Ladies and gentlemen,

I am honoured to join such a distinguished audience. After so many years spent as the Governor of the National Bank of Romania, today's discussion gives me yet another opportunity to look back at the role that monetary policy has played in supporting nominal and real convergence in Romania. It is almost two decades since the Romania – EU accession negotiations had been opened (back then, in 2000, I served as the prime-minister). Romania has been an EU member for more than 10 years already. Allow me to share with you my view, shaped by the lessons learned over all these years, on the relationship between monetary policy and economic convergence.

Let me first make a couple of considerations about economic convergence. First, while the nominal convergence criteria are deeply rooted in the minds of policymakers, the Maastricht Treaty also explicitly stipulates that "a high degree of sustainable convergence" is needed. Yet, this requirement seems to have been overlooked sometimes. Second, practical experience with euro adoption so far has proved that real convergence is also critical for success. Even in the absence of a clear definition and a consensus on a numerical benchmark, it became clear that a high-enough level of real convergence is a prerequisite for minimising the costs associated with losing monetary policy independence after euro adoption. Recent years have shown that the euro area is not a cosy place for economies with lagging competitiveness or rigid markets. We should not forget that euro adoption involves a permanent commitment, as Otmar Issing, the first ECB chief economist, pointed out.

Romania made significant progress in terms of real convergence, with growth resuming and gaining momentum after the global economic crisis. This led to a rise in GDP per capita as a percentage of euro area average (based on PPS) from 31.7 percent in 2005 to 58.6 percent in 2017. The advance was the fastest within the group of peer countries which recorded similar trends.

Clear prospects for EU entry favoured Romania's real convergence before 2007. Afterwards, actual membership in the EU "convergence club" has fuelled the catching-up process. The obvious next stage is joining the euro area. A successful adoption of the single currency, however, requires optimal timing. This, as I pointed out before, is mainly conditional upon achieving a high-enough level of real convergence, alongside compliance with the nominal convergence criteria. Unlike the EU, the euro area is not a "convergence club", as its current members did not necessarily increase their convergence level after adopting the euro. While the optimal level of real convergence for a successful euro area entry is still a hotly debated issue, **the consistency and sustainability of real convergence are, in my opinion, at least as important as its level**. And in order to remain on track, economic convergence – both real and nominal – must advance in step with the economy's fundamentals lest progress be jeopardised by abrupt setbacks. At the end of the day, forcing convergence is as harmful as postponing it.

Looking at nominal convergence, between July 2015 and November 2017 Romania had been fulfilling all Maastricht convergence criteria (yet without being part of the exchange rate mechanism). The fact that currently the reference values for the long-term interest rate and inflation are no longer being met is a warning that efforts should be made to achieve nominal convergence in a lasting, rather than coincidental or transitory manner. This is possible only when the two types of convergence reinforce each other.

On the way towards sustainable and smooth convergence, a first guiding principle is to avoid divergence. Not only across countries; reducing development gaps within countries is also essential to mitigate the trade-offs challenging the policies confronted with asymmetric shocks. In Romania, for instance, one can find areas that are comparable, in terms of development and living standards, to Western economies, but also regions that trail well behind. Moreover, in 2016, the wealthiest region in Romania was almost four times richer than the poorest one (measured by the regional GDP per capita as a percentage of the euro area average).

The second guiding principle towards sustainable and smooth convergence is to keep going. By this, I mean that progress, once made, should not be undone. We now need to maintain the economy on an upward trend, while being extremely careful to preserve the macroeconomic equilibria restored through a painful adjustment after the crisis. The only way ahead is by means of a coherent macroeconomic policy mix and resolute structural reforms aimed to boost the economy's growth potential, while making it more resilient. This approach should never leave room for pro-cyclical policies.

As we have clarified that the consistency and the sustainability of real convergence are extremely important, now it is time to discuss how monetary policy can support these two dimensions of the convergence process.

It is beyond any doubt that countercyclical monetary policy favours smooth convergence. This has always been one of the guiding principles for calibrating the stance of NBR's monetary policy, as well as for developing and employing our policy tools. An example of the latter are the unorthodox prudential measures taken before the global crisis to mitigate the impact of extremely volatile capital flows; with these in mind, the IMF mentioned the NBR as being among "the pioneers" of what was later referred to as "macroprudential instruments".

