Confidential

(Translation)

MINUTES *

OF THE 241st MEETING OF THE COMMITTEE OF GOVERNORS

OF THE CENTRAL BANKS OF THE MEMBER STATES

OF THE EUROPEAN ECONOMIC COMMUNITY

HELD IN BASLE ON TUESDAY, 9th JANUARY 1990 AT 10.00 a.m.

Those present at the meeting were: the President of the Deutsche Bundesbank and Chairman of the Committee, Mr. Pöhl, accompanied by Mr. Tietmeyer and Mr. Rieke; the Governor of the Banque Nationale de Belgique, Mr. Verplaetse, accompanied by Mr. Rey and Mrs. de Wachter; the Governor of Danmarks Nationalbank, Mr. Hoffmeyer, accompanied by Mr. Mikkelsen; the Governor of the Bank of Greece, Mr. Chalikias, accompanied by Mr. Papademos and Mr. Karamouzis; the Governor of the Banco de España, Mr. Rubio, accompanied by Mr. Linde and Mr. Durán; the Governor of the Banque de France, Mr. de Larosière, accompanied by Mr. Waitzenegger and Mr. Cappanera; the Governor of the Central Bank of Ireland, Mr. Doyle, accompanied by Mr. O'Grady Walshe and Mr. Reynolds; the Governor of the Banca d'Italia, Mr. Ciampi, accompanied by Mr. Dini and Mr. Santini; the President of De Nederlandsche Bank, Mr. Duisenberg, accompanied by Mr. Szász and Mr. Brockmeijer; the Governor of the Banco de Portugal, Mr. Tavares Moreira, accompanied by Mr. Amorim; the Governor of the Bank of England, Mr. Leigh-Pemberton, accompanied by Mr. Crockett and Mr. Price; the President of the Commission of the European Communities, Mr. Delors, accompanied by Mr. Pons, Mr. Dixon and Mr. Boyd; the Director General of the Luxembourg Monetary Institute, Mr. Jaans. Also present at the meeting was Mr. Dalgaard, Chairman of the Group of Experts. The Secretary General of the Committee, Mr. Morelli, his Deputy, Mr. Bascoul, Mr. Scheller and Mr. Giles, and Mr. Bockelmann and Mr. Dagassan also attended.

* Final text approved at the meeting on 13th February 1990, which incorporates some drafting changes.

The Chairman opened the meeting by thanking his colleagues for the confidence they had shown in him. He added that he would try to strike a balance between his duties as Chairman of the Committee, in which capacity he would have to be neutral and represent the whole Committee, and his task as President of the Deutsche Bundesbank, which would lead him to defend the interests of an institution that was certainly the one to attract most criticism within this forum from time to time.

The Committee was at a juncture that was absolutely crucial to the development of Europe. It greatly appreciated the fact that President Delors attended the meetings so often, thereby vividly demonstrating the importance of the Committee's work, for the Governors of the central banks were called upon to play an important part in the process leading to Economic and Monetary Union. There were grounds for optimism, for, after agreeing on the "Delors Committee" report, which was a sizable contribution to the construction of Europe, the Governors had rapidly reached a consensus on the changes to be made to the Committee's organisational arrangements. The Finance Ministers had also moved swiftly but had been unable to adopt the Decision amending the 1964 Decision because the European Parliament had not delivered an opinion. The Governors were nevertheless determined to press ahead; they had already made progress on the substance by reaching agreement on the general approach to, and content of, monetary co-operation and on the need to make monetary policies more compatible with one another.

The Chairman congratulated Mr. Hoffmeyer, who had celebrated both his twenty-fifth anniversary as Governor - an extremely rare occurrence - and his sixty-fifth birthday. He mentioned that Professor Beleza, of the Banco de Portugal, who had participated in the Committee's December meetings, had recently been appointed Minister of Finance in Portugal, and he asked Mr. Tavares Moreira to convey to him the Committee's congratulations and best wishes.

The Chairman welcomed Mr. Tietmeyer, who was attending for the first time as Mr. Pöhl's Alternate. Mr. Tietmeyer was well known to everyone through the posts he had occupied previously, and the Committee was delighted to have him in its midst.

Lastly, the Chairman pointed out that Mr. Waitzenegger would be retiring at the end of January and was therefore taking part in a meeting of the Committee for the last time. Mr. Waitzenegger, who had been a Deputy Governor of the Banque de France since 1984, had been an extremely regular participant in the EEC central bank Governors' meetings in Basle. His co-operation and contribution had always been valuable and balanced, and he had also been very active in bilateral co-operation with the Bundesbank in particular, which he had conducted like a perfect gentleman. The Committee thanked Mr. Waitzenegger and conveyed to him its best wishes for the new life which lay ahead of him.

Mr. de Larosière said that he had been unable, at the meeting of the Group of Ten Governors the previous day, to mention Mr. Waitzenegger's departure and that he therefore wished, as Chairman of that Group, to express to him his thanks, appreciation and good wishes. Mr. Waitzenegger was very well known to everyone, as he had been attending the Basle meetings for more than ten years. At the Banque de France he had been a most marvellous and valued colleague of the Governor owing to his vast knowledge of the matters dealt with and his wide experience of the foreign exchange market.

I. Approval of the minutes of the 240th meeting

The Committee approved the minutes of the 240th meeting on the understanding that the editorial amendments suggested would be incorporated in the final text.

II. Monitoring of economic and monetary developments and policies in the EEC based on:

- Preparation by the "Dalgaard Group" and discussion by the Committee of Alternates;
- Statistical charts and tables

A. Statement by Mr. Dalgaard

The US dollar had continued to decline in December and early January, losing approximately 7% of its value against the Deutsche Mark in the course of those six weeks. It had fallen nearly 20% from its June 1989 peak but was still higher than in late 1987 and early 1988. It was even higher than at the time of the Louvre Accord in February 1987, if adjustment was made to take account of differences in the development of costs. The reasons for the dollar's weakness were the reduced interest rate differential relative to the Deutsche Mark, the easing of international tension (in Panama, eastern Europe and elsewhere), the particular strength of the Deutsche Mark and perhaps also central bank intervention.

With regard to intervention, net dollar sales had been close to US$ 6 billion during December and early January, and the Federal Reserve had appeared to be worried about the dollar sales by European central banks, fearing that they could cause the dollar to fall too fast and too far. A rather unusual episode had occurred on Thursday, 4th January, when the Bundesbank had sold US$ 50 million, triggering a fall of nearly 3% in the dollar rate. The Bank of Japan had already sold US$ 750 million on Wednesday, 3rd January in New York and had continued to sell in London on Thursday, when the Bundesbank had intervened in Frankfurt, followed closely in Zurich by the Swiss National Bank, which had stated that it had been taking part in concerted action. The markets had believed this to be the case - hence the dollar's sharp fall against the European currencies. The fact that the Bundesbank had, shortly before its intervention, returned to the previous procedure of variable interest rate repurchase agreements had also created uncertainty in the markets, which had seen this as a tightening of monetary policy.

The yen had remained fairly stable against the dollar in December, as it had done over the past six months, and had therefore fallen sharply against the European currencies (by around 20% against the Deutsche Mark since the beginning of 1989). This trend was considered unreasonable and unhelpful by the experts, given that the fundamentals called rather for a strengthening. The political situation in Japan, with elections forthcoming, probably in February, was certainly the main cause and explained the weak monetary policy, for instance. On top of that, Japanese investors continued to be very interested in investing abroad, particularly in the United States. Interest rates were expected to rise in Japan after the elections, and this should support the yen, but it was difficult to say to what extent.

Within the EMS exchange rate mechanism, tensions had continued to be moderate. They had not been visible in the exchange rates in the narrow band, given that since December these rates had polarised, with the Deutsche Mark and the Dutch guilder near the top and the other currencies close to the bottom. The width of the narrow band had, however, remained around the 2% mark. The Italian lira and the peseta had weakened somewhat. For most ERM currencies intervention had been necessary, as had an increase in interest rate differentials relative to the Deutsche Mark. The reasons for this development were the particular strength of the German currency, associated with events in eastern Europe, and the persistent rumours of a realignment, which in December had been linked mainly to the expectations of a narrower margin for the lira, a move perceived as presenting an opportunity for a general adjustment.

The narrowing of the margin for the lira had been decided by the Italian authorities after the adoption by Parliament, just before Christmas, of a budget for 1990 which signalled a tightening of fiscal policy. The operation had been carried out in such a way that the lower intervention limit remained unchanged, which had implied a 3 3/4% formal depreciation of the central rate against the other currencies. In order to ensure an orderly transition, the Banca d'Italia had brought the lira to a position close to the middle of its new margin but slightly below the level of the narrow band which Italy had in fact had been shadowing for nearly a year. Consequently, there had been a fairly marked weakening of the lira during December. On Monday, 8th January, the first day after the operation, the lira had strengthened. This was what could have been expected, for, after such a mini-realignment, the market had been able to assume that there would be no further realignment in the near future, which meant that interest rate differentials would assume greater importance and the high interest rate currencies should tend to strengthen. It was difficult to say to what extent that would happen. As was usually the case after a realignment, the markets needed some time to adjust to the new situation.

