Confidential

(Translation)

MINUTES*

OF THE 230th MEETING OF THE COMMITTEE OF GOVERNORS OF THE CENTRAL BANKS OF THE MEMBER STATES OF THE EUROPEAN ECONOMIC COMMUNITY HELD IN BASLE ON TUESDAY, 13th DECEMBER 1988 AT 9.30 a.m.

Those present at the meeting were: the Governor of the Banque Nationale de Belgique and Chairman of the Committee, Mr. Godeaux, accompanied by Mr. Rey and Mr. Michielsen; the Governor of Danmarks Nationalbank, Mr. Hoffmeyer, accompanied by Mr. Mikkelsen; the President of the Deutsche Bundesbank, Mr. Pöhl, accompanied by Mr. Schlesinger and Mr. Rieke; 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. Pêgo Marques and Mr. Amorim; the Governor of the Bank of England, Mr. Leigh-Pemberton, accompanied by Mr. Price; the Director-General for Economic and Financial Affairs at the Commission of the European Communities, Mr. Costa, accompanied by Mr. Mingasson; the Director General of the Luxembourg Monetary Institute, Mr. Jaans; the Secretary of the Monetary Committee, Mr. Kees. 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, identical to the draft, approved at the meeting on 14th February 1989.

I. Approval of the minutes of the 229th meeting.

The <u>Committee</u> unanimously approved the minutes of the 229th 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 most striking development recently had been the weakness of the dollar in October and during the first two weeks of November. The dollar had fallen by 8% against the Deutsche Mark during that period. The fall had occurred in spite of an increase in the interest rate differential in favour of the dollar. In the second half of November the dollar had stabilised, and at the beginning of December there had even been signs of a slight improvement. On balance, however, the dollar was at a higher level at the beginning of December than in May 1988 and was 10% above its lowest level, recorded at the end of 1987. The central banks had responded to the fall in the dollar by purchases which had amounted in November to about US\$ 8 billion, US\$ 2 billion of which had been by the Federal Reserve and US\$ 2.5 billion by the Bank of Japan. The Deutsche Bundesbank had purchased approximately US\$ 350 million and had sold small amounts in early December when the dollar had firmed slightly. However, it appeared that the Bundesbank's influence on the dollar exchange rate had been much more marked in November, since it had allowed an increase of DM 3 billion in its net foreign exchange reserves. Since then, these reserves had been reduced by approximately DM 1.5 billion by rechannelling dollar earnings onto the market. This policy was grounded in the belief that adjustment was moving in the wrong direction. In fact, since the second half of 1988, Germany's net exports had started to rise again, chiefly to other European countries but also, more recently, to the United States. This development was not desirable and was leading the Bundesbank to resist a depreciation of the Deutsche Mark. The experts were of the opinion that adjustment in the United States would take time and that a

rise in the dollar would jeopardise the process. Nevertheless, it did not seem likely that the dollar would show any lasting appreciation, given the persistence of fundamental problems in the United States. Furthermore, it seemed that the US and Japanese authorities were not very concerned about the current situation, although the statistics confirmed that adjustment between the United States and Japan had also come to a standstill.

Within the EMS the situation had been calm and there were evidently no expectations of a realignment in the near future. It was acknowledged, however, that the recent sharp expansion in the German trade surplus vis-à-vis the other EEC countries could generate tensions within the exchange rate mechanism if it were to last too long. The experts had also pointed out that the foreign exchange markets were influenced these days not only by trade balances but perhaps more by ever increasing capital flows. These could neutralise current-account deficits, even over long periods, but the financing of deficits in this way had repercussions on interest rate differentials. Moreover, the fact that the last realignment had taken place almost two years previously tended to encourage expectations of a change in parities, and that could cause interest rate differentials to widen further.

