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The Eurosystem's Approach to Monetary Stability

Ulf Dahlsten

It is an honour and a privilege for me to introduce to you the President of the Deutsche Bundesbank Professor Hans Tietmeyer.

Hans Tietmeyer is a distinguished scholar with multiple doctorates. He has for many years been the leading voice in Europe. A voice listened to with respect not only by the financial markets in Germany, but by politicians, economists and markets all over the world. Feared by some, and respected the more by others for being outspoken and never hesitating from telling the truth and take action however inconvenient it may be. Being all that he has gained the confedence of world leaders as a man to be trusted. From 1982 to 1989 he was stats secretary in the Ministry of Finance. From the 1st of October 1993 he has been President of the Deutsche Bundesbank and the German Governor at the IMF. Since 1st of January 1994 he has been the Chairman of the G-10 Central Bank Governors. Hans Tietmeyer is not only a very powerful man, one of the few most powerful, but he has also been instrumental in creating the euro, in building the ECB and the monetary regime that are independent and stand for a strong currency and a stable low inflation. He has time and time again pointed out the necessity for European governments to keep their house in order and thereby being extremely important in creating the atmosphere that made the successful launching of the euro possible. Professor Tietmeyer will speak about the Eurosystem's approach to monetary policy. His speech will be commented by Professors Torsten Persson and Lars E.O. Svensson. The Swedish Economic Association is proud and honoured to welcome you Professor Tietmeyer. The floor is yours.

Hans Tietmeyer

At the beginning of this year, the euro was launched as a common currency in eleven of the 15 member states of the European Union. As you all know, Germany was one of those countries whereas Sweden, by its own choice, was not. But I am hopeful that this state of affairs – as far as Sweden is concerned – will not persist for too long.

As the president of the Deutsche Bundesbank and a member of the Governing Council of the ECB, I have been following the recent debate in your country on the merits and drawbacks of joining the Euro area with particular interest. I hope you will therefore allow me to take advantage of your invitation to argue in favour of the Eurosystem's approach to the attainment of lasting price stability which contributes to an environment conducive to lasting growth. I realise that this will not be an easy task in a country whose central bank is now reaping the fruits of many years of efforts to achieve price stability.

- The Sveriges Riksbank has recently actually lowered its repo rate slightly below that of the Eurosystem – thus creating a situation which the Eurosystem, of course, could not leave unchanged. Of course, this was not the only reason for our somewhat surprising decision last Thursday. There were other reasons, too. I will come back to them later. In retrospect, in the eyes of the central banks involved, the merging to form a common, larger monetary area went beyond a mere geographical reorientation of monetary policy.

It is true that, in the run-up to monetary union (and bolstered by the Maastricht Treaty), there had already been a large measure of convergence in monetary policy thinking in Europe. That primarily affected the ultimate goal of monetary policy, and its institutional framework for achieving that objective.

But right up to the start of what was known as stage three of EMU, there remained national differences – some of them substantial – in the practical implementation of policies. To be sure, the now unified monetary policy of the Eurosystem has recourse in many areas to elements of the earlier national approaches. Even so, in the aggregate it represents a conceptual fresh start.

A new system has come into being that calls for adjustments from its members at all levels of monetary policy action. The Bundesbank, too, was and is affected by this change. We have likewise had to adjust to the common approach in a number of respects, and are still doing so today. Against the background of this experience, I should like to single out in this lecture some aspects of the common monetary policy of the Eurosystem which, as it seems to me, are of particular interest to those nations which are preparing for participation in the future.

The best and most lasting contribution that monetary policy can make to long-run economic welfare is that of safeguarding price stability. The Statute of the ESCB annexed to the EC Treaty spells out that objective correspondingly clearly. And the assignment of tasks by the Swedish Central Bank Act in the wording in force since the beginning of this year is equally unambiguous. Despite this gratifying correspondence as regards the overall objective and also the large measure of convergence in practical orientation, there are still, if one looks more closely, some differences. Of course they should not be overinterpreted, nor should they be neglected. From the standpoint of monetary policy, with the responsibility for safeguarding the value of money, the question arises, in particular, as to the yardstick by which one's efforts must be measured.

Such a yardstick is not provided explicitly in the Maastricht Treaty. After thorough debate, we in the Governing Council of the ECB decided to define an annual increase of less than 2 per cent in the Harmonised Consumer Price Index (HCPI) as being consistent with price stability in the euro area.

In my view: There are good reasons for

such a definition: the choice of a broad index at the consumer-price level takes due account of the addressees of a stability-oriented monetary policy, for ultimately those are consumers. And the quantitative level of the definition by the ECB Governing Council follows from the past experience of the member countries with a long history of stability. By contrast, as far as l know, Sveriges Riksbank has geared its policy hitherto to an inflation target – measured in terms of the rise in the Swedish consumer price index – of an annual rate of 2 per cent. In addition, the Bank has made it clear that it would tolerate deviations from that target variable in either direction up to a level of 1 percentage point.[1] This was said at least in the Quarterly Review 4/1998 of the Sveriges Riksbank.

On average, therefore, price movements in line with the objective of the Swedish Central Bank seem to be compatible with the top edge of the quantitative definition of price stability under the Eurosystem. Even so, on the way to that average, the Swedish target definition tolerates inflation rates exceeding the Eurosystem's definition of price stability.[2] Much the same also applies to the Bank of England, which is pursuing a year-on-year inflation target of 2.5 per cent, measured in terms of the RPIX (retail price index excluding mortgage interest payments). That is all of what I say on the small, but not negligible differences in the context of target definition.

In the run-up to stage three of European economic and monetary union, however, more heat was generated by the debate on which monetary policy strategy should be used to reach the objective than by the precise definition of what is deemed to be compatible with price stability. In the upshot, the Eurosystem today is relying on two pillars for attaining its quantitative idea of price stability: on the one hand, on a comparison of monetary growth with a reference value for the movement of the broad money stock M3; and, on the other, on a broadly-based analysis of the prospects for future price movements in the euro area. But, unlike the practice of the Swedish and UK central banks, both of which are pursuing a strategic approach of direct "inflation targeting", the Eurosystem's policy approach – at least till now – has not culminated in the publication of an inflation forecast. And, in my view, there are very good reasons for not doing that! I shall revert to this point later on. In my opinion, all this implies that the Eurosystem has opted for a strategy that reflects with all due clarity the particular responsibility of monetary policy for *medium-term* price movements. It thus does justice to the assignment of roles prescribed by the Maastricht Treaty.

Well, answering the question as to the medium-term orientation of monetary policy is one thing. But the question as to the shorter-term orientation of monetary policy within the business cycle is quite a different matter.