With regard to the Spanish peseta, the initial reaction seemed to have been quite different. On Monday, 8th January the peseta had come under pressure and the Banco de España had decided not to intervene but to let the currency slide. Consequently, the peseta had fallen to a level below that of the lira and the Deutsche Mark, and all the currencies in the mechanism were now within the narrow band. The narrowing of the lira margin gave the peseta, the only wide-band currency, full flexibility, i.e. it could fluctuate by 5% above or below the band, whereas previously this flexibility had been limited by the position of the lira.

Two relatively minor points deserved to be mentioned.

While the lira market had been calm, despite the fairly widespread expectation that the margin would narrow, pressure had built up sharply, apparently triggered by a report from the Smick Medley Institute predicting a substantial realignment within the EMS. The Banca d'Italia had had to intervene on a massive scale, to the tune of more than US$ 600 million in one day.

The falling dollar had influenced capital outflows from France, as many French companies, which had made major investments abroad in 1989, had apparently taken advantage of the dollar's weakness to convert their foreign currency financing into French francs.

B. Statement by Mr. Rey

The Alternates had focused their attention on three topics: the decision of the Italian Government to take the lira into the narrow band of the EMS, the cohesion of the currencies within the EMS and the behaviour of the other major currencies.

1. The inclusion of the Italian lira in the narrow band

The decision of the Italian authorities and its implementation had been hailed as a positive contribution to strengthening the EMS. They were accompanied by the welcome decision, approved by Parliament, to tighten fiscal policy. The Community procedures had been applied flexibly in a demonstration of exemplary co-operation.

Without detracting from this positive assessment, the Alternates had asked the following questions.

Firstly, did the Italian initiative accord with economic fundamentals? Might it not have been preferable to have made a larger adjustment to the central rate?

The Italian Alternate had emphasised that the general pattern of economic performance was favourable, in terms of both activity and the major balances. The competitiveness and profitability of Italian firms were sound. Foreign trade performance was satisfactory.

A number of Alternates had stressed the need for a policy mix geared to the narrowing of the margin; thus the decision to tighten fiscal policy was welcome but it was very important, above all, that the authorities should show diligence and determination in implementing it.

A second set of questions related to the sequence of steps necessary in preparation for Stage One of Economic and Monetary Union. Had it been necessary to join the narrow band before the full liberalisation of capital movements, or should it have been the other way round? Arguments could be advanced to support either view, but the Alternates had acknowledged that the chosen scenario had become inevitable once the political decision to narrow the margin had been publicly announced. By signalling a rigorous exchange rate policy stance, the authorities could create a climate of expectations that was conducive to the implementation of the full liberalisation of capital movements in conditions of stability.

A third set of questions concerned the procedure adopted, and in particular the role of the Committee of Governors in the process. It had been pointed out that, at the time of the accession of the Spanish peseta to the exchange rate mechanism, the Committee had been very active, too active, even, in the opinion of some. On this occasion its role had been more than modest. Was this a satisfactory situation? Did it call for particular comment?

2. Cohesion of the currencies within the EMS

The System continued to function satisfactorily, given the influences to which it was subjected. The abolition of the last remaining exchange controls in France, six months before the time-limit, had been well received by the markets and had had hardly any adverse effects, either for France or for the the System as a whole.

However, while there had been no major tensions, it had to be acknowledged that signs of nervousness had become apparent during the last few weeks. They had given rise to interest rate fluctuations and to an overall volume of exchange market interventions which could not be disregarded.

In this context two questions arose:

- Did the Italian initiative make it possible to count on a prolonged easing of tensions? An easing of tensions, certainly. It should be noted in this regard that the Bundesbank had emphasised that the recent money market operations did not reflect a change, for the time being, in the course of monetary policy. Whether this easing of tensions would be prolonged was less certain; it had to be acknowledged that the strength of the Deutsche Mark had become a fundamental feature of the monetary landscape.
- Were the interventions not excessive, if fluctuations in interest rates were taken into account? It could be held that the last few weeks had been characterised by particular factors, such as the thinness of the markets and rumours of an imminent realignment. It could be observed that international capital flows were

acquiring a growing structural significance that could be expected to be reflected in the volume of interventions. Nonetheless, there were grounds for monitoring developments closely in the next few weeks.

3. Behaviour of the other currencies

Mr. Rey confined himself to mentioning two points:

- There was general dissatisfaction at the level of the Japanese yen, which was depreciating in an economically unjustifiable way. However, the part played by political factors in this development made any action, or persuasion, difficult before February's elections.
- The Alternates had mentioned the episode of the recent interventions by the Bundesbank, together with other central banks, to nip in the bud any renewed appreciation of the dollar. The remarkable success of this initiative had been stressed, but at the same time the hope had been expressed that, in similar circumstances, there might be prior concertation.

C. Discussion by the Committee

The Chairman thanked Mr. Ciampi for his very constructive co-operation in the narrowing of the margin for the lira. This had not been an easy operation, but its timing had been good and it had not caused tension within the EMS.

Mr. Ciampi stressed that the decision that had been taken was an important one, certainly for Italy but also for all the participants in the System, and he briefly reviewed Italy's experience since the inception of the EMS. Italy had submitted to EMS membership because the authorities had been convinced of the need to participate in the exchange rate mechanism even if they had been very concerned about the extent to which the Italian economy diverged from those of the other partners. Tribute should be paid to Mr. Baffi, who had had the idea of the wide band that had enabled the lira to enter the mechanism in a credible and convincing manner, as experience had shown. The discipline of the EMS had been beneficial, but it should not be forgotten that it had been difficult and risky to conduct a rigorous exchange rate policy and a strict monetary policy in a country where businesses were suffering serious financial difficulties and were heavily indebted. Authoritative commentators had said at the time that the chosen policy would lead to the de-industrialisation of Italy. Nothing of the sort had happened and, in fact, businesses had grown stronger. There had been difficulties, but it had been possible to overcome them, in particular thanks to EMS membership. The Banca d'Italia's complete autonomy with regard to intervention on the foreign exchange market should be mentioned, as this had been very useful.

The time to decide on a switch to the narrow band had been ripe at the end of 1989. The existing band had become too wide to continue to exert discipline on economic agents and had lost its justification with a current inflation differential of 2 to 3%, whereas it had been nearly 15% at the outset. At the economic level, while inflation had increased last summer, as in other countries, reaching an annual rate of 7%, it was now falling: by the spring it could fall below 6% and then continue to decline, to come close to the most stable rate in the Community.

The current exchange rate seemed to be appropriate for the balance of payments. The deterioration in the current-account balance in 1989 had been largely due to non-commercial transactions, such as tourism and debt service payments. The worsening of the trade balance was attributable mainly to oil prices and the level of the dollar throughout most of 1989. The substantial deterioration in the bilateral balance of trade with certain countries, such as Germany, was due less to the weakness of the Deutsche Mark than to the strong demand for investment in Italy.

Opinions had varied in Italy as to which should come first, the narrowing of the margin or the full liberalisation of capital movements. Even though the latter was complicated by the fiscal inequalities in Europe, Italy would fulfil its commitments and liberalise short-term capital movements by 1st July 1990 at the latest. It would, however, take some fiscal counter-measures to make this liberalisation a less perilous undertaking. Once it had been decided that it would be useful to carry out both liberalisation and the narrowing of the band by 1st July 1990, a start had had to be made with the latter, or it would have risked being postponed indefinitely. Public finances were, in fact, still the critical item in the Italian economy, and the entry into the narrow band had been rightly presented by the Government as a major commitment to stabilisation of the budget. The Banca d'Italia would continue to push the Government in that direction, if only because of the strict control over monetary financing of the public debt which was brought about by the so-called divorce between the Treasury and the central bank in 1981. More recently the abolition of the practice to set a reserve auction price had enabled Treasury bills all to be subscribed at market rates. In 1989 the Banca d'Italia's portfolio of these bills and Treasury bonds had not increased at all.