The Italian lira had been firm recently, notably as a result of a rise in interest rates due to domestic factors. In October the Banca d'Italia had taken advantage of this strength to purchase foreign currency, but these purchases were scaled down in November in order to limit the impact on domestic liquidity. The lira's position within the fluctuation band had strengthened and was very close to the narrow band. Although the measures to liberalise capital movements introduced on 1st October 1988 had had no decisive effect, they had played a role insofar as private foreign borrowing to finance the purchase of foreign securities had risen. In Denmark the full liberalisation of capital movements that had taken place on 1st October 1988 had not had any notable impact. In Ireland the announcement of liberalisation measures had caused bond yields to rise at the end of October and the beginning of November; since then they had returned to the previous levels. In Germany interest rates had begun to rise again: bond yields started to do so at the beginning of November and short-term rates at the end of November. This had resulted in a narrowing of differentials vis-à-vis a number of countries, such as Belgium, Denmark, France, Ireland and the Netherlands. In the last-mentioned country, where the markets were extremely sensitive to slight variations in the differentials vis-à-vis the Deutsche Mark,

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their development had led the central bank to intervene to support its currency before domestic interest rates adjusted to the new German rate levels. The French franc had remained stable despite the narrowing of interest rate differentials vis-à-vis the Deutsche Mark and labour unrest. In the United Kingdom the fight against inflation had been pursued by means of a further raising of interest rates; this had caused a degree of appreciation of sterling, which had been contained by a number of interventions. It was to be noted that the sterling/Deutsche Mark parity had since March 1988 remained within narrow fluctuation limits (DM 3.10 - 3.25 to the pound).

The Spanish peseta had continued to firm in the context of a relatively high level of interest rates that was justified by the acceleration in the rate of inflation. The Banco de España had barely intervened at all in the last two months.

B. Statement by Mr. Rey

On hearing the report presented by Mr. Dalgaard, the Alternates had felt that the monitoring exercise was of especial importance in present circumstances.

The problems that currently arose should be set in the context of the international adjustment process. In this connection the Alternates had listened very attentively to the point of view expressed by the German delegate, which could be summarised as follows:

If the process of adjustment was currently at a standstill, or was at the very least slowing down, this should be seen notably as reflecting the impact of exchange rate relationships. In particular, it was symptomatic that the German trade balance had stopped adjusting or was even improving, mainly vis-à-vis countries whose currency had risen against the Deutsche Mark in the course of the year.

At the same time the German economy was growing at a rate of 3 1/2 to 4%, i.e. far in excess of the growth potential, and indicators showed that production capacity was fully utilised. In these conditions it was scarcely possible to consider taking macro-economic policy action to further the adjustment process by stimulating domestic demand. This was the backcloth against which the Bundesbank's exchange rate policy and monetary policy outlook were to be seen.

Concerning exchange rates, German policy was to resist any depreciation of the Deutsche Mark, which would add further fuel to the risk of

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inflation. The Bundesbank was thus taking the opportunity to counter the rise in the dollar exchange rate, but this policy was being applied prudently and did not reflect any relaxation of the co-operation with the Japanese authorities, contrary to the impression recently gained in the markets.

Concerning interest rates, the Alternates agreed with Mr. Dalgaard in recognising that it was particularly important to maintain appropriate interest rate differentials, even widening them, when exchange rate stability within the EMS relied on a less convincing international adjustment process. Indeed, the Alternates had noted the recent narrowing of this differential following the rise in short-term Deutsche Mark rates since the end of November. This increase was apparently attributable at this stage to technical factors linked with the proximity of the end-of year settlement deadline, and not to central bank action in the money market.

However, some stressed the danger that this spontaneous development of interest rates might be perceived in the market, willy-nilly, as the outcome of deliberate action, as had already happened in the past. If, on the other hand, it was desired to raise interest rates to counter any risk of inflation and any depreciation of the Deutsche Mark, this would make the task of attaining the appropriate differential all the harder for the other countries in their conduct of monetary policy.

