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President
of the Deutsche Bundesbank

**Speech at his official inauguration
as Bundesbank President**

in Frankfurt am Main
on 12 May 2004

Check against delivery

Mr Eichel

Mr Trichet

Ladies and gentlemen

On 30 April the Federal Finance Minister presented me with my certificate of appointment as the ninth President of the Deutsche Bundesbank. I would like to thank you, Mr Eichel, for the recognition and trust which the federal government has bestowed on me in making this appointment.

I would like to thank you, Mr Trichet, for the kind reception at the European System of Central Banks and the Governing Council of the ECB. As an academic, I have observed the monetary policy of the Eurosystem from a theoretical standpoint from the outset. As a result, the opportunity of being able to participate in the practical side of monetary policy in the Governing Council of the ECB has a particular appeal for me.

I would like to thank you, Mr Palsbröcker, and the 14,500 Bundesbank employees whom you represent for the warm welcome to the Deutsche Bundesbank.

And I would like to thank my colleagues on the Executive Board for my successful initiation and the friendly working atmosphere. Our working relationship got off to a constructive and very promising start last week.

As an institution, the Deutsche Bundesbank, with whose future I am now entrusted, has gone through an extremely difficult phase during the past few weeks. It has stood in the limelight as never before, and it has been criticised to an extent and with an intensity that it had never previously known. After Mr [Ernst] Welteke had decided to stand down from office for the time being, Dr [Jürgen] Stark in his capacity as Vice-President of the Bundesbank took over as acting President.

Dr Stark, I would like to extend a very special word of thanks to you for your stewardship of the Bundesbank during these three difficult weeks. It is thanks to you personally that the loss of reputation sustained by the Bundesbank was held in check.

1 Independence The special circumstances in which the change of office took place again reminded the general public that the independence of central banks is enshrined in law and for good reasons. This reminder may not have come in the right manner, but it certainly came at the right time. From an anti-inflationary stance, guaranteeing the independence of the national central banks has also proved problematical during the current negotiations on the EU constitution.

The Bundesbank's role as guardian of the currency requires it not only to point out the danger of weakening the foundations of a stable euro through the backdoor in the European Convention's draft Constitution but also to insist on a remedy. Specific proposals for the drafting of this, which take account of our concerns, were passed on to the Irish presidency by the ECB in mid-April. Now it is up to the politicians. They must not jeopardise the institutional foundations of a stable common currency.

2 Continuity ...

Ladies and gentlemen

With the introduction of monetary union, monetary policy autonomy was deliberately abandoned in favour of European unity. However, the ESCB has been devised in such a way that the national central banks continue to provide extensive central bank services for the European economies – granting loans within the framework of monetary policy, supplying the economy with cash and providing payment channels. In addition, the Bundesbank is highly respected within the Eurosystem. It contributes expertise and experience to the ESCB and plays an active role in forging a stable and strong monetary union.

2.1 ... at the Deutsche Bundesbank as an institution

The Bundesbank's strategic reorientation towards "Europe" began long before the introduction of monetary union in 1999. It was followed by an organisational reorientation once the legislature had concentrated the running of the Bundesbank in the hands of the new Executive Board in May 2002. The Executive Board did not waste any time in

deciding on the future organisational structure as well as on the staffing requirements and timetable for implementing the plan. The reorganisation was rounded off by devising strategies for cash handling and the branch network.

On this point I would like to carry on with the work of my predecessor and proceed with the structural reform as laid down. The planned changes are necessary, they are feasible and they are within the limits of what those directly concerned may be expected to bear. After we have achieved our goal in 2007, we will have to consider whether further changes are necessary.

With this reorganisation the Bundesbank has no need to fear either a comparison with other public institutions or with other central banks in the Eurosystem. Owing to differences in the definition of their respective national tasks, however, comparing the national central banks in the Eurosystem has to be done with care. The downsizing and reorientation of the Bundesbank that have been advocated so frequently in the past few weeks are already in full swing; the Bundesbank is by no means behind the curve in this respect.

Throughout the world questions concerning financial system stability are becoming more important for central banks. A stable and efficient financial system is absolutely essential if the central banks are to fulfil their stability mandate. In the past few years the Bundesbank has expanded its analytical and research capacity for identifying potential risks to financial stability and will extend this field further in future. We will include the results both of the analysis of current risks to the financial system and the research into the underlying relationships in the international debate on financial system stability and developments in the international financial architecture at the G-10 meetings.

2.2 ... in monetary policy

The primary objective of a central bank is and will remain safeguarding monetary stability. Since the start of monetary union just over five years ago the Eurosystem has built up a

good reputation and has gained the confidence of experts and the public alike. The euro is a stable and internationally respected currency.

According to the provisional estimate by Eurostat for the Harmonised Index of Consumer Prices, the price level in the euro area was 2.0% higher in April year on year compared with 1.7% in March. This is consistent with the ECB's target of keeping price inflation to less than but close to 2% in the medium term.

To achieve its monetary policy targets the Governing Council of the ECB applies its proven monetary policy strategy, which was slightly revised last year. The overall evaluation of the risks to price stability consists of two pillars which ensure that the primary purpose of the monetary analysis is to countercheck that the short-term and medium-term assessments arising from the economic analysis will also be applicable in the long term.

The economic analysis suggests that the gradual recovery which began in the euro area this spring will continue. While export demand continues to have an expansionary impact, domestic demand remains subdued, especially in the case of private consumption.

