17th June 1991

Confidential

Final

MINUTES

OF THE 255th MEETING OF THE COMMITTEE OF GOVERNORS OF THE CENTRAL BANKS OF THE MEMBER STATES OF THE EUROPEAN ECONOMIC COMMUNITY

HELD IN BASLE ON TUESDAY, 14th MAY 1991 AT 9.30 a.m.

Table of contents

I. Approval of the minutes of the 254th meeting

The Committee approved the minutes of the 254th meeting on the understanding that the 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, Chairman, Foreign Exchange Policy Sub-Committee (Monitoring)

The US dollar had been rather volatile in April; at month-end it had reached its highest level against the Deutsche Mark for eighteen months. This rise had occurred despite the lack of clear statistical data to support any evidence of an upturn in the US economy. It had been partly attributed to expectations of concerted interest rate movements following the meeting of the Group of Seven in late April. Following the lowering of the Federal Reserve's discount rate on 30th April 1991 the dollar had weakened, although its current level against the Deutsche Mark was 20% above its low level in February 1991. However, the market had changed its perception and now considered that the Federal Reserve was concerned more with the low level of real growth than with inflation. In late April the Deutsche Bundesbank had intervened to stop the rise of the dollar but the effect had been limited, as had been the intervention amounts. The dollar had not moved significantly against the Japanese yen during the period under review.

Domestic demand in Germany had continued to expand strongly and inflation had remained low, but the high wage increases recently agreed, the rise in taxes and the weakening of the Deutsche Mark might put some pressure on prices. There had been tentative signs that the economic situation in the eastern Länder was gradually improving.

In the ERM tensions between the peseta and the French franc had continued; the fundamental causes had remained the same and there had been considerable interventions at the limits. However, the strong foreign demand for Spanish government bonds might be waning. The market had appeared to disregard the exchange rate risk for the peseta, which could fall by 10% within its ERM band. The bilateral financing arrangements between the Banco de España and the Banque de France had meant that interventions had not been fully reflected in changes in the official gross reserves of the Banque de France and the market had, therefore, not been fully aware of their magnitude. The Italian lira remained the strongest currency of the narrow band. With effect from 14th May 1991 the Banca d'Italia had lowered the discount rate by 1 percentage point (to 11.5%), partly as a consequence of action taken by the Italian Government to reduce the budget deficit for the current fiscal year.

2. Statement by Mr. Rey, Chairman, Committee of Alternates

The Alternates had welcomed the further relaxation of exchange controls in Greece and Spain.

In the ERM, tensions between the French franc and the peseta had lessened somewhat since early May. In Spain the situation had improved; if the April indicators confirmed the continued slowdown in economic activity it would restore monetary policy's room for manoeuvre. In France, economic activity had been sluggish thereby justifying somewhat lower interest rates, but the scope for such reductions remained limited.

The decline in Italian official interest rates had represented an adjustment to the fall in market rates and should not be interpreted as a relaxation of monetary policy. The decision had been taken in the light of the position of the lira in the ERM, the slowdown in economic activity and the measures adopted to reduce the budget deficit. The Italian Government's decision had been welcomed, as had been the intention to pursue the adjustment policy in a more structured manner.

In Germany there had been more positive signals from the eastern Länder and the German Alternate had expressed the hope that the downturn might have bottomed out. The need to arrest any possible cost-price spiral as a result of recent wage and tax increases and a weaker Deutsche Mark meant that a relaxation of monetary policy would be ruled out for the time being.

With regard to the US dollar, it had remained difficult to offer an agreed assessment of its appropriate level, as well as of the prospects for its immediate future. The recent note by the Economic Unit had been welcomed as a useful initiative, although some Alternates had questioned its conclusions. It had been argued by some that the dollar's present level remained a matter for concern, especially with regard to its bilateral relationship with other major currencies. The cyclical situation and the imbalance in the US balance of payments had also to be taken into consideration. Some Alternates, however, had not shared this concern and had felt that with the dollar at its present level US exports remained competitive.

