11th February 1992

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Final

MINUTES

OF THE 262nd 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 JANUARY 1992 AT 10.20 a.m.

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The Chairman opened the meeting by saying that, at a restricted session of the Committee of Governors, it had been agreed that Mr. Rey should be asked to continue as Chairman of the Committee of Alternates until the end of 1992. Mr. Rey had also been asked to identify those issues for which preparation would be required in the run-up to Stages Two and Three of EMU and to prepare a paper defining the tasks of the Committee of Governors in this connection and the way in which the work should be organised. This would be considered at the next meeting of the Committee. The Committee had also determined that it was within its field of competence to consider and make proposals on those issues which had to be decided before the EMI came into being. This position would be reported to ECOFIN, and to journalists if questions arose.

I. Approval of the minutes of the 261st meeting

The Committee approved the minutes of the 261st meeting.

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

- Preparation by the Foreign Exchange Policy Sub-Committee (Monitoring):
- Statistical charts and tables prepared by the Secretariat

1. Statement by Mr. Saccomanni, Chairman, Foreign Exchange Policy Sub-Committee (Monitoring)

The Monitoring Group had concentrated its attention on three main issues. Firstly, the tensions that had appeared in the run-up to the Maastricht Summit, and ahead of the meeting of the Deutsche Bundesbank's Central Bank Council on 19th December 1991, had almost completely disappeared. In January 1992 exchange market interventions had virtually ceased and short-term interest rates had declined in most EC countries from the high levels reached at the end of 1991. Furthermore, the width of the narrow band had been reduced to about 2% following a period in which it had been extended to the maximum permissible limit, with interventions being required at the margin. In the wide band, the spread between the Spanish peseta and the pound sterling had remained close to 6%; however, the situation had been kept under control with only modest interventions.

Nevertheless, a degree of caution was still required for the following reasons. The US dollar remained volatile; it had recently risen sharply following a period of pronounced weakness. This turnaround, however, did not appear to be related to fundamentals, but largely reflected market expectations of possible G7 action in support of the currency. Thus, a further downward trend of the US dollar could not be precluded. In addition, Germany had recorded a trade surplus in November 1991, reflecting the gradual disappearance of the demand-pull effect of German unification. This development might well lead to a strengthening of the Deutsche Mark in the period ahead. A third source of tension might be the relative weakness of the pound sterling following the United Kingdom's decision not to increase official rates after Germany's action; the market might continue to put pressure on the pound sterling, particularly if the US dollar weakened further. Despite these factors, a realignment was no longer regarded by the markets as likely in the foreseeable future.

The second issue discussed by the Monitoring Group related to the real economy in the Community, which had continued to show a pronounced slowdown in domestic demand, and to the measures of monetary restraint which might further weaken consumer confidence and depress investment. However, success in the fight against inflation should eventually lead to better growth prospects. Interest rates in bond markets had already declined significantly in most countries, particularly in Germany, where they were at their lowest level since the announcement of unification. The markets seemed to be convinced that interest rates had peaked almost everywhere in the Community, although the question remained whether the decline in interest rates was a sign of lower inflation ahead or presaged a more pronounced recession in the near future.

Thirdly, the Deutsche Bundesbank's recent monetary policy decisions had caught the markets by surprise since they had expected a smaller increase in the lombard rate. Given the high degree of convergence of interest rates among ERM countries, even a relatively small unexpected change in official rates in one country was likely to cause repercussions elsewhere, thereby creating tensions that would eventually require similar policy adjustments in others. Although an exchange of information had occurred prior to the decision by the Deutsche Bundesbank's Central Bank Council, this had not allowed meaningful consideration to be given jointly by the ERM countries of the likely effects of different policy options. The Group had felt that it should be possible to achieve this goal without jeopardising the autonomy of the decisions of national central banks.

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

Although the Alternates' discussion had been almost entirely devoted to the situation in the EMS, this did not imply that the more global development had been considered to be problem-free. On the contrary, the high degree of volatility in world financial markets had been viewed with concern, even if perceptions of exchange rate risks might at present help protect the US dollar against the full consequences of a widening interest rate differential vis-à-vis the Deutsche Mark. Dissatisfaction had also been expressed with regard to the still low level of the Japanese yen.

