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BANQUE CENTRALE DU LUXEMBOURG

EUROSYSTEM

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OFFICIAL STANCE

THE MISSION

The BCL is in charge of managing all the monetary and financial responsibilities granted to it as one of the National Central Banks of the ESCB.

It is also a member of the Eurosystem that gathers the European Central Bank and the National Central Banks that have adopted the euro.

On a national level, the Bank has to carry out the tasks imposed on it by the national laws and conventions.

It is developing the following fields of competence:

- Research and studies aimed at preparing, on the one hand, monetary policy decisions and, on the other hand, the development of wider knowledge concerning monetary, financial and economic issues

- Collection and analysis of statistics in the monetary, financial and balance of payments fields

- Implementation of monetary policy instruments

- Organisation and supervision of the payment and settlement systems

- Issuing and circulating banknotes and coins

- Financial asset management, both for itself and for third parties

- Participation in the prudential supervision of the financial system and the exercise of the oversight of payment and settlement systems, in order to guarantee the stability of the financial system in Luxembourg

- Advising the legislative and regulatory authorities in financial and monetary areas

- Publication of its studies and research and of the decisions in which the BCL has taken part together with explanations.

THE VISION

The BCL intends to become a centre of competence, excellence even, whose performance generates public confidence in the Central Bank.

Among Luxembourg's institutions, the BCL takes every care to be in a position to fulfil all its national, European and international obligations.

In view of the wide variety of its duties and activities, both in the public sector and in a competitive environment, the BCL must generate an income guaranteeing its institutional, functional and financial independence.

CORPORATE VALUES

As a consequence, the values associated with its action are:

- Professionalism, guaranteed by highly specialised staff, high-performance tools and high-level infrastructure
- Quality in all its services
- Stability provided by its long-term vision of all its activities
- Objectivity resulting from the establishment of precise rules that are equally applied
- Integrity, guaranteed by the transparency of its internal operation and by respect for professional ethics

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THE GOVERNOR'S MESSAGE

After the strong growth rates recorded in the first quarter of 2011, euro area economies are likely to slow down due to the combination of several external and internal factors. In addition, the economic and financial crisis has severely impaired the prospects of the financial sector. A deeper integration of Europe is the most effective way to deal with these adverse developments. The single monetary policy has already provided an effective protection against various attacks directed at the euro. However, EMU should be supplemented with a more effective fiscal framework, with structural reforms and with a close surveillance of macroeconomic imbalances.

The latter dimension is essential. Current account imbalances tend to have a less direct impact on national economies within a monetary union. At the same time, the accumulation of persistent internal imbalances is likely to prove extremely corrosive for the cohesion of such a union. This is the reason why current account deficits and other macroeconomic imbalances have to be monitored closely and even pre-empted and why the corrective mechanisms have to be reinforced at the European level. Stronger surveillance mechanisms are of paramount importance also for the proper function of markets. EMU presupposes the ability to intervene on financial markets, where public and private institutions finance their activities. The authorities should be able to intervene in a flexible way on these markets in order to secure the smooth financing of these activities and the good functioning of the transmission channels of monetary policy.

However, preventive action should be favoured over ex post financial interventions, which underlines once more the need for effective surveillance mechanisms, including stronger sanction mechanisms and more automatic rules. The cohesion of EMU also calls for effective action, at the European level, against national mechanisms such as the automatic indexation of wages. This is the only way to prevent adverse drifts in competitiveness, the related imbalances and the ensuing contagion of national crises.

These changes are compatible with the current legal framework. The Maastricht treaty is certainly not a frozen, static document. Already at its inception, it was considered as a minimum minimorum as regards the sharing of common responsibilities between Member States. The Treaty was reinforced by the Stability and Growth Pact, whose reform in 2005 appears as a major mistake in retrospect. This relaxation of the common fiscal rules indeed undermined fiscal discipline and contributed to pave the way to the sovereign debt crisis. The latter crisis calls for a stronger fiscal surveillance framework and for the appropriate consolidation measures in several Member States. This is the only way out. Default is certainly not a solution, as it would only create insuperable problems and complicate the financing of our common future.

More generally, we should reject the "siren calls" of those who argue for a looser European union, which is a way to undermine the free movement of goods, services and citizens and to derail the indispensable structural reforms. The attacks against the Schengen agreements are another face of the same coin. Each European citizen must defend the European unification process in these difficult circumstances.

