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Committee of Governors

Group of experts under the
Chairmanship of M. Raymond

27th June 1990

SUPPLEMENTARY NOTE ON CERTAIN ASPECTS OF THE COMMON FRAMEWORK FOR THE MONITORING OF MONETARY POLICIES

1. Mandate

During the discussion of the special report by the Committee of Governors, a suggestion was made to explore the following two-stage procedure whereby:

- national monetary authorities would continue to set and publish intermediate objectives (in cases where targets are established);
- the Committee of Governors would subsequently issue a statement explaining that such targets were formulated in the framework of a co-ordinated strategy.

The Committee of Alternates has requested the group to propose a draft summary statement. In accordance with this mandate the group has discussed:

- the contents of such a communiqué;
- the relevant procedural aspects.

2. Proposed contents of the communiqué

A draft communiqué based on the below-mentioned considerations is attached (Annex I). It should be regarded as an example, since the final version will depend on the situation prevailing at the time of publication.

The first part of the final communiqué should outline the general strategy adopted by the Committee of Governors, and need not necessarily be repeated in subsequent communiqués. It would, inter alia, include the commitment that the central banks of the Community would consider appropriate corrective measures if the intermediate variables were to deviate in a critical and unacceptable manner.

The second part should recall national targets already published. Several experts considered that the communiqué should at least (the second year if not in the first) make reference to previous monetary developments. The communiqué should refer to the mutual consistency of these targets without necessarily mentioning the technical aspects involved by the ex ante exercise. The Belgian delegates considered the possibility of making a reference to the closer linking of their national currency with the Deutsche Mark.

In the opinion of some experts, a third section could be added which would include an assessment of individual countries; in doing so, however, account should be taken of the fact that there appears to be little value in repeating verbatim the contents of national communiqués and that alternative formulations would entail comparisons that generate undesirable misinterpretation by the public and the press.

The Committee of Governors should ensure that the communiqué provides an appropriate balance between the necessity to be prudent in order not to impair the credibility of the exercise in the future and the aim of effectively influencing expectation which would necessitate the sufficiently precise information.

In this respect, most experts felt that section 2 of Annex I was the minimum that could be published.

Nevertheless, the Bank of England believes that only limited publicity should be given to this exercise initially. In its view the value of monetary aggregates as a guide to policy will be adversely affected by the German Monetary Union, increased capital mobility and financial innovation, and it is likely that conflicts between domestic monetary objectives and exchange rate objectives or obligations will continue. The Governors would therefore be unwise to issue a communiqué which consisted mainly of a restatement of national targets for monetary aggregates. To illustrate the possible style and format of an alternative form of communiqué, the Bank of England members of the group submitted a draft which is also attached (Annex II).

3. Procedural aspects

The group considered that the Committee of Governors should not publish the communiqué later than at its January meeting. On this basis, the ex ante examination of the envisaged orientation of national monetary policies in the forthcoming target period would have to be undertaken in, say, November. The results of this exercise, however, would not be published but conveyed to the competent national authorities which would set and publish the monetary targets before the end of the year. The majority of experts considered that when announcing their targets, national authorities should refer to the consultation procedure within the Committee of Governors. This consultation is provided for by Article 3 of the revised Council Decision on co-operation between Community central banks. This article stipulates that "the Committee shall normally be consulted before the national authorities take decisions on the course of monetary policy such as the setting of annual money supply and credit targets".

For most Community central banks this implicit time schedule would normally cause no inherent problems since existing mechanisms already cater for or can be adapted to such a procedure. Difficulties might arise in the following countries:

- the United Kingdom's M0 target is set by the Government at the time of the Budget, normally in March. This means that it could not be included in a joint communiqué issued around the turn of the calendar year. The aims of the UK monetary policy are in any case not adequately summarised by a statement on the M0 target.
- In Italy targets are set and published before the end of October, prior to the proposed ex ante exercise. This means that the target is established before the Committee of Governors has expressed a view. The Banca d'Italia is prepared to take the necessary steps at government level to ensure that the target will be subject to revision following the afore-mentioned exercise.

In Ireland the monetary programme is adopted following the presentation of the Government's budget at end-January. The Central Bank of Ireland publishes its statement towards end-February. However, monetary aggregates are not targeted since the exchange rate policy primarily determines the stance of monetary policy.

In Greece the monetary targets are usually announced in February but the Bank of Greece will fully participate in the common exercise.

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

27th June 1990

Annex I

DRAFT COMMUNIQUÉ

1. In the context of Stage One of Economic and Monetary Union, the Committee of Governors of the central banks of the Member States of the European Economic Community has implemented a system of monitoring based on a commonly agreed framework of targets and indicators of monetary policies. This new system is part of Community central banks' common anti-inflationary strategy designed to ensure price stability in the medium run throughout the Community. This is not only an aim in itself, but also a precondition for sustained economic growth, exchange rates stability and further progress towards economic and monetary integration.