The Deutsche Bundesbank's decision to raise official rates by 50 basis points had been taken against the background of an overshooting of the monetary target, unsatisfactory price developments and the need to give a clear warning signal to the social partners in the current wage round. In contrast to some past episodes, it had not been possible to take a relaxed view of the behaviour of German M3 in the present environment, which had been marked by strong price pressures and a relative depreciation of the Deutsche Mark in real terms. With some reservations regarding the size of the increase in the lombard rate, the Alternates had generally acknowledged that the decision had not been unexpected and that it had helped to strengthen the credibility of the Deutsche Bundesbank's policy stance. It had been noted with satisfaction that the rise in short-term interest rates had since been partly reversed, while long-term rates had declined steadily in line with world interest rate developments.

Given the repercussions of the interest rate increases in other countries, the EC-wide implications of Germany's unbalanced policy mix had been discussed. Some Alternates had observed that the German decision had not been harmful to growth given the decline in long-term interest rates, whilst others had pointed to the danger that monetary policy might be held responsible for impairing growth prospects in the Community and risked losing public support as a result. Arguments had therefore been repeated in favour of a more restrictive stance in German fiscal policy as well as stronger Government influence in the wage formation process. It had been pointed out that the forthcoming surveillance exercises - by the Monetary Committee in January and by the ECOFIN in February - and the convergence programme which the German authorities planned to submit to the Commission would each provide an opportunity to assess German economic policies. However, in the absence of progress in other areas of economic policy, the German monetary authorities had little choice but to avoid ambiguity about their priorities and to exercise their responsibilities accordingly.

The Alternates had also taken note of the recent liberalisation of capital movements by the Spanish Government.

3. Discussion by the Committee

Mr. de Larosière agreed that tensions within the EMS had decreased although there remained risks at the global level, particularly with respect to the US dollar's volatility and its possible consequences for the functioning of the world financial system. However, the fight against inflation must continue, particularly in Germany, where tensions were becoming apparent and where the policy mix did not appear to be appropriate. Interest rates alone could not be used to signal the authorities' concern about inflationary tensions and should be not used as a substitute for other action, for example fiscal and public sector wage policies. Changes in interest rates by one country had an impact on its own economy and also on the economies of other countries. Furthermore, too much satisfaction should not be derived from the fact that long-term interest rates were falling; this was not only a reflection of the credibility of anti-inflationary monetary policies but also due to the influence of declining interest rates in other major markets outside the Community. In addition, prospects for economic activity were poor in many parts of the world owing to the high level of real interest rates.

Mr. Schlesinger said that Mr. Rey had given a very balanced assessment of the current situation. The Deutsche Bundesbank's action had been decided on following an in-depth discussion of the situation in Europe and the consequences of the measures to be taken. German M3 had increased during the previous three months at an annualised rate of 7.5%, compared with a target range of 3.5 - 5.5%. In addition, lending to the public and private sectors had risen by 11.5% and had seemed likely to increase further. The transformation of the former GDR's economy was not being financed by the new states, but by the banks and through financial subsidies provided by the German Government. However, while the public sector deficit had risen to DM 110 billion at the end of 1991, this was less than had been forecast earlier in the year. The net borrowing requirement would fall further in 1992, but probably only by a relatively modest amount. These special problems had resulted in the German inflation rate rising to 4%, with a wage round in prospect and a threatened strike in the German steel industry, whose union had rejected proposals for a 5.5% wage increase. A further consideration had been the Deutsche Mark's anchor role in the ERM. The increase in official interest rates had to be assessed in the light of several factors. Whilst the discount rate had been increased by half a percentage point, the rediscounting of bills by domestic non-banks had not become much more expensive since the exchange tax (formerly up to 0.6%) had been abolished simultaneously. Furthermore, money market rates had not risen fully in line with the increase in the lombard rate, whilst yields in the bond and securities markets had decreased across all maturities, as they had done when similar decisions had been taken in January and August 1991. Overall, the Deutsche Bundesbank's action had added to confidence as far as long-term developments were concerned. Finally, there had been intensive discussion in Germany concerning the outcome of the Maastricht Summit. However, it was incorrect to say that the Deutsche Bundesbank had been pushed into taking the measures as a result of the Summit, although such ideas had been suggested in the media. The German Government was now conducting a publicity campaign to try to counter the fears which had been triggered by tabloid headlines regarding the "death" of the Deutsche Mark. It was hoped that this would persuade the public to view recent developments in a more reasonable manner.