Besides acting in a countercyclical manner, in order to preserve the consistency and the sustainability of real convergence, monetary policy should also be flexible while avoiding extremes. On one hand, it should by no means ignore the threat of inflation for the sake of fast and easily gained (and therefore illusory) prosperity. On the other hand, it should avoid becoming, in Mervyn King's words, an "inflation nutter". With this philosophy, back in 2005, the National Bank of Romania decided to adopt a "light" version of inflation targeting, as monetary targeting had to be abandoned mainly due to the broken relationship between monetary aggregates and inflation. Light inflation targeting was deemed more suitable than any other monetary policy regimes for sustainably achieving price stability, while limiting the cost of excessive volatility in output and employment. A peg was not a feasible option, since exchange rate flexibility was seen as an asset for an economy as big and rigid as Romania was at the time, especially given the widening external imbalance and the upcoming stages of capital flows liberalisation. We focused our monetary policy strategy on the medium-term achievement of the inflation objective rather than on hitting the target as fast as possible at any costs. This strategy has been supported by a managed floating exchange rate, which proved to be a highly effective alternative to free floating in cushioning the economy from the impact of sizeable capital flows. As a matter of fact, after the crisis, forex interventions re-entered the arsenal of many central banks, including some of the previously more purist free floaters.

The NBR has never had the luxury of being concerned exclusively with price stability and interest-rate setting in the belief that financial stability and exchange rate stability will follow. With freely moving capital and a significant degree of euroisation, the idea of being able to manage aggregate demand solely via interest rates is clearly an illusion.

In the first years after adoption of inflation targeting and prior to the EU accession, Romania saw substantial capital inflows fueling an already fast growing economy. Attempting to contain aggregate demand and anchor inflation expectations only with the interest rate instrument would have entailed additional and more aggressive hikes. This would have been self-defeating, leading to even larger capital inflows and an unsustainable nominal appreciation, boosting foreign currency lending, increasing external sector imbalances, and amplifying financial sector vulnerabilities.

I dare say that, **when it comes to price stability, just as in the case of economic convergence, consistency and sustainability are at least as important as the levels of headline inflation rates,** especially since non-core components are beyond the influence of the central bank. Moreover, as we all know, economic integration goes hand in hand with price convergence, since prices, along with incomes, also tend to adjust towards EU levels. Therefore, monetary policy in catching-up countries – unlike that in advanced economies – must also foresee and take into account price convergence patterns in the long run and this is a challenge that still lies ahead of us.

The years that passed since the adoption of inflation targeting in Romania were quite out of the ordinary. Until 2008, we had witnessed an economic boom and widening macroeconomic imbalances amid large capital inflows, only to move towards the subsequent bust in 2009 following the outbreak of the global crisis, with the plethora of problems related to correcting domestic and external imbalances. Over the last years, our economy has come a long way, and is now better prepared to deal with external shocks than it was at the beginning of the crisis. It seems that the "light" version of inflation targeting has been working fairly well for a catching-up economy as Romania, providing a combination of rules and flexibility to overcome such trying times.

Of course, a coherent macroeconomic policy mix is needed to maintain the economy on an upward course without putting at risk the hard-regained balances. In general, irrespective of how well-designed the monetary policy may be, in the absence of adequate complementary policies, it is likely to achieve sub-optimal outcomes.

I would like to end by trying to answer, based on my experience as a central banker, two simple questions related to inflation and real convergence that concern not only Romania, but also other catching-up economies. **With regard to inflation, one may ask "how much is too much?". I believe that the answer does not lie in pinning down certain numbers, but in the commitment to maintain a relatively low and stable inflation in the medium and long run.** Experience has taught me that inflation is an insidious disease that should not be treated carelessly. **With respect to real convergence, a question raised by many is "how fast is fast enough?". Again, I would not look for a certain figure; I would tackle this issue by approaching real convergence not as a race where the fastest track is also the right one, but rather as a complex process giving the steady runner (a marathoner rather than a sprinter) the opportunity to reap most of the potential benefits, while avoiding excessive risks.** Much like the fable about the turtle and the rabbit, which we all know how it ends...

Beyond targets and levels, and irrespective of the convergence gap an economy faces or the monetary policy regime a central bank opts for, what matters for both real convergence and price stability (as part of nominal convergence) is the consistency and the sustainability of the effort. In other words, being and staying on the right track.

Thank you.