That debate is currently undergoing a renaissance in Europe. Given the new monetary policy regime, which still has to be "run in", and the differing former traditions of monetary policy orientation in the individual countries, that comes as no surprise. Many countries in the euro area were

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[1] Cf., for instance, Lars Heikensten and Anders Vredin, Inflation targeting and Swedish monetary policy – experience and problems, in: Sveriges Riksbank (Ed.), Quarterly Review, 4/1998, pages 5–33, especially page 5.

[2] A direct comparison of the differing definitions of inflation rates deemed to be consistent with price stability presupposes that the underlying (different) indices do not diverge substantially. In point of fact, the HCPI encompasses about 80 per cent of the Swedish consumer price index. Cf. Sveriges Riksbank, Inflation Report 1998, page 9, footnote 1 and page 51, chart I in the appendix, for a comparison of the movements of the two indices.

hardly affected by that question for a long time, since they were primarily pursuing a policy of exchange-rate orientation. The Eurosystem, however, cannot and will not do that. It has to follow its own internal orientation! And, against the background of the clouded prospects for economic activity in the euro area as a whole, calls for recourse to monetary assistance measures, which are comparatively easy to deploy, have become more vociferous of late. I should first of all like to emphasise with all due clarity that the assignment of roles under the Maastricht Treaty does not provide for ex ante co-ordination of different economic policy areas in the sense of co-ordinated demand management. Incidentally, such co-ordination is neither desirable nor necessary if every policy area discharges its own responsibility.

Complying with our responsibility for price stability, we in the Governing Council of the ECB last Thursday decided to lower our interest rate for the main refinancing operations by 50 basis points.

Based on both pillars of our strategy, that decision was taken in a forward-looking perspective. We judged that current trends in monetary aggregates do not signal future inflationary pressures, and that – assessing all other relevant information – the price movements most probably will keep in line with our definition of price stability. Thursday's decision keeps our monetary policy on a longer-term stability-oriented course.

The decision and its underlying rationale demonstrate continuity and do not in any way indicate a paradigm change to short-term demand management. By doing so, the decision contributes to creating an economic environment in which the considerable growth potential of the Euro area can be exploited. Those responsible for other policy areas are urged now even more to take the necessary steps to improve longer-term growth prospects for the euro area. A cut in the central bank's rates cannot be a substitute for convincing structural reforms in the economics.

That should always be kept in mind in discussions on the stabilisation potential of monetary policy. If monetary policy tries to meet other objectives, the risk of missing the main objective is great. Specifically, the Eurosystem is sometimes accused by critics of squandering opportunities because of the type of final goal definition selected. That relates, to begin with, to the alleged asymmetry of statistical price rises that are consistent with price stability in the view of the Eurosystem. But the assumption of asymmetry is based primarily on a misinterpretation of the quantitative definition. Thus, it is quite clear from the formulation chosen that, in the view of the monetary policy makers in the euro area, both a deflation in the sense of a sustained decline in the price level and a rate of monetary erosion of 2 per cent and more are deemed to be harmful. Hence undue importance should not be attached to the fact that the ECB has refrained from formally defining a floor for the objective of price stability. That is due not least to uncertainties with regard to the measurement-error problem posed by the Harmonised Consumer Price Index.

But the criticism sometimes also applies to the formulation of the stability objective in the shape of a target corridor, rather than a possible orientation towards a single-figure target. If the criticism were warranted in this respect, it would, incidentally, also apply to the Swedish central bank, which – unlike the practice of inflation targeting in, say, the UK – has likewise formulated its target variable in the shape of a corridor. The starting point of this corridor debate is therefore the fact that – at least in theory – a central bank that gears its policy to a single-figure target, rather than a target corridor for price movements, is likely to take monetary countermeasures earlier if changes occur in the price outlook; hence, it tends to be more activist. To the extent that observed variations in inflation were due to similar cyclical fluctuations in macroeconomic activity around its trend rate, the more activist policy would, according to the critics, achieve two things at once: the stabilisation of the variations in inflation and the stabilisation of output. But, in response to that assertion, it must be said that not every change in price movements is due to cyclical fluctuations in demand.

If, however, the cause is to be sought in changes on the supply side (e.g. in advances in productivity) monetary countermeasures with the aim of bringing the inflation rate back on to its target path as quickly as possible may accomplish just the opposite of what is wanted. For example, such a monetary policy would run the risk of stimulating macroeconomic growth to an extent that is incompatible with the long-term production potential of the economy.

That stimulus would then have to be countered again by monetary policy action. Hence an unduly activist policy would tend to cause volatility by itself. Moreover, differing time-lags between taking the decision and its coming into effect might well engender unwelcome cyclical effects. Excessively volatile monetary policy likewise hampers long-term financing in the markets, and thus exacerbates the risk posed to real investment on the financing side. The criticism of the Eurosystem expressed in this connection also pays too little heed to the role played by the quantitative definition of price stability within the chosen strategy. It is true that, if an approach based an inflation targeting is pursued, it is primarily the forecast deviation of the inflation rate from its target rate that serves as the guideline for the deployment of policy instruments.

Hence, under this approach, the specific definition of the stability objective is indeed of crucial importance for monetary policy in the short run. That, however, is not the approach adopted by the Eurosystem! Instead, the strategy of the Eurosystem opens up other options for the appropriate consideration of the interaction between the deployment of monetary policy instruments and macroeconomic fluctuations.

At this juncture, I only wish to allude briefly to the fact that the reference value for monetary growth was derived with due consideration of the prospective movement of production potential. To this extent, the Eurosystem's strategy already includes to some extend a built-in stabiliser within the business cycle. Anyway, it seems to me to be questionable how far monetary countermeasures only based on inflation forecasts (which are by their very nature always uncertain) can satisfy theoretical requirements. After all, they neglect the uncertainty ruling in practice about future price movements. The degree to which such uncertainty exists over forecasting horizons that are relevant to monetary policy is also demonstrated for Sweden, after all, by the inflation forecasts of Sveriges Riksbank.[3]

For instance, the width of the corridor in which the future inflation rate will lie with a probability of 50 per cent for a one-year time horizon is already roughly one percentage point. For a two-year perspective it actually doubles. If this degree of uncertainty of the inflation forecast is compared with the target corridor of the Eurosystem's definition of price stability, the criticism levelled at the corridor concept appears at most to be relevant in theory. A major prerequisite of the Eurosystem being successful in discharging its stability mandate without incurring unnecessary real economic costs lies in it rapidly acquiring the credibility that it can do just that. Needless to say, such credibility is particularly essential for a new institution like the ECB. In this context, it has become fashionable to draw

[3] Cf. Sveriges Riksbank, Inflation Report 4/1998, page 42f.

attention to the role played in this by the transparency of monetary policy. Disinclined though I am to question this correlation between credibility and transparency (quite the contrary!), I find myself unable fully to comprehend the criticism – mainly coming from outside the euro area.

First and foremost, the concept of transparency designates quite generally the disclosure of information that is relevant to the conduct of monetary policy. Such information may relate to utterly different areas of central bank policy:

- to the basic institutional framework under which it operates,
- to its precise objectives,
- to its strategy, and
- to the instruments at its disposal.