3. Discussion by the Committee

Mr. Rubio briefly described the situation with regard to monetary policy in Spain. He mentioned in particular that monetary aggregates had been slowing; inflation had also been declining but not as rapidly as had been anticipated. Furthermore, he said that the Banco de España would take every opportunity to reduce tensions within the ERM, although such action should not give rise to additional inflationary pressures.

Mr. Ciampi said that the intention to lower interest rates in Italy had been confidentially announced to the Governors during the meeting in Luxembourg and that it was appropriate to reinforce co-ordination. The move had mirrored market developments and it had been taken in a background of a weak performance of the Italian economy, the deceleration of monetary aggregates, and the strong position of the lira in the EMS, although inflation remained a source of concern. He described the events leading to the Italian Government's action to implement measures to bring the budget deficit for the current fiscal year back to target, which effectively meant a saving of 1% of GNP within the next seven months. These measures, however, would not solve the structural problems associated with the public finance. He outlined the proposed reforms to the pension system, and described the plans for the privatisation programme and the measures to be adopted concerning Government accounts and balance sheets. Mr. Ciampi mentioned that a law would be introduced which would impose restrictions on the ability of Parliament to amend the Government's budget proposals.

In the context of the arrangements between the Banco de España and the Banque de France, Mr. Duisenberg questioned the purpose of keeping secret the size of the interventions. In the Netherlands the public would have known within a week of the nature of the interventions and he felt that this stimulated confidence and helped stabilise the market. He suggested that a common approach should be adopted in this respect.

Mr. de Larosière said that in accordance with the bilateral arrangement between the Banque de France and the Banco de España, the greater part of the interventions resulted in an increase in the Banco de España's reserve holdings of French francs; the remainder was covered by bilateral credit but the resulting increase in the Banque de France's liabilities could not easily be associated with exchange market interventions. Given the circumstances, this had been a practical arrangement, rather than a conscious attempt to conceal the transaction from the public; greater signalling might have had a negative impact.

In response to a question from the Chairman, Mr. Rubio said that the Banco de España had taken measures to stem any inflationary repercussions as a result of the increase in liquidity following the rise in reserves.

The Chairman thanked the Economic Unit for its highly regarded note on the US dollar. Mr. Rubio and Mr. de Larosière echoed this view.

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 April and the first few days of May

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

IV. Economic and Monetary Union

1. Follow-up to the recent IGC meetings

(a) Statement by Mr. Christophersen, Vice-President, European Commission

A number of issues raised in the informal ECOFIN meeting in Luxembourg would need further careful examination; two of them should be included in the Conclusions of the Presidency of the forthcoming European Council meeting in order to signal the progress which had been made since the European Council meeting of October 1990.

With regard to the conditions for moving from Stage I to Stage II, the Commission believed that the convergence programmes could be the key to the compromise needed. While all Member States should be obliged to undertake an appraisal of their economic situation and medium-term strategy, it was clear that the achievement of greater convergence would require more efforts in some Community countries than in others. The

Commission intended to discuss the issue with some of the countries concerned. The programmes should be submitted to ECOFIN as soon as possible so that by the end of the EMU Treaty negotiations there would be firm commitments in the area of convergence on the part of the Member States.

With respect to the attitude of the Government of the United Kingdom, the Commission had felt that the formula presented by President Delors, which offered the possibility to opt-out but without a veto, had provided a basis for discussion.

There had also been an exchange of views at the informal ECOFIN meeting on the Danish proposal to narrow the ERM margin to 1.5% at the start of Stage II.

The Personal Representatives would shortly deal with a number of issues which were of specific interest to the Governors, for example, the transfer of official foreign reserves and the financial provisions of the ESCB. They would also prepare the discussion of the IGC meeting at ministerial level on 10th and 11th June 1991 on the issue of cohesion. It would be important to draw a distinction between the different types of resource transfers available within the Community. The long-term objective, which would be to help the less developed regions catch up with the developed regions, was not related to EMU. Indeed, EMU was not expected to make this task more difficult; it should rather facilitate it. Thus, the long-term cohesion objective would have to be dealt with in the IGC on Political Union. A second short-term objective would be to strengthen the economic policy adjustment needed to move quickly to Stage III, which would have to be considered by the IGC on EMU.