C. Discussion by the Committee

<u>Mr. de Larosière</u> offered a number of comments on the monetary target that had just been adopted in France for 1989. A range of 4 to 6% had been set for the expansion of M_2 in 1989. In 1988 the target had been the same, and at end-October 1988 M_2 growth had stood at 4.1%. GNP growth in 1988 would probably be 3.7% in real terms, and inflation would be in the order of 3%. Nominal growth would thus be around 6.5 to 6.7%, and the fact that the French economy had been able to function with M_2 growing at around 4% was explained by the acceleration in the velocity of circulation of M_2 , which was a classic phenomenon in a period of upturn in business activity such as experienced in 1988. M_3 had expanded by 7.3%, whereas in 1987 it had grown by over 9%. The broadest aggregate, L, had risen by 9.5%, which again represented a slowing-down from the 1987 figure (11.7%).

The forecasts for 1989 were for real growth of the order of 2.6% and inflation around 2.5%, with nominal GNP growth thus in the region of 5%. It had seemed reasonable to expect the velocity of circulation of M_2 to

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stabilise and not to accelerate any further, given that the pace of economic activity was forecast to slacken somewhat in the course of 1989. In these conditions it had appeared desirable for M_2 growth to centre around the 5% point, and thus the 4 to 6% range had been retained and announced at the beginning of December. The objective aimed for was to ensure disinflation, safeguard the stability of the franc and not to leave any margin for prices to get out of control or for an excessive rise in consumption, while at the same time not impeding a reasonable rate of economic growth.

Lending had grown quite strongly in 1988: total lending to the economy would have risen by almost 12%. This development warranted very close monitoring and had led the Banque de France to decide on the establishment of a register to permit a better appraisal of consumer lending, which was growing very rapidly at over 20% per annum. This register was to be based on the Belgian model and should enable defaults on lending to households to be detected.

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 November and the first few days of December 1988.

The <u>Chairman</u> noted that the Committee approved the "concertation report", which would be sent to the EEC Ministers of Finance in the usual way.

IV. Examination of Report No. 64 prepared by the group of experts chaired by Mr. Dalgaard on recent developments in the use of the private ECU.

A. Statement by Mr. Dalgaard

Report No. 64 was the fifth report by the group of experts on the use of the private ECU and covered three main areas: the development of the ECU on the financial markets, the growing use of the private ECU by the central banks and the review of the ECU basket.

Since the middle of 1987 there had been a marked expansion of the private ECU on practically all markets, whereas previously it had stagnated.

There had been an increase in ECU bank lending and deposits, and banks' net ECU exposure had risen from ECU 10 billion at end-June 1987 to ECU 13 billion at end-June 1988. The ECU had also strengthened its position on the bond market, where the 1988 issue volume exceeded the record levels observed in 1985. Short-term instruments in ECUs had also made an appearance in the form of Italian and UK Treasury bills, of which nearly ECU 7 billion were outstanding at end-November 1988. This expansion of the ECU on the financial markets was related to a number of factors. Firstly, in 1988 as in 1985 the ECU had benefited from a combination of exchange rate stability between the component currencies and relatively high intra-Community interest rate differentials. Secondly, tax considerations had played a role, especially in Italy. In contrast, the elimination of restrictions on the ECU in Germany and Spain had not had any notable effect.

The use of the ECU for invoicing and settlement of commercial transactions had increased only slightly and overall would seem to account for only 1% of intra-Community and extra-Community trade.

The most important element was undoubtedly the appreciable increase in transactions in ECUs by the central banks and in their holdings of ECUs. A number of factors were behind this development: ECU borrowing by certain governments, reserve diversification on the part of some central banks and increased interventions in ECUs. Half of these interventions had been carried out by the Bank of England during a short period when purchases of dollars were not thought to be desirable and the acquisition of Deutsche Mark was not considered acceptable by the Deutsche Bundesbank. The experts had wondered whether the growth in interventions in private ECUs necessitated a review of methods and practices. This question had already arisen in 1984; the experts had taken the view that, despite the recent increase, the share of interventions in ECUs remained very small and that it was not necessary to apply special rules for this type of intervention. Nevertheless, it was important that all EEC central banks intending to intervene in ECUs took into consideration the effect of such interventions on the other EEC currencies. Hitherto interventions in ECUs had been purchases, but there might be a greater risk of a disturbing influence on individual currencies in the case of sales. The "Monitoring group" would closely follow developments in ECU interventions.

