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MINUTES

OF THE 252nd MEETING OF THE COMMITTEE OF GOVERNORS OF THE CENTRAL BANKS OF THE MEMBER STATES OF THE EUROPEAN ECONOMIC COMMUNITY

HELD IN BASLE ON TUESDAY, 12th FEBRUARY 1991 AT 9.30 a.m.

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I. Approval of the minutes of the 251st meeting

The Committee approved the minutes of the 251st meeting on the understanding that the editorial amendments suggested would be incorporated into the final text.

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

- Preparation by the Foreign Exchange Policy Sub-Committee (Monitoring) and discussion by the Committee of Alternates;
- Statistical charts and tables

1. Statement by Mr. Dalgaard

The Monitoring Group had focused its attention primarily on the renewed decline of the US dollar and the situation in the ERM after the rise in German official interest rates on 1st February 1991.

In the second half of 1990 the US dollar had fallen by about 15 percentage points against the Deutsche Mark. In December 1990 and early January 1991 the US dollar had recovered somewhat, but since the start of the Gulf War it had weakened again and had reached new historical lows in early February, at times standing below DM 1.45. There had been a variety of reasons for this decline: firstly, further evidence of the weakening of the US economy; secondly, the effects of the Gulf War; and, thirdly, problems in the US banking system. In early February the increase in German official interest rates and the reduction in the US interest rate had resulted in an increase in short-term differentials, leaving the three-month US dollar interest rate 2.5 percentage points below that of the Deutsche Mark. This development had led to a fall in the US dollar/Deutsche Mark rate to below DM 1.46 on 4th February 1991. As a result, the Federal Reserve Board had resorted to interventions to steady the markets. During the ensuing week intervention purchases had amounted to about US$ 2.25 billion, of which the Federal Reserve Board had purchased about US$ 1 billion, with the remainder being distributed amongst fourteen central banks in the concertation group. Virtually all the interventions had been made against the Deutsche Mark. The reason for the Federal Reserve Board's action had been the belief that the US dollar had reached a level that would ensure US competitiveness and that a further weakening would only add to inflationary pressures; in accordance with the G-7 statement,

the Federal Reserve Board had felt that an attempt had to be made to stabilise financial markets. Some Community central banks had also been concerned about the effects of the low US dollar and had agreed that it would be preferable if the US dollar stopped falling. Furthermore, it had been their opinion that the US dollar should be supported by other measures. In this respect, however, the situation had been somewhat contradictory in that the US authorities had lowered domestic interest rates and statements had suggested the possibility of further reductions. To judge from statements by US officials, including the Secretary of the Treasury, the US authorities did not appear to be particularly concerned about the US dollar's exchange rate. Despite this handicap, the interventions had had some effect on the market and it had been possible to maintain the US dollar at the same level during the ensuing week. Had the central banks not intervened the markets might have interpreted such inaction as condoning the decline of the US dollar.

Interventions had mostly taken place when the US markets opened, and therefore in the afternoon Central European Time. The Monitoring Group had agreed that it would probably have been of advantage had the interventions not been quite so predictable. The chances of stabilising the US dollar solely through interventions had been discussed: this might be possible if the markets perceived that the US dollar was already close to its trough, that there would be a recovery in the US economy - based on a quick victory in the Gulf War - and a subsequent rise in US interest rates as a consequence of increased consumer spending. Furthermore, there would have to be no further unhelpful statements from US officials and no further rises in European interest rates. On the other hand, if there were no expectations of such interventions, there would be a danger that the US dollar might continue to drift downwards.

The Japanese yen had recently remained relatively stable vis-à-vis the Deutsche Mark and had therefore firmed against the US dollar. The fact that the Bank of Japan had not participated in the concerted intervention was acceptable since there had been no wish to prevent an appreciation of the yen, which remained much weaker in relation to the European currencies than it had been in 1988-89.

In the ERM, the situation had been relatively quiet in January. In early February there had been a slight widening of the narrow band. The most significant event was the increase - by 0.5 percentage point - in the

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official interest rates of the Deutsche Bundesbank, effective as from 1st February 1991. Contrary to the situation in early November there had been no overall effect on German market interest rates, which had started to decline in mid-January and had continued to do so in February. As a consequence, there had also been little change in relative positions within the ERM. The Belgian franc had continued to be the strongest currency and the Dutch guilder had remained close to its Deutsche Mark parity. The spread between these three and the remaining ERM currencies had, however, widened marginally.

