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Confidential

Final

MINUTES
OF THE 273RD MEETING OF THE COMMITTEE OF GOVERNORS OF THE CENTRAL BANKS OF THE MEMBER STATES OF THE EUROPEAN ECONOMIC COMMUNITY

HELD IN BASLE ON TUESDAY, 9TH FEBRUARY 1993

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List of participants attached

The Chairman began the meeting by welcoming Mr. Gaspar as the new second Alternate from the Banco de Portugal.

I Approval of the minutes of the 272nd Meeting

The Committee approved the minutes of the 272nd meeting.

II Monitoring of economic and monetary developments and policies in the Community

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

The Monitoring Group had focused on the EMS tensions at the end of January. Firstly, the devaluation of the Irish pound had exemplified the limitations of the Basle/Nyborg instruments when confronted with protracted tensions, even if they were applied resolutely by a country with sound fundamentals. Given the uncertainty surrounding the EMS, exceptionally high levels of interest rates had been insufficient to restore order in the currency markets and had made the defence of parities incompatible with other domestic objectives. Secondly, with regard to the attack on the Danish krone, the Group had noted that intramarginal interventions conducted by a number of central banks in co-ordination with the Danmarks Nationalbank had impressed the markets. The liquidity squeeze technique adopted by the Danmarks Nationalbank was regarded as an effective way of penalising speculators although it was noted that, if it were to be applied systematically for prolonged periods, it could become equivalent to a restriction on short-term capital flows. Thirdly, it was noted that the Belgian franc had weakened somewhat following the attack on the Danish krone and had moved out of its very narrow band vis-à-vis the Deutsche Mark. That had occurred with the release of some unfavourable data on the Belgian economy but appeared to be caused mostly by the fear that speculators might attempt an attack on the core of the ERM. Finally, the interest rate measures taken by the Deutsche Bundesbank had been viewed as having had a positive effect on the exchange markets.

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

The following points had emerged from the Alternates' discussion. Firstly, the Irish Alternate had stressed that as pressure had developed against the Irish pound use of the Basle/Nyborg instruments had not succeeded in calming the markets. The Irish Alternate had expressed the view that the developments in the United Kingdom had not been the decisive factor behind the Irish pound's devaluation; the situation had become unsustainable primarily because of the long duration of high interest rates in Ireland and a threat of a substantial rise in mortgage rates. Community countries were in different positions with regard to the speed and the extent to which changes in money market conditions spilled over to bank lending rates, including mortgage rates; subject to the Governors' endorsement, the Alternates had asked the Monetary Policy Sub-Committee to examine that issue.

Secondly, the Danish Alternate had explained that, while the Danish authorities had not been particularly concerned in the past when the Danish krone had reached the bottom of its fluctuation band, the massive interventions at the limit which had recently been necessary had created a difficult situation. The tensions had been halted through a combination of concerted interventions, a change in the discount rate in Denmark and, ultimately, the monetary decisions taken in Germany. The Danish Alternate had expressed her reluctance to draw any conclusion about the efficiency of intramarginal versus marginal interventions simply on the basis of the recent limited experience. The Alternates had shown interest in the measures taken by the Danmarks Nationalbank to penalise speculators by squeezing the market and enhancing the perception that speculation was a two-way risk; the Danish Alternate had offered to describe these measures in writing.

Thirdly, the German Alternate had explained the background to the Deutsche Bundesbank's decisions on 4th February 1993; they had been taken as a result of careful preparations with a view to adjusting and enlarging the set of available monetary policy instruments under conditions which would not upset market interest rates. The lowering of official interest rates, as well as the narrowing of the spread between the Lombard and the discount rate fitted into that pattern.

Fourthly, the Belgian Alternate had ascribed the temporary weakening of the Belgian franc to a combination of some less favourable indicators about inflation and unemployment and the press coverage given to a confidential Commission document questioning the credibility of the current exchange rate commitment. The Belgian central bank had reacted by reducing liquidity in the money market, which had driven up interest rates in Belgium, and a public reaffirmation that there had been no change in its policies.

Finally, some Alternates had urged the avoidance of statements on intervention activity, especially in other currencies, although that did not apply to the confirmation of past or ongoing concerted action.

3. Discussion by the Committee

The Chairman recommended that the Governors endorse the Alternates' request that the Monetary Policy Sub-Committee study the transmission mechanisms in Community countries of short-term interest rates to other segments of the markets.

Mr. Rey said that it was very important for the functioning of the ERM that central banks have the ability to move short-term money-market interest rates when necessary; the ability to do so was probably greater if the transmission process affecting interest rates for longer maturities was slower than if it had a more immediate effect. The study should not be prescriptive rather it should analyse why the transmission to domestic rates was faster in some countries, as in Britain and Ireland, than in other countries such as France.