At the ECOFIN meeting on 10th June 1991, there would be a discussion on the convergence issue in the framework of multilateral surveillance. The Commission intended to present a paper taking stock of the state of convergence.

It was thought that the Luxembourg Presidency would present as many compromise legal texts as possible at the end of June. The open questions would have to be handed over to the Dutch Presidency. The work programme for the second half of 1991 had not yet been adopted but the IGC was still expected to conclude in November or December of this year so that the new Treaty could be signed before the end of 1991.

(b) Statement by Mr. Rey, Chairman, Committee of Alternates

The Alternates had considered the follow-up to the recent ECOFIN Council meeting and to the discussions of the Personal Representatives on the draft Statute.

With regard to the ECOFIN Council meeting, two issues had been considered. Firstly, the Italian Alternate had expressed strong concern about the declaration made by the Chairman of the Monetary Committee on the adoption of "crash programmes" in three countries; this issue had not been discussed in the Monetary Committee.

Secondly, the Alternates had noted that the Danish proposal to narrow the ERM fluctuation margin from 2.25% to 1.5% at the start of Stage II called for an opinion from the Committee of Governors. While the opinion of the Alternates had been divided on the wisdom of this proposal, it had been suggested that the Foreign Exchange Policy Sub-Committee should study the possibilities and implications of such a move and report to the Governors in time for the July meeting.

Concerning the IGC and in particular the review of the draft Statute of the ESCB by the Personal Representatives, the Alternates had decided to explore two aspects in further detail:

- the monetary financing of the public sector in order to clarify whether the wording of Article 21.1 corresponds to its aim, and
- the size of the capital of the ECB and the transfer of foreign exchange reserves,

and to report back, probably in July, to the Committee of Governors.

The question had also been raised as to whether and at what point the Committee of Governors should react to proposed amendments to the draft Statute by the Personal Representatives. While it had not been considered advisable to react to all proposed amendments, the Committee should pay attention to the need to maintain the Statute's overall consistency and signal its views in case of substantial deviations. With regard to the timing of a possible action by the Committee of Governors, it had been felt that premature reaction could be counterproductive. At present, the right moment had probably not yet come but it had also been recognised that the transition between too early and too late was likely to be very short. With regard to Chapter IX (Transitional Provisions), the Alternates considered that there had still been no firm political guidance with respect to their drafting, but that lines should be kept open between the central banks in case the situation changed and an (immediate) response were warranted.

(c) Discussion by the Committee

Mr. Jaans said that besides the two issues mentioned by Mr. Christophersen, the Conclusions of the Presidency of the forthcoming European Council meeting might also comprise the idea of a gradual phasing-in of EMU over a period of time, with a core group of countries making an early move to EMU and others joining as and when appropriate. Even if this issue was not spelled out so clearly in Luxembourg, the idea had appeared not to raise major discomfort among the participants of the informal ECOFIN meeting.

Mr. Ciampi supported the views expressed by Mr. Christophersen. He said that convergence monitoring should be applied to all countries. While some stimulus at Community level was desirable to enhance efforts in Community countries to achieve greater convergence, it was at the same time necessary to be cautious since inappropriate pressure could be counterproductive.

Mr. Leigh-Pemberton said that he had been aware that in some instances the Personal Representatives had taken an alternative approach to the position (unanimously) adopted by the Committee, for example concerning prudential supervision. In such circumstances he asked when it would be opportune for the Committee to respond to the Representatives.

Mr. de Larosière said he concurred with the views of Mr. Leigh-Pemberton. The Committee had produced a Statute which had been based on a consistent concept. At an appropriate juncture, and in instances where a major amendment had been suggested and in matters where the Governors were the competent body, the Committee should react.

