's Eve and concentrate instead on pickled herring and all its trimmings, no one will try to stop us. But we are fairly likely to see market pressure for increasingly standardised opening times and will no doubt have to grow accustomed to the idea of more and more functions being on tap for more and more days. The Riksbank will be taking initiatives to get a discussion going on these matters.

This question and many others will have to be solved in the time ahead. The EU work in Sweden has not come to a standstill even though we will not be participating in the euro area from the start.