Mr. Leigh-Pemberton said that part of the problem in the United Kingdom was that most mortgages were granted at floating rates which quickly reflected movements of official interest rates and that the higher interest rates which had been considered in the United Kingdom last September would not have been accepted as sustainable.

Mr. Doyle said that Ireland's position was similar to that of the United Kingdom with regard to the quick reaction of mortgage rates to changes in official interest rates. That had been the deciding factor the previous weekend when faced with an imminent rise of not less than 3 percentage points in mortgage interest rates. The Irish pound had gone through a number of phases since September 1992. When sterling had left the ERM there was a widespread consensus in Ireland, which had held even after the renewed tensions in November, to maintain the central parity of the Irish currency. However, the defensive measures employed had involved extremely high overnight interest rates which had gradually affected domestic rates. The first two times that the overnight rate was increased to 100% it did not have any lasting effect, but on the third occasion one-month interest rates immediately rose to 25%. Therefore, while the interest-rate instrument was useful in coping swiftly with exchange rate pressures, it could not be applied repeatedly over a long period. The political consensus in Ireland had evaporated when there was the prospect of a further large rise in retail interest rates. He noted that co-ordinated intervention seemed to have worked in the case of the Danish krone; had that kind of intervention been available for the Irish pound in September and November 1992, the subsequent course of events might have been different. However, in the light of the fall of sterling over that period and the apparent preference in the United Kingdom for interest-rate cuts, which the markets had interpreted as an abandonment of any rigid view about the exchange rate, the outcome might anyway have been the same.

Mr. Leigh-Pemberton said that the interest-rate cut did not imply that the UK government had no view about the sterling exchange rate. In the Chancellor's statement to a Parliamentary committee in November, the exchange rate had been recognised as an important indicator of the monetary situation. The reduction in interest rates in the United Kingdom had been felt to be justified on the basis of the most recent economic indicators; however, it was the timing of its announcement which had caused the markets to believe that the Government had become indifferent to the exchange rate. Had the announcement been made immediately after the publication of the relevant data, the interest-rate cut would probably not have been associated with political pressure for lower interest rates.

With regard to the recent pressure on the Danish krone, Mr. Hoffmeyer said that the markets had expected that the Danish government would yield to the negative economic developments such as a declining rate of growth, even though it was higher than the Community average; an increase in unemployment; high real interest rates compared with Germany; and the effective appreciation of the Danish krone. However, there was no disagreement within the new Danish government on the course of action to take. Short-term interest rates had been increased immediately when the pressure had started but, despite statements by members of the government reaffirming its exchange rate policy, pressure had become so strong that interventions amounting to half of Denmark's foreign exchange reserves had to be made within a day. Since the system as a whole appeared to be at risk, an arrangement had been made with a number of Community central banks that, in parallel with a two percentage point increase in the discount rate in Denmark, concerted intramarginal intervention would be undertaken in support of the Danish krone. The pressure had eased further following the announcement of the reduction in official German interest rates. Since the implicit rate of return by reference to forward exchange rates had been 40%, the Danish central bank had decided to provide refinancing to commercial banks only at the same rate. He did not agree with Mr. Saccomanni's remarks that the action taken by the Danmarks Nationalbank had amounted to a restriction on capital flows, rather it was a question at which price funds would be made available to the banks; that had been understood and accepted by participants in the Danish money market.

Mr. Saccomanni said that the point had been made in the Monitoring Group that the way in which the measure had been applied in Denmark had not posed particular problems but, if the technique of forcing market participants to borrow from the central bank for a specified duration was applied on a systematic basis, it could be likened to a restriction on capital flows.

Mr. de Larosière said that he agreed with Mr. Hoffmeyer. Another technique had been used in France: at the beginning of January , when the banks and their customers had taken positions against the French franc extending beyond the date of the French elections in March, the Banque de France had reduced the period for which it was prepared to provide financing to the banks to twenty four hours. That had created considerable uncertainty for the banks which had lent to their clients at a fixed rate for a number of months. Although not the same technique as that used in Denmark, the objective had been similar: refinancing facilities provided to the commercial banks by central banks must be at least as costly as the price paid by speculators for financing; a bank should not be able to make a profit on funds provided to it by a central bank. That was not a restriction on capital movements. The Banque de France had never refused to refinance the banks, but the cost of refinancing had been made high and uncertain.