Mr. de Larosière pointed out that as from 1st January 1990 capital movements had been completely liberalised in France and that this measure did not appear to have had any effects on the foreign exchange market. Indeed, the anti-inflationary monetary and fiscal policies being conducted are likely to avoid capital outflows. Monetary policy had been tightened at the end of December: the target range calculated for M_2 had been fixed at 3.5-5.5% for 1990 instead of 4-6% in 1989, and the Banque de France's key rates had been raised by 1/2 point, increasing the penal repurchase rate to 10 3/4%. The internal and external stability of the currency was the clearly reaffirmed objective of French monetary policy. A few figures illustrated the internationalisation of the French franc, a development which had taken place well before the abolition of the last remaining exchange controls. While the current-account balance was virtually in equilibrium, give or take Fr.fr. 20 billion, purchases of French franc securities by non-residents had totalled Fr.fr. 165 billion in 1989, i.e. double the amount for 1988. Conversely, French direct investment abroad had amounted to more than Fr.fr. 100 billion in 1989, an increase of 50% over 1988. Non-residents' French franc balances currently exceeded Fr.fr. 200 billion, compared with Fr.fr. 50 billion a year earlier. The internationalisation of the franc appeared to be an irreversible phenomenon, and it made the policy of monetary stability all the more essential.

III. Adoption of the Committee's report to the EEC Ministers of Finance on developments on the foreign exchange markets of the nineteen countries participating in the concertation procedure during December 1989 and the first few days of January 1990

The Chairman took note of the Committee's adoption of the "concertation report", which would be sent to the EEC Ministers of Finance in the usual way.

IV. Reorganisation of the Committee of Governors in view of Stage One of Economic and Monetary Union

Before calling upon Mr. Papademos to speak about the recent organisational arrangements made by the Governors, the Chairman asked President Delors to inform the Committee of the precise situation regarding the 1964 Decision.

Mr. Delors said that first of all he would remind the meeting of the background to the two Decisions of 1964 and 1974 and of the institutional rules and would then address the political problem raised by certain members of the European Parliament.

In accordance with its right of initiative, the Commission had proposed two drafts: one to amend the 1964 Decision, incorporating the text of the draft prepared by the Governors; the other - which it had drawn up itself - to amend the 1974 Decision. On a proposal from the Monetary Committee, the draft relating to the 1964 Decision had subsequently been amended slightly. The European Parliament had perhaps failed to understand that these texts were necessary to initiate Stage One of Economic and Monetary Union and that, if this stage did not exist or was a failure, there would be no subsequent stages.

The two main innovations adopted were, firstly, that the Committee of Governors should become the principal centre for the discussion and formulation of monetary policies, and the Committee had organised itself to meet that challenge and be the sole interlocutor of the Council of Ministers. The second innovation was that, within the framework of a surveillance exercise, the Council should hold frank discussions leading to operational conclusions that would be made public. The likelihood of Stage One succeeding depended on the two main bodies, the Committee of Governors and the ECOFIN Council.

The latter had not been formally obliged to seek the opinion of the European Parliament, but it had done so on psychological and political grounds. However, for a variety of reasons Parliament wished to block the proposal and had refrained from delivering an opinion. It was necessary to explain that the present European Parliament had not yet found its feet. Unlike its predecessor, it was not dominated by a Christian democrat/socialist coalition; on the contrary, a majority could be formed in a number of ways. As a result, there was continual infighting, for instance on the Social Charter adopted at the European Council meeting in Strasbourg, and on environmental policies, where Parliament was blocking the establishment of the European Agency. With regard to the two Decisions of 1964 and 1974, the ECOFIN Council had two choices: either it withdrew its texts, which was possible from the institutional point of view but would create a political incident with Parliament, or it tried to obtain an opinion from the latter. At the moment, the Commission was trying to obtain a majority opinion from Parliament and, to that end, it would adopt three basic lines of argument, on which the opinion of the Governors would be useful. On the draft concerning the 1964 Decision, two concessions could be made. Firstly, Parliament would be told in no uncertain terms that the definition of the Stage One texts could not anticipate the subsequent stages. The democratic control which Parliament was endeavouring to introduce under Stage One had nothing to do with that stage and would jeopardise its success. Parliament had proposed seventeen amendments, some of which were redundant; the redundancy derived from its obsession about not referring solely to stability but wanting to add a high level of growth and employment and economic and social cohesion. A solution could be found if the Governors agreed to state in the recitals of the 1964 Decision that the objectives were, of course, price stability in order to permit non-inflationary growth, a high level of employment and the achievement of economic and social cohesion. Secondly, Parliament wished to be able to hear the Chairman of the Committee of Governors and had proposed, in Amendment No. 10, a formula whereby he would appear before Parliament on the occasion of the publication of the Committee's annual report and could be called upon to come before the relevant committee of Parliament in the event of special economic and monetary circumstances within the Community. These two suggestions had not been made to Parliament, and Mr. Christophersen had not been instructed to present them.

With regard to the 1974 Decision, the Commission was not prepared to accept the idea of a surveillance discussion at Parliament when the Ministers had not yet agreed to transparency or to debates that would be made public. The Commission would propose that one of its members should inform Parliament's Committee on Economic and Monetary Affairs before and after the multilateral surveillance exercise, confining himself to what could be made public and what the Ministers would agree to being said.

If these three gestures were not made to Parliament, the only solution would be to withdraw the texts and create a political incident. As far as the 1964 Decision was concerned, the Commission would follow the

Governors' opinion; it did not want to embarrass the Committee and wished it to have the best of conditions, but it felt that the two amendments proposed deserved to be discussed by the Governors.

Mr. de Larosière said that he was in two minds: on the one hand, it would be regrettable if there were deadlock with the European Parliament and if relations were broken off; on the other, it was necessary to make things crystal-clear and not accept the slightest change of substance or a watering-down of the concepts and objectives adopted by the Governors. Parliament's Amendment No. 10, which proposed that the Chairman of the Committee of Governors should appear before Parliament once a year, when the Committee's annual report was published, seemed to be a good suggestion in that it accorded with the Governors' desire to give their Committee a high profile but would not reduce the authority or the autonomy of the Committee. However, Parliament's idea of adding to the text references to the general objectives of economic policies, such as a high level of growth and employment, had to be treated with great caution. It was necessary to ensure that the wrong signals were not given. While these references could not be contested in terms of the principles involved, they would perhaps be more appropriate in the 1974 Decision, and this subject called for further thought.

Mr. Duisenberg shared Mr. Delors's opinion concerning the advisability of trying to come to an agreement with the European Parliament. Like Mr. de Larosière, he could accept Amendment No. 10, but he was rather perplexed with regard to the other amendment. Nonetheless, if price stability remained clearly affirmed in the 1964 Decision as the primary objective of monetary policy, the inclusion of a reference to other economic objectives could be accepted.

The Chairman drew the Committee's attention to the legal and formal aspects of the problem under discussion. The Governors had made a proposal concerning the text of the Decision amending the 1964 Decision, but it was for the Council and not the Committee to adopt the Decision. Moreover, this Decision was essentially an expression of opinion and had no weight or binding force with respect to institutions such as the Committee. Furthermore, it was necessary to be very careful not to prejudge the conclusions of the Inter-governmental Conference, and a number of the amendments proposed by the European Parliament fell within the remit of the Conference rather than the context within which the Committee was holding the present discussion.

With regard to the suggestions made by President Delors, it seemed preferable not to change the text of the 1964 Decision by adding references to various economic objectives, for any new formula would need to be worded extremely carefully, as the Governors had no powers in matters of growth, employment or regional structures. However, even if the amendment concerning relations with the European Parliament also anticipated the future to some extent, the idea could be accepted that the Chairman of the Committee should be invited to appear before the European Parliament either from time to time or once a year on the occasion of the publication of the Committee's annual report.

The Chairman thanked Mr. Delors for defending the interests of the Committee and felt that the latter should continue to press ahead with its reorganisation along the lines already laid down, even if the Decision amending the 1964 Decision had not been adopted by the Council.

Mr. Leigh-Pemberton approved the idea that the Chairman of the Committee should address the European Parliament: it could only enhance the authority of the Committee, and a number of Governors were used to this procedure with their national parliaments. The suggestion that references to economic objectives should be added to the 1964 Decision raised problems. It would, obviously, have to be maintained that the Committee's primary objective was price stability and to be stated that this was a sine qua non for the achievement of other economic and social objectives. It would, however, be very difficult to find the right wording. For the moment, the Chairman's proposal that the text should not be changed seemed reasonable, although this did not rule out the possibility of some new forms of words being found in due course to meet the political objections put forward by Parliament.

Mr. Duisenberg pointed out that the law establishing the Deutsche Bundesbank stated that the Bank had as its prime objective price stability, while at the same time it was to support the Government's general policies. Perhaps a similar form of words could be used as a basis.

The Chairman remarked that the Committee as such could not support any policy. Each Governor could, of course, endeavour to achieve price stability, and collectively this could be adopted as a common objective, but the Committee had no power to support, for instance, the Community's regional policy.

The Chairman suggested to Mr. Delors that he tell the Ministers that the Committee was prepared to report to the European Parliament and the ECOFIN Council once a year but that it would prefer that the text, which had been carefully weighed up by the Governors, should otherwise remain unchanged. If the Ministers were nevertheless to amend the text for political reasons, there was nothing that the Governors could do about it.