The assets in private ECUs of the EEC central banks had more than doubled between end-June 1987 and end-November 1988, rising from ECU 4 to 9 billion; the increase had been particularly sharp in the case of the Bank of England. With the exception of the Deutsche Bundesbank and the Nederlandsche

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Bank, all the EEC central banks were holders of private ECUs, but these represented widely divergent proportions of their reserves.

Report No. 64 addressed, finally, a future issue, viz. the implications of the forthcoming review of the ECU basket. The revision of the weights of the component currencies resulting from this review would be likely to have two main effects on the market: it would increase ECU interest rates and heighten exchange risks for banks with net asset positions in ECUs.

The strength of these effects would depend on the extent to which the currency weights were changed, which would be all the greater given the inclusion of the peseta and the escudo in the basket. At any event, uncertainty as to the changes could lead to disturbances on the markets and to a tendency for banks to minimise their risks by withdrawing from the ECU market. With a view to limiting these effects and problems, the experts had suggested that a two-stage procedure could be adopted: the official decision on the new currency weights would be taken and announced, but would only enter into force at a later date, giving the markets time to adapt.

B. Statement by Mr. Rey

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1. The Alternates expressed satisfaction with the quality of the report prepared by Mr. Dalgaard, his Group and the Secretariat. They were in broad agreement with the analysis and with the conclusions drawn.

2. The Portuguese Alternate had announced his authorities' intention to apply for inclusion of the escudo in the basket. This step was to be seen in the context of Portugal's general advance towards full integration in the EMS. It was stated that the inclusion of the escudo could be undertaken without affecting the stability of both the ECU and the escudo.

Three points had attracted particular comment, viz.:

- the increase in the volume of the central banks' ECU interventions and ECU assets;
- the operation of the ECU clearing system;
- the effects of the revision of the ECU basket on the functioning of the market.

On the first point the Alternates, like the experts, felt that the central banks' operations in ECUs during the period under review had

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not given rise to any particular problems despite the increase in volume and therefore did not call for any new regulations. It was, however, important that central banks considering intervening in ECUs - whether they belonged to the EMS exchange rate mechanism or not - should take account of the impact of their interventions on exchange rate stability within the EMS and on the level of EMS exchange rates vis-à-vis other currencies. In addition, consideration had been given to a request that the Group should carry its analysis of the effects of ECU interventions further by taking into account the size of ECU positions covered by the basket of constituent currencies.

As regards the clearing system, the Alternates had noted that the operation of the system and the admission of new banks were at present under discussion within the ECU Banking Association. The Commission representative said that he would submit to the Committee a note concerning certain specific aspects of the operation of this mechanism. It was recalled that until further notice the conditions governing intervention by the BIS in the ECU clearing had been agreed within the Committee and remained in force.

Finally, as regards the third point, the Alternates thought that in view of the size of the market and of the banks' net creditor position in ECUs careful attention should be paid to ways and means of safeguarding the smooth functioning of the market as the time for the revision of the ECU basket approached. They had expressed interest in the possibility of a two-stage revision procedure, in contrast to the method adopted in 1984. They suggested that when sending off Report No. 64, the Chairman of the Committee of Governors should send a letter to the President of the Commission and the Chairman of the Monetary Committee, drawing their attention to the analysis of the question and to the importance attached to the smooth functioning of the exchange markets and the money markets as the time for revising the ECU basket drew near.

C. Discussion by the Committee

<u>Mr. Rubio</u> congratulated Mr. Dalgaard and the group of experts on the quality of the report and made a few comments on the modification of the ECU basket and the consequences of including the peseta. The solution of informing the markets before the new weights for the component currencies came into effect was acceptable; it remained to be seen whether it was feasible at the formal level. In any event, the market would anticipate the probable range of weights and would not be far from their actual values in

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the end. The Banco de España was ready to take any measure necessary to ensure the smooth functioning of the markets during the transition period, and it was convinced that the inclusion of the peseta in the ÈCU in September 1989 would not raise any problems.