Mr. Saccomanni said that it was not the view of the Monitoring Group that speculators should not be penalised, rather it was the technique adopted by the Danish central bank which had raised questions: banks had been given no choice but to borrow for a term of seventeen days, irrespective of the fact that they might have needed the funds for a shorter period.

Mr. Hoffmeyer said that the central bank could have reduced the financing period to one day if it had so wished. However, the aim had been to make the central bank's actions unpredictable and the cost of financing high.

Mr. Doyle said that a technique similar to that to that used in Denmark had been adopted in Ireland by increasing the overnight rate to 100%. However, by the second occasion on which that was done, the speculators had become more sophisticated insofar as they had already fixed the rates at which they were doing their deals; it was therefore the commercial banks which had been hit by the high marginal interest rate. While he agreed with Mr. de Larosière that the banks which were financing the speculation should be penalised, the measures taken in Ireland had increased the general pressure for a further rise in retail interest rates and, to that extent, had backfired politically.

Mr. Schlesinger said that the Deutsche Bundesbank had not reduced its official interest rates because of pressure on the Danish krone. The cut in official interest rates was part of a package of measures which had been planned in advance. As a result of the amendments made to the Deutsche Bundesbank Act in November 1992, the German central bank had decided on 4th February 1993 to offer DM 25 billion of the newly introduced liquidity papers in the market at the beginning of March. The decision had also been taken to lower the minimum reserve ratios for time and savings deposits from 4.5% to 2%. The result of those measures had been two-fold. Firstly, the issuing of liquidity paper had extended the scope of the Deutsche Bundesbank's intervention in the money market so that it could influence the interest-rate structure at the short end and, to a lesser degree, at the longer end. Secondly, the reserve requirements could be lowered without generating additional liquidity as the impact would be offset by issuing liquidity paper and by reducing the level of repo business undertaken. The competitive disadvantage from which German banks had suffered vis-à-vis other markets where no reserve requirements existed had therefore been reduced. He added that the decisions taken by the Deutsche Bundesbank had virtually coincided with the agreement that civil service and public sector wages would only increase by 3%, rather than by 5.5% as originally demanded, and that serious steps were taken in the area of fiscal policy in order to regenerate confidence. Furthermore, a consolidation programme had been submitted by the government which required the approval of the sixteen Länder. Finally, the increase in the rate of inflation to 4.4% in January had been the result of the increase in VAT. However, the current level was not tolerable in the long term and the Bundesbank's margin for manoeuvre would be small if the rate of inflation did not decline.

Mr. Ciampi made two general comments. Firstly, the continuous attacks against various currencies confirmed that a mistake had been made in September when the central banks had not faced up to the problems posed for the parity grid. Secondly, recent events had shown that only concerted action was successful. The best way to prevent future attacks on currencies would be to convince the markets that the authorities of the Member States were prepared to engage in concerted action.

III Adoption of the Committee's report to the EEC Ministers of Finance on developments on the foreign exchange markets of the nineteen countries participating in the concertation procedure during January 1993 and the first few days of February 1993

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

IV Review of the EMS Exchange Rate Mechanism

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

The Alternates' discussion had focused on two broad issues: the policy responses to exchange market pressures and possible changes in the technical and institutional arrangements of the system. The Alternates had agreed that a periodical in-depth assessment of the sustainability of existing central parities would be useful although the assessments could not be expected to result in formal conclusions that a particular central rate had become unsustainable, or provide a "seal of sustainability" which would entitle central banks to some form of collective support in case market pressures on certain currencies developed. Furthermore, there was little prospect of achieving consensus on the issue of symmetry of action in response to tensions in the ERM. The defence of a currency would remain the primary responsibility of the country concerned; co-operative action was not excluded but circumstances would dictate the appropriate response. In examining the use of the Basle/Nyborg instruments, there was a clear consensus that realignments remained an essential feature of the EMS, although views varied concerning the use of the other instruments. Some Alternates had favoured giving priority to interest rates whilst others had preferred a more pragmatic approach involving the use of all of the instruments. There was, however, broad agreement on two ways of adding value to the Basle/Nyborg instruments. Firstly, by enhancing the markets' perception that speculation was a two-way risk; that matter was being considered by the Foreign Exchange Policy Sub-Committee. The second possibility had been illustrated in the case of the recent collective support given to the Danish krone, which had been combined with the rise in the Danish discount rate and the decision to settle intervention debt on the same day. Finally, strong doubts had been expressed about the usefulness of collective statements in support of central parities; those were potentially damaging for the credibility of the system if not backed by immediate action.