In addition, the detailed and up-to-date notification of the general public about monetary policy decisions and the reasons behind them must certainly also be included. There is general agreement on the advantages of monetary policy transparency:

Firstly, as I mentioned before, transparency is able to enhance the effectiveness of monetary policy. Moreover, the understanding of monetary policy is facilitated among the general public, always provided it is successful, the credibility of monetary policy can be fostered more readily in this way. This is accompanied by the anchoring of the public's inflation expectations at the level envisaged by the central bank. That minimises friction between monetary policy and other economic policy areas.

Secondly, the transparency of monetary policy plays a major supporting role in connection with a central banks accountability. That applies particularly to central banks which, in the light of their legal status, can operate independently of other policy areas. The disclosure of their objectives and of the reasons for their decisions constitutes the preconditions for an effective "monitoring" of central bank policy – of its intentions and its efficiency alike – by the public at large.

It follows from this that notably the Eurosystem (as a new monetary policy institution, which, moreover, enjoys a status of substantial independence in the discharge of its stability policy mandate) should endeavour to adopt a policy approach which is as transparent as possible. Frankly speaking, l cannot see what more the Eurosystem could do in order to accomplish that. In the first place, its objective is defined with all due unambiguity in the Treaty of Maastricht. And with respect to the chosen monetary policy strategy, and also to the range of instruments at its disposal, the Eurosystem has meanwhile kept the general public comprehensively informed.

At the centre of the current debate on the transparency of monetary policy in the euro area is the issue of how precisely, and especially in which form, the public should be notified of details of the internal decision-making process and the decision-making rationale. Specifically, the question is, inter alia: to what extent should information-disseminating instruments which have been used by other central banks likewise be deployed in the Eurosystem? Besides the above-mentioned publication of explicit inflation forecasts, frequent reference is also made in this connection to the publication of the minutes of ECB Governing Council meetings.

I would like to say the following: Additional information presented to the general public actually enhances the transparency of monetary policy only if it can help to make the monetary policy decision-making process clearer than it was before. Specifically with reference to the publication of a model-based inflation forecast by the Eurosystem, that may be doubted.

For one thing, the Eurosystem is, after all, not pursuing a strategy of inflation targeting, under which the precise forecast path of future inflation (supplemented, if need be, by information on the degree of uncertainty of the forecast) plays the key role in the decision-making process. It is this that distinguishes monetary policy in the euro area from the policy pursued by those central banks which publish explicit inflation forecasts and gear their policies to them. The Eurosystem is geared to two pillars: the reference value for monetary growth and a broadly-based analysis of future price movements. On the publication of an official inflation forecast, that forecast might assume, in the eyes of the general public, an importance which it does not merit under the strategy adopted. To this extent, such a forecast could actually be misleading. In any case, it is legitimate to ask whether it is prudent for a policy-maker to publish a precise forecast. On the one hand, there is always the risk of a self-fulfilling prophecy, and on the other, a problematic yardstick for his credibility may be erected without him being fully in control of its realisation himself. For another thing, in view of the change in the monetary policy regime, inflation forecasts for the euro area are currently subject to even more uncertainty than usual. The need for frequent revisions also militates against any overly prominent role for that communication tool.

Similarly, the debate on a publication of the minutes of the meetings of the ECB Governing Council reflects in my view not so much the question of principle concerning the enhancement of transparency as, rather, the differing approaches towards achieving that. In the "philosophy" of the Eurosystem, the Governing Council of the ECB, as a collective body, is committed to displaying accountability vis-à-vis the general public. National considerations should not be of any significance in the decisions taken by that supranationally operating body.

The publication of the standpoints adopted or of the final votes cast by individual Council members, which, for them, always involves the risk of being exposed to political pressure in their respective countries, tends to be disadvantageous here. Quite apart from the fact that publicising differences of opinion is likely to do more harm than good to the stabilisation of expectations. By contrast, it appears to me that the chosen route of detailed notification of the general public by the ECB President immediately after the meetings of the Governing Council promises to be more successful. Those statements by the President discussed and agreed by the Council members reflect the prevailing assessment of the Governing Council and set forth in some detail the conclusions which it considers necessary to divulge. That makes the current state of debate transparent to an extent such as does not obtain in any other central bank. At any rate, a statement by the ECB President immediately after the decision was taken and in front of the critical journalists seems to meet the need of the public and the markets for explanation and transparency more efficiently than a mere reference to a later publication of minutes does. To make my views on this point abundantly clear: I consider a maximum of monetary policy transparency to be desirable. However, I am not convinced that that is necessarily synonymous with the publication of very specific information on minutes.

Transparency and information are indispensable, not only to the efficiency of monetary policy but also to the avoidance of crises in the financial system. Hence the fostering of appropriate standards of transparency and disclosure for all marker players formed an integral part of the proposals I submitted last February with a view to improving international financial architecture.

Incidentally, the Financial Stability Forum which I suggested, and which was endorsed by the G-7 ministers and governors, will convene in Washington on the day after tomorrow under my chairmanship for its constituent meeting. However, these proposals and ideas must be sharply distinguished from calls for the central bank to specify preventively how it intends to respond in the event of a crisis besetting the financial system. The ECB is sometimes criticised for having not clarified its role as a tender of fast resort in a crisis situation. In that connection, transparency may be positively harmful.

In this context, two concepts are of key significance: "lender of last resort" and "moral hazard". It is its monopoly position in the creation of central bank money as a definitive payment medium that enables a central bank to cope with a system-imperilling liquidity shortage in the financial sector. If the central bank supplies liquidity for that purpose – i.e. acts as the lender of last resort - that may have undesirable repercussions. Just possibly, more liquidity will be created than is consistent with the objective of price stability. Besides this conflict with monetary policy objectives, the role of being the tender of last resort may also give rise to serious adverse developments in the banking sector: if individual banks believe that they can rely on the central bank "bailing them out" in the event of liquidity problems, that encourages lax risk management or even deliberately over-risky behaviour – that is to say, the above-mentioned "moral hazard".

Transparency with respect to the lender-of-last-resort function would ultimately amount, for those players who regard themselves as being safeguarded thereby, to nothing but a blank cheque on the central bank. This is why, as long ago as 1974, following the Herstatt crisis, the G-l0 central bank governors expressly reaffirmed the risks associated with any foreseeable action as lenders of last resort, and rejected ex ante regulations.

I regard that statement by the governors as being as topical as ever. Correspondingly, central banks, if I may borrow a phrase from my colleague, Eddie George of the Bank of England, consistently practice what he called "constructive ambiguity": a lower degree of transparency fosters the careful valuation of risks and thus results in a higher degree of financial market stability. Furthermore, the Deutsche Bundesbank does not even have an express mandate to safeguard financial market stability. Even less does that apply to any lender-of-last-resort function, however that may be defined. Although it is involved in banking supervision, it is not responsible for the decisions itself, either. In other European countries, most central banks are more directly involved in financial market supervision and banking supervision.