Mr. Tavares Moreira confirmed the information given at the meeting of the Alternates, viz. that the Banco de Portugal had examined the possible consequences of including the escudo in the ECU and that it was highly likely that the Portuguese authorities would formally apply for inclusion. Measures had already been taken to broaden the convertibility of the escudo; it could be used unrestrictedly for the majority of current and capital transactions with other countries, and its full convertibility was assured for non-residents. The International Monetary Fund had announced Portugal's acceptance of the obligations under Article 8 of the Articles of Agreement. The market for the escudo was growing in the major financial centres such as London and Paris, to be joined in the near future by Madrid, and the Banco de Portugal provided support for market-makers. Moreover, the weight of the escudo in the basket would be unlikely to create problems either for the Portuguese currency or for the ECU and the functioning of the markets. Portuguese exchange rate policy was currently aimed at an effective depreciation of the escudo of 0.25% per month; this rate would be gradually reduced as the inflation differential between Portugal and its trading partners narrowed.

<u>Mr. Leigh-Pemberton</u> congratulated Mr. Dalgaard, the experts and the Secretariat for the excellent report presented. He recalled that in their first discussion on the private ECU five years previously the Governors had wondered how the use of the private ECU was to be encouraged. It was comforting to note today how its use had grown, but there was a question mark over the development in 1989 on account of the review of the ECU basket in September. Indeed, there seemed to be growing nervousness as this prospect drew nearer. The ECU Banking Association, meeting very recently in London, had stressed this aspect. Certain elements in the review of the basket, in particular the criteria to be used in determining the currency weights, were essentially the domain of the ECOFIN Council and the discussions on this subject were liable to be difficult. However, it was the particular obligation of the Governors to draw the attention of the Commission, the Monetary Committee and the Council to the possibility of market disturbances during the transitional period. The experts had very appropriately raised

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this aspect and had shown clearly that, whereas the revision of the ECU basket had passed off without a hitch in 1984, the very substantial growth in the use of the ECU that had taken place since then imparted a different dimension to the forthcoming operation. One should not underestimate the damage that might be inflicted on the ECU markets and, in particular, the risk that the short-term market would dry "p in 1989 and every five years thereafter. It would be desirable for the "Dalgaard Group" to examine in greater depth the likely impact of the forthcoming review of the ECU basket and of the prolonged period of uncertainty that might result from it. The Governors could address this study at their meeting in February 1989 and thereby make a useful contribution to the discussion that would arise in due course in the other competent bodies.

The <u>Chairman</u> noted that the Committee agreed to entrust the "Dalgaard Group" with the study proposed by Mr. Leigh-Pemberton, it being understood that the Committee did not wish to relieve the authorities concerned of their responsibility for deciding on the revision of the ECU basket but to prepare the ground for the decision.

V. Extension of the EMS revolving swap mechanism

The <u>Chairman</u> said that the Alternates had had no comments to make on this question and he took note of the Committee's approval, as to substance and form, of the extension of the EMS revolving swap mechanism, as proposed in a note from the Secretariat dated 6th December 1988, viz.:

1. The entry in the minutes of the present meeting of the following text:

"In order to ensure the continuation of the revolving swap mechanism of the EMS beyond 13th March 1989, its expiry date stipulated in the Governors' decision of 9th December 1986, the Governors decided, in pursuance of Article 20.1 of the Agreement of 13th March 1979 between the EEC central banks laying down the operating procedures for the EMS, as amended by the Instruments dated 10th June 1985 and 10th November 1987, that:

- the swaps referred to in Article 17.3 and 18a.4 of that Agreement shall not be unwound on 13th March 1989;
- the swap mechanism shall be extended for a further two-year period, at the end of which, save in the event of a unanimous decision to

the contrary, the said swaps will be unwound. During the said period (that is, until 13th March 1991) the swap mechanism will remain subject to the same provisions of the Agreement of 13th March 1979, it being understood, however, that the Governors may, by a unanimous decision, shorten this period and modify the mechanism in the event that the transition to the institutional phase of the EMS takes place before 13th March 1991."

2. The sending of a letter from the Chairman of the Committee of Governors to the President of the ECOFIN Council, the text of which is annexed to the above-mentioned note from the Secretariat.