Mr. Ciampi said that economic conditions in Germany were very different from those in most other European countries and that this had been a cause of the disturbances in the European markets. Italy's initial reaction to the German interest rate increase had been not to follow suit, but it had done so after the sharp cut in US rates and the resultant increase in tensions in the ERM. Recent events had shown that the control of inflation and the preservation of the benefits which had been obtained by maintaining parities within the ERM were now being given top priority. Furthermore, the markets also expected an ever-greater degree of monetary convergence. Mr. Ciampi recalled that in April 1991 Mr. Rubio had written a letter to the then Chairman of the Committee of Governors, Mr. Pöhl, in which he had requested greater co-ordination between monetary policies and that in March 1990 the Council of Ministers had agreed to strengthen the co-ordination of monetary policies, emphasising the need for prior consultation. The current practice, with which the Deutsche Bundesbank had fully complied, was to inform other central banks before a policy decision was announced. However, it was now appropriate to review existing consultation procedures in order to avoid the impression that interest rate measures were taken without sufficient co-ordination. Although greater consultation would make the decision-making process more complicated, each central bank would remain free to take its own decisions and retain responsibility for its own monetary policy until the start of Stage Three of EMU. Mr. Ciampi suggested that the Chairman should organise a study of procedural proposals for consideration by the Committee.

Mr. Leigh-Pemberton said that the United Kingdom had not followed the December interest rate rises since to have done so would have been seen as a serious political failure for the UK Government. The forecasts which it had made last year about the length and depth of the recession had proved optimistic. In response to criticism, the Government had reiterated its commitment to the ERM and to its continued counter-inflationary stance which, in the end, should produce a lasting recovery. A rise had also not been necessary from the point of view of the United Kingdom's domestic monetary and economic situation since the inflationary trend was downward, monetary conditions were tight and the real economy was sluggish. The pound sterling was also affected, rather more than other European currencies, by the vagaries of the US dollar. Furthermore, the weakness of the currency had largely come from selling pressures in New York, where there had been a particularly strong expectations that the United Kingdom might devalue or even leave the ERM. The UK Government had made it clear that it would raise interest rates if necessary rather than devalue or seek a realignment. Little intervention had, however, been required, despite the currency's position near the bottom of the wide ERM band. The policy of intervening as necessary and avoiding an interest rate rise would continue.

Mr. Rubio said that in Spain the complete liberalisation of all capital movements had been achieved, with the exception of the export of bank-notes in excess of Pts. 5 million and the issuance of securities in Spain by non-residents.

III. Adoption of the Committee's report to the EEC Ministers of Finance on developments on the foreign exchange markets of the nineteen countries participating in the concertation procedure during December 1991 and the first few days of January 1992

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

IV. Follow-up to the decisions taken in Maastricht

- Note by the Secretariat entitled "Preparatory work for Stage Two of EMU".

1. Statement by Mr. Christophersen, Vice-President of the European Commission

Mr. Christophersen thanked the Committee for its valuable contribution to the Maastricht Summit. The Commission was now compiling a list of measures which needed to be approved in order that the Maastricht decisions could be implemented. With regard to the EMI, the Commission wished the Committee of Governors to prepare the groundwork for its creation. It was hoped that much of the preparatory work could be done this year, although the Treaty provisions were unlikely to be ratified before the end of 1992 given that some Member States had rather lengthy ratification procedures, notably Italy, which was also due to hold elections. The matter of the seat of the EMI was linked to other institutional questions, although it was the intention of the Portuguese Prime Minister to raise this issue at the Lisbon Summit. With regard to languages, the EMI would be seen as a Community institution and thus all nine Community languages should be used to a certain extent; the European Parliament and the Council of Ministers were likely to ask that annual reports and other public documents be produced in all languages. However, the EMI could apply the Commission's flexibility with regard to working languages. As far as the co-ordination of macro-economic policies was concerned, the Commission had already approved the Portuguese and Italian convergence programmes and, in the coming months, discussions would be held with the Irish, Greek and German authorities regarding their respective programmes. However, examination of the UK programme would be postponed until the beginning of 1993, i.e. after both the United Kingdom's elections and its Presidency of the European Council. An early decision on the UK's programme was not needed since its macro-economic indicators were not too far out of line with the criteria set out in the Treaty proposals. Finally, whilst the Treaty included a provision for a cohesion fund, this formally had nothing to do with EMU, although one of the conditions for the disbursement of credits from the fund would be the existence of reliable convergence programmes. Given this proposed linkage, some consultations between the Commission and the Committee of Governors might well take place and it was hoped that this would lead to discussions in the ECOFIN Council in this regard.

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

The Alternates' discussion had focused on two major issues: the interpretation of Article 109 K, paragraph 4, which dealt with the irrevocable fixing of exchange rates and the eventual introduction of the ECU as the single currency of the Community; and the work programme to be established with a view to preparing the subsequent stages of EMU.