The monetary analysis indicates that there is a persistently large liquidity overhang in the euro area. This is mainly the result of previous portfolio shifts. In view of the lack of consumer confidence, I do not see any danger of this excess liquidity leading in the near future to increased price pressure as a result of a sudden surge in demand.

The very low level of key interest rates, the ample liquidity supply and the favourable financing conditions are providing plenty of scope for economic recovery. The present monetary conditions are therefore to be seen as appropriate.

2.3 ... in fiscal policy

The rate of economic growth in Germany is slightly below that of the euro area in general. Most of the current forecasts are more or less consistent with the expectations on which

the federal government based its budget plans. At approximately 1.5%, the expected real growth rate for Germany is only slightly below the estimated rate of potential growth.

The fiscal policy situation in Germany has rarely been as strained as it is now. In the current year the government deficit will exceed the ceiling set by the Maastricht Treaty for the third time in succession.

The current budget deficit would be much smaller if the government had been more conservative in estimating its revenue and had pursued its expenditure consolidation targets with greater determination. Some of its consolidation plans failed because government and opposition could not reach a consensus. In the interests of our country I appeal to those bearing political responsibility to agree on the cornerstones of a sustainable consolidation strategy with the utmost speed. This was achieved in the case of the health system reform, and I can only hope that it will also be achieved in the case of fiscal policy.

Germany's fiscal and economic policy makers must face the challenge of quickly reducing the large deficits, improving the statutory framework for macroeconomic growth through permanent reforms and preparing the social security systems to meet future burdens.

The most acute fiscal policy problem is how to bring the large government deficit below the 3% ceiling in 2005. The greatest scope for consolidation lies in the excessive government consumption expenditure. Switching expenditure from consumption to investment is also essential if provision is to be made for the future and the obligation of drawing up a budget that conforms to the constitution is to be met.

Mr Eichel, I would like to offer you and the federal government my explicit support in your efforts to adhere to the consolidation course by taking determined steps in that direction. The EU's Stability and Growth Pact should serve as regulatory guide here. The commitment made to EU partners to reduce the structural deficit by 0.5 percentage point a year must not be put in question any longer.

The pact is one of the two pillars of the ESCB, the other being the monetary constitution enshrined in the Maastricht Treaty. The purpose of the pact is to guarantee sound public finances in the EU on a sustainable basis. This is not being achieved by the pact at the moment. However, no conceptual changes to the pact are necessary; instead, all member states need to have the will to comply with the agreed rules.

That would not only avoid overtaxing future generations; it would also make a major contribution to achieving faster growth and more employment. After all, public confidence in the future can be strengthened only by a fiscal policy that is predictable and based on government finances which are sustainable in the long term. By contrast, a lack of confidence in the future gives rise to uncertainty, encourages greater precautionary saving and reduces the propensity to consume.

If the emerging upturn is to be sustained, we need fiscal policy consolidation together with clear economic policy guidelines and ambitious structural reforms. By contrast, an anti-cyclical fiscal policy would work, at best, only in the short term and, as a rule, would have little quantitative effect. In the long term the ensuing increase in debt would impede dynamic economic growth.

The upshot is that we must restore the confidence of the German public and our European partners in the sustainability of German fiscal policy. This would also make it easier for monetary policy makers to guarantee sustained price stability and low interest rates in the euro area.

2.4 ... in the gold reserves

Ladies and gentlemen

That part of the Bundesbank's reserve assets that is held in gold has frequently been the object of desire. And so in the present difficult budgetary situation there is no lack of suggestions on how this asset could be used.

The Bundesbank decides on gold sales in accordance with the gold agreement it concluded with the other G-10 central banks. The use to which the valuation gains realised from possible gold sales is put is decided by Parliament within the framework of the statutory regulations governing the use of the Bundesbank's profit.

It is only the realised valuation gain that can be distributed. The precise amount depends on the gold price and the dollar exchange rate at the time of the sales; if the sales option now included in the new gold agreement of the G-10 central banks were to be exercised in full, a sum of no more than several billion euro would accrue within five years given the present market situation. By way of comparison, we might consider that the federal budget for 2004 amounts to €257.3 billion, €29.3 billion of which is financed by means of net new loans.

Consequently, sound fiscal planning disregards any sizeable financing potential from the gold reserves or any significant relief for the federal budget. Mr Eichel, I am pleased that you yourself made this fact clear at our first joint press conference in Berlin two weeks ago.

3 Conclusion

Ladies and gentlemen

I think my work during the eight years that lie ahead of me will focus on four main elements.

1. Safeguarding stability
2. Continuing the work of the past few years and so further enhancing the image of the Bundesbank by making informed contributions to the major themes of monetary union and actively participating in the further development of that union
3. Using my independence to enrich the economic and fiscal policy debate in Germany, especially on how to achieve a steeper growth path, and, last but not least,
4. Bringing the internal reform of the Bundesbank to a successful conclusion

I received no shortage of premature praise on my appointment as Bundesbank President. That has both a good side and a bad side. It is good because the advance expressions of confidence are making my work much easier at the moment. It is bad because there is no doubt that not all of the high expectations can be fulfilled.

To enable me to rise to the high expectations that have been made on me personally and on the Deutsche Bundesbank as an institution I would like to ask you all for your support, and that includes support of a quite critical nature. If I can count on that support, I can take up office full of confidence.

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