Stability in the ERM had been achieved despite the fact that most other ERM countries had allowed their interest rate differentials to decline vis-à-vis Germany. Only the Nederlandsche Bank had raised its official rates, but, as in Germany, money market rates had also fallen. The principal effect of the rise in German interest rates had been experienced in Italy and the United Kingdom. In Italy, the Banca d'Italia had found it necessary to demonstrate to the market that it would maintain a tight monetary policy and - as a result - short-term rates had been allowed to rise. This had proved sufficient to stabilise the lira without resorting to intervention. In the United Kingdom, the Bank of England had been required to intervene temporarily since the rise in German interest rates had added to a series of events which had already tended to weaken the pound sterling, namely the falling US dollar, lower oil prices and strong expectations of lower domestic interest rates.

The Spanish peseta had continued to be relatively strong. The margin between the peseta and sterling had increased and now exceeded 5.0 percentage points. The Banco de España had decided to abolish the official fixing in Madrid with effect from March 1991, following the examples of the Nederlandsche Bank and the Banque Nationale de Belgique. The effective exchange rate of the Greek drachma had weakened considerably since the outbreak of the Gulf War, partly because of fears of the effects on tourism. The Portuguese escudo had fluctuated in line with the authorities' more flexible exchange rate policy but these fluctuations had remained within reasonable limits.

2. Statement by Mr. Rey

The Alternates had discussed foreign exchange market developments and policies against the background of political events which, in the short-term, had weighed heavily on the behaviour of the main currencies.

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There had been four areas of primary concern:

Firstly, with regard to the US dollar, it had been observed that the instruments that could be used to influence the exchange rate had been pulling in different directions. The short-term interest differential vis-à-vis European currencies had been moving sharply in a direction that would weaken the US dollar, and remarks made by US Treasury officials had given rise to anticipations that there would be further movements in the same direction. Following the recent depreciation the US authorities had expressed concern about the level of the US dollar's exchange rate and several Alternates agreed that there would be little benefit in a further decline of the currency, especially given the present competitive edge of the United States; however, any action - especially through recourse to interventions - could only be effective if consistent signals were given on the other side of the Atlantic.

From this point flowed the second question of concern, namely the effectiveness of the international co-ordination process as embodied, in particular, in the G-7. One observation had been that if the authorities were unwilling to change their fiscal policy at a time when monetary policy was directed at domestic objectives, then there would be only very limited scope for international policy co-ordination. This had imposed severe limitations on what the G-7 could deliver in terms of calming exchange market expectations. Other observations had related to the effectiveness of the concerted interventions which had been undertaken during the previous week. Doubts had been expressed about their appropriateness given the inconsistent signals which had emanated from the United States. Several Alternates had referred to the possibility of improving the technical conditions under which such concerted interventions were carried out, particularly with regard to their timing; others felt that such factors were of minor importance relative to the broader issues raised in this context. The abstention of Japan from these concerted interventions had so far been regarded as justified, but this judgement should be reviewed if the US dollar became subject to renewed pressure.

The third area of concern had been the situation in the ERM. Although it had remained fairly satisfactory, cyclical disparities had tended to deepen and might cause pressures which would strain exchange rate stability.

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Once again, the situation in Germany had attracted attention, and although the adjustment of official rates had been generally well understood, some doubts had been expressed concerning the degree of buoyancy of the German economy. The German Alternate pointed out that the most recent figures had so far shown no sign of abating demand pressure on capacity. This had provided grounds for repeating the call already made for a prudent fiscal policy in Germany; the Alternates had heard that progress in this field would be forthcoming, at least at the Federal level.

Amongst the other possible ways of handling cyclical divergences without disturbing ERM relationships, the British Alternate had drawn attention to the positive contribution that could result from wider use of the band, as had been observed lately. This had been helpful in relieving some of the tension without endangering the credibility of the exchange rate policy.

The last area of concern related to non-ERM Community countries. The Greek drachma had come under strong pressure recently and, despite repeated interventions, had lost about 2% in effective terms; the reasons cited had been expectations of an unfavourable impact of the Gulf War on tourist receipts and large redemptions to non-residents of maturing government ecu bonds.

In Portugal, the surplus registered on the current account in 1990 had led the authorities to accept some appreciation of the escudo, as had been experienced over the last few months.

3. Discussion by the Committee

Mr. Hoffmeyer said that a distinction could be drawn between interventions in disorderly markets and those in market conditions arising as a result of differences in fundamentals. During the previous week the markets could not have been classified as disorderly and, therefore, the issue at stake was one of fundamentals. In that case, interventions would not solve the problem unless they were accompanied by appropriate policy measures. He questioned, therefore, the appropriateness of the recent interventions.