VI. Chairmanship of the Committee

The <u>Chairman</u> announced that, on the basis of the contacts and consultations he had had with the Governors, he was able to propose Mr. Chalikias, Governor of the Bank of Greece, as the new Chairman of the Committee as from 1st January 1989 and for the customary one-year term.

The Committee approved the Chairman's proposal.

<u>Mr. Chalikias</u> thanked his colleagues for the honour they had paid him in entrusting him with the chairmanship of such a prestigious committee. On behalf of all the Governors he expressed his gratitude to Mr. Godeaux for the very substantial contribution which Mr. Godeaux himself and the Banque Nationale de Belgique had made to the work of the Committee in 1988. The Governors had all appreciated and admired the professionalism of their Chairman and his profound devotion to the European cause, and also the skill with which he had succeeded in guiding the Committee with a hand both firm and courteous through all the varied and often difficult tasks it had undertaken in 1988. Such an example did not make the task of his successor an easy one.

VII. Other matters falling within the competence of the Committee: Meeting between the Chairman of the Committee and the Governor of Norges Bank

The <u>Chairman</u> informed the Committee that on the preceding Sunday, 11th December 1988, he had held a meeting with Mr. Skanland, Governor of Norges Bank, and his colleagues, within the framework of the monetary cooperation that had been developing between the Committee and Norges Bank since 1984, primarily in the form of an annual meeting. The exchange of views had focused, on the one hand, on the economic and monetary situation in Norway and, on the other, on the main developments in the activities of the Committee during 1988. A brief resumé of this exchange of views would be circulated shortly to the members of the Committee.

VIII. Date and place of the next meeting

The next meeting would be held in Basle on Tuesday, 10th January 1989 at 9.30 a.m.

Committee of Governors of the Central Banks of the Member States of the European Economic Community Annex 13th December 1988 Confidential

BRIEF REPORT ON

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

NOVEMBER 1988

This report summarises developments on the exchange markets of the countries whose central banks participate in the concertation procedure¹ and briefly describes their interventions during November and the first few days of December 1988.

I. EXCHANGE RATE DEVELOPMENTS

The main feature of the foreign exchange markets in November was a further decline of the US dollar despite some central bank intervention support.

The <u>US dollar</u> moved lower on balance against all major currencies amid concerns about the prospects for continued reductions in the US budget and trade deficits. The dollar's decline was limited, however, by coordinated central bank intervention and expectations of a further rise in short-term dollar interest rates. The dollar closed the month approximately 1.75% lower against the Deutsche Mark, 2% lower against the yen and 3.5% lower against sterling.

The <u>EMS</u> was free of tensions. The only important change was a strengthening of the Italian lira by almost 1% in the second half of the month. The currencies within the narrow band did not change their relative positions.

1 The central banks of the EEC, Norway, Sweden, Finland, Switzerland, Austria, Japan, Canada and the United States. The <u>Deutsche Mark</u> was fairly stable. Vis-à-vis the US dollar it firmed by 1.8%. It weakened slightly against the currencies participating in the exchange rate mechanism. A sharper decline, of 1.9%, occurred vis-à-vis sterling. At the end of November the Deutsche Mark's weighted index vis-à-vis fourteen industrial countries stood at 170.4, only marginally below its end-October level of 170.6 (1972 = 100).

Against the background of rising interest rates abroad the <u>French</u> <u>franc</u>, on which interest rates remained stable, weakened only slightly vis-à-vis the group of currencies in the narrow band. The worsening of the trade balance in October (with a deficit of Fr.fr. 4 billion following a surplus of Fr.fr. 0.6 billion in September) and the spread of the labour disputes had only a limited impact on the franc's performance.

The Banque Nationale took advantage of the firmness of the <u>Belgian</u> <u>franc</u> to purchase foreign exchange and lower official rates, reducing the three-month Treasury bill rate twice by 0.05 percentage point to 7.15% and the discount and lombard rates by 0.25 percentage point to 7.25% and 7.50% respectively.

There was no change in the <u>Dutch guilder</u>'s position in the upper part of the EMS band.

The Danish krone remained just below the middle of the EMS band.