In Luxembourg, 2010 was the year of the economic rebound, which followed the worst contraction recorded since the steel crisis in 1975. Real GDP indeed decreased by 3.6% in 2009. According to our December macroeconomic projections, real GDP growth in 2011 would be in the 3.7% to 4.3% range, in line with the developments in 2010 or slightly more favourable.

However, caution is needed more than ever. One swallow doesn't make a summer. Uncertainty is still very high. Energy and commodity markets are still extremely volatile. In addition, new fiscal consolidation measures will be implemented by our trade partners and this should in turn negatively impact on our exports. Uncertainty also prevails as regards the future evolution of the financial sector, which represented no less than 26% of gross value added in 2009. According to our calculations, potential GDP growth would not exceed 2% to 3% at the current juncture.

Luxembourg should take advantage of the current economic upswing to implement the indispensable reforms related to labour markets, competitiveness and public finances. It should also put in place the required institutional measures. As regards labour markets, I note that the unemployment rate has recently stabilised at around 6%. This illustrates the end of the "Luxembourg model" in this respect. Our country achieved much better outcomes in the past, either in absolute terms or compared with the neighbouring countries. Unemployment in Luxembourg was only slightly higher than 2% in 2001 and 4% at the end of 2007. Moreover, the unemployment rate is increasingly of a structural nature, as illustrated by a growing proportion of people on the dole for more than one year and of unskilled unemployed people. In these circumstances, professional training and education should be enhanced and complemented with a more dynamic employment policy that would also fully integrate the cross-border dimension.

We should also urgently restore our competitiveness, also with a view to stronger employment. Price and cost competitiveness has markedly declined over the last ten years, due inter alia to inflation rates systematically higher in Luxembourg than in the neighbouring countries and in the euro area. The automatic wage indexation mechanism still applied in Luxembourg contributed to this drift. Under the "unchanged policy assumption", the first indexation tranche in 2012 will already be paid in March, namely less than six months after the previous tranche. Such a situation would induce a strong increase in the average wage cost, which would on average grow by 5.2% in 2012 according to our June 2011 projections. Luxembourg companies cannot afford such a penalty when they are already confronted with rising commodity prices.

The third challenge is the consolidation of public finances. The central government deficit amounted to no less than 3.2% of GDP in 2010, which is the worst result since the implementation of the ESA 95 statistical framework. The general government balance is more favourable owing to social security surpluses, but the social security accounts are bound to deteriorate in the future due to steeply increasing pension expenditure. In these circumstances, I deeply regret the lack of ambition of the recent update of the Luxembourg Stability Programme, where no credible consolidation track is spelled out, in spite of the "European semester" which was implemented for the first time this year. Luxembourg authorities should pay respect not only to the letter of the new European governance framework, but also to the spirit of this reform of paramount importance.

The crisis also highlighted the need for more effective regulation and supervision of the financial sector. Commendable inroads have already been made in this respect, but this is still an unfinished business. It is essential to implement the "Basel III" banking regulation and to ensure that it is fully compatible with monetary policy and supportive of the efficiency of credit institutions. The new European supervision architecture should also pay respect to the competences of central banks, particularly in the field of macro-prudential supervision. At the national level, the Luxembourg financial centre should be endowed with an efficient governance system, in line with the developments witnessed in other EU Member States. The BCL has taken over new competences in this field. Having been granted a new regulatory competence by the law of 24 October 2008, the Bank has become a proper supervisory authority. It has accordingly published its first directly applicable regulations and is currently preparing other such regulations. The BCL also endeavours to collaborate more closely with other supervisory authorities at the national, European and international level and contributes to the work of the European Systemic Risk Board. In 2010, it proposed legislative changes of its own organic law, inter alia, in order to clarify its competences in the fields of macro-prudential supervision, financial stability and external representation, also with a view to guaranteeing its financial independence. The Bank made other legislative proposals, for instance in order to introduce a new bank resolution mechanism.

To sum up, the painful experience of a few other euro area members, where the indispensable structural reforms were delayed for too long, should prompt Luxembourg to implement as soon as possible far-reaching reforms. We should take advantage of the current economic upswing to do so, before the onset of the next economic deceleration.

Yves Mersch