The Chairman, in his capacity as President of the Deutsche Bundesbank, explained that at the recent G-7 meeting he had counselled against raising expectations which the members were unable to fulfil because fundamentals were tending to move in the opposite direction. Prior to that meeting the markets had been rather calm, in spite of the Gulf War

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and in spite of the increasing negative interest rate differentials of the US dollar. The G-7 meeting and the subsequent communiqué might have contributed to unrest in the markets by signalling the authorities' concern about exchange rate developments. It had been interesting to note that US dollar/Deutsche Mark interest rate differentials had widened only at the short end of the market; at the long end the differentials had narrowed. There remained a number of factors which continued to support the US dollar: firstly, the political situation in eastern Europe; secondly, the domestic situation in Germany, which had included a growing fiscal deficit as a result of the budget and the Gulf War contribution; and, thirdly, the obvious overselling of the US dollar.

The Deutsche Bundesbank had participated in interventions and would continue to do so. However, the Bundesbank's room for manoeuvre was rather limited. The substantial size of its present US dollar holdings would make it difficult to increase them by large amounts. In addition, too much intervention could cause difficulties for the management of the money markets and the money supply. US authorities in turn held Deutsche Mark reserves in the region of DM 50 billion. The Chairman noted that virtually all recent US dollar interventions had been conducted against the Deutsche Mark. This had made it easier for partner countries to maintain their position vis-à-vis the Deutsche Mark and to avoid direct effects on market conditions.

The reason for raising German official interest rates, which had not led to higher market interest rates, had not been to tighten monetary policy, but rather to regain control of the money markets where rates had moved above the lombard rate. The discount rate had also had to be raised because the margin between it and the lombard rate was too wide. Following the adjustment of official rates, the Deutsche Bundesbank had provided repurchase facilities at a fixed rate of 8.5% in order to indicate the preferred position of money market rates. The Deutsche Bundesbank had also wished to give a signal to both the Government and the two sides of industry concerning the size of wage claims and settlements. The Chairman said that he had been somewhat confused and surprised by the reaction outside Germany where some countries apparently had not appreciated the complex nature of the situation in Germany and where it was not always understood that the underlying philosophy of German monetary policy was oriented at money supply rather than the exchange rate. The credibility of

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monetary policy in Germany would only be preserved if the money supply target was achieved.

Mr. Verplaetse said that the Belgian franc had continued to be fairly strong because of the good performance of the economy and the confidence shown by financial markets in Belgium's monetary policy. Given the size of the Belgian economy and its openness, it would be of little value to set a monetary target. Instead, the policy of aligning the franc with the strong European currencies had been pursued.

Recently the Belgian authorities had completed their reform of the instruments of monetary policy. In Belgium, there is about B.fr. 400 billion of currency in circulation. The Banque Nationale de Belgique holds two-thirds of its assets in the form of foreign assets and one-third in the form of domestic assets. The latter were, until recently, mostly composed of claims on the Treasury which had furthermore access to central bank credit through a credit line to the Fonds des Rentes of a maximum amount of B.fr. 110 billion. With the recent reform, direct credit to the Treasury had now been reduced to a maximum of B.fr. 20 billion, of which only B.fr. 2 billion had been drawn down since the new policy came into operation. This meant that the Banque Nationale de Belgique had now reduced monetary financing to virtually zero in anticipation of the requirement set for the later stages of Economic and Monetary Union.

It was within this framework that the advances rate - which was already regarded as too high - had been raised by 0.5 percentage point. While the reform in itself no longer implied that the Bank published official rates, it was found necessary to reinstate the advances rate to avoid confusion with respect to the basic stance of monetary policy. However, rates in the money market had not increased; on the contrary, they had begun to fall. Indeed, confidence in the authorities' policy had made it possible for the rate at which the central bank had injected funds into the market to fall by 0.5 percentage point within a two-week period. The move in German interest rates had not caused the Belgian authorities undue difficulties. The Deutsche Bundesbank should be asked to maintain a tight monetary policy and to continue pressing for moderation on the part of both the Government and the two sides of industry since Germany's success in checking inflation would also benefit its European partners.