Mr. Delors understood that the Chairman would prefer a slightly different wording for Parliament's Amendment No. 10: the Chairman would be invited by Parliament and would thus be able, if necessary, to decline the invitation.

Mr. Papademos read the following text summarising the discussion held and the decisions taken by the Governors at their restricted meetings of December 1989 and January 1990.

"The first issue discussed was the adoption of a system of monetary policy monitoring aimed at strengthening the co-ordination of monetary policies in the Community. There was general agreement that price stability should be the primary objective of monetary policy, as stated in the proposed amendment of the 1964 Council Decision, and that achievement of this objective by all Member States in Stage One of Economic and Monetary Union would require the reinforcing of monetary policy co-ordination. A system of monetary policy monitoring based on mutually agreed monetary aggregates, as intermediate targets and leading indicators, would provide a common framework for formulating and evaluating the effectiveness of monetary policies. It was noted, however, that such a framework should be implemented flexibly in view of differences in the financial structures and economic conditions in member countries. The organisation and work of the Committee of Governors should contribute to strengthening the co-operation of Community central banks and the co-ordination of monetary policies.

The Governors then discussed issues relating to the reorganisation of the Committee in view of Stage One of Economic and Monetary Union. The discussion was partly based on the Report from the Committee of Alternates and on a paper prepared by President Pöhl. The following decisions were taken:

1. Committee of Governors

1.1. Seating arrangements

The seating arrangements will be changed. Only the Governors, a member of the Commission (as an invited guest), the Chairman of the Alternates, the Secretary General of the Committee of Governors and a rapporteur (alternating) will sit at the central table. Two representatives of each Governor, one representative of the member of the Commission and two members of the Secretariat will sit at the tables at the back.

1.2. Voting

The present rules governing voting shall be maintained.

1.3. Chairmanship

The Committee shall appoint a Chairman from among its members for a period of three years. Should the Chairman be unable to attend a meeting, his duties shall be carried out by the longest serving member of the Committee.

1.4. Meetings

The frequency, date and place of meetings will remain unchanged. At the request of Committee members, the Chairman may convene restricted meetings attended by the Governors only.

2. Committee of Alternates

2.1. Tasks

The Committee of Alternates will be retained and its existence will be recognised in the Rules of Procedure. The principal tasks of the Committee of Alternates will remain unchanged.

2.2. Chairmanship

The Chairman of the Committee of Alternates will be appointed by the Committee of Governors for a period of three years. His term of office will not run concurrently with that of the Chairman of the Committee of Governors. To this end, the first Chairman of the Alternates will be appointed for a term of two years. The Chairman of the Alternates will come from a different institution to that of the Chairman of the Committee of Governors.

3. Sub-committees

The structure and composition of the three sub-committees will not be changed at this juncture. It was noted that the "Raymond Group" should be more involved in analyses of monetary policy matters.

4. Research Unit and Secretariat

4.1. Structure

The Research Unit and the Secretariat will be organised as one entity under the administrative authority of the Secretary General of the Committee of Governors. The head of the Research Unit could also be the Secretary General. The existing administrative and operational arrangements with the Bank for International Settlements will be maintained. Members of the Secretariat and the Research Unit will be employed by the BIS, but they shall report to the Chairman of the Committee of Governors. It was noted that these administrative arrangements implied no organic link between the Committee of Governors and the BIS.

4.2. Mandate, composition and recruitment

The mandate of the Research Unit will be defined by the Committee of Governors.

The Research Unit shall consist initially of up to five professional economists. One of them will be appointed head of the Research Unit. Appointments shall be for a term of three years and could be renewable. Members of the Research Unit who are recruited from Community central banks would be seconded to the Unit. They shall be independent of their national central banks and function within the framework laid down by the Committee of Governors.

The members of the Research Unit shall be chosen on the basis of their professional qualifications. The composition of the Unit should ensure the necessary expertise and diversity of views. Members should have a broad spectrum of knowledge, and combine a solid academic background and practical experience, especially in the field of monetary policy.

Professor Alexander Lamfalussy, General Manager of the BIS, will be asked to prepare a profile of the economists to be recruited for the Research Unit. Each Governor will propose a number of economists judged to possess the required qualifications. Applications should be sent to Prof. Lamfalussy. The Committee will select the members of the Research Unit upon the proposal of the Chairman."

V. Exchange of views on the Committee's work programme for 1990

A. Statement by Mr. Rey

The Alternates had reviewed this item, which traditionally appeared every year on the agenda for the Committee of Governors' January meeting. The Alternates had noted that the work programme for 1990 was a full one and had to be viewed flexibly, which meant that the dates proposed and even the topics to be examined would have to be constantly reviewed in the light of future developments. In addition, three specific comments had been voiced:

- Firstly, the programme had to be supplemented by the work in progress on the subject of interventions in Community currencies. This work had been entrusted to the "Monitoring Group" in November and the Group's report - probably oral - could be presented in February.
- Secondly, the Alternates would also deal with the matter of the transmission of non-voice data between the Community central banks via the existing telephone network. A working party set up recently was studying the subject.
- Thirdly, as far as preparation for the Inter-governmental Conference was concerned, the Alternates had recognised that, while the Committee of Governors had not been expressly invited to report to the Ministers, the question had nevertheless been raised. A discussion on the Inter-governmental Conference was scheduled for the informal meeting of the ECOFIN Council on 31st March 1990; it was to be based chiefly on a paper prepared by the Commission and on the report requested from the Monetary Committee. If the Governors were to decide to submit some comments of their own to this informal Council meeting, the suggested timetable for Item 9 in the outline work programme would have to be changed accordingly, in which case, of course, the Alternates were ready to receive the necessary instructions.

The Chairman pointed out that the work programme essentially comprised ordinary matters but that two new topics should be highlighted: firstly, the studies on monetary targets that had already been undertaken but which should give new impetus to monetary policy co-ordination and, secondly, the preparation for the Inter-governmental Conference. The Governors would certainly have to give their views on this subject; however, given that the Council had requested a report from the Monetary Committee and that the Governors were represented on this Committee by their Alternates, it would be better to await this report before the Governors expressed an opinion. The Governors would, in any event, be in Ireland at the end of March for the informal meeting of the ECOFIN Council at which the Inter-governmental Conference would be discussed.

VI. Continuation of the review of the formal rules relating to the official ecu

Statement by Mr. Rey

The Alternates had discussed how far the postponement agreed by the Committee of Governors at its last meeting had enabled a compromise solution to be found. They had taken note of the statement made by the German Alternate, who had thought that it might be possible to reach a solution within the Committee on condition that there was unanimous agreement on two points:

- firstly, formalising the acceptance of official ecus in intra-Community settlements up to 100% had to be prevented from leading to an unbalanced composition of exchange reserves and/or the emergence of excessive net positions in ecus;
- secondly, all the elements of the Basle-Nyborg Agreement should be reaffirmed, in particular the rule that interventions in EMS currencies required prior agreement by the issuing central bank.

The Alternates had felt that the wording of the supplementary recital proposed by Mr. Dalgaard at the Committee's December meeting should allay the first concern mentioned. As regards the second, a statement reaffirming the principles of the Basle-Nyborg Agreement could be entered in the minutes of the Committee's meeting at which the formal amendment of Article 16.1 of the EMS Agreement was adopted. The Secretariat had been instructed to prepare the draft of such a statement and to submit it in good time in order to facilitate the internal approval procedure required at some central banks.

The Chairman noted that the Committee was in agreement on the Alternates' proposals and added that, as President of the Deutsche Bundesbank, he had to enter a formal reservation in view of the fact that the approval of the Bundesbank Council was needed to amend the EMS Agreement, although this approval should be forthcoming.

VII. Other matters falling within the competence of the Committee:

- Commission proposal for a Regulation on guarantees

Statement by Mr. Rey

At the December meeting of the Committee of Alternates the Bank of England had distributed a paper relating to a proposal published by the European Commission in January 1989 concerning a Council Regulation on guarantees issued by credit institutions or insurance undertakings. The Alternates had discussed the matter at their meeting on Monday, 8th January.

Some Alternates had felt that the Commission's proposal would have far-reaching implications for the EEC central banks in their operations and dealings with their national money markets, banking supervisory authorities and export credit agencies. Consequently, the Alternates had agreed that the matter should be looked at in further detail.

Following the circulation of the Bank of England's paper at the December meeting, the Commission representative had said that he had asked the Financial Institutions and Company Law Directorate to clarify the situation. While he had not yet received a response, he would endeavour to obtain it for the February meeting of the Alternates. In addition, it had been mentioned that the matter could be usefully referred to the Supervisory Sub-Committee - the so-called Quinn Group.

VIII. Date and place of the next meeting

The Committee's next meeting would be held in Basle on Tuesday, 13th February 1990 at 9.30 a.m.

