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PRESS RELEASE

Ten years of monetary union in retrospect

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January 1st 1999 marked the start of stage 3 of European Economic and Monetary Union (EMU). Ten years later, the original group of eleven countries has expanded to fifteen, and will become sixteen once Slovakia joins in 2009. This article gives an overview of the first decade of EMU, with a focus on monetary policy, fiscal policy, the role of the euro in economic integration, the economic growth performance of the euro area and the divergences and adjustment mechanisms within the monetary union. It concludes by listing a number of important challenges for the future.

In the first ten years of monetary union, monetary policy succeeded in ensuring a high degree of price stability, despite the significant changes in relative prices in the context of globalisation. Achieving price stability provided the conditions for sustainable economic growth. Moreover, price stability did not come at a cost in terms of increased fluctuations in economic activity: as in other industrialised countries, the pattern was less volatile than in the 1970s, 1980s and 1990s. The ongoing credit crisis is a serious challenge for the common monetary policy. Confronted with an increasing reluctance of banks to engage in transactions on the interbank market, the Eurosystem has adapted its liquidity providing framework and has to a large extent taken over the intermediation role on this market. As the crisis became more acute in September and October and it became clear that the hitherto upside risks to price stability had greatly diminished owing to plummeting demand, the key interest rate was cut in several stages. It also appears that monetary union prevented the repercussions of the credit crisis from being exacerbated by the additional tensions which it would have triggered in the various Member States in the absence of the euro.

Regarding fiscal policy, insufficient use was made of the favourable phases in the economic cycle during the period of monetary union to achieve lasting consolidation of public finances, whereas substantial progress had been made in the run-up to EMU. While it is appropriate to allow the automatic stabilisers to operate in the impending downward phase in the business cycle, it is still of vital importance to achieve structural consolidation of public finances, in view of population ageing.

The international use of the euro expanded steadily until a few years ago, after which its importance stagnated somewhat. The introduction of the euro reduced the costs of international trade within the currency union and probably stimulated international trade flows, with smaller firms, in particular, addressing the international market. The increasing trade integration also encouraged price convergence in the euro area. Financial integration appears to have progressed further for markets more closely connected with monetary policy; in contrast, the retail banking market is still highly fragmented.

The standard of living in the euro area is significantly lower than in the United States, and that has changed little during monetary union. Both productivity and the number of hours worked are below the levels in the United States, although there has been a turnaround on the latter point since the start of monetary union. However, that is offset by the fact that productivity growth has diminished sharply in the euro area in the past 10 years. Once again this points to the need for structural reforms under the Lisbon Strategy, which aims to bolster the growth potential of the euro area.

In historical terms and in comparison with the US, growth and inflation differentials between euro area countries are not large. Moreover, those differentials are not necessarily problematic in a currency union, since they may be due to real convergence. However, during the first ten years of monetary union there have been divergences of a more cyclical nature, e.g. in the case of Spain, Ireland, the Netherlands and Germany. In addition, they were fairly persistent, indicating sluggish adjustment mechanisms. Certain divergences in wage and price trends were also due to inappropriate national policies and structural inefficiencies. It is

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therefore important to implement policies which ensure the smooth operation of the product and labour markets, leading to appropriate pricing and wage-setting in line with the underlying fundamentals. Belgium's membership of the monetary union can be generally regarded as a success, though there is a need for constant vigilance over the movement in labour costs; however, the recent surge in inflation made it equally clear that further work is required on competitive markets, not least for energy.

The future presents major challenges for EMU. Population ageing requires structural consolidation of public finances. Structural reforms can make those budgetary challenges easier to bear because they support potential growth and thus increase prosperity. The expansion of the monetary union to include other EU countries may increase the divergences between the participating countries, at least temporarily, and will therefore seriously test the efficiency of the adjustment mechanisms. Finally, the financial crisis presents a significant challenge for monetary policy and the maintenance of financial stability. The crisis has shown that, as a result of financial integration, control of systemic risk, in particular, is a cross-border issue so that the European dimension needs to be reinforced in this area and an effort must be made to adopt a more integrated approach.

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