

Speech

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Sweden and EMU

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Stage Three of EMU, the economic and monetary union, began with the new year. This means that eleven countries in the European Union are now sharing a single currency and a single central bank.

The inauguration of the monetary union is a historical event. EMU is to be seen as a step towards creating “an ever closer union among the peoples of Europe” and is therefore in many respects a political project. Visions of a common currency have been entertained ever since the European Communities were established in the 1950s. The adoption of the euro is another major advance on the road to integration.

The financial markets' initial reception of the new currency has been favourable. However, the euro's presence on the global stage will pose challenges for economic policy in the euro area. This will also affect other countries, such as Sweden, even though we have chosen not to join the euro area from the start.

Many years of extensive preparations

When the foreign exchange markets opened on January 4th, with the euro as one of the tradeable currencies, it could be seen that many years of intensive preparations, to which Sweden had also contributed, were bearing fruit.

The national central banks in all the EU countries had been working since January 1994 to build up the new European Central Bank, with all that this entails. Central bank representatives at various levels had participated in around thirty different committees and working groups in joint efforts to ensure that everything would be in place and working properly in every respect from day one of the new

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monetary union. Some of the matters have been weighty, others less significant. They have covered everything from the strategy to be adopted for monetary policy to the detailed appearance of the euro notes. On behalf of the Riksbank, our various representatives made between 1500 and 2000 trips to Eurotower in Frankfurt. Since the autumn of 1994 I myself have been in Frankfurt between 40 and 50 times.

The preparatory work remained intensive right up to the kick-off. At central banks and commercial banks throughout the Union, many of those concerned had to abandon their customary new year celebrations and concentrate on dress rehearsals, trial runs and telephone conferences. Operational tests were performed of payment, information and signalling systems between the national central banks as well as with the financial sector. Work on the final preparations was also in progress at the Riksbank all through the conversion weekend.

On the first working day with the euro—January 4th—the central banks were already busy in the small hours to ensure that the new currency had a stable introduction. The Riksbank's facilities were manned before 5 a.m. The launching of what could well be the world's largest monetary policy project, after years of unflagging preparations, was indeed an impressive occasion.

The initial period with the new currency has proceeded smoothly. The ECB announced and staged its first monetary policy operation and the payments were channelled through the common TARGET system. The euro was favourably received in the financial markets and market interest rates moved downwards in all the euro countries. In the financial system there were no serious disturbances. The vast payment system took off with just a few minor technical hitches. The participants in the common payment system include all the national central banks in the European Union as well as the ECB and more than 5,000 European credit institutions. The value of the transactions within and between the countries concerned totals SEK 1000 billion a day.

Sweden's situation

In December 1997 the Riksdag (Sweden's parliament) decided that Sweden would not be joining the euro area from the start. Weak popular support was cited as the main consideration. In choosing not to participate from the start, Sweden lost influence on central aspects of the EMU deliberations in the Community in the course of 1998. We had less possibility of leaving our mark on the solutions that were finally adopted.

In connection with its decision, however, the Riksdag underscored that future participation in the euro area may be feasible if the situation changes. It was therefore emphasised that the national preparations were to continue. For the Riksbank, this meant—and still means—maintaining a persistently high state of readiness should the political system come to a different conclusion in the future. The Riksbank has set its sights on coping with the necessary changes within a year after a Riksdag decision in favour of participation.

The political system has recently signalled that a decision on participation in the euro area may be made earlier than expected. The Prime Minister has stated that the Social Democratic Party may hold an extra congress on EMU early next year. The Finance Minister has expressed the view that a decision would be desirable

before Sweden succeeds to the EU presidency in the spring of 2001. It also looks as though opinion in Sweden is moving in a more positive direction.

These signals, however, do not warrant any other conclusion by the Riksbank than that we must continue to maintain a high state of readiness. Whether and when the political system will be ripe for a decision in this matter is difficult to foresee. But if the will to participate is there, at least the process will not be obstructed by any lack of readiness.

Assuming, for the sake of argument, that the political decision-making process does unfold in the course of next year, the most realistic timetable—given the practical preparations—would seem to point to Sweden's participation from 1st January 2002. In that case it would coincide with the introduction of euro notes and coins in all the euro countries.

With Sweden outside the euro area, however, there is more to do than work on the technical preparations. Continued efforts are also needed in economic policy. We must not delude ourselves that the measures which have been taken to date, although admittedly very extensive and important, have restored economic policy's credibility once and for all. Confidence has to be earned and cultivated continuously.

We should also bear in mind that the prevailing conditions for the Swedish economy do not stem from the establishment of the monetary union; they have more to do with the economic reality in which we are living, with closely integrated markets and free cross-border movements of capital and labour. There is no lack of examples in other countries of what can happen when economic policy is not sufficiently disciplined.

Good conditions for a credible policy

Conditions today are favourable for maintaining Swedish economic policy's credibility. The direction of economic policy in recent years, with the focus on budget consolidation and low inflation, has contributed to this and so have important institutional changes.

One major institutional move that is helping to enhance the credibility of Swedish economic policy is the Riksbank's stronger status. It should be underscored that the new legislation has not made the Riksbank *unaccountable*, but it has rendered the Riksbank *formally independent*. The Riksdag has given Sweden's central bank the objective of price stability. With this as its ultimate aim, the Riksbank can make its contribution to sustainable growth and employment.