Mr. Chalikias said that the drachma had come under increased pressure in January and had depreciated rather sharply despite repeated

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intervention by the Bank of Greece. The pressure had reflected, in part, unfavourable expectations as a result of the Gulf War and the probable negative impact on receipts from tourism. It had also, however, been due to a large redemption of ecu-linked government bonds held by non-residents. Recent developments did not reflect a change in exchange rate policy; the depreciation of the drachma would not fully offset inflation differentials and exchange rate policy would continue to have an anti-inflationary character. Nominal interest rates had remained high while real interest rates had been rising. The annual rate of inflation had reached a peak in December 1990 (22.8%) and had fallen by about 1 percentage point to 21.7% in January 1991. There had been signs that inflation would decelerate over the coming months. The anticipated high real yield on government securities had sustained a high level of demand and had enabled the Government to sell regular amounts of drachma-denominated bonds directly to the public. These developments had contributed to the further deceleration of money growth.

The policy mix in Greece had been extremely inappropriate; for a number of years monetary policy had been tightening whilst fiscal policy had been over-expansionary. The Government had now changed this policy and this had been reflected in the three-year fiscal stabilisation programme, which would substantially reduce the budget deficit. Interest rates on overdrafts with the Bank of Greece were now 30% and this had had the effect of greatly reducing liquidity in the private sector. Mr. Chalikias considered that monetary policy had reached its limits and the main problem, therefore, would be for the Government to reduce the size of the public deficit.

Mr. Leigh-Pemberton said that it could be argued that, unless there was appropriate guidance or intervention from the authorities, markets could drive themselves to excess or overreact to a given situation; in such circumstances there was a function in this respect for the authorities.

In the United Kingdom there had been increasing concern that the recession had been accelerating and deepening and would last longer than had originally been anticipated. The growth of the monetary aggregates had been falling quite sharply, with M0 back within its target range and M_4 showing negative growth for the last recorded month. Unemployment had been rising and industrial reports had revealed a picture of decreasing confidence. In such circumstances it had been reasonable to suggest that

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the UK domestic economy would benefit from a fall in interest rates. The reason for not implementing such a reduction had been the UK authorities' commitment to the ERM and sterling's disappointing position within the mechanism. However, this might be due to the markets' having already anticipated a fall in interest rates. Until such an expectation had been fulfilled, sterling would continue to remain at the bottom of the band; this dilemma had made it difficult to engineer the appropriate reduction. The authorities were looking for an opportunity to undertake a cut within the constraints of the ERM. Two weeks ago such an opportunity had arisen, but the upward movement of interest rates in Germany and the downward movement in the United States had frustrated such action. It was well known that sterling tended to move in closer relationship with the US dollar than with other European currencies and it would probably be correct to say that the weakness of the US dollar had exacerbated sterling's problems. Therefore, the indifference of the US authorities to the US dollar's decline had been particularly unsatisfactory for the United Kingdom.

In the context of the German interest rate move, Mr. Leigh-Pemberton asked whether there was not a better system for conducting monetary policy than having three different interest rates operational at one time. It was undeniable that a move in the German lombard rate had international significance, especially with regard to exchange rates.

Mr. de Larosière said that the rise in German interest rates had demonstrated, to some extent, the strictness of German monetary policy. It had, however, also highlighted the imbalance between the components of German economic policy. Such a policy mix, which gave too much weight to monetary policy to bring about an adjustment, might have negative consequences for European cohesion. The country of any currency which acted as an anchor and which did not have a balanced policy mix would run the risk of diminishing the cohesion of partner currencies. With regard to France, there was no domestic reason to match the rise in German interest rates. The interest rate differential which existed between the two countries, together with the moderate behaviour of the French money supply, meant that no rise in interest rates could be justified and, furthermore, there was no fundamental imbalance in the economy. Considerable attention had been paid to safeguarding the French franc within the ERM, and to the ability of the authorities to react flexibly on a day-to-day basis.

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The US dollar had been affected by German and US interest rate changes around the turn of the month. Mr. de Larosière considered that there was no fundamental reason for the downward trend in the US dollar. The conditions under which the US Treasury had organised its funding indicated that there was no drastic capital outflow. The US dollar had already depreciated sufficiently for the market to accept the situation. However, he felt that under certain circumstances benchmarks had to be set to ensure that the markets would not think that there was little or no control. Some doubts could be expressed as to the value of interventions, but, when the decision had been taken to intervene, it was best to undertake the operation in a professional and concerted manner and not leave the reaction wholly to the markets. In this respect he had been grateful to Mr. Dalgaard for the role he had played in bringing the technicians closer to the exchange markets; techniques had improved. If this meant that the central banks could intervene without using excessively large amounts then this would indeed be a beneficial outcome. Furthermore, it would be unhelpful to advise the markets in advance about the intervention policy to be pursued. He regretted that such a statement had been made by a senior official of one Member State the day prior to the Governors' meeting.