Historical-induced differences in the "supervision culture" likewise affect the attitude towards a lender-of-last-resort function. But in the final analysis this, too, is another variant of "constructive ambiguity".

Incidentally, the Maastricht Treaty deliberately left banking supervision – at least, for the time being – in the hands of the national authorities. However, that situation can be changed (pursuant to article 105 paragraph 6) by a unanimous decision of the Council of Ministers. Yet the ESCB is required to contribute to the smooth execution of national supervision over credit institutions, and to the stability of the financial system.

The approach adopted in Germany to the prevention of crises has been distinctly successful so far. It has included – besides the stability-oriented stance of monetary policy, which has helped, for instance, to avoid exaggerations in asset prices ("asset-price inflation"), the primarily long-term oriented financial market culture and efficient banking supervision above all the mechanisms of internal control and peer-group pressure in the banking industry. I may mention as examples the very far-reaching deposit guarantee scheme in Germany and the joint audit associations of the various large categories of banks. Correspondingly, in the event of a crisis, all possible private sector solutions are normally sounded out first, just as in most other countries. The internal control mechanisms of the banking industry in Germany, in respect of liquidity assistance in crisis situations, led to the establishment of what is known as the Liquidity Consortium Bank (Liko Bank) in 1974. The various categories of the banking industry and the Deutsche Bundesbank hold participating interests in that bank.

In a crisis, the Liko Bank can grant short-term liquidity assistance to institutions which are considered to be solvent and have run into liquidity difficulties through no fault of their own. The Liko Bank is financed through capital and reserves which can be increased by virtue of an obligation on the part of shareholders to make further contributions and by bills of exchange whose standing is assured by corresponding signatures of other banks. Such securities can be used as blue-chip collateral to obtain funds from the Bundesbank.

Hence the Liko Bank acts, so to speak, as a tender of next-to-last resort. It ensures a kind of "institutions transparency" as far as the management of liquidity crises is concerned, without impinging on the Bundesbank direct. By this means, and thanks to the involvement of the commercial banks, the moral hazard risk is minimised. This appears to me to be a successful model that might also be applied in EMU and we have to discuss this. However, the existing differences in the approaches towards containing systemic risk in the financial sector in Europe are – it may be emphasised once again – more differences of degree than differences of a fundamental nature. Hence the ability of the Eurosystem to act in the (unlikely) event of a crisis imperilling the system is assured.

There are in the meantime clear agreements to this affect within the Eurosystem. Under these agreements, should the need actually arise, the diverse national arrangements would be applied first. But it goes without saying that the Eurosystem would be involved as well if liquidity effects on a scale relevant to monetary policy were felt. In the shape of the ECB Governing Council and Executive Board, the Eurosystem has decision-making bodies which – if need be – can take the requisite decisions swiftly. Without a country of such rich tradition and strong economic performance as Sweden undoubtedly is, European monetary union remains incomplete. That is why we were all delighted that Sweden ratified the Maastricht Treaty.

Myself, I am quite convinced that one day it will take advantage of the options the Treaty envisages, meet all the convergence requirements and join the monetary union.

But the decision rests, of course, with the Swedes themselves.

All l can say is: you are warmly welcome.

Ulf Dahlsten

Thank you Professor Tietmeyer. I will now invite Professor Lars E.O. Svensson, who is Professor in Economics at the Institute for International Economic Studies, to make his comments. He has a special interest in monetary policies and lately participated in the debate around the ECB and the European monetary policy. He is also advisor to the Sveriges Riksbank. But he is not speaking as advisor to the Riksbank right now but as an independent professor. The floor is yours.

Lars E.O. Svensson

It is of course a great honour to get the opportunity to comment on Dr Tietmeyer's talk. Dr Tietmeyer is the head of

Europe's and arguably the world's most successful central bank in controlling inflation. Now, he is also a very influential member of the Eurosystem's Governing Council.

I will comment on Dr Tietmeyer's presentation of the Eurosystem's monetary-policy strategy. I will first talk about the definition of price stability. I will also talk about the two pillars: the prominent role for money with a reference value for M3 growth and the broadly-based assessment of the outlook for future price developments. I will dare give some modest recommendations for possible improvements on the strategy. I will not talk about transparency. I will leave that important topic to my co-discussant, Torsten Persson.

So let me start with the Eurosystem's definition of price stability. On October 13 last year, the Eurosystem announced its definition of price stability. "Price stability shall be defined as a year-on-year increase in the HICP for the euro area of below two percent." There are several good things about this definition and the Eurosystem's clarification of it in later speeches and publications. It is very good to have a quantitative definition of price stability. The HICP, the harmonised index of consumer prices, is a sensible price index. The Eurosystem has emphasised that the index refers to the euro area as a whole. It has also emphasised that there is a medium-term orientation. It has stated that it intends to make gradual and measured responses to threats to price stability. It has emphasised that there will be unavoidable short-term fluctuation in prices which monetary policy can do nothing about. All of this is good and sensible.

However, there is one problem with the definition. No explicit lower bound was announced. About a month later, Mr Duisenberg clarified that the word "increase" in the definition actually excludes "decrease" and therefore excludes deflation. A sensible interpretation is then that the lower bound is 0 per cent, so the midpoint is 1 per cent and the target range is 0-2 per cent. This sounds familiar; it was actually the target range for the Reserve Bank of New Zealand from around 1993 through 1997.

On December 1, the M3 reference value of 4.5 per cent was announced. From the presentation of the reference value, one could deduce that the Eurosystem had actually used an inflation target of 1.5 per cent. If that 1.5 per cent is the middle of an interval with an upper bound of 2 per cent, the lower bound must be 1 percent. Then the target range is 1–2 per cent instead of the 0–2 per cent I reported above. This is a fairly narrow target range.

There have also been other differing statements. The Eurosystem has announced that it has not announced a lower bound because of uncertainty about any measurement bias. Dr Tietmeyer repeated that today. The Eurosystem has also announced that "current inflation is consistent with price stability." It said so when current inflation was 0.8 per cent.

Clearly, everything isn't right and unambiguous here. My modest recommendation is to set an ambiguous symmetric inflation target. Symmetry is the best safeguard against both inflation and deflation. The definition of price stability can be a point target or a target range with a midpoint. That is not so important. The mid point provides an anchor for inflation expectations and a target to aim at. If one wants to maximise the probability to be within the range one should aim at the midpoint.

Given that the Eurosystem has started with a target range, with the upper bound already given at 2 per cent, it just remains to clarify the lower bound and the midpoint. Uncertainty about the measurement bias is not a good reason for being ambiguous. For one thing, any uncertainty about measurement bias would seem to apply to the upper bound as well as the lower bound. I believe clarity is more important than whether the midpoint is 1, 1.5 or 2, or even 2.5 per cent.