Committee of Governors of the
Central Banks of the Member States
of the European Economic Community

9th January 1990

Confidential

BRIEF REPORT ON
DEVELOPMENTS ON THE FOREIGN EXCHANGE MARKETS OF THE COUNTRIES
WHOSE CENTRAL BANKS PARTICIPATE IN THE CONCERTATION PROCEDURE

DECEMBER 1989

This report summarises developments on the exchange markets of the countries whose central banks participate in the concertation procedure[1] and briefly describes their interventions during December 1989 and the first few days of January 1990.

I. EXCHANGE RATE DEVELOPMENTS

The main features of the foreign exchange markets in December 1989 were:

- a further decline of the US dollar against all other currencies, except the Japanese yen;
- moderate tensions in the EMS which were partly linked to the continued firmness of the Deutsche Mark;
- further downward pressure on sterling.

The US dollar moved lower against most other major currencies. Economic data released during the period under review was interpreted as evidence of a slowdown in US economic growth. A narrowing of interest rate differentials favourable to dollar assets also contributed to downward pressure on the dollar. Towards month-end the dollar came under pressure particularly against the Deutsche Mark as the German currency benefited

1 The central banks of the EEC, Norway, Sweden, Finland, Switzerland, Austria, Japan, Canada and the United States.

from favourable assessment of developments in Eastern Europe. The dollar traded relatively steadily against the Japanese yen against a background of reports of continued demand by Japanese investors. On balance the dollar declined by more than 5% against the Deutsche Mark while rising less than 1% against the yen.

In the narrow band of the EMS exchange rate mechanism the relative positions of the participating currencies changed little, with a more pronounced polarisation between the Deutsche Mark and most of the other participating currencies. Exchange rate movements were contained by an increase in interest rate differentials vis-à-vis the Deutsche Mark and a higher volume of intramarginal intervention sales in support of some currencies. In the wide band, the Spanish peseta stabilised, whereas the Italian lira depreciated, moving clearly outside the narrow band.

With some fluctuations, the Deutsche Mark continued on the upward trend of recent months, with a clearer firming also against the other EMS currencies. Its effective nominal rate vis-à-vis the EMS currencies rose over the month by 0.7% to 222.1 (1972=100), a new record level. Adjusted for relative inflation rates, however, its effective rate vis-à-vis the EMS currencies at the end of December is estimated still to be some 3% lower than at the beginning of 1987.

The performance of the French franc was somewhat influenced by foreign exchange purchases by French companies in connection with investments abroad, following the sudden fall of the dollar in mid-month. These sizable outflows coincided with continuing upward pressure on the Deutsche Mark and, at the end of the month, rumours of a realignment of the Italian lira. In this context and in conjunction with the announcement of a more restrictive orientation of monetary policy for 1990, the French authorities raised key rates by 0.5 percentage points (to 10% for the intervention rate and 10.75% for the repurchase rate). In addition, the authorities regulated the franc's position in the lower part of the band through interventions.

The Belgian franc was also affected by the tensions which developed within the EMS, in response to which the Banque Nationale de Belgique raised its key very short-term interest rates (Treasury certificates) on several occasions and intervened in US dollars and Deutsche Mark to support the currency.

The Dutch guilder weakened slightly vis-à-vis the strengthening Deutsche Mark, but remained close to parity with the Deutsche Mark. The Nederlandsche Bank supported the guilder on a moderate scale by means of interventions. As in most other European countries, Dutch interest rates continued to rise.

The Danish krone remained one of the weakest currencies in the narrow band.

The Irish pound continued to experience some capital outflows in the early part of the month. The Central Bank responded with net sales of foreign currency, and increased its Short-Term Facility lending rate by 1 percentage point to 12%, effective from 8th December. Subsequently, there were sizable capital inflows which were offset by net purchases of foreign currency by the Bank.

As a result of the rise of the Deutsche Mark, the Italian lira was allowed to fluctuate below the narrow band. The depreciation did not give rise to tensions and the Banca d'Italia had to conduct only limited smoothing interventions, in a market made thin by the holiday season and by strikes in the banking sector. Rumours of an EMS realignment in connection with an early narrowing of the fluctuation band for the lira did not have a major impact on the market attitude.

The Spanish peseta continued to experience downward pressures, especially in the first half of the month. These pressures, which were associated with the strength of the Deutsche Mark, translated into some intervention sales and a slight depreciation of the exchange rate with respect to the German currency. Vis-à-vis the ecu, the peseta ended 0.1% higher.

Benefiting from the Prime Minister's victory in the Conservative Party leadership ballot and from the publication of weak UK retail sales figures for November, sterling edged quietly firmer against most currencies during the first half of the month. However, as markets became thinner over the holiday period, sentiment turned bearish and sterling fell to a new all-time low of DM 2.7025 on 29th December. Some modest official support and the release of better-than-expected trade figures for November enabled the pound to close above its lows. Sterling's trade-weighted index fell by 0.8% to 85.7 (1985=100).

As expectations for a Greek drachma devaluation weakened, market pressure on the currency diminished. Following this development, the drachma strengthened against the US dollar by 4%, while it declined versus the ecu by 1%. In effective terms, it depreciated by 0.3%.

In effective terms the depreciation of the Portuguese escudo was 0.25% in the period under review, and 3% during 1989, in line with the foreign exchange policy defined by the authorities. Against the US dollar the escudo rose by 4.1%.

The Swiss franc strengthened by 3.6% against the US dollar. It also quoted firmer vis-à-vis the Japanese yen and sterling. However, against the Deutsche Mark and the other EMS currencies, the Swiss franc weakened by more than 2% despite the significant rise in domestic money market rates. The Euro-franc rates increased by 1 to 1.5 percentage points to reach 9% to 9.50% for maturities of one to twelve months. They are now above the money market rates of the United States and Germany. With effect from 14th December, the difference between the average call money rate and the flexible lombard rate was increased from 1% to 2%. The money supply target was set at 2% for 1990.

The Austrian schilling firmed vis-à-vis the US dollar by 5.8%. Against the Deutsche Mark it fluctuated by only 0.06%. Short-term liquidity support was given with approximately DM 3 billion of Deutsche Mark/schilling swaps.

The Norwegian market was relatively quiet during most of the period. Supported by small, but rather frequent interventions, the Norwegian krone moved within a fairly tight fluctuation band, and ended the month 0.2% weaker in effective terms.

The Swedish krona was under some demand during the first half of the period following an uptrend in interest rates in the domestic money market and on 8th December the discount rate was increased from 9.5% to 10.5%. Lower interest rates towards the end of the month, concern about the growing current account deficit and the inflation outlook, following larger than expected wage settlements, led to some weakening of the krona and the Riksbank's index moved from 131.7 to just above the benchmark of 132.0.

The Finnish markka stayed rather stable and the short-term money market rate level remained virtually unchanged.

The Japanese yen moved in a very narrow range against the US dollar ending 0.7% lower at Yen 143.60. Meanwhile, it depreciated by 5.5% against the ecu over the period, due mainly to the cross-currency purchasing of the Deutsche Mark. Effective from 25th December, the Bank of Japan raised the official discount rate by 0.5 percentage point to 4.25%.

The Canadian dollar firmed by 0.6% against the US dollar to close the month at US$ 0.8632. The strength of the Canadian dollar vis-à-vis the US dollar continued to be associated with the large positive spread between comparable Canadian and US interest rates.

II. INTERVENTIONS

Total interventions amounted to the equivalent of US$ 11.3 billion, approximately the same amount as in November 1989.

Gross interventions in US dollars totalled US$ 7.1 billion; they resulted in net sales of US$ 4 billion, roughly the same amount as in the preceding month. The main sellers were the Banque de France, the Banca d'Italia, the Swiss National Bank, the Banco de España and the Bank of Japan.

Gross interventions in Community currencies and private ecus amounted to the equivalent of US$ 4 billion, compared with US$ 4.2 billion in November. The bulk of these interventions were carried out by EMS central banks whose interventions totalled US$ 3.5 billion (against US$ 2.3 billion in November) and mainly consisted of intramarginal net sales of Deutsche Mark (US$ 2.5 billion). The main net sellers were the Banque de France and, to a lesser extent, the Banca d'Italia, the Banque Nationale de Belgique and the Banco de España.

Interventions in other currencies only totalled the equivalent of US$ 0.2 billion.