Mr. Ciampi said that there appeared to be broad agreement that the central banks should, in consultation with the Federal Reserve, continue to intervene in support of the US dollar. The market trend could not be turned around; hence it was important not to intervene with large amounts but to select carefully the most appropriate moment in order to give the right signal. That speculators profited from the interventions of the central banks was probably unavoidable. However, for reasons both of substance and of image it was essential to demonstrate to the markets that such action was co-ordinated.

With regard to Italy, following the increase in German interest rates the Banca d'Italia had reacted quickly and the lira had been stabilised without intervention following the increase in market rates. Domestically, there had been a slowdown in the real economy. The increase in December in domestic credit and the money supply was attributable partly to the banks' year-end window-dressing exercise and partly to an abnormally large increase in the demand for cash, the reason for which would be investigated.

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Mr. Tavares Moreira said that, contrary to projections, the current account in Portugal had shown a surplus in both 1989 and 1990. This had supported the new exchange rate policy which had been in operation since August 1990. In October the basket of currencies for the calculation of the exchange rate target of the escudo had been changed. Productivity gains in the tradable goods sector had been significant and had benefited from strong investment in the past five years. The effectiveness of the new exchange rate policy could be demonstrated by the price divergence between the tradable and non-tradable goods sectors. At the end of 1990 the price increase in the latter sector had been more than double that of tradable goods. In spite of the two elections held in 1990, the Banco de Portugal, in co-operation with the Ministry of Finance, intended to keep a firm hold on monetary conditions. It was expected that in 1991 inflation would be significantly below the level of 1990.

The Chairman, responding to issues raised concerning the situation in Germany, pointed out that long-term interest rates were lower now than they had been in May 1990. This was remarkable given the strong economic growth and the effects of unification. Concerning the observations of Mr. Leigh-Pemberton, he said that feasibility studies had been carried out with a view to introducing a flexible lombard rate, along the lines of the Swiss system; for institutional reasons this had not been accepted by the Council of the Deutsche Bundesbank. The policy mix in Germany had already been discussed by the Committee and most were already aware of the Deutsche Bundesbank's point of view. However, fiscal policy was under considerable pressure as a result of the unification process, the Gulf War and assistance to eastern European countries. At the same time, it had to be pointed out that the present policy mix had considerable beneficial effects on the economies of Germany's trading partners.

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 January 1991 and the first few days of February

The Committee adopted this report, which would be sent to the EEC Ministers of Finance in the usual way.

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IV. Economic and Monetary Union

1. Completion of the draft Statute

(a) Statement by Mr. Rey

In line with the Committee of Governors' mandate, the Alternates had resumed work on the completion of the draft Statute. The discussion had focused on the provisions relating to the distribution of income (Article 32), the completion of which had been left by the Governors to a later stage.

The distribution of income was a complex issue and would necessitate further analysis. Some Alternates, taking into consideration the pace of change and the fact that any system devised for the allocation of income would not become operational for some years, had raised the question of whether it would be conceivable to phrase Article 32 in such a way as to provide freedom to delay a decision on the issue until a later stage. The general view of the Alternates had been that the Intergovernmental Conference (IGC) would be unlikely to accept a draft which merely postponed an agreement on substantive provisions about income distribution. However, it had been recognised that it would be prudent to maintain a degree of flexibility; this could be achieved by giving the Council some leeway in the application of the provisions and making sure that these provisions were themselves amendable, perhaps on the basis of the simplified amendment procedure applicable to other Articles of the draft Statute.

The Alternates had sought to reach agreement on the guiding principles with which the mechanism should comply and on how future work could be organised in order to translate these principles into operational provisions. The two important principles governing income distribution should be consistency and equity. The first principle meant that considerations relating to income distribution should not impede the efficient implementation of a monetary policy designed to achieve price stability. The second principle meant that a procedure for a fair allocation of income had to be established. In this respect it was noted that a distinction might be made between seigniorage income and other income, for example that deriving from the return on capital.

In respect of the procedure to be followed, the Alternates had agreed that the Secretary General would draw up a note outlining the

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guiding principles and the main operational features of the System which would be relevant for the issue of income allocation. This note would form the basis of a thorough analytical review undertaken by a special working party, the composition of which had still to be determined by the Committee of Alternates in consultation with the Secretary General.

(b) Discussion by the Committee

The Committee agreed to the proposals made by the Alternates and asked them to continue their work on completing the draft Statute. The Chairman hoped that the Committee of Governors could reach a broad degree of consensus with regard to the outstanding provisions.