Let me next go to the so-called first pillar, a prominent role for money with a reference value for M3 growth. There was one good thing with the announcement of the reference value, namely that monetary targeting was actually rejected by the Eurosystem. The Eurosystem said explicitly that it would not respond in order to bring M3 growth back in line with the reference value. Dr Issing, in the ECB Executive Board, has said that "…relying on a pure monetary targeting strategy would constitute an unrealistic, and therefore misguided, commitment." So money growth relative to the reference value is only an indicator, not a target. The idea is that deviations of current money growth from the reference value will signal risks to price stability.

Unfortunately this indicator is a likely to be a bad indicator. It is a very noisy indicator. It has low predictive power for inflation at the relevant horizons. A classic paper by Kareken, Muench and Wallace, in *American Economic Review* 1973, showed that money growth was a poor indicator. In some recent work of my own, presented at conferences at Carnegie-Mellon University and the Bundesbank, I come to the same conclusion.

Actually, if the M3 indicator were taken seriously by the Eurosystem, it should have raised the interest rate instead of lowering it by 50 basis points. Instead, if you want an indicator of threats to price stability, the best indicator is simply an inflation forecast, conditional on an unchanged interest rate. That indicator signals misses of the inflation target if you don't adjust policy. It also signals the required direction of change of the interest rate in order to maintain price stability.

Thus, the first pillar will actually not provide much support for the Eurosystem's monetary policy. Instead the Eurosystem will have to rely almost exclusively on the second pillar: the broadly-based assessment of the outlook for future price developments. Of course, this is a long euphemism for an inflation forecast. It is very good that the Eurosystem has announced this second pillar. It means that the Eurosystem will in practice end up doing inflation-forecast targeting. This is the most sensible way of controlling inflation. The most sensible way is to set the interest rate so that, conditional on that interest rate, the inflation forecast is on target at the appropriate horizon.

Dr Tietmeyer warned about over-activism. Indeed, the best way of avoiding over-activism is to aim at a fairly long horizon. A longer horizon means less activism and avoids causing unnecessary variability of the real economy.

Dr Tietmeyer seemed to indicate that inflation forecasts disregard uncertainty, that they do not take uncertainty into account. On the contrary, these forecasts as constructed today by the inflation-targeting central banks indeed explicitly take uncertainty into account.

Given the unavoidable uncertainty in monetary policy, making forecast is the most efficient and flexible use of available information. These forecasts are not made mechanically from a model. They always include judgmental adjustments and extra-model information. So they are not based on models alone. Of course it is difficult to make these inflation forecasts, given the amount of uncertainty. Still, under this uncertainty, making these forecasts is the best you can do. Even if the forecast is uncertain, you should set the interest rate so that the forecast conditional on that interest rate is on target. Then you will, on average, minimise the deviations of inflation from the target.

Making forecasts is indeed necessary, given the lags in the effects of monetary policy. Indeed, the Eurosystem often emphasises the need for monetary policy to have a forward-looking medium term orientation. As a nice side effect, this also provides a principle for assigning weights on individual indicators. The weights should simply depend on the power in forecasting inflation. This also goes for money. The weight on money should depend exclusively on its forecasting power.

Coming to the end of my comments, I dare give some recommendations to the Eurosystem. The Eurosystem has already made some progress in the development of its monetary strategy, but there is still some room for improvements. Certainly the Eurosystem should clarify the price-stability definition, that is, clarify the midpoint and the lower bound of the target range. Nothing is gained from being ambiguous about the definition.

The Eurosystem should also reduce the emphasis on the money-growth indicator. This indicator is a very noisy one. It doesn't deserve to be a separate pillar. At most, it deserves to be a brick, one brick of many that build the remaining pillar. That remaining pillar is the inflation forecast. The Eurosystem needs to increase the emphasis on its inflation forecast. It basically needs to do explicit forecast targeting. Actually, it needs to look not only at the inflation forecast but also at the forecast of the output gap, so as to avoid unnecessary real variability.

I seriously think the Eurosystem should avoid statements that indicate that there are better alternatives than forecast targeting and that forecasts are misleading. In the end, it will surely regret such statements. Indeed, the Eurosystem can learn a lot from Bank of England, from Sveriges Riksbank, and from the Reserve Bank of New Zealand. These banks already have working systems set up, where they make forecasts, drawing conclusions for policy and set the interest accordingly. These banks have accumulated a lot of useful experience.

Furthermore, I don't think either outside observers or the Eurosystem should expect the Eurosystem to get everything right from the start. Indeed, the banks that I just mentioned did not get everything right from the start either. There has been quick learning, though. So there should be some flexibility, and the system should be modified due to learning.

The inflation and output gap forecasts will be the crucial inputs in the internal decision framework in the Eurosystem. But they should not only be for internal use. Since they are the crucial inputs in monetary policy decisions, they are also the best tools to motivate the policy and communicate with the general public and outside observers.

Thus, publishing forecasts can improve the transparency of the Eurosystem. Let me end here, however, and leave the discussion of the important issue of transparency to my co-discussant.

Ulf Dahlsten

I would like to give an applaud to Professor Torsten Persson who is also Professor of Economics at the Institute for International Economic Studies and also happens to be advisor to the Sveriges Riksbank. But he is also speaking as an independent professor here. He has a good international reputation for his research. He is secretary of the Prize Committee of the Alfred Nobel Prize in Economic Sciences.

Torsten Persson

Thank you Ulf. And thank you Dr. Tietmeyer for your most interesting speech that touched on a number of interesting issues. Because of lack of time, I have decided to focus on just one and try to say something intelligent—or at least intelligible—about the transparency of the Eurosystem.

So I would like to begin by recalling why we think it is important, in general, to have a transparent monetary policy. One argument is that it will be easier to handle the market if the participants understand policy well and adapt their strategy to it. Success on this front means that policy becomes more credible and thereby more efficient. Another reason is that transparency promotes accountability. Accountably, in turn, has two beneficial effects. The first one is that it can serve as an incentive mechanism, in that it can induce the central bank to perform well and to acquire high competence in its analysis. Second, accountability is the mechanism for insuring political legitimacy among the public for the delegation of the powerful policy instruments such as those of monetary policy. This is indeed a prerequisite in a democracy for having an independent central bank.

Among other elements of important background, I would also like to point to the special status of the Eurosystem among central banks. First, it is a new institution and therefore has to earn both its credibility and legitimacy. Second, it is a body among EU-bodies. This means that it has very long chains of delegation, where the number of steps between the individual citizen and the policy maker is longer and more complex than in the nation state. There are also fewer instruments of political control that can be used to exercise accountability in the EU. Indeed, the only other body with comparable executive powers in the EU is the European Commission. And as we know the European Commission recently got into trouble largely because of its lack of transparency. And I think if would indeed be a disaster for the project spear-heading EU-integration, if the Eurosystem got into similar kind of problem.