The new monitoring system comprises forward-looking and retrospective consultations. The annual forward-looking consultation is in line with Article 3 of the revised Council Decision on co-operation between Community central banks which stipulates that "the Committee shall normally be consulted before the national authorities take decisions on the course of monetary policy such as the setting of annual money supply and credit targets". In the regular retrospective consultations, recent developments will be assessed in order to identify any deviations and to consider corrective action. The conduct of the new monitoring system will be a learning process and the Governors will review the methods used from time to time, in the light of experience.

2. The first forward-looking consultation took place in November 1990 and dealt with [developments in 1990 and] prospects for 1991. It was concluded that [although a modest slowdown in growth in the Community was in prospect for 1991, pressures on resource use were likely to remain high

so that firm monetary policies were necessary to bear down on inflationary pressures][1].

In line with these considerations, the following intermediate objectives of monetary policy have been adopted by the respective monetary authorities.

In the EMS exchange rate mechanism four countries formulated their intermediate objectives in terms of broad money stock.

Country	Target variable	Target or target range
Germany		
France		
Italy		
Spain		

In Denmark, Ireland, Belgium, Luxembourg and the Netherlands, the primary objective will be exchange rate stability in the EMS. [Possible reference to closer linking for the latter three countries.] This objective is supplemented by targets for domestic money creation in Denmark and the Netherlands.

Country	Target variable	Target or target range
Denmark		
Netherlands		

The intermediate objectives of the countries which do not participate in the EMS exchange rate mechanism are as follows:

Country	Target variable	Target or target range
Greece		
Portugal		
[United Kingdom]		

The mutual consistency of the above targets was commonly assessed by the Committee of Governors. The targets are conducive to increased

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1 The text between brackets is an example of a possible statement.

convergence towards a low level of inflation. Nevertheless, the success of the anti-inflationary strategy will also depend on support from other policies, in particular budgetary and structural policies.

3. Comments by country (optional)

See example on page 2 (between square brackets) of Bank of England's draft.

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Annex II

PROPOSAL MADE BY THE BANK OF ENGLAND REPRESENTATION OF THE RAYMOND GROUP

DRAFT COMMUNIQUÉ AS IF TO BE PUBLISHED (JANUARY 1990?)

The Committee of EC Governors decided on .... to implement a system of monitoring and surveillance of economic and monetary conditions based on an agreed framework of indicators. This new system is part of Community central banks' common anti-inflationary strategy designed to bring about price stability in the medium term throughout the Community.

[In this first exercise] developments in 1989 were analysed and prospects [and objectives] for 1990 discussed. The Committee noted [with concern] that inflation in the Community had risen through 1989 to an average of [..%] and that there had been little further progress towards improved economic convergence. They reaffirmed their commitment to the pursuit of policies conducive to increased convergence towards price stability and endorsed [the tightening of monetary policy/increase in interest rates] that had occurred in stages through 1989 in [all] Community countries.

A modest slowdown in growth in the Community was in prospect for 1990, but pressures on resource use were likely to remain high and given the buoyant economic conditions the Governors noted that a continuation [and if necessary intensification] of firm monetary policies was necessary to bear down on inflationary pressures, and make progress towards price stability. They noted that in some countries [with large budget deficits] a tightening of the fiscal stance could provide helpful support to this process.

The Governors welcomed the process of political and economic restructuring in Eastern Europe. Although future developments were clouded with uncertainty they recognised that this process was likely to increase, directly or indirectly, demand for investment and consumer goods from all Community countries, although some might be affected more than others. The additional demand would tend to increase inflationary pressures, and the

Governors emphasised the need for close surveillance of events and co-operation to minimise this threat.

In the light of the start of Stage One of Economic and Monetary Union on 1st July 1990 the Committee welcomed the participation of the peseta in the Exchange Rate Mechanism and the steps taken towards the further liberalisation of capital movements in some Community countries. They looked forward to the start of Stage One.

The Committee discussed the conjuncture and prospects for each country in turn in the light of indicators and national objectives, and assessed the implications for improving convergence towards price stability. The following policy priorities were acknowledged: [optional country statements e.g.].

....

[In the UK the rapid rise in domestic demand in recent years had been associated with a pick up in inflation and widening of the current account deficit. Monetary policy has been tightened markedly to slow demand down, although a continuation of a tight monetary stance is essential to dampen inflation expectations and to counter the effects of recent weakness in the exchange rate. A reduction in inflation is a pre-requisite for sterling's entry into the ERM.]

....

The Governors considered that the present stance of policies was consistent with a steady reduction of price inflation in 1990 and should foster greater convergence in the Community. They would continue to monitor developments closely in their regular discussions and stressed their readiness to see further policy tightening should inflationary pressures be stronger than expected.