With regard to the former, the present text had given rise to three questions. Firstly, did the provision permit a final realignment in the period between the time when the decision on participation in Stage Three was taken and the moment parities became irrevocably fixed? In the opinion of the Alternates, the Treaty would permit this, although most of them pointed out that it would not be consistent with the achievement of a high degree of convergence or with the spirit of the Treaty. A related question was whether the irrevocable fixing of exchange rates could itself entail marginal changes for the purpose of rounding. Secondly, when would the ECU become the single currency of the Community? There had been broad agreement that the Treaty did not require the ECU's immediate introduction as the single currency. It had stated only that this would have to occur "rapidly" and that the measures to be taken by the Council - at some later date - would be essentially of a practical nature, e.g. relating to the exchange of bank-notes and conversion of balance sheets.

The third question concerned the interpretation of the wording "the ECU will become a currency in its own right" at the time of the irrevocable fixing of exchange rates. Against the background of the IGC discussions, this reflected the intention that, from the start of Stage Three, the ECU would no longer be defined as a basket; it would become an abstract monetary unit with its exchange rate irrevocably fixed vis-à-vis the currencies of the Member States participating in Stage Three. However, the Alternates had not reached a conclusion on the legal tender status of the ECU in the interim period before it became the Community's single currency. Would it imply that Community countries participating in Stage Three would be free to treat the ECU in accordance with existing national legislation, or would it imply equal treatment compared with national currencies?

With regard to the work programme, the Alternates had agreed that it would be unwise to seek an amendment of the text of Article 109 K, paragraph 4, with a view to clarifying the scope of this provision before the Treaty was signed on 8th February. However, it would be useful if, after consultation by each central bank with the Treasury negotiators of the Treaty, the Committee of Governors could reach an understanding on the interpretation of this paragraph so that a uniform explanation could be given to the national parliaments and to the public. The Alternates therefore proposed that the Foreign Exchange Policy Sub-Committee should be asked to study the issues relating to a last realignment and the constraints which might arise from the stipulation that this should not change the external value of the ECU. In addition, the Secretariat should be asked to reflect on the legal tender implications of the term "currency in its own right".

The Alternates would resume their discussion on the basis of that work and report their findings to the Committee.

3. Discussion by the Committee

Mr. Duisenberg said that he agreed with the proposed procedure.

Mr. Schlesinger also agreed and emphasised that the matter of interpretation was important since questions had been raised about the future relationship of creditors and debtors with regard to bonds issued in a Community country's national currency which would mature after the start of Stage Three, particularly in the light of the possibility of a last realignment. Using German unification and the time when the Saarland had joined Germany as examples of the determination of appropriate exchange rates to illustrate his point, he said that, when politicians were confronted with this problem, the tendency was to take political factors into consideration. Any room for manoeuvre in this regard should be minimised.

Mr. Christophersen pointed out that, if Member States wished to introduce a single currency at the beginning of Stage Three, provision for this had been made in the Treaty, although it was clear from studies undertaken by the Commission that it could easily take three to four years to make the necessary technical preparations.

Mr. Duisenberg said that he was alarmed by the prospect that all of the EMI's and ECB's public documents might have to appear in nine languages and asked whether this would be obligatory. He hoped that the ECB would be sufficiently autonomous to decide this for itself.

Mr. Christophersen replied that in his opinion the Member States would ask for it, not the Commission, which was flexible on this issue.

Mr. Rubio said that he understood the problems pointed out by Mr. Schlesinger. Nevertheless, he thought that the Committee of Governors was not authorised to deviate, in its own interpretation, from the terms agreed at the Maastricht Summit.

Mr. de Larosière said that, if all the criteria for convergence had been observed and if there had been no realignment during the previous two years, he could not see how a fundamental disequilibrium that would justify a realignment could occur at the time of entry into Stage Three. However, some marginal changes might be appropriate for the sake of arithmetical simplicity. Furthermore, when the parities of the currencies of participating countries were locked, the ECU would at that point become a currency in its own right and would lose its basket character. The ECU would not necessarily be the sole currency in circulation in Member States at that time, but its legal tender status should be uniform across Member States. Turning to Mr. Rubio's point, it was not for the Committee of Governors to redefine the decisions of the negotiators and legislators, although it was appropriate that the Committee should arrive at a common interpretation of the Treaty proposals. This would, of course, have to be done in liaison with the respective ministers, since they were the negotiators.

The Chairman said that if there was uncertainty over interpretation, convergence would be hindered. There would be suspicion in the markets which would be reflected in interest rate differentials.