Mr. Leigh-Pemberton said that Article 32 was a matter of intense interest to governments and Treasuries. In contrast, the important issue for the central banks was to analyse how the profits from seigniorage and other such elements would affect the effectiveness and efficiency of the System.

2. Intergovernmental Conference

The Chairman noted the written report on the IGC which had been prepared by the Secretary General and invited Mr. Delors to report on the state of the discussion.

(a) Statement by Mr. Delors

At the last meeting of the IGC, the UK, Spanish and French delegations had submitted Treaty proposals. The IGC had expressed satisfaction with the work carried out by the Committee of Governors and had agreed that the draft Statute would serve as the fundamental basis for its discussions. Two possible working methods had been considered: the Ministers could review those points on which no agreement had been reached, or they could discuss each draft Article in turn. The second method had been chosen. Mr. Delors said that he would have preferred the first method, since it would have allowed the Ministers to concentrate simply on those items which had not yet been resolved.

With regard to the discussions there had been six main issues:

(i) The content of economic union: the politicians had insisted on there being parallelism between monetary and economic union. There was disagreement over the degree of stringency of rules in the economic area, and in this context a number of different proposals had been put forward.

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Policies with respect to competition would also have to be discussed, as would common policies which might be strengthened from an institutional point of view within the framework of the Treaty on political union.

(ii) Economic and social cohesion: this was a concept contained in the Single Act and it had become a psychological cornerstone for an agreement between the twelve Member States. The Committee for the Study of Economic and Monetary Union had come to the conclusion that EMU would not aggravate the disparities that existed between countries and regions. However, the question of social and economic cohesion was likely to give rise to a great deal of political discussion when the financial perspectives of the Community for the period 1993 to 1997 were reviewed at the beginning of 1992.

(iii) External monetary policy: in this respect there appeared to be considerable differences between the Member States, especially with regard to the shared responsibility for foreign exchange policy.

(iv) The role of the ecu in the move towards EMU: the attention of the Governors was drawn to the publication of a number of proposals recently tabled. There remained considerable differences of opinion between the Member States, as well as a number of difficult technical issues that had to be resolved. This would probably be one of the main issues for discussion.

(v) Stage Two of EMU: according to the report of the Committee for the Study of Economic and Monetary Union, this could be a short phase during which the European System of Central Banks would be established. This would assume that during Stage One there would be greater convergence between economic policies, that the multilateral surveillance exercises would be successful and that the Committee of Governors would become the focal point for monetary policy discussions. In this respect, Mr. Delors said that he had been struck by the fact that the issue of Stage One had totally disappeared from the discussions of the IGC; the impression was given that EMU would take effect on 1st January 1994; if allowed to continue, this impression would completely skew the debate and could prove to be a handicap to the success of the work of the IGC.

(vi) The institutions and the issue of democratic accountability: here there was a close link with the Conference on Political Union. At present there were tensions between Member States as to the underlying philosophy of institutions. Positions had hardened dogmatically and doctrinally and

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considerable efforts would have to be made to resolve the problem. This would be the last issue to be discussed by the IGC.

With respect to the role of the Committee of Governors in the IGC, Mr. Delors said that it was important for the Governors to maintain their involvement and help clarify options, focus attention and orient discussions. The Committee was an integral part of the Community structure. Mr. Delors hoped that the Committee would continue to be very active and help guide the discussions without pre-empting the outcome.

(b) Statement by Mr. Rey

The Committee of Alternates had expressed its appreciation to the Secretary General for both the written and the oral reports on the first working sessions of the IGC, and had voiced encouragement for the continuation of reporting on similar lines.

On the basis of the report the Alternates had concluded that there was no need for immediate action on the part of the Committee of Governors.

Most Alternates, however, had considered it appropriate for the Committee of Governors to undertake an examination of the issues raised in connection with Stage Two and, in particular, of the proposals made by the United Kingdom, Spain and France. It had been observed that the timetable of the IGC entailed a risk that these issues would come to political negotiation at a moment when the Committee of Governors would no longer have the time to undertake a careful examination of the technical issues. The Alternates had felt it desirable, therefore, that the Committee of Governors should be in a position to formulate its opinion, whether on its own initiative or at the request of the IGC. The French Alternate, however, felt that it would be difficult to examine issues relating to Stage Two without benefiting from political guidance about the concept, nature and length of the Stage.

(c) Discussion by the Committee

Mr. Duisenberg said that the Nederlandsche Bank had definite views as to how the future arrangements should be made. It was actively engaged in national discussions and preparations for IGC meetings and part of the Dutch delegations at both levels. He hoped that other central banks would follow a similar approach, which had not appeared to have been the case hitherto.