The Alternates had discussed a number of proposals concerning the institutional and technical arrangements of the EMS. Firstly, the Nederlandsche Bank had proposed that, as long as a country did not fulfil the convergence criteria set out in the Maastricht Treaty, except the condition of ERM participation, there was a presumption that the country should participate in the wide ERM band. That should apply also to countries wishing to enter or to re-enter the ERM. An exercise of collective assessment could enhance the credibility of the system. However, some Alternates had considered that the convergence criteria would not constitute an appropriate basis for a decision on the width of the fluctuation band. Secondly, the German Alternate had suggested that a temporary move from the narrow to the wide band might be considered a better option than withdrawal from the ERM, particularly in a period of acute speculative tensions. That proposal had met with much scepticism among the Alternates. Thirdly, interventions had reached unprecedented amounts in the recent crisis. Two sorts of circumstances could be observed: one of prolonged and substantial interventions, and very sudden massive interventions during the course of a single day. With regard to the former, some Alternates had suggested that informal thresholds be set beyond which consultations to assess the most appropriate response could be triggered. However, that suggestion had met with little support as even informal thresholds would become known to the markets thereby creating additional uncertainties. In the second instance, it could be worth examining whether emergency action in the form of the suspension of intervention obligations could be taken before the markets closed, although that could raise legal issues and prejudge political decisions. Fourthly, the Banca d'Italia had already suggested in an earlier paper submitted to the Committee that the size of the credit facilities currently available under EMS arrangements deserved to be reviewed. While that proposal had been supported by several Alternates, others had expressed their concern that any extension of the financing arrangements could be seen as a loosening of the disciplinary effect of the ERM. Another proposal by the Banca d'Italia was to examine the possibility of scaling down the support given to the currency of a country if, following a collective assessment, that country failed to adjust appropriately the central parity or its domestic polices. That proposal raised many objections to the extent that it could imply withdrawal of obligations to intervene at the limit, although it might be more acceptable if it were to concern only reduced commitment in other less strategic aspects of EMS financing arrangements, such as the size and availability of short-term monetary support. Finally, there was broad agreement that the ECU-denomination of EMCF positions had led to significant exchange rate losses for creditor countries; several proposals had been made to amend the sharing of the burden in respect of those foreign exchange risks. There was a Belgian proposal to correct the conversion rates of the ECU for movements of currencies which had dropped out of the ERM to the extent that those movements went beyond the last observed intervention limits. The German proposal was to settle EMCF positions in the currency of the creditor country when they exceeded certain thresholds. The French Alternate had suggested that commission might be paid by the debtor country to the creditor country in proportion to the intervention support given. Finally, the British Alternate had suggested that arrangements be found to multilateralise the sharing of foreign exchange risks resulting from interventions when those were conducted in defence of a parity which was collectively considered to be appropriate.

2. Discussion by the Committee

Mr. Leigh-Pemberton agreed that a periodic, in-depth assessment of the sustainability of central parities by the Governors in restricted session would be useful. That should not preclude preparation of the assessments by the Alternates and participation of the Chairman of the Alternates in the restricted sessions. He doubted that symmetrical policy responses to tensions were appropriate but co-operative actions would be useful if it was accepted that there had to be collective responsibility for the system. He favoured a pragmatic use of the Basle/Nyborg instruments since the situation of Member States differed with regard to the size of their economies, the degree of financial integration with other countries and how quickly official interest-rate changes worked through to the real economy. He agreed that statements of support were not effective and might be counterproductive in defence of parities that were under pressure. The choice of the narrow or the wide band must be a collective decision in respect of a country joining or rejoining the ERM. However, he questioned whether the Maastricht criteria alone should determine the choice of band; the rules should not be made more strict for countries joining the ERM than they were for existing members. The Governors should remain sceptical about the value of temporarily widening the band or moving to the wide band, although that should be examined further. He disagreed with having quantified limits to intervention but supported having procedures that would enable the rapid assessment of situations when interventions threatened to get out of hand. The possibility should be examined, in spite of the legal or political difficulties that might arise, of allowing the suspension of intervention obligations during the day if market conditions made that desirable. He had no strong feelings about increasing the size of credit facilities in the VSTF; facilities should be big enough to resist unwarranted speculative pressures but not so big as to substitute for more substantial action. With regard to the proposal to scale down the level of the VSTF support given to countries that did not take adjustment measures, some way had to be found to bring peer pressure to bear on such countries. Finally, all the suggestions to change the denomination of EMCF positions had both advantages and drawbacks; the technicalities should be examined by the Foreign Exchange Policy Sub-Committee.