Mr. Duisenberg said that he strongly supported the views of Mr. Leigh-Pemberton. As soon as the Personal Representatives had finalised their review of the draft Statute the Committee should consider responding to the amendments where they ran counter to the rationale of the Statute. Mr. Rubio supported this view.

Mr. Christophersen acknowledged that the issue of banking supervision raised a whole series of legal issues, especially if the Commission would be required to cede part of its responsibilities to the ESCB. This was not a major problem and could be resolved in a pragmatic manner.

Mr. Doyle said that the Committee should exercise care; the final decision rested with the Ministers, who were already fully aware that the Statute represented a consensus of the Committee following detailed discussion and analysis.

Mr. Ciampi said that the Committee should defend its position. Observations should be made at the appropriate moment in order to achieve the maximum effect. While he recognised that the final decision rested with political authorities, two types of action could be envisaged. The first would be a response by the Committee of Governors which should, however, await the finalisation of the Personal Representatives' work. The second action would consist of the individual central bank Governors defending the consistency of the Statute at national level by drawing the attention of their respective Ministers to those parts which were likely to be amended by the Personal Representatives. This might avoid a situation where the Committee of Governors would be in formal opposition to the IGC. He asked the Secretary General to keep the Committee fully appraised of developments.

Mr. Jaans endorsed the views of Mr. Ciampi and said that he would not wish to see the Committee in direct opposition to the IGC. However, in accordance with Article 102a, the Committee of Governors had to be formally consulted on all institutional changes in the monetary field.

Mr. Duisenberg drew the attention of the Committee of Governors to the fact that at the request of the French delegate the Monetary Committee had been asked by the Personal Representatives to examine the compatibility of monetary and supervisory functions.

Mr. Leigh-Pemberton agreed that any intervention by the Governors should be carefully timed; however, there might come a point when the collective strength of the Committee should be used to exert leverage.

The Secretary General said that it would be a little premature for the Committee to react at this juncture; the Committee should first have sight of the Presidency's considered reactions to the draft Statute before considering a response. At this juncture, the number of agreed changes had been relatively small; other amendments had not been agreed unanimously amongst the Representatives and would be reflected in the form of alternative articles or brackets in the Presidency's non-paper on the Statute.

The Chairman said that the Treaty would be agreed to by Governments and approved by national Parliaments. If the character of the Committee's proposal were materially changed then the Governors should point out where they differed from the Committee's submission. The Committee should mark time and see whether the proposals materially changed the Statute. Comments should initially be undertaken at national level and if the situation warranted it, a response from the Committee of Governors could be prepared. A dispute between the Personal Representatives and the Committee should be avoided; the Personal Representatives acted upon instruction from their Ministers and were not the appropriate counterpart of the Committee of Governors.

2. The role of bank notes in EMU: President Duisenberg's letter to the Chairman dated 18th April 1991

Mr. Duisenberg explained the rationale behind his proposal to establish a special working group dealing with the role of bank notes in EMU.

Mr. de Larosière said that he fully supported such an initiative and suggested that the cashiers should also be involved in the discussions.

Mr. Leigh-Pemberton asked whether the Bank-note Printers Conference could establish a special sub-group, comprising only representatives of EC Member States, which would deal specifically with this issue.

Mr. Ciampi said that he also supported the initiative since the gestation period for the production of a bank-note was considerable. He felt that the Bank-note Conference would not be the most appropriate forum to establish such a working party, however, and he favoured establishing a sub-group of the Committee of Governors.

Upon a proposal from the Chairman, the Committee agreed that an ad hoc meeting of experts under the chairmanship of Mr. Van Droogenbroeck of the Banque Nationale de Belgique should be convened to hold an exploratory exchange of views on the question of bank-notes in an EMU; their conclusions should be forwarded to the Committee in due course which would then decide on the necessity of establishing a Working Group.