Mr. Christophersen added that, in connection with the legislation on the Single Market which would come into force in 1993, once the Treaty provisions had been ratified an amendment would have to be made to the existing regulations to remove the provision concerning regular revision of the ECU basket. There would thus be a need for consultation between the Commission and Committee of Governors on this issue in due course.

Mr. de Larosière added that, while he agreed with the thrust of the Secretariat's paper, there were two issues to which he attached importance and which he would like to be included. Firstly, the question of ECU bank-notes: clearly, a great deal of preparatory work needed to be done in this field, in which, inherently, significant lead-times were common. This issue was particularly important for those EC central banks with printing facilities which wished to clarify the position as regards future work programmes. He therefore recommended that, after consideration of the Alternates' paper, the Committee of Governors should ask the Group of Experts on Bank-note Printing and Issuing, which had met in September 1991, to reconvene to consider the various issues and report back before the end of 1992. The second issue concerned payment systems, on which work was currently in progress. This matter, which was important for the efficiency of the functioning of the banking system, should also be brought within the ambit of the Alternates' work.

The Committee agreed that the Alternates' studies should include the two issues raised by Mr. de Larosière.

V. Other matters falling within the competence of the Committee

1. Exchange of staff among EC central banks

Mr. Duisenberg said that, given the increasing co-ordination of monetary policy and greater co-operation in a range of areas that Stages Two and Three would necessitate, the staff of EC central banks would need to work increasingly closely with each other. To enable them to familiarise themselves with the working methods (and possibly even languages) of other EC central banks, consideration should be given to the possibility of exchanging personnel. The Commission had recently proposed an exchange programme for national civil servants. The Nederlandsche Bank was preparing a memorandum on an exchange-and-visits programme which would be sent to Mr. Baer with the request that it be discussed by the Alternates and, ultimately, by the Committee of Governors.

Mr. de Larosière said that he fully supported this initiative.

2. Annual Report of the Committee of Governors

Mr. Rey said that the Alternates had discussed the first draft of the Annual Report as well as the procedure for editing it. It was important that the Report should be published as soon as possible before it became out of date. The Alternates therefore proposed that a revised draft should be submitted to the various central banks by the end of January, with an invitation to submit comments in writing. An editorial committee, comprising the second Alternates, should then convene to prepare a final draft, which would be submitted to the Alternates and the Governors for their approval at their meetings in March. The Alternates would consider various technical issues concerning the publication of the Report at their February meeting. The question of languages had also been raised in this connection. Since the Report would be sent, inter alia, to the European Parliament, it was likely that it would need be made available in the nine Community languages. Although only the English version would need to be ready by March, arrangements would have to be made for it to be translated, possibly with the assistance of the various central banks.

3. Approach from the staff unions

Following an approach made to him by the Danish representative on the Standing Committee of the European Central Bank's Staff Unions, the Chairman reported that he was willing to have an exploratory meeting with Mr. van der Schelde, the Chairman of the Standing Committee, to find out what kind of questions the latter wished to raise with him; he would then report back to the Committee of Governors.

Mr. Duisenberg said that he and others who had held the chairmanship of the Committee had had similar contacts with the staff unions, which, in his recollection, had been useful. He sought, and received, the Chairman's confirmation that it was not the intention that the exploratory meeting should be followed up by a meeting of staff union representatives with the Committee as a whole.

4. Multilateral surveillance by the ECOFIN

The Chairman said that, in advance of the ECOFIN Council meeting on 10th February, at which multilateral surveillance would be on the agenda, a draft statement to be made on behalf of the Committee of Governors would be circulated for comments. The statement would include an assessment of current monetary policies and policy issues as well as a brief reference to the commencement of the Committee's preparatory work in connection with the moves to Stages Two and Three of EMU.

VI. Date and place of next meeting

The next meeting of the Committee of Governors would take place in Basle on Tuesday, 11th February 1992, starting at 10.00 a.m.

262nd MEETING OF THE COMMITTEE OF GOVERNORS

14th JANUARY 1992

Those present were:

Chairman of the Committee of Governors	Mr. Hoffmeyer
Banque Nationale de Belgique	Mr. Verplaetse Mr. Rey* Mr. Michielsen
Danmarks Nationalbank	Mrs. Andersen Mr. Hansen
Deutsche Bundesbank	Mr. Schlesinger 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. Christophersen
Chairman of the Foreign Exchange Sub-Committee	Mr. Saccomanni
Secretariat of the Committee of Governors	Mr. Baer Mr. Jenkinson Mr. Stone

* Chairman of the Committee of Alternates