So it is easy to agree with Dr Tietmeyer's starting point: transparency is of utmost importance. It is perhaps not so easy to agree with his statement that he can see no improvements in the apparent situation, and I am going to try and argue that point quite forcefully. I should also say that when commenting upon these questions, I start from that remarks that Dr Tietmeyer made today. But I have also looked at various speeches made by council members, the ECB bulletin, and not least the press releases made in connection with policy changes by the ECB.

Let me then discuss transparency in steps. I will speak first about transparency of the strategy, secondly about transparency of the analysis and thirdly about transparency of the decision making. I happen to agree with Lars that a better strategy might be outright inflation targeting. But, as we have heard, Dr Tietmeyer has explained that this is not the approach the Eurosystem is taking. Let's take the "two-pillar approach", as given and discuss from there.

Of course, it is still very early to say how the *strategy* is working, but I would claim that there are couple of points where transparency of the strategy is at least not perfect. The first point has to do with the relative weight that the Eurosystem intends to put on inflation control vs. output stabilisation, in the short run. On the one hand, Dr Tietmeyer – as well as many others, and official documents – emphasise a medium-term orientation for inflation and warns against mistakes in pursuing too activist a policy. On the other hand, the December and last-week cuts in the interest rate, still give an impression that current output plays some role. One wonders exactly how large a role. The second point where the situation is less clear is the weight that going to be attached in the decisions on the money indicator vs. the macroeconomic forecasts, of inflation and output. On the one hand, the bulletin as it's written now puts a lot of emphasis on monetary developments. In general, the discussion about macroeconomics is backward-looking, commenting more on past data than data in the future. No forecasts are published. On the other hand, the cut last week was made in spite of the money growth being above its reference value, so again there is some ambiguity exactly about what one is going to do.

So I would say, that at this stage the strategy is still pretty opaque. It is vague enough to permit very different interpretation of what the strategy amounts to. One interpretation would be that the Eurosystem intends to pursue some kind of non-activist "range of inaction" policy. Namely, as long as the inflation is between zero and two – or some number like that – you don't do anything. Only when you see that the money indicators signals future inflation you start doing something. Another possibility is that Eurosystem may engage in inflation forecasting targeting "in disguise". That is Lars hope, and that in that scenario, of course, money is unimportant and the macroeconomic forecasting is all important. I think the language used so far and the actions taken so far – though it is still early to say – are vague enough for both this interpretations to fit the picture.

Actually, one almost gets the impression that at the current juncture, the Council wants to maintain maximum discretion for doing what they would like to do. And that is perhaps natural during the initial learning phase in a new regime. Particularly so as the absolute majority of the members in the council don't have hands-on experience of independent monetary policy, following – as they were – the Bundesbank's policy in the recent history. So that may be understandable. But if discretion continues to be maximised over the future, without clarifying the strategy on these points, that is a bit risky. First, you might magnify speculations on political infighting inside the council, speculations that are already taking place. And you may also invite outside pressure to exploit the central bank's apparent discretion for narrow short run gains.

Let me get to the transparency of the *analysis*. The major point here is of course whether the internal forecast made within the Eurosystem about inflation and output growth should be published or not. There are arguments against, like those Dr. Tietmeyer have referred to here. One argument is that such forecasts risk to be self-fulfilling. I don't find that very convincing. That is quite a defensive attitude from a powerful central bank. Supposedly, forecast showing that things are going wrong would mean that the central bank is going to react, and the public is going to adapt to that. Another argument against publishing is that this forecasts are so uncertain that they are hard to take seriously. On the other hand, when the outlook is very uncertain then speculation about what the central bank is doing is bound to be particularly large. So you can turn the argument around and say that it is particularly important to clarify exactly how the central bank looks at the situation.

I think there are arguments for publishing these forecasts that are more convincing. The first one is that such publications of the forecasts are needed to better understand the Eurosystem strategy. Lags in the effects of monetary policy imply that monetary policy necessarily must be forward looking and if I don't know the forecasts that the central bank has, how can I then distinguish between the outlook for future inflation, the outlook for future output, and the relative weighting of future outlook and future inflation in the objective of the central bank. We must know the forecasts in order to infer the weighting. Similarly, if you wonder about the relative weight that is attached to money versus macroeconomic forecast in the decisions. You must also know the forecast to infer weighting. So progress on both the points where I argued before that the strategy is less than clear would actually be promoted a great deal by publishing the forecasts.

The second argument for publishing, is that publication is needed to enhance the accountability mechanism. Sometimes it's said that the bank should be held accountable for outcomes and not for the analysis. I don't find that very compelling. What you need to do is to judge the outcome against the analysis. If I may try a very cheap metaphor: if my fund manager tells me I have a very high return, I would like to know if this is because of good analysis and investments, or because of very risky investments, before I say that this is good performance. Similar arguments hold for judging the quality of monetary policy I believe.

Finally, what about transparency of the *decision making*? Here the major issues are whether to publish the minutes of the meetings and whether to publish the votes of the individual council members. Again, arguments go in two directions. At least for the purpose of this discussion, I find the arguments against not all that convincing. One argument is that publishing the minutes would stifle the quality of discussion. If that is a problem, of course, one could publish an edited summary instead of an extensive report. That would take care of that aspect. Dr Tietmeyer said that that it is better to do the press conference right after the decision than wait six weeks for the minutes. I surely agree, but why would these approaches be substitutes; why can't they be complements?

When it comes to the individual voting record the argument is that one wants to protect individual council member from political pressure and that revealing disagreement would enhance that pressure. I am not sure that is true. It doesn't really help that to pretend that differences of opinion doesn't exist. If people will expect that it exists then that pressure will be there one way or another. Again, I think the argument for publishing eventually the individual voting record is one of accountability. You want to evaluate the quality of the analysis, as I emphasised before, hence the competence of the Council as a whole. I think incidentally, that the idea of collective responsibility is not such a great idea. It has been a problem for the Commission lately, whose legitimacy has suffered. Furthermore, the members of the council of the Eurosystem are appointed as individual caretakers of price stability and presumably they are appointed to do this relatively one-dimensional task because of their individual competence in these matters. They should be judged as individuals, not as a collective.

Let me wrap up. I agree with Dr Tietmeyer that maximum transparency is of utmost importance for the Eurosystem. I disagree with the view that the Council today is doing all it can to promote it. I hope, as the Governors become warmer in their clothes, that they will reveal to the public and to the markets, a great deal more specific detail about the strategy, the underlying analysis, and the decision making. I think such transparency is not a hypothetical idea. On the contrary it's "best practice central banking", as it is defined by some existing central banks today.