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The Chairman suggested that the Committee should wait until the IGC asked the Governors to undertake additional work. He felt that it would be difficult to make proposals to the IGC which might differ from the positions of the members' respective governments.

Mr. de Larosière said that the discrepancy between the proposals of the French Government and those of the Committee of Governors provided an insight into the intellectual independence of the Banque de France, which was not institutionally involved in the negotiations at the IGC. It should rest with the governments to undertake the necessary negotiations. In this respect, he agreed that the Committee should complete the unfinished Articles and should stand ready to answer any questions raised by the negotiators. He would be reluctant, however, to produce papers for the IGC without appropriate political guidance. There would be a need for the Governors to do some work on the instruments that would lead the Community to a global monetary policy, for example the creation of a single monetary aggregate for the Community.

Mr. Jaans said that he did not think that the Committee of Governors should engage in an exercise of preparing a synthesis of the various proposals which were on the table for Stage Two, although these proposals could not be ignored. The IGC might well ask the Committee of Governors to give an opinion on the operational implications of these proposals in due course.

Mr. Ciampi said that several chapters in the draft Statute remained uncompleted, for example those on financial provisions and transitional arrangements. The most pressing need was to complete these two sections.

The Chairman agreed that the IGC was likely to ask the Committee of Governors, and perhaps the Monetary Committee, to comment on certain proposals; in this respect, there might be a need to study the issues and co-ordinate a response. Whilst acknowledging the point made by Mr. Ciampi, he felt - largely on political grounds - that it would be best to await an official request from the IGC before considering the transitional arrangements. He also agreed with Mr. de Larosière that the Committee had work to do with a view to improving the co-ordination of monetary policies and to creating consistent indicators, targets and instruments of monetary policy.

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Mr. Duisenberg doubted the merit of studying the individual proposals because it would be difficult for a member of the Committee of Governors to look objectively at his own Government's proposal. If it were decided to create an institution in Stage Two, it would be extremely useful to study the appropriateness of the draft Statute's applicability to a Stage Two institution, perhaps on the lines of the Secretariat's recent note. This view was shared by Mr. de Larosière, who reiterated that the Committee should focus on its fundamental tasks.

V. Recent developments in the use of the private ecu and policy issues

1. Statement by Mr. Dalgaard

The Foreign Exchange Policy Sub-Committee had held one meeting to discuss the report; the conclusions had been finalised by teleconference. The remainder of the report was submitted on the Chairman's own responsibility.

The report covered the period from end-June 1989 to end-December 1990. Chapter I contained a short summary of financial developments, its main point being that the ecu financial market had continued to expand vigorously, especially the securities market. There had, however, been no expansion in the issue of short-term government securities, and the use of the ecu in the invoicing and settlement of commercial transactions had not changed materially and had remained at a very low level. The report also looked at the position of ecu clearing and the future introduction of an intermediation facility; it was pointed out that the temporary ad hoc working group on payment systems would examine this issue in greater detail.

Chapter II reviewed the transactions of central banks which had expanded vigorously. The increased volume of ecu interventions was caused primarily by situations where the use of the traditional intervention currencies would not have been appropriate.

Chapter III considered the development of ecu interest and exchange rates, which were an especially interesting feature of the report. The trends in the market ecu interest rates compared with theoretical rates and the widening exchange rate spreads demonstrated that the market ecu was showing greater independence from its basket definition than had previously been experienced. The conclusion had been that there was no institutional link between the private ecu and its basket and that the market ecu had

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behaved more like an independent currency. There was no institution overseeing its development and therefore there was in principle no limit to the spread between market rates and its theoretical value.

Chapter IV described the remaining obstacles to the use of the private ecu; on the whole the impediments were not overly burdensome and were not hindering the development of the private ecu. The possible consequences for the private ecu of proposals to "harden" the ecu were studied in Chapter V. Mr. Dalgaard outlined the case for dispensing with future revisions of the basket and abolishing the basket definition.

Mr. Dalgaard also briefly reviewed the report's principal conclusions and recommendations. He mentioned that the monitoring graphs now included a page which showed the spread between exchange and interest rates and also interventions. Mention was made of the proposal to release the separate statistical review to interested third parties.