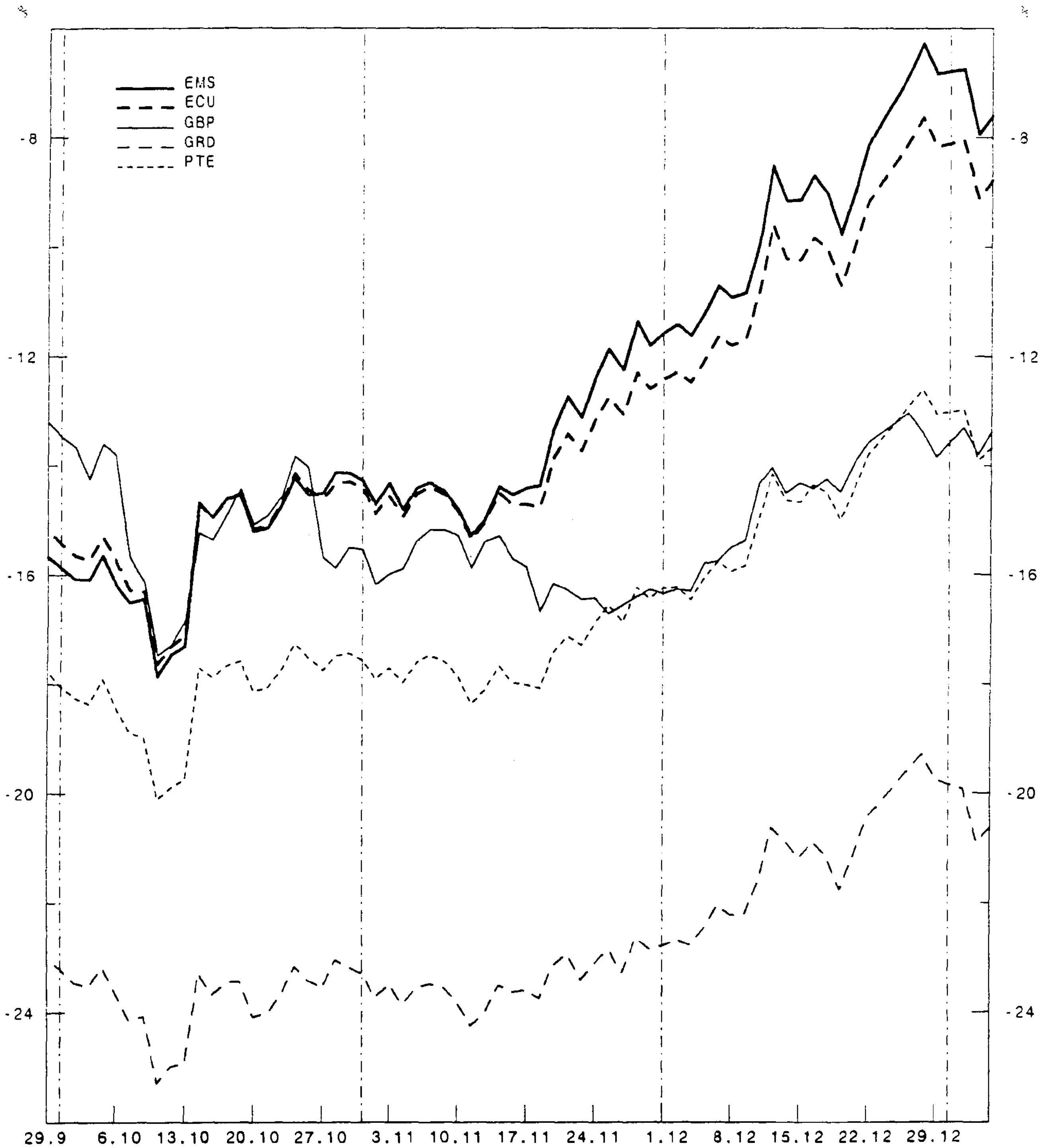
III. DEVELOPMENTS IN THE CURRENT MONTH UP TO 5TH JANUARY 1990

The US dollar was volatile. In the first two days of the new year, it regained ground in particular vis-à-vis the Deutsche Mark despite an increasing negative interest rate differential, appreciating by around 2%. However, following intervention sales by the Deutsche Bundesbank and the Swiss National Bank, which took the market somewhat by surprise, the US dollar fell again to its end-December level. The Japanese yen appreciated slightly.

The situation in the EMS exchange rate mechanism remained virtually unchanged, although downward pressure on the Italian lira and the

Spanish peseta intensified. On 1st January France abolished all remaining exchange controls. On 5th January following a decision by the Italian government to reduce the fluctuation margins of the lira in the EMS to ±2.25%, the Ministers of Finance and Central Bank Governors of the EC countries agreed the new central rate for the lira at approximately its market rate, leaving its lower intervention limits unchanged.

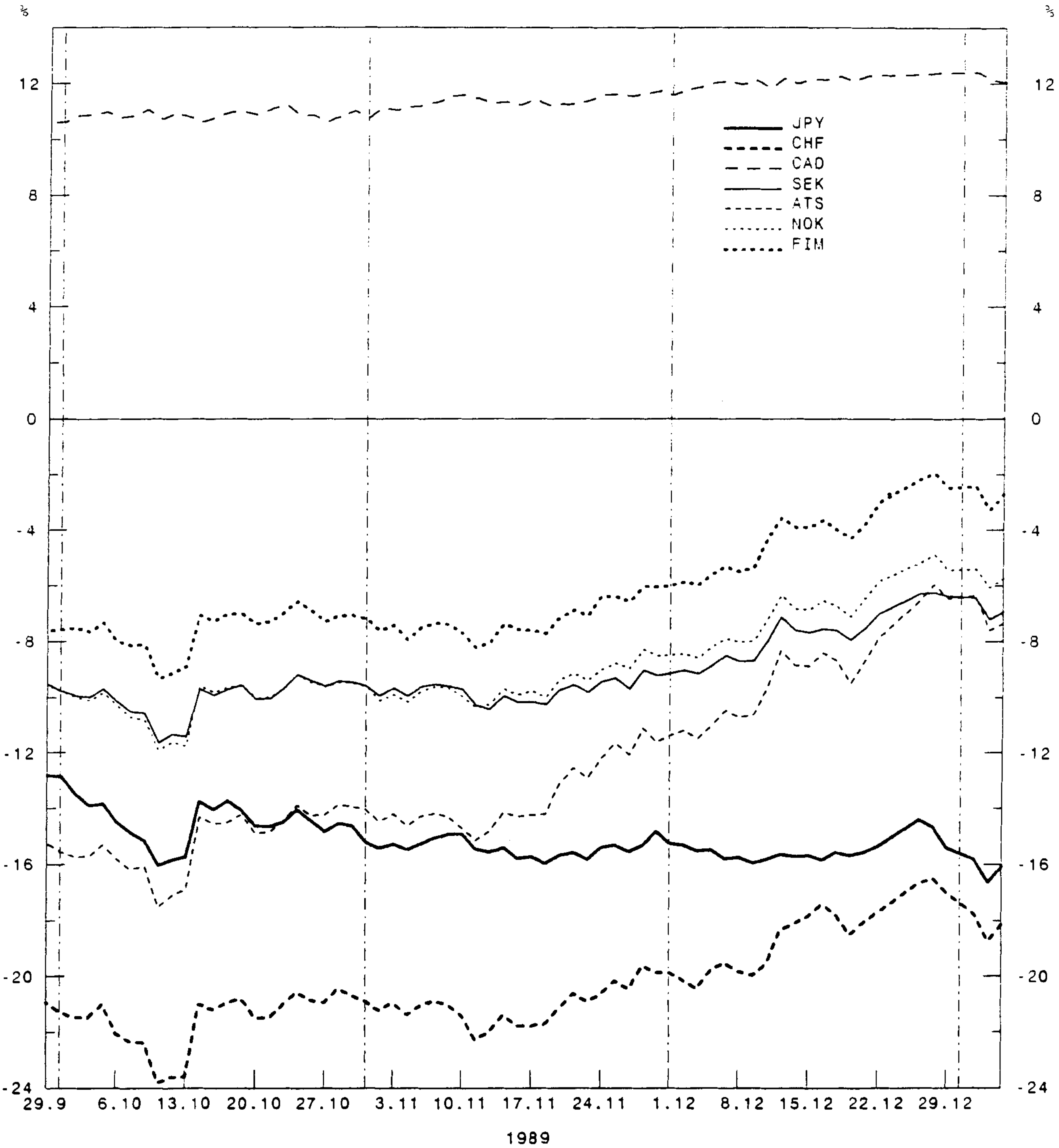
EVOLUTION OF THE ECU, THE MIDDLE RATE OF THE CURRENCIES PARTICIPATING IN THE EXCHANGE RATE MECHANISM OF THE EMS, AND THE CURRENCIES OF THE EEC CENTRAL BANKS WHICH DO NOT PARTICIPATE IN THAT MECHANISM, ON THE BASIS OF THE EXCHANGE RATES PREVAILING ON 31ST DECEMBER 1987 AGAINST THE USD*



* See next page.

