



EUROPEAN CENTRAL BANK

## OPINION OF THE EUROPEAN CENTRAL BANK

of 3 June 2004

**at the request of the French Ministry of Economic Affairs, Finance and Industry  
on a draft legislative provision authorising inflation-indexed loans from credit institutions**

(CON/2004/20)

1. On 1 April 2004 the European Central Bank (ECB) received a request from the French Ministry of Economic Affairs, Finance and Industry for an opinion on a draft legislative provision authorising inflation-indexed loans from credit institutions (hereinafter the 'draft provision').
2. The ECB's competence to deliver an opinion is based on the first and sixth indents of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions<sup>1</sup>, as the draft provision relates to currency matters and rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.
3. Under current French law, statutory or contractual provisions are prohibited from containing clauses providing for indexations based, *inter alia*, on the general level of prices or of salaries<sup>2</sup>. However, by way of exception from this general provision, debt instruments and financial futures may be indexed to the general level of prices<sup>3</sup>. The ECB notes that the French authorities wish to extend this exception to loans granted by credit institutions or by the *Caisse des dépôts et consignations* (CDC) by amending Article L. 112-3 of the Code. The ECB understands that the draft provision affects consumer loans (including home loans), corporate loans and inter-bank loans.
4. The European Monetary Institute (EMI) has previously examined the issue of indexation clauses in its Opinion CON/97/24<sup>4</sup>. The EMI noted that 'according to Article 9, §1, a provision of the [German] Currency Act shall be deleted which lays down a requirement for the prior authorisation of index clauses by the competent authority. (...) The monetary law of the Community currently

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1 OJ L 189, 3.7.1998, p. 42.

2 Article L. 112-2 of the Monetary and Financial Code (hereinafter the 'Code').

3 Article L. 112-3 of the Code.

4 EMI Opinion CON/97/24 of 16 December 1997 at the request of the German Ministry of Justice, under Article 109f(6) of the Treaty establishing the European Community (The 'Treaty') and Article 5.3 of the Statute of the European Monetary Institute (EMI), on a draft act (the 'draft law') for the introduction of the euro.

under consideration does not contemplate any prohibition or Community control of index clauses. Therefore, the EMI agrees with the conclusion of the Explanatory Memorandum that, with regard to the monetary policy function, national provisions on index clauses are no longer necessary. However, Member States may, for other policy requirements, establish or maintain indexation provisions relating to the competence of the national legislator, e.g. in the field of contractual law, such as the provision (...) for residential rent contracts'. The EMI's statement is still valid today and the ECB therefore considers that Member States may, in principle, authorise indexation clauses, as long as they comply with Community law.

5. According to the French authorities, the draft provision is necessary to ensure coherence with the regime for inflation-indexed securities. The ECB takes note of the objective pursued by the French Government of extending the freedom of contract, in order to allow economic agents to hedge against the inflation risk, and to enlarge the range of available financial products. However, the ECB would stress that a widespread use of indexation clauses would give rise to considerable concern. In particular, widespread indexation in wage and price setting may generate excessive rigidity in the relative price system and would risk fuelling inflation spirals. Although the demand for indexation clauses, in the current environment of low inflation, appears relatively limited, it cannot be fully excluded that households when faced with an increased debt-service burden, as a result of inflation rising faster than wages, would request that their wages be more closely indexed to prices. Similarly, certain firms might be tempted to pass any nominal increase in their debt-burden on to the prices they charge to consumers. If the economy were hit by a persistent inflationary shock, in case of widespread indexation, it would be very difficult to reduce the use of indexation clauses once inflation rates have passed a certain threshold.
6. The implementation in France of the 2003 reform introducing the automatic indexing of regulated savings rates to inflation will require banks to marginally adjust the management of their assets and liabilities in order to minimise inflation risk. The ECB understands that the proposed change would be particularly important for the CDC which channels deposits on regulated savings accounts and uses these funds, *inter alia*, to finance public housing and to grant loans to public housing bodies. However, since these specific loans are themselves indexed to regulated savings rates, the option of directly indexing them to inflation is likely to be of limited use. The French authorities consider that authorising the indexation of bank loans to inflation poses no specific risks to the stability of the financial system, in particular because its impact would remain limited. The ECB has no comments on this aspect.
7. A decree of 24 October 2001<sup>5</sup>, which will also apply to the draft provision, further specifies the terms and conditions for the indexation of certain financial instruments to the general level of prices. The Decree provides that the harmonised index of consumer prices (HICP), excluding

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<sup>5</sup> Décret no 2001-966 du 24 octobre 2001 portant modalités d'indexation de certains instruments financiers sur le niveau général des prix, *Journal Officiel de la République Française*, no 248, 25 octobre 2001 (Decree No 2001-966 of 24 October 2001 setting out the terms and conditions for the indexation of certain financial instruments to the general level of prices, *Official Journal of the French Republic*, No 248, 25 October 2001).

tobacco, for the euro area as published monthly by Eurostat may be used to implement the indexation. However, as is the case for French inflation-indexed Government bonds, other general price indices, such as the French consumer price index, may in principle also be used. The ECB considers that indexation to a national price level or rate of inflation, rather than to a euro area index, may risk increasing the heterogeneity of financial systems across the euro area and in general of the different euro area economies. Indexation to a euro area index would therefore be clearly preferable from a monetary policy viewpoint. The ECB also supports, for reasons of transparency and comparability, the use of the HICP for the euro area.

8. The ECB confirms that it has no objection to the competent national authorities making this opinion publicly available at their discretion. This opinion will be published on the ECB's website six months after the date of its adoption.

Done at Frankfurt am Main, 3 June 2004.

[ signed ]

*The President of the ECB*

Jean-Claude TRICHET