I would like to say that it is even more important for the Eurosystem to be transparent than it is for other central banks, because it has a harder task with its double handed approach. It has a specific role as an EU body that other central banks also do not have. A better understanding of the details I have discussed will lead to more stability, I hope. There is always going to be policy speculation about the policies that are being pursued by such a powerful institution. It is better that this speculation is informed than it's uninformed. I think it would help to be clear, to gear the policy debate in Europe toward interesting details of policy, rather than promoting general complaints that policy is not expansive enough, as one sometimes hears now. And – perhaps most importantly – I think greater clarity will help the Eurosystem earn legitimacy at a faster pace, and help it avoid the mistrust that sometimes have been directed towards other EU-bodies from time to time.

Ulf Dahlsten

Thank you. These remarks certainly calls for some comments. Professor Tietmeyer.

Hans Tietmeyer

First of all I wish to thank the two commentators very much for their critical remarks. I would like to begin by underlining that there are more similarities than there are differences. First of all, I realise that they are in favour of a longer-term orientation of monetary policy. I find that very important because short-term activism itself creates uncertainty or even volatility in the market. And I could go on now and talk about recent developments in the UK under the new government. When Gordon Brown presented the new legislation giving more autonomy to the Bank of England, he said “We want to overcome the short-term orientation of monetary policy in our country and we want to go to a longer-term orientation”. This was the main reason for this move, and I can only agree. The second point I would like to make is: credibility is important, and I realise that both commentators share that view. The question is: how does one gain credibility? By spelling out all steps in one’s line of argument? By moving to collective wisdom and spelling out the steps in-between – or does credibility come from the results ultimately achieved? Only to mention that: sometimes the Bundesbank is called the most credible central bank in the world. Even if it was clearly not the most transparent in terms of short-term explanations of the precise deliberations behind the decisions.

Of course, I am in agreement with the recommendation made by Professor Svensson – that despite considerable progress, there is still room for improvement. Room for improvement is always there. The question is, in what direction, and how? One must clarify the definition of price stability, its midpoint and lower bound. Why is that necessary? For arithmetical reasons? No. Behind that is the fact that normally price stability means no inflation. But there are uncertainties in the measurements and in the cyclical development. Therefore, we must have some room. Whether that should go precisely up to 1.5 or 2 is debatable. One can argue over whether this number should be 2.5, but what I want to say is this: what’s important is to clarify whether there is a risk of moving beyond the limit which is tolerable. And, of course, if it spends half a day, or let say half a month, or half a year below zero, I would not necessarily have a problem. Of course, deflation has to be avoided. But deflation is in my interpretation an accelerating process of going downward. Not the question of only being below zero. If you have a productivity gain, if you have price stability import from the outside, from the exchange-rate side and so – it can be even a little bit below zero. So what I am saying is: of course, you can ask whether one can say it should normally be between zero and two per cent. But what is the real gain of that precise mathematical definition? It is a yardstick. And the people are looking at it to see whether there is price stability. And the capital markets are looking to see whether there is price stability in the long run and what expectations really exist. That is the point.

Now, about reducing emphasis on the money growth indicator: if we were talking about Germany I would say we should go on with monetary targeting. But for the euro area it’s true that we don’t have enough empirical evidence about the correlation between the money aggregate development and the real economy or you could say inflation. Because, firstly, the countries have lived in clearly different situations, and secondly, we are not sure how the introduction of the euro will impact on the behaviour of the individual market participants. That is the reason why we said "OK, we don't have precisely enough empirical evidence for the whole area. We can't go with monetary targeting as we did in Germany, but we have to look at this as an important information indicator and we have to look at what the empirical evidence is after some time". That is the reason why we are not precisely following the German approach, which is hierarchical in its orientation, with a monetary aggregate as the predominant indicator and all other indicators being used only to explain whether the appropriate information is being provided by that indicator or not. That was the German concept. Under the present circumstances in Euroland, we will use the monetary growth indicator as one indicator but it is not the only leading one.

Now you can go in the opposite direction and say "OK, let's abolish the whole money indicator." In this context, I would like to say this: after 30 years of experience, the Bundesbank has had relatively positive results with that. One advantage is that the money growth is a forward-looking indicator that says what will happen in the future. It gives you an orientation. Whether it is always precisely giving the appropriate indication or not – that is the question we have to look at. Therefore we in the Governing Council of the ECB said that we want to have two pillars. But giving up monetary targeting completely would mean giving up the advantage of 30 years' experience compared with the other experiences. And that, in my view, is not the appropriate solution.

Now, about increasingly emphasising inflation forecasts. We are doing inflation forecasting internally, including the use of models. But we see that the models sometimes present different results. Is it really increasing transparency for the markets to present different results to the public? Is that really positive information by the central bank? This work is done by the research institutes. We are not forbidding any discussion, nor are we forbidding any publication. But why should we put a seal of approval on this and that forecast? Endorsing a specific forecast is, in my view, a very dangerous thing. Saying that a particular forecast is the best one means saying this is the guideline for our decision. But, at the same time, we have to look at the monetary aggregates and at a lot of other information because we are aware of the uncertainties. That is the reason why we are saying, "OK, we are doing inflation forecasts internally. We are looking, we are perceiving, we are even publishing internally or externally the different forecasts, no problem with that." But to say that is our forecast is, in our view, not the appropriate way. Forecasts can be misleading. I have seen so many forecasts in my life which were misleading because there are a lot of influences coming from different circles which can lead to different results, so one has to be very careful. What I am saying is that forecasts should be done in a competitive way. That means competition among the forecasters. That's how it should be done, and not by giving such forecasts a seal of approval. And using forecasts to motivate policy is an especially dangerous thing. If you do so, and if your forecasts are wrong, then you run the risk of undermining your future credibility.

Let's talk now about improving transparency of the decision-making process. A decision-making process is in my view a discussion, a debate, an exchange of views and learning from each other's arguments. If you publish precisely the positions taken in the last meeting in the minutes and compare that with what we say in the next meeting, what is that worth? I mean, whether this sort of transparency will really improve collective wisdom is another story. I find the British experience very interesting. Publication of the minutes has given some information to the financial markets, true. But that has sometimes led to avoidable speculation. And it has sometimes contributed to speculation if one is quoted in the minutes of the previous meeting as having taken a certain position and next time he is moving in another direction. In my view that can make the whole thing very difficult. So my point is that it is necessary to inform the public about what is the basic thinking, what is the mainstream thinking. That is something we are trying to do in the statements issued after the meetings. Saying there are these arguments, and showing that after serious discussions we have come to the conclusion that these arguments are not as important today as other arguments, and that we came to this or that policy conclusion. I think this form of transparency provides better information to the public then the other form of transparency. We can not transfer experience from academe to the policy-making sector. And it is likewise not appropriate to compare the European Central Bank with other political institutions, which have to deal with a lot of objectives and which almost always have to decide among the most relevant of the different objectives. The mandate of the European Central Bank is one single objective. If there were different objectives, this would really raise the question of weighing the objectives in the different situations. And, in my view, that is precisely not the role of a central bank. I am strongly opposed to a central bank which has more than one single objective. The mandate of an independent central bank must be clear. I feel that an independent central bank can only be accepted in a democratic system as long as it has a clear-cut mandate and has to explain what it is doing to accomplish that objective. This does not include weighing different objectives. The central bank is only geared towards a single objective and it has to be transparent. But this means a transparency which in the end contributes productively towards fulfilling its statutory objective. And that means that it has to gain credibility, it has to be accepted in the financial markets.