5.1.1990

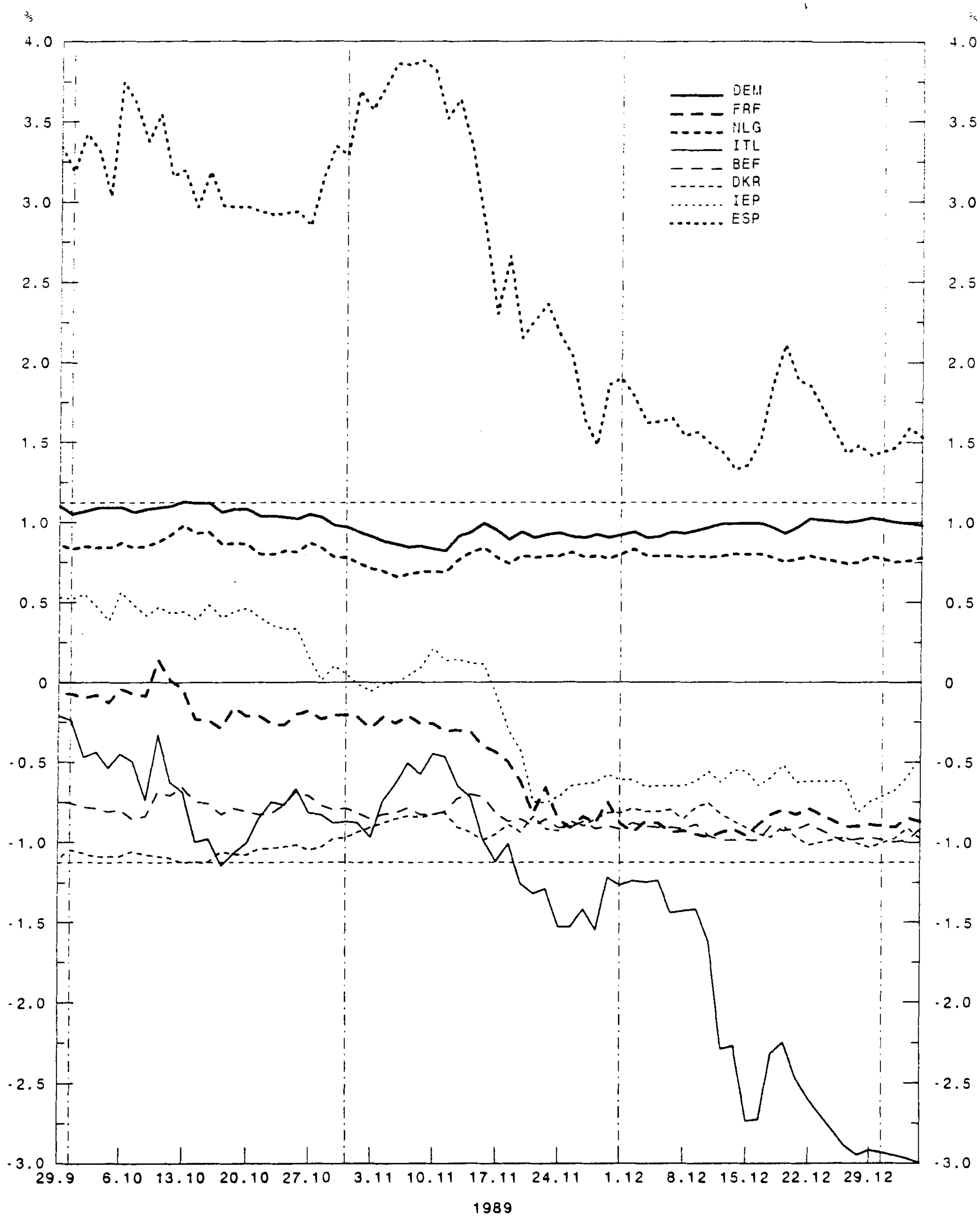
EVOLUTION OF THE CURRENCIES OF THE NON-EEC CENTRAL BANKS PARTICIPATING IN THE CONCERTATION, ON THE BASIS OF THE EXCHANGE RATES PREVAILING ON 31ST DECEMBER 1987 AGAINST THE USD*



* ECU 0,767254; GBP 0,5346; GRD 126,2002; ESP 107,8498; PTE 130,0242; FIM 3,945; CAD 1,302; CHF 1,2775; JPY 121,4501; SEK 5,795; NOK 6,233; ATS 11,129; middle rate of the currencies participating in the EMS 0,77324. The middle rate of the currencies participating in the EMS represents the daily average of the exchange rates of those two currencies which have the largest divergence from their current bilateral central rates, with a maximum fluctuation of 2.25%.