Mr. Schlesinger said that before discussing burden sharing, consideration should be given to the ways and means of preventing the burden from becoming too heavy. An important proposal was for the Governors to monitor the sustainability of a central rate. Secondly, it should be accepted that the stability of a national currency meant preserving price stability. A country which had to protect its own price stability should not be forced down a path which would deflect it from that objective, as had been the experience of the Bundesbank in honouring its intervention obligations. German M3 had increased at an annualised rate of 15% in September and 20% in October 1992, which had led to a considerable overshooting of the German monetary target and had created the potential for an increase in the rate of inflation. The main issue in the context of the EMS was whether the Member States were moving in the direction of an average inflation or towards the rates prevailing in the low inflation countries; current developments were not encouraging. Consideration should be given to whether it was advisable for a currency to move into a wider band under certain circumstances if it came under pressure. Another issue for examination was the possibility of suspending interventions before the close of business if, during the course of a day, obligatory interventions rose to intolerably high levels for both the debtor and creditor countries. On the question of exchange risk sharing, the possibility of setting limits for obligatory interventions, or devising a different rule to govern the settlement of exchange losses, should not be excluded. There was a connection between the two: if obligatory interventions were limited, so would be the exchange risk. The most important issue should be to avoid unlimited intervention obligations. It was of primary importance that a country should not lose control of its monetary policy.

Mr. Ciampi said that the EMS had been a disciplinary instrument for the past twelve years which had enabled inflation-rate differentials between member countries to reach an all-time low. However, recent events had impaired the credibility of the system and of the Community central banks. The ultimate aim should be to ensure that the system was perceived as a co-operative arrangement. The consequences of the recent turbulences in various countries, and the impact that they had had on the growth of the money stock and monetary aggregates in Germany, could have been avoided if a response had been made in good time. If the markets had perceived that the Community central banks had operated in a co-ordinated manner and had promptly taken the necessary decisions, many of the difficulties that had been encountered could have been avoided. He agreed that the Governors should periodically assess the appropriateness of exchange rate parities and that pressure should be exerted on individual countries if it was felt that a particular exchange rate was no longer justified.

Mr. Rojo said that he was particularly in favour of finding a solution to the sharing of exchange losses resulting from interventions and would consider any of the proposals made on the condition that they were simple and in accordance with the principle of multilateralisation. However, the Governors should not consider proposals which implied any modification of the Maastricht convergence criteria. The suggestion that a country which did not satisfy the economic convergence criteria should participate only in the wide ERM band could represent such a modification. Furthermore, it was worth considering the possibility of extending the very short-term financing for intramarginal interventions in the case of a currency which was being attacked whose parity was considered sustainable.

Mr. Beleza agreed with Mr. Ciampi that the ERM entailed collective responsibility. Apart from its regular consultations and monitoring, the Committee should proceed to periodic reviews of the parity grid. Whilst there was room to improve the functioning of the ERM, he doubted whether the time had been reached to change the rules. It should not be forgotten that monetary policy remained the responsibility of the national authorities until Stage Three of EMU. He was not sure if it could be possible to come to a decision whether a specific parity grid was appropriate. Although the proposal to link a currency's participation in the ERM band to the convergence criteria was worth considering, those could not be seen as strict entry or re-entry criteria, adding new formal guidelines to the agreed procedures. It might nevertheless be useful to take these criteria into account when considering the position of individual currencies and the sustainability of the parity grid. It would be seen as a weakening of the commitment to the ERM if the rules on compulsory interventions were changed either formally or informally. The question of what procedures should be employed in situations of very large intraday interventions required further study. Burden sharing was an essential issue to be resolved, although he had not yet formed a view on which of the proposals could be the most appropriate. He felt that the actions taken by the Danmarks Nationalbank illustrated an effective use of the Basle/Nyborg instruments; indeed, a similar technique had been used successfully in Portugal. Finally, the question of the spillover of high interest rates to the real economy was a problem which should be addressed.

Mr. de Larosière said that the recent ERM crisis had originated not in the ERM mechanisms but in the fact that the fundamental principle according to which exchange rates should be stable but adjustable had not been respected. Realignments which had become necessary because of changes in relative competitiveness had not been made promptly enough. Furthermore, markets assessed not only the quality of a country's fundamentals, but also the credibility of future policy and the determination demonstrated by governments and central banks to preserve the parity of their currency. He fully supported the periodic review of the validity of the parity grid in the light of economic fundamentals. He did not think that the rules of the EMS should be changed because those had not been the cause of the crisis. The unlimited nature of interventions at the margins should be preserved; the existence of a limit would soon leak to the markets and be considered as an indication of a weakening of the solidarity among Community central banks. He recognised that when interventions reached such a level as to endanger the monetary policy and credibility of one or several member countries consultations must take place; moreover, the Committee should not be rigid in laying down hard and fast rules as to what should be done if certain levels were reached. He was prepared to review the question of burden sharing because there might be serious consequences for a country whose currency had appreciated vis-à-vis the ECU, although the basic principle of denominating VSTF operations in the ERM should not be altered. He would therefore prefer a system whereby commission would be payable by the debtor to the creditor country. Finally, any solution which led towards greater solidarity among Community central banks would be beneficial; the help that had been given to the Danish authorities had exemplified that.