In various ways the Riksbank is continuously working for transparency. Besides giving people and the political system rightful insights into the grounds for our monetary policy decisions, this makes it clear to savers and investors that the Riksbank is consistently guided by its objective and not by other considerations. The latest move towards increased transparency is our decision to publish the minutes of the monetary policy discussions, albeit with a time lag of 6 to 8 weeks. These minutes will show how we have deliberated and voted. I believe transparency as such helps to anchor monetary policy in society and that is important not least while Sweden is outside the euro area.

Budget policy is another important matter where institutional changes have been made to promote a more long-term approach. The Budget Act from January 1997 was accompanied by a ceiling on nominal expenditure. This means that

additional expenditure in one budget item has to be financed by reassessing other expenditure items so that the overall ceiling is not exceeded. The procedures for monitoring expenditures during the fiscal year have also been tightened.

The innovations make the budget process more disciplined and thereby counter tendencies for a deficit to arise in public finances. Together with the Government's goal of achieving a budget surplus of 2 per cent of GDP, calculated over a business cycle, this lays a good foundation for sound government finances.

The need for a budget surplus has to do with the huge burden of debt that accumulated earlier in the 1990s. From a level of just over 40 per cent of GDP at the beginning of this decade, the consolidated government debt grew rapidly to a high of about 80 per cent of GDP in 1994. Since then the level has tended to fall; but a government debt stock in the region of SEK 1,500 billion does mean that government finances are still highly vulnerable to movements in market interest rates. In time, an upward shift in interest rates of one percentage point, for example, would boost expenditure by SEK 15 billion. This clearly illustrates the importance of maintaining what might be called the good economic circle.

No one can tell for sure just when confidence would start to weaken if, for some reason, government finances were to move into the red again at some future date. But we can be sure that the vicious economic circle would add more and more burdens to the pile. If government debt is high, confidence ebbs and market rates of interest rise, a deficit will spawn future deficits that become larger and larger.

The Swedish krona

As we saw during last autumn's financial crisis, however, some fluctuations in the financial markets may occur even if we do our bit. Despite a policy focused on stability and good economic fundamentals, the krona weakened to a degree that seemed unwarranted. But Sweden was not alone in this respect. Similar tendencies were experienced in other countries, such as Canada and Australia, that have a flexible exchange rate and target inflation directly. Their currencies weakened.

Since the turn of 1998, moreover, the krona has strengthened. In comments on the exchange rate fluctuations, the political signals about EMU have been cited as one of the causes. Market observers consider that the krona has appreciated in the new year because its conversion rate in the event of adherence to the monetary union would be stronger than the present level. It can then be said that the EMU signals have given the krona a push in the direction that Sweden's economic fundamentals have been pointing for a long time.

In the public discussion of the krona's development last year it has been asserted that causes of the depreciation are to be found in Sweden's structural problems as well as in a goal for inflation that is said to be less ambitious than the ECB's. I do not find these arguments convincing.

It is not clear that the structural problems in Sweden's economy are appreciably greater than those in many countries in continental Europe. Further structural adjustments in Sweden may be called for in a global perspective but this could hardly have occasioned a shift in confidence in the Swedish krona during 1998. Furthermore, Sweden's productivity performance in the 1990s has been considerably better than in the preceding decades and also good in an international comparison.

Neither do I accept that the krona's path had to do with differences between Sweden and the EMU area in the operationalisation of monetary policy's commitment to price stability. Allowing for differences in the levels of instrumental rates, it seems that long bond rates in Sweden have not differed much from those in the euro area. This indicates that in the foreseeable future, savers and investors count on inflation in Sweden being virtually as low as in the monetary union. Here I should like to point out that talk of the Riksbank's inflation target being less ambitious than the ECB's is definitely premature because the ECB has not yet formulated its level of ambition as specifically as Sweden.

It should also be borne in mind that a floating exchange rate will, indeed, float. The United Kingdom, Australia, Canada and New Zealand have all experienced this. In every country that, like Sweden, has had a flexible exchange rate and an inflation target, exchange rate movements in recent years have been at least as pronounced, in some cases more so.

Further support for this perception is provided by the Swiss franc. Switzerland is a small, open economy with an exchange rate that has been flexible for a couple of decades. In the past twenty years and adjusted for price differences with the rest of the world, the Swiss franc's fluctuations from its mean have been of the order of ± 10 per cent.

Market players should thus expect some exchange rate movements in a flexible regime. If expectations take this into account, the consequences need not be all that great.

Conclusion

The monetary union has begun without Sweden as one of the participants. An outside position does not allow us to relax. It makes it imperative to focus economic policy on stability. We should accordingly continue in the direction that points to a sound economy with sustainable growth and low inflation. The objectives that have been established—with good goals for fiscal and monetary policy—must be upheld. That is the only way in which we can attempt to reduce any economic costs that an outsider may incur.

The recent debate has shown how quickly the situation may change. Continued preparations are therefore needed to ensure that a state of readiness exists when the political system calls for it. This applies to work at the Riksbank and also, to a high degree, to other agents in the financial sector.