3. Proposals for studying the technical aspects of monetary policy: Governor Rubio's letter to the Chairman, dated 22nd April 1991

Mr. Rubio said that his aim had been to increase the co-ordination of monetary policies and progressively develop a greater understanding and a common approach. The Economic Unit should therefore continue to prepare issue papers for the attention of the Committee of Governors. In addition, there were some long-term problems such as the harmonisation of the accounting rules or monetary policy instruments. A suggested way forward would be for such work to be undertaken by individual central banks and submitted to the Committee for consideration.

The Secretary General said that given the present set-up of the Secretariat there was neither the spare capacity nor the range of skills to undertake research into such topics as the harmonisation of central banks' accounting practices and balance sheets. Furthermore, work would soon have to start on preparing the annual report and this would severely limit the Economic Unit's ability to undertake new work.

Mr. Duisenberg welcomed Mr. Rubio's initiative, and supported the idea of studying accounting and balance-sheet harmonisation. He also supported Mr. Rubio's intention to ask individual central banks to prepare such studies on an ad hoc basis rather than to establish additional sub-committees or working groups. This view was shared by Mr. Leigh-Pemberton.

The Chairman said that this was a complicated issue which would require further examination; it was agreed that the Alternates would consider the matter in greater detail and report to the Committee at the meeting in July 1991.

V. Common framework for the monitoring of monetary policies

1. The first ex post exercise

(a) Statement by Mr. Raymond, Chairman, Monetary Policy Sub-Committee

The first ex post surveillance exercise had followed up the ex ante co-ordination exercise carried out in autumn 1990. In the intervening period some trends had become clearer and Community countries had increasingly found themselves in cyclically rather divergent positions.

Mr. Raymond reviewed the major developments since the ex ante report, which included: the Gulf war, which, in the end, had not fundamentally changed the underlying trends of the world economy; the greater-than-expected deceleration of growth in many countries; the volatility of the dollar; the growing budget deficit in Germany and, more generally, less fiscal adjustment in the countries (other than Greece) where it was particularly needed. As a result of these developments the policy mix in the Community had not improved as much as had been anticipated, and inflation was decelerating only slowly. The monetary stance which had been recommended in the autumn remained appropriate. However, convergence, except in the case of current accounts, would be less than expected.

From this analysis the Sub-Committee had drawn the following conclusions:

- neither the recent depreciation of European currencies nor the greater-than-expected economic slowdown justified a general response in the level of interest rates;
- interest rate reductions could be envisaged in only a few countries, provided their exchange rate constraints permitted it;
- only slow progress was being made with regard to price performance and it was not realistic to expect convergence on a low rate of inflation in the Community in the next few years. In the medium term this might give rise to tensions in the ERM.

(b) Statement by Mr. Rey, Chairman, Committee of Alternates

The Alternates had taken note of the report by the Sub-Committee, but owing to the pressure of other business there had not been enough time for a detailed discussion of its contents. The Alternates had taken note of the report, which underlined the changes in the environment of monetary policies and believed that it would be difficult to achieve price convergence in the next two or three years. However, given the importance attached by the Committee of Governors to the ex post exercise, and since the report raised important policy issues, the Governors might nonetheless wish to discuss it.

(c) Discussion by the Committee

The Chairman congratulated Mr. Raymond and the Sub-Committee on an excellent report.

Mr. Tavares Moreira stressed that the issue should not be addressed exclusively in terms of nominal convergence; real convergence would also be an important consideration. This applied especially to Portugal. He then described the progress which Portugal had made in the five years since joining the Community. In particular, inflation had been reduced from 20% to between 11% and 12%, although the Portuguese authorities recognised that this progress was not sufficient and further efforts were needed. The anti-inflation policy had been strengthened since the middle of last year. Both monetary and exchange rate policies were tightened and in the fiscal field a medium-term adjustment programme was adopted. After a peak of 14.4% in October 1990, the annual inflation rate had fallen in each of the last six months to 11.8% in April 1991 and he hoped it would be brought below 10% by the end of 1991. This would imply a 4-5 percentage point reduction over the year.