Mr. Hoffmeyer said that he understood the difficulties created for German monetary policy as a result of the excessive interventions which had been necessary. However, in order to restore credibility to the system, care had to be taken in changing the rules. Discretionary rules, if introduced, would need to cover a wide number of cases that were not similar and should not be treated in a similar way. At one extreme there might be doubts about the willingness of a government to bring the fundamentals in line with the Maastricht criteria whilst, at the other extreme, a government might wish to meet the criteria but the markets doubted whether it could bear the consequent increase in unemployment and reduction in growth. There should be a commitment not to loosen monetary policy in countries whose currencies had been the subject of intervention until the outflows had been recouped. Alternatively - and with the same effect - debtor countries could raise market loans in the currency of the creditor.

Mr. Christodoulou said that questions which arose from fundamental differences in approach could not be solved through technical means or institutional arrangements. If the system was to provide the frame of reference that would motivate members to bring the European Community closer together, measures should not be adopted that achieved the opposite result. The convergence criteria in the Maastricht Treaty set out the Member States' determination to move closer together and to merge their economies. Community countries should therefore be careful about the approach they chose concerning the means of co-operation during crises.

Mr. Doyle underlined the view expressed by Mr. Ciampi that, if the credibility of the system was to be restored, a systemic response had to be found. There had to be a collective response, when a currency was attacked, otherwise there would not be a system. A major part of the difficulties that had occurred in recent months was owed to the fact that a collective view had not been taken in September 1992. If a concerted response such as that made in support of the Danish currency had been taken in the previous September, the system would not be facing its current difficulties. He agreed that a periodic assessment of the appropriateness of parities should be undertaken by the Governors. That would enable collective doubts to be conveyed to a national government, as necessary, about the appropriateness of its currency's parity. He agreed with Mr. Hoffmeyer that future crises would not take the same form and that no matter how elaborate new rules would be, there had to be scope for a discretionary approach to problems. He agreed that proposals linked to the Maastricht convergence criteria warranted consideration. Furthermore, consideration should be given to whether there was a qualitative difference between the position of a small currency when it came under attack and a large one. It was easy for a large number of banks to mount an attack on a small currency using what, for them, were relatively small resources. There must be a way of trying to distinguish between the types of transactions taking place, be they trade or finance related or speculative.

The Chairman said that there did not appear to be a broadly-held desire among the Governors to change the formal rules of the system but that work should focus on the application of the rules and procedures. There was broad support to intensify co-operation through having periodic assessments of the appropriateness of the existing parity grid in restricted meetings of the Governors. In emergency situations, in which large-scale and excessive interventions were necessary to defend a currency, a restricted meeting of the Governors or a teleconference might be convened. The issue of suspending intervention obligations during the day needed to be studied further, not least because such a decision would have to involve the Ministers. There was general agreement on the limited value of public statements which might be counterproductive if not backed by measures. The various proposals made on the issue of burden sharing had been openly received by the Governors; the Alternates should study the matter further and revert to the Committee with a proposal.

Mr. Rey said that the Alternates would produce a report in time for the Governors' meeting in March taking into account the comments made at the current meeting.

Mr. Christophersen said that there was a link between the discussions of the Governors and those of the ECOFIN Council. He felt that one of the political consequences of the recent turbulence would be a strengthening both of the multilateral surveillance process and the regular examination of convergence programmes. There would be an examination in the ECOFIN Council during the spring of the implementation of the convergence programmes; he suggested that consideration be given to how the discussions by the Committee and other fora could be co-ordinated. Something had to be done to give more credibility to the way in which the macro-economic strategies of Community countries were examined.

Mr. de Larosière said that he agreed with the Chairman's summing-up. He added that collective statements of support for a currency were of little use although bilateral statements, if underpinned by action such as higher interest rates, could be effective. With regard to suspending intervention obligations during the course of a day, he had reservations as that would mean that the limits on a country's exchange rate had been surpassed and would imply that a realignment had been made before the Monetary Committee and the Ministers had considered the matter.