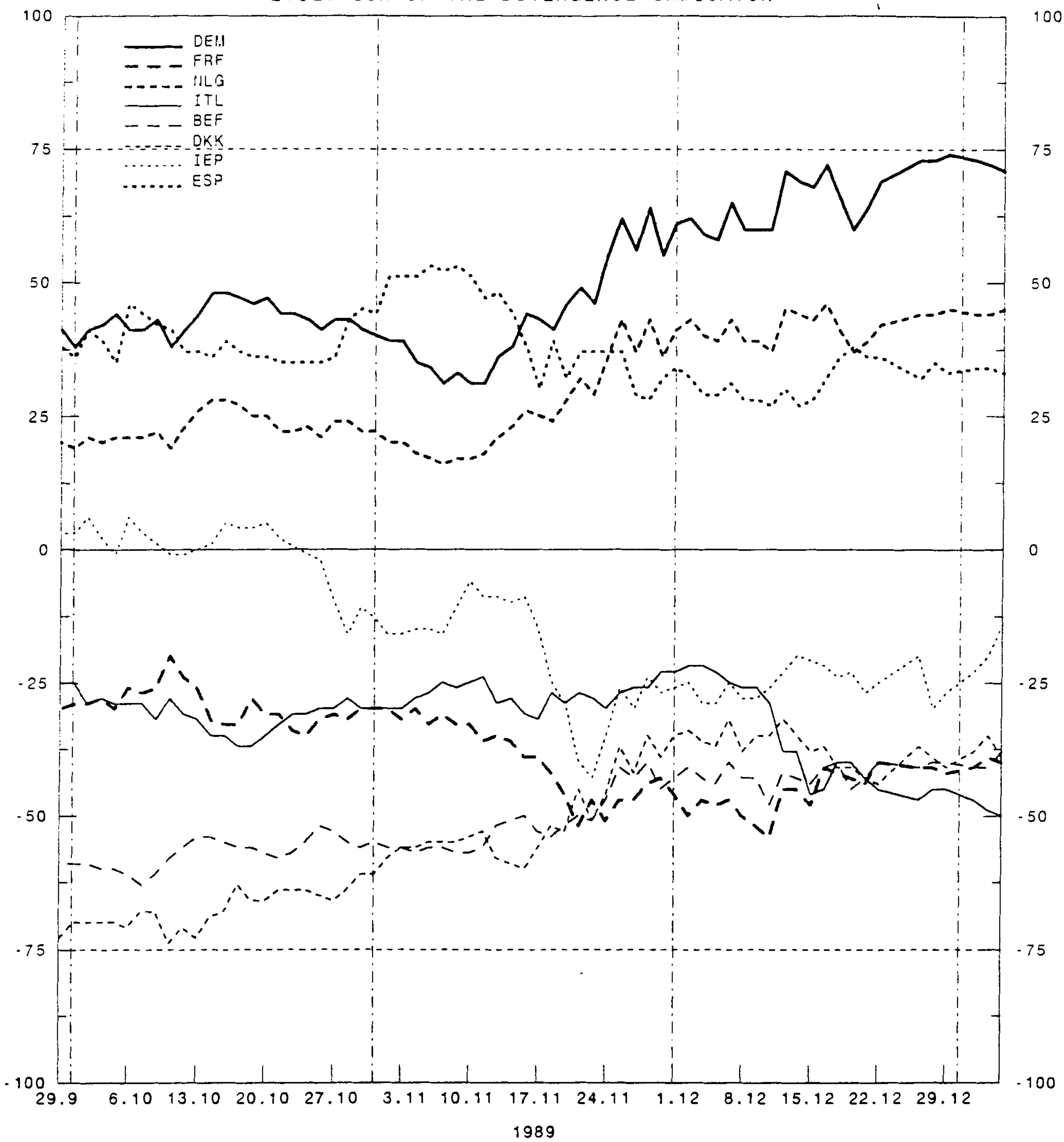
5.1.1990

MOVEMENTS IN THE EMS PARITY GRID



5.1.1990

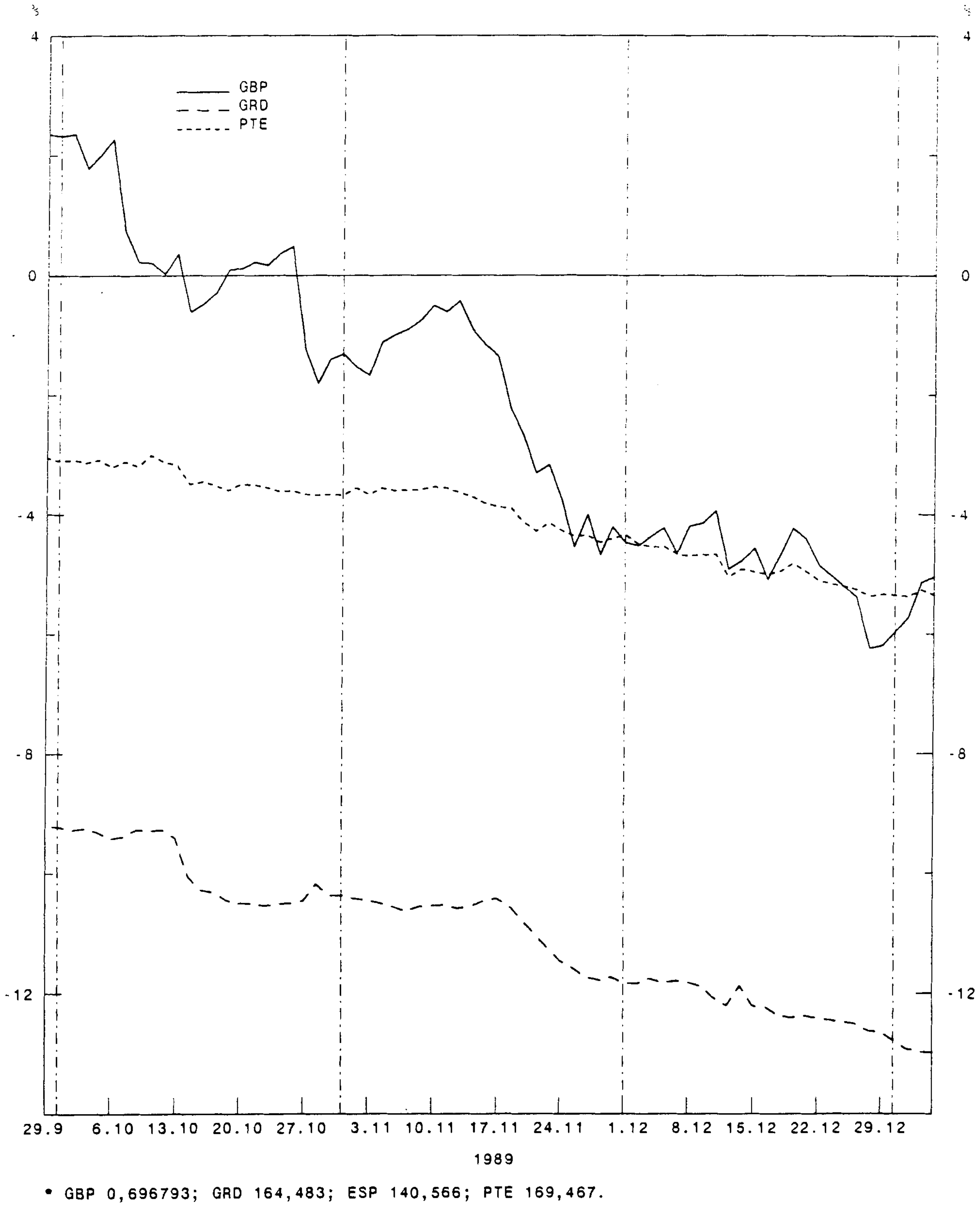
EVOLUTION OF THE DIVERGENCE INDICATOR*



* The divergence indicator provides a uniform measure of a currency's position in relation to its ECU central rate. The maximum divergence spread is the maximum percentage by which a currency's market rate against the ECU may appreciate or depreciate in relation to its ECU central rate; it is expressed as +/-100, the divergence threshold being +/-75. The data which has been used to draw this graph are the ECU rates against the different currencies, adjusted to eliminate the effect of the fluctuation of the Italian lira, the Spanish peseta, the pound sterling and the Greek drachma outside the 2.5% margin against the other currencies participating in the EMS.

5.1.1990

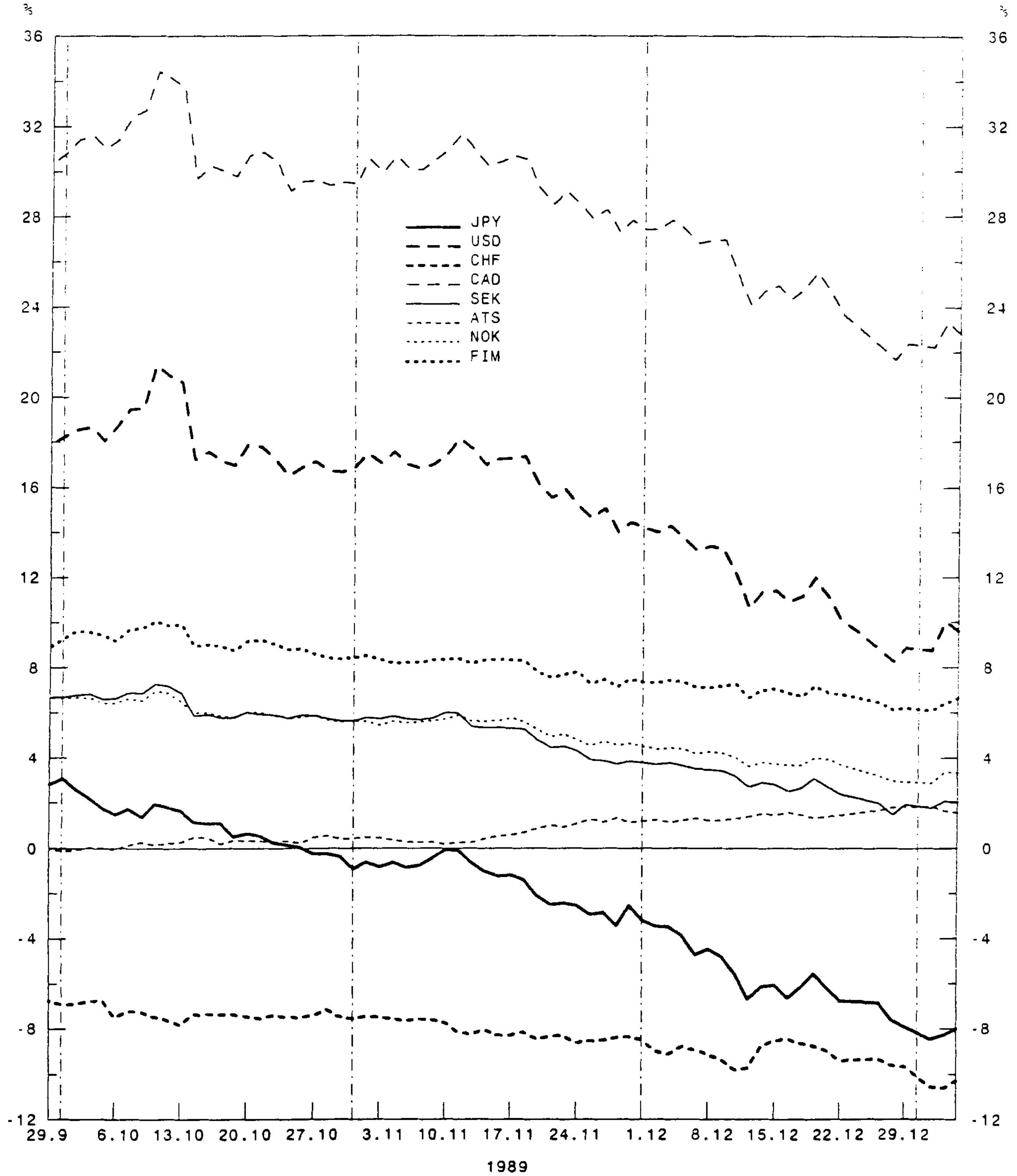
EVOLUTION OF THE POUND STERLING, THE GREEK DRACHMA, AND THE PORTUGUESE ESCUDO, ON THE BASIS OF THE MARKET RATES PREVAILING ON 31ST DECEMBER 1987 AGAINST THE ECU*



* GBP 0,696793; GRD 164,483; ESP 140,566; PTE 169,467.

5.1.1990

EVOLUTION OF THE CURRENCIES OF THE NON-EEC CENTRAL BANKS PARTICIPATING IN THE CONCERTATION, ON THE BASIS OF THE EXCHANGE RATES PREVAILING ON 31ST DECEMBER 1987 AGAINST THE ECU*



* USD 1,30335; CAD 1,69696; CHF 1,66503; JPY 158,292; SEK 7,55292; NOK 8,12378; ATS 14,5050; FIM 5,14172.

5.1.1990