The <u>Irish pound</u> was relatively stable in the upper half of the EMS band. Small net inflows of currency over the month resulted in modest net purchases of currency by the Central Bank of Ireland.

The <u>Italian lira</u> strengthened in the EMS in the second half of the month due to continued short-term inflows. The Banca d'Italia conducted only limited intervention purchases to contain the monetary impact of such inflows.

<u>Sterling</u> was on the sidelines for much of November, trading narrowly but with a firm tone against the Deutsche Mark until the release of the October trade figures. The record £2.9 billion deficit caused sterling to fall briefly before the 1 percentage point increase in interest rates, to 13%, brought a sharp recovery. With the Chancellor also emphasising the importance of a firm pound as part of his counter-inflation policy, sterling ended the month at six-month highs. Sterling's trade-weighted index rose by 2.5% to 78.3 (1975 = 100).

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The <u>Greek drachma</u> appreciated by 0.7% against the US dollar and depreciated by 1.3% against the ECU. In effective terms the drachma depreciated by 1.3%.

Following the increase of 1/4 percentage point (to 11.75%) in the Banco de España's three-month repurchase agreement rate on 15th November, the <u>Spanish peseta</u> firmed during the second half of the month due to some capital inflows driven by the higher interest rates and the expectation of further rises. The peseta appreciated by 1.1% with respect to the ECU and by 3.2% with respect to the dollar.

Vis-à-vis the US dollar the <u>Portuguese escudo</u> rose by 1.8%. In effective terms the escudo decreased by 0.25%.

Vis-à-vis most currencies the <u>Swiss franc</u> firmed slightly. On an export-weighted basis the increase in value amounted to 0.6%. As against the US dollar, it strengthened by 2.3%. Euro-franc rates for maturities of up to three months rose markedly (by 3/4 to 1 1/4 percentage points) to just under 5%. The rise for longer maturities was less pronounced, thus leading to an inverse interest rate structure.

The <u>Austrian schilling</u> firmed by 1.7% vis-à-vis the US dollar, with a monthly spread of 4.1%. Against the Deutsche Mark it fluctuated by only 0.08%.

The <u>Norwegian krone</u> came, in the second week of the month, under strong selling pressure as rumours of a devaluation started to circulate in various foreign markets. Domestic interest rates increased sharply as heavy central bank interventions drained liquidity and market participants anticipated increases in signal interest rates. This market reaction helped to halt the outflow of foreign exchange and with higher oil prices resulting from the OPEC agreement, the krone started to firm as both foreign and domestic investors rebuilt their krone positions. Before the month ended, one third of the reserve reduction was restored through intervention purchases, interest rates declined and the effective exchange rate was only 0.3% weaker than when the month started.

The <u>Swedish krona</u> has been relatively stable with a tendency to strengthen towards the end of the period.

The <u>Finnish markka</u> firmed slightly in the course of the month. On 30th November the base interest rate was cut by 1/2 percentage point effective 1st January 1989. The fluctuation range of the currency index was widened from 4.5% to 6%.

The <u>Japanese yen</u> strengthened by 2.6% against the US dollar, reflecting the persistent bearish sentiment towards the US dollar. It reached its post-war high (on a Tokyo closing rate basis) of Yen 121.15 per US dollar on 24th and 25th November. The Bank of Japan intervened in the market in a concerted fashion throughout the month to counter the sharp appreciation of the currency. Meanwhile, the yen was unchanged against the ECU.

The <u>Canadian dollar</u> appreciated by 3.4% against the US dollar to close at US\$ 0.8432. The currency traded in a volatile way, falling to a two-month low of US\$ 0.8078 early in the month before moving sharply higher to close the month at a new seven-year high. Exchange rate weakness earlier in the month was linked to doubt about the passage of the free trade agreement with the United States given the uncertainty surrounding the outcome of the 21st November federal election. In the event, the re-election of the conservative party with a majority was interpreted positively by market participants since ratification of the US/Canada free trade agreement by the Canadian Parliament is assured.