Mr. Schlesinger said that he agreed with the suggestion of implementing the rules and not changing them. One should bear in mind the experience with the decision-making process at government level. For instance, the realignments in January 1987 and September 1992 had not been proposed by the country of the currency which was under pressure but rather by the creditor country, Germany, which had been concerned about the consequences of the size of the interventions it had been obliged to undertake: DM 15 billion in 1987; and DM 27 billion vis-à-vis the Italian lira in September 1992. Given that experience, the Deutsche Bundesbank had suggested placing a limit on the size of obligatory interventions; otherwise a creditor country was exposed to the exchange market consequences of a situation in a debtor country over which it had no direct influence.

V Status of central banks

Mr. Rojo said that the draft law of autonomy for the Banco de España had been sent to the Spanish parliament in the last week of January. Its aim was to give full independence to the central bank in the definition and implementation of monetary policy. The law had been prepared under two types of restraint. Firstly, it preserved the existing functions of the Banco de España in non-monetary areas such as banking supervision and the maintenance and improvement of the payment system. Secondly, there were organisational restraints on the central bank. The governing bodies of the bank would be the Governing Council and the Executive Board. The Governing Council would comprise the Governor and the Deputy Governor, both of whom would be appointed for non-renewable, six-year terms; six elected members who would be appointed for eight-year terms; and two ex-officio members. Since the Banco de España would retain its responsibility for banking supervision, the Finance Minister had insisted that both the General Director of the Treasury and Financial Policy and the vice-president of the National Securities and Exchange Commission be ex-officio members of the Governing Council. However, they would not be entitled to vote on matters concerning monetary policy. The six elected members would also be appointed by the government, but after consultation with the central bank Governor. However, they were to be subject to very strict limitations in that they should not have anything to do with banking and financial activities. They would attend meetings of the Governing Council but would not be permanently based at the central bank: the current administrative structure of the central bank would be preserved.

The Chairman said that the draft law followed the most important features of the draft statute of the European Central Bank although it did not explicitly state that the central bank could not accept instructions from other parties.

Mr. Rojo said that it had not been expressed in those terms but the central bank would have full, legal institutional autonomy.

Mr. Verplaetse said that the Belgian government fixed the par value of the Belgian franc after consulting the central bank. The government had no power to give instructions to the central bank, but the Minister of Finance and the government commissioner had a veto right although that had been used only once since 1945. The government had placed a draft bill before a parliamentary commission which would abolish the veto right on issues concerning: the basic tasks of the Bank. The Governor's current veto right against the central bank's Council of Regencey was likely to be rescinded. With regard to the financing of the government by the central bank, Belgium had had an interest-rate policy up until two years previously according to which the key interest rate on Treasury certificates was fixed following consultations between the Ministry of Finance and the central bank. Since January 1991, the central bank had carried out the management of money-market liquidity by way of repo and open market operations. At that time, the ability of the Belgian Treasury to borrow from the central bank had been reduced to a single credit line of BEF15 billion, which would be abolished in the near future . The Governor was appointed by the Crown for a renewable five-year term and could be suspended from office for a maximum period of three months but this has never happened.

Mr. Christodoulou said that the Bank of Greece had proposed to the Greek government changes in the central bank legislation, which would be laid before parliament during the first half of the year, aimed at making it compatible with the Maastricht Treaty. The proposed legislation specified that the central bank would be responsible for the formulation and implementation of monetary policy, with price stability as a primary objective. It described the main tasks and functions of the bank and included a provision analogous to the one in the Treaty stating that the bank's governing bodies would not be subject to instructions from the government or other political authorities.

Furthermore, the proposed legislation specified the central bank's monetary functions and prohibited central bank financing of the government and all other public entities. The Greek government had stated in its recently-adopted convergence programme that it was committed to increasing the central bank's independence and to introducing the other provisions required by the Maastricht Treaty. No legislation had yet been submitted to the Greek parliament with the exception of a provision which halved the government's overdraft facility with the central bank in 1993 and would abolish it on 1st January 1994. For the first time, the overdraft facility had not been drawn down on 1st January 1993.

Mr. Ciampi said that the Italian Minister of Finance did not attend meetings of the Banca d'Italia board nor did any member of the government attend the central bank's general assembly. The statute of the Banca d'Italia guaranteed it a large degree of autonomy, for example with regard to the appointment of the board members. He added that, a year ago, a bill had amended the procedure for fixing official interest rates so that the right was now vested solely in the Governor. A draft bill was approved by the previous government, and reformulated by the present one, which would abolish the obligation on the Banca d'Italia to finance the Treasury within certain limits and which would give the Banca d'Italia the authority to modify compulsory reserve requirements. He offered to send a summary of these bills to the Governors.