Mr. Chalikias said that the prospects for convergence in Greece had been improving since the implementation of the three-year adjustment programme. He reviewed the latest data, which showed that money and credit expansion had been slowing, although there had been some uncertainty about the magnitude of the reduction in the deficit. The Greek authorities intended to keep monetary policy tight. All long-term capital controls on the transactions of Greek residents within the Community had recently been lifted, as had the allowances for Greek residents travelling within the EC. The measures should have no adverse effect on the balance of payments as the three-year adjustment programme had been implemented and confidence had been strengthened.

2. Proposals for harmonising broad monetary aggregates

(a) Statement by Mr. Rey, Chairman, Committee of Alternates

The Alternates had noted that the proposals for harmonisation:

- followed the pragmatic approach endorsed by the Committee of Governors in January 1991;
- had been addressed to each central bank with due regard for differences in financial structures;
- had been made on the basis of a commonly applied method and were aimed at preserving the link between monetary aggregates and the final goals of monetary policy.

The Alternates had recommended that the Monetary Policy Sub-Committee should comment on the possibility of implementing the proposed changes, taking due account of the progress made in the work completed by the Economic Unit in close consultation with experts from the national central banks.

3. Discussion by the Committee

The Committee endorsed the recommendation of the Alternates; it asked the Monetary Policy Sub-Committee to examine the possibility of implementing the proposals made by the Economic Unit and to report back to the Committee of Governors at its July meeting.

VI. Other matters falling within the competence of the Committee

1. The appointment of new Chairmen of the Monetary Policy and Foreign Exchange Policy Sub-Committees

Upon a proposal by the Chairman, the Committee appointed Mr. Borges of the Banco de Portugal as Chairman of the Monetary Policy Sub-Committee and Mr. Saccomanni of the Banca d'Italia as Chairman of the Foreign Exchange Policy Sub-Committee, for a period of three years with effect from September 1991.

2. Ad hoc working group on EC payment systems: additional staff for the EC Secretariat

The Committee endorsed the proposals contained in Mr. Padoa-Schioppa's letter to the Chairman dated 10th May 1991. It was agreed that Mr. Santema and Mr. Godeffroy would join the EC Secretariat in July 1991 for the period to end-March 1992, when the working group's report would be finalised and submitted to the Committee of Governors. It was noted that an additional secretary (typist) would also be required and that the Secretary General would make the necessary arrangements in this respect.

3. Financial Matters

Mr. Hoffmeyer said the Committee on Financial Matters had agreed to monitor the expenses of the Committee of Governors on a quarterly basis; the statistics prepared by the Secretariat on the first quarter of 1991 suggested that expenses had been within projections. The Committee on Financial Matters had also requested the Secretariat to draw up an estimate of the costs of the temporary ad hoc working group; according to this estimate, the costs were in the region of Sw.fr. 650,000 on an annual basis. If the working group were to complete its task by end-March 1992, actual expenses would be approximately Sw. fr. 500,000. With regard to the future, the Committee on Financial Matters had suggested that wherever it was proposed to establish a working group such requests should be accompanied by an estimate of projected costs. Costs associated with the various sub-committees should also be monitored. As the current workload of the Secretariat meant that its capacity was fully utilised, the creation of new sub-groups would have consequences for the expenses of the Secretariat.

The Committee endorsed the proposals of the Committee on Financial Matters.

Mr. Doyle asked the Secretary General to provide the Committee on Financial Matters with an estimate of the costs on an annual basis of the smallest working group using the services of a single member of the Secretariat together with normal back-up facilities; likewise, the cost of the most expensive sub-group should be calculated. The purpose would be to provide the Governors with a yardstick enabling them to measure and compare costs when establishing new sub-groups.

VII. Date and place of next meeting

The next meeting of the Committee of Governors would take place in Basle on Monday, 10th June 1991 at 9.30 am.

255th MEETING OF THE COMMITTEE OF GOVERNORS

14th MAY 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 Mr. Boot
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. Christophersen Mr. Pons
Chairman of the Monetary Policy Sub-Committee	Mr. Raymond
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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* Chairman, Committee of Alternates