2. Statement by Mr. Rey

The Alternates had praised the Foreign Exchange Policy Sub-Committee for an excellent report. The report's conclusions had been largely endorsed; however, two reservations had been expressed. The German Alternate could not endorse paragraph 1.7 of the Conclusions, particularly since he felt that it was not appropriate to merge the two proposals to harden the ecu for the purpose of discussing their impact on the private ecu market. The British Alternate had objected to some of the conclusions in respect of the UK proposals to harden the ecu. He considered that these proposals would not give rise to unmanageable problems for the existing ecu markets and challenged the view that the hard ecu would not be able to compete with the strongest EMS currencies.

A number of Alternates had wished to underline the observation made in the report that it was only now being fully appreciated both by ecu market participants and by central banks that the absence of an institutional link between the official and private ecu meant that the values of the theoretical and market ecu could deviate from each other with no obvious limit. This development should be monitored, as the widening spread between the market and the theoretical ecu could mean that the ecu was in fact developing as a parallel currency without a pilot; in the opinion of some market participants this could become an obstacle to the greater use of the ecu.

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With respect to the follow-up, the Alternates had endorsed the report's recommendations. One Alternate had recommended that additional work should be carried out by the Sub-Committee in two areas, namely:

- the removal of obstacles to the use of the private ecu;
- the contribution that an efficient organisation of the ecu clearing system would make to reducing the spread between the theoretical and market value by making arbitraging more efficient.

The Alternates had agreed to recommend that the Governors authorise the release to interested third parties of that part of the report entitled Statistical Review. It was also recommended that the report - as usual - should be made available to the Monetary Committee.

3. Discussion by the Committee

Mr. Hoffmeyer observed that the major part of the increase in deposits of private ecus with banks had been made by the central bank, which had obtained such assets as a result of their governments' borrowing in the ecu security market. The central banks had used part of their ecu balances for interventions when there had been a lack of other appropriate intervention currencies. He concluded from the report that there appeared to exist a relationship between central bank transactions and the spread of the ecu.

Mr. Dalgaard said that there was also a link between the strong central bank demand for bank deposits in ecus and the premium on the ecu in the exchange market. On the other hand, the greater use of the private ecu had originated from the heightened demand for ecu bonds, which was market-oriented and not central bank led.

The Committee agreed that the report should be made available to the Monetary Committee. It was also agreed to release the Statistical Review to interested third parties.

VI. Other matters falling within the competence of the Committee

1. Multilateral surveillance (Session of the ECOFIN Council on 28th January 1991)

The Chairman said that he had attended the session of the ECOFIN Council in Brussels on 28th January 1991, which was devoted to multilateral surveillance in accordance with Article 1 of Decision (90/11/EEC) of

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12th March 1990. The exercise was introduced by presentations of the EC Commission, the Monetary Committee and the Committee of Governors. With a view to avoiding repetition he had shortened his remarks, which he hoped the members considered had been balanced. Unfortunately, there had been no real discussion, nor had there been any real response to the various speeches. Several national representatives had made statements but there had been no debate. On the positive side, the criteria by which the Finance Ministers would measure economic performance appeared to be better defined than in the past. On balance, it had been a good exercise which would improve as time went by.

VII. Date and place of next meeting

The Committee's next regular meeting would be held in Basle on Tuesday, 12th March 1991 at 9.30 am.

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252nd MEETING OF THE COMMITTEE OF GOVERNORS

12th FEBRUARY 1991

Those present were:

Chairman of the Committee of Governors	Mr. Pöhl
Banque Nationale de Belgique	Mr. Verplaetse Mr. Rey Mr. Michielsen
Danmarks Nationalbank	Mr. Hoffmeyer Mrs. Andersen
Deutsche Bundesbank	Mr. Tietmeyer Mr. Rieke
Bank of Greece	Mr. Chalikias Mr. Papademos Mr. Karamouzis
Banco de España	Mr. Rubio Mr. Linde Mr. Durán
Banque de France	Mr. de Larosière Mr. Lagayette Mr. Cappanera
Central Bank of Ireland	Mr. Doyle Mr. Coffey Mr. Reynolds
Banca d'Italia	Mr. Ciampi Mr. Dini Mr. Santini
Institut Monétaire Luxembourgeois	Mr. Jaans
Nederlandsche Bank	Mr. Duisenberg Mr. Szász
Banco de Portugal	Mr. Tavares Moreira Mr. Borges Mr. Bento
Bank of England	Mr. Leigh-Pemberton Mr. Crockett Mr. Foot
Commission of the European Communities	Mr. Delors Mr. Pons
Chairman of the Foreign Exchange Sub-Committee	Mr. Dalgaard
Secretariat of the Committee of Governors	Mr. Baer Mr. Scheller Mr. Guiomard

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