II. INTERVENTIONS

A. Interventions in US dollars

Net purchases of US dollars by central banks in November amounted to US\$ 7.9 billion, compared with net purchases of US\$ 2.6 billion in October. The purchases, which were partly made as concerted operations, were undertaken by a large number of central banks; the Bank of Japan, the Federal Reserve Bank of New York, the Bank of Canada, Norges Bank and the Banca d'Italia being the major purchasers. The major sellers of US dollars were Norges Bank and the Bank of Canada.

B. Interventions in Community currencies and in private ECUs

Interventions in EMS currencies by Community central banks amounted in November to the equivalent of US\$ 1.3 billion, compared with the equivalent of US\$ 2.3 billion in October. The Banca d'Italia purchased Deutsche Mark and French francs.

Among non-Community central banks, Norges Bank was a major seller of Deutsche Mark.

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III. DEVELOPMENTS IN THE CURRENT MONTH, UP TO 9th DECEMBER

The US dollar continued to fluctuate, influenced, inter alia, positively by expectations concerning reductions in military expenditure.

EVOLUTION DE L'ECU, DU COURS MEDIAN DES MONNAIES PARTICIPANT AU MECANISME DE CHANGE DU SME ET DES MONNAIES DES BANQUES CENTRALES DE LA CEE NE PARTICIPANT PAS A CE MECANISME, SUR LA BASE DES COURS RELEVES LE 31 DECEMBRE 1986 VIS-A-VIS DU \$EU*



* Voir page suivante.



EVOLUTION DES MONNAIES DES BANQUES CENTRALES HORS CEE PARTICIPANT A LA CONCERTATION, SUR LA BASE DES COURS RELEVES LE 31 DECEMBRE 1986 VIS-A-VIS DU \$EU*

* ECU 0,93425; \neq 0,6773; DR 138,7601; PTA 131,8700; ESC 146,0995; FIM 4,7925; \$Can 1,3805; FS 1,6215; Yen 159,7993; KRS 6,7750; KRN 7,3975; Sch 13,6520; cours médian des monnaies participant au SME 0,92913. Le cours médian des monnaies participant au SME représente la moyenne journalière des cours des deux monnaies à marge de fluctuation de 2.25 qui construction de la cluste de la cours de la cluste de fluctuation de 2,25% qui se sont éloignés le plus de leurs cours-pivots bilatéraux actuels.



MOUVEMENTS A L'INTERIEUR DE LA GRILLE DE PARITES DU SME CALCULES SUR LA BASE DES COURS DE L'ECU DANS LES DIFFERENTES MONNAIES PARTICIPANTES



* L'indicateur de divergence a pour but de mesurer, sur une base comparable pour toutes les monnaies participant au mécanisme de change européen, la position d'une monnaie vis-à-vis de son cours-pivot ECU. L'écart maximal de divergence est le pourcentage maximal par lequel le cours de marché de l'ECU dans chaque monnaie peut s'apprécier ou se déprécier par rapport à son cours-pivot ECU; il est exprimé par +/-100, le seuil de divergence étant +/-75. Les données qui ont servi de base à l'établissement de ce graphique sont les cours de 'ECU exprimés en termes de diverses monnaies, cours qui sont toutefois corrigés des effets des fluctuations de la lire italienne, de la livre sterling et de la drachme grecque au-delà de la marge de 2,25% vis-à-vis des autres monnaies participant au SME.

8.12.1988

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EVOLUTION DE LA LIVRE STERLING, DE LA DRACHME, DE LA PESETA ET DE L'ESCUDO PAR PAPPORT A L'ECU SUR LA BASE DES COURS DU MARCHE RELEVES LE 31 DECEMBRE 1986*

8.12.1988



EVOLUTION DES MONNAIES DES BANQUES HORS CEE PARTICIPANT A LA CONCERTATION PAR RAPPORT A L'ECU SUR LA BASE DES COURS DU MARCHE RELEVES LE 31 DECEMBRE 1986*

* \$EU 1,07038; \$Can 1,47766; FS 1,73562; Yen 171,046; KRS 7,25181; KRN 7,91812; Sch 14,6128; FIM 5,12978.