Ulf Dahlsten

I will now give the floor to three questions and then the final word to Professor Tietmeyer. The first question from Lars Tobisson, the first vice chairman of the Swedish Conservative Party, Moderata samlingspartiet. Very short now.

Lars Tobisson

Yes. Thank you Mr Chairman. When the credentials of the prospective entrants into the third stage of the economic and monetary union were examined last spring, there was general agreement, and even the Swedish government concluded, that Sweden failed in one respect when it comes to the convergence criteria – that of a stable currency. The government has decided not to enter the ERM or the ERM2. I wonder if there is any other way outside the ERM to gain entrance into the third stage of the monetary union. I put this question to our Minister of Finance in written form, and he was supposed to answer me tomorrow at two o’clock. He might have had other reasons for his decision to resign, but all the same I won’t get his answer and now I put the question to you, Dr Tietmeyer.

Ulf Dahlsten

OK, next question, Professor Lars Jonung. He is Professor of Economics.

Lars Jonung

Business cycles are not synchronised across the member states of the EMU – at least not yet. This poses a dilemma for the policy authorities. When an economy is booming, interest rates should be raised. When an economy is falling into recession, interest rates should be reduced to stabilise the economy. However, such a policy can not be adopted within an individual EMU-country as interest rates are set centrally by the ECB.

This may seem to be an academic point of view, but actual events on Ireland are illustrating this policy dilemma. I am curious, Dr Tietmeyer. What kind of advice would you give the Irish policy authorities? Should they introduce old-fashioned Keynesian fiscal restraints or should they allow the business cycle to run its course hoping that it will not end with a crash.

Of course, I do not expect you to advice the Irish to leave the EMU. But here is a policy dilemma and it has to be solved. I would like to know your approach to this problem. Thank you.

Ulf Dahlsten

Thank you and last question from the president of Sveriges Riksbank, Urban Bäckström.

Urban Bäckström

First of all Mr Chairman I will have to promise President Tietmeyer that I will not talk about the exchange rate criteria. I could always debate that with you I know your position and I will not go in to the fact that there is no ERM system anymore. There is an ERM2 system but not an ERM system. So I will not go in to that.

The second point is that I would like to thank you for a very stimulation and though provoking discussion here tonight. And I was a little bit embarrassed I must admit when some opponents suggested that you should look to Sweden and to England and to the Reserve Bank of New Zealand for guidance. To tell that to a president for the Bundesbank is really embarrassing for me. I mean you have a long standing record in inflation fighting. Never the less, I think that the two gentlemen here, distinguished professors, have raised some very important arguments. Not because Bundesbank needs all that transparency, openness and clarity. But because ECB is a new institution and it is an institution that works with much larger population than the Bundesbank. I mean the German population has seen Bundesbank pursue monetary policy in a very successful way for a long term. But the Spanish people, the Swedish people, people in Portugal, in France, in other countries have not experienced 50 years of price stability and I think the ECB needs that kind of understanding and support from the general public or for that matter from the political system that the two gentlemen, distinguished professors, have discussed here tonight. And I think that there are some points that needs to be looked into in the framework. But we all understand of course that the ECB is a new institution and it has to develop its way to pursue monetary policy over time. Thank you very much and let me finally say that I am very happy that you came to Sweden, Hans on a personal basis, let me say that we have had a very interesting discussion here tonight. Thank you.

Ulf Dahlsten

Last word to Professor Tietmeyer.

Hans Tietmeyer

To the first question. Two years of membership is enshrined as a criterion in the Maastricht treaty. Urban is right in saying that at that time it was ERM and not ERM 2. That's true. But was ERM really different from ERM 2? That is a question which has to be clarified. But I will not go into that issue now. The only point is that two years of ERM membership without tensions is part of the Treaty. And the Treaty has been ratified by all parliaments in Europe. ERM membership is a test period where a country can go along with an *ex ante* defined exchange rate. That is the whole idea of belonging to the ERM for two years without any tension as is set forth in the Maastricht Treaty. So I can only say that the Treaty is clear and the interpretation of the Treaty by the majority of the governors in the EU is clear, too.

Secondly, business cycles are not harmonised. That is a problem within EMU. But it is true that cycles are not always synchronised in the United States, either. We have sometimes seen different business cycles in the United States, which makes monetary policy difficult. This problem can be solved, but monetary policy cannot always be conducted in line with the needs of all the different parts. That is a special problem but one we have to live with. In the starting position, where we are now, there is really a special problem and you mentioned that: the case of Ireland. In my opinion, this issue, and I can say it because I have said it publicly before, could have been solved earlier through a larger revaluation of the Irish pound. We argued in favour of that. Unfortunately, it was not decided. But that is the past. Now the question is: what can be done today? To some extent we have to live with the consequences of missing this opportunity to adjust the central rate at the right moment. But in my view there is some room for manoeuvre by using fiscal policy to some extent. But it is up to the authorities in Ireland to decide on that part.

Urban, you are, of course, right. We have to learn. The ECB is a young institution and it can not be compared to the Bundesbank, which is already an older institution. Of course, compared to you, even the Bundesbank, is a young inexperienced girl. 300 years, that is really an old and experienced lady. And the Bank of England is an old lady too. So we have to learn, and we are willing to learn. Coming back to the ECB: the ECB as a young institution needs to build up credibility. And for that transparency is necessary. No doubt about that. In the substance, we share common views. But the question what sort of transparency in detail, we will discuss it. In my view, the credibility ultimately depends on the decisions that are made. On whether the European Central Bank is able to take the appropriate decision at the right time. But this will ultimately be judged in a backwards-looking way. After all, it depends on the results and not on whether you are informing in detail the financial markets, which have different motives altogether; they seek to obtain all the information they can because nothing is more important or interesting to the financial markets than news or information. Hence, it is useful to show that you are going a steady course and that your steady course will in the end really bring the appropriate results as far as monetary stability is concerned. Therefore, we must be very careful in the decision-making process and we must not make our decisions in a volatile way, giving very volatile information. Gaining trust is precisely what is necessary. And I think that in the end it depends on the results. Thank you very much.

Ulf Dahlsten

Thank you Professor Tietmeyer for a most inspiring lecture. I think we have enjoyed it all immensely. And thank you or your willingness to directly and openly answer the most difficult questions. Thank you very much for coming here.