The Chairman said that that would be helpful because he proposed giving a preliminary report at the informal ECOFIN Council meeting in May on the progress made in the Member States towards central bank independence.

VI Preparatory work for the move to Stages Two and Three of EMU

1. Monetary financing of government deficits and intra-day credit

The Committee took note of the disagreement among the Alternates concerning certain questions raised in the report of the Monetary Policy Sub-Committee and agreed to postpone discussions until a future meeting.

2. Status report prepared by the Secretariat

The Committee took note of the Secretariat's status report on the preparatory work.

VII Other matters falling within the competence of the Committee

1. Request by EFTA countries for involvement in the preparatory work for the move to Stages Two and Three of EMU

Mr. Rey said that there was a consensus among the Alternates that, taking account of the fact that the five EFTA countries which had written to the Chairman were at different stages in their relationship to the European Community, it would be advisable to follow a pragmatic approach with regard to their suggestions for closer co-operation between their respective central banks and the Committee. In particular, it would be premature to institutionalise meetings with the Committee or the Alternates, or to grant the five EFTA central banks an observer status in the Sub-Committees and Working Groups. The Alternates had suggested that a reply to the EFTA central banks could include the following elements. Firstly, the Chairman would take the initiative to meet occasionally with the governors of the EFTA central banks in order to inform them about the Committee's preparatory work; he would subsequently report to the Committee on the outcome those meetings. Secondly, the Committee could make available to the EFTA central banks' documents such as reports produced by the Sub-Committees and Working Groups or the Secretariat's bi-monthly progress reports. Thirdly, briefing sessions could be held between the Secretary General and senior officials of the EFTA central banks. Any arrangements would be without prejudice to the special consultations currently held with the central banks of Norway and Finland and the attendance of meetings of the Working Group on Statistics by a central bank official representing the EFTA central banks.

Mr. Christophersen said that it was not yet clear what action Switzerland would take following the negative Swiss referendum on the European Economic Area agreement. Furthermore, the Commission felt that it would be useful if the Committee would consider discretely issues relating to ERM membership of the EFTA countries joining the Community. So as to prevent the ERM from running into credibility problems, consideration should be given to how the smooth integration of additional currencies to the system could be achieved. He added that the normal rule was that countries were allowed to participate in all Community institutions as observers as soon as the adhesion treaties had been signed but before they had been ratified.

The Chairman said that Mr. Christophersen's points were covered by the pragmatic approach that had been suggested by the Alternates. The response proposed by the Alternates would be incorporated in a draft letter which would be submitted to the Committee for approval at its March meeting prior to being sent to the five EFTA countries concerned.

2. Chairmanship of the Banking Supervisory Sub-Committee

The Committee agreed to reappoint Mr. Quinn as chairman of the Banking Supervisory Sub-Committee until 31st December 1993.

3. Own financial resources of the EMI

The Committee endorsed the approach proposed by the Alternates. According to this approach, the Community central banks would undertake to provide the EMI with the funds necessary to finance both the initial investment expenditure and the estimated recurrent expenditure for the first year of its functioning. The necessary amount should be determined on the basis of the functions which have been assigned to the EMI by the Treaty. These funds should be considered as prepayments of the contributions which the Council of the EMI will eventually determine in accordance with Article 16.1. Payments would thus be made in anticipation of the payment obligations arising from the decision to be taken by the Council of the EMI. The sum to be prepaid would be shared out in accordance with the key laid down in the Statute of the EMI (i.e. the key based on population and GDP in equal parts). The obligations would be denominated in ECUs (the unit of account of the future EMI). While the precise method of payment would still have to be decided, there was agreement that the management of the contributions would be left to the EMI. This would not rule out the possibility of using one or several central banks in managing funds.

4. **Contacts between the Working Group on the Printing and Issuing of a European Bank-note and the Mint Directors**

The Chairman said that contacts between the Working Group on Printing and Issuing of a European Bank-note and the Mint Directors in the various Members States needed to be handled in a more satisfactory manner. He noted that the latter had adopted a comparatively high profile. Since the Mint Directors were under the authority of their respective Ministers of Finance, he proposed writing a letter to the President of the Council of Ministers setting out his view on how contacts between the two bodies should be established.

The Committee agreed with the approach proposed by the Chairman.

5. **Matters relating to the Working Group on EC Payment Systems**

The Chairman said that the Banking Federation in the Netherlands was well advanced in its plans to introduce a general purpose prepayment card, or "electronic purse", during the second half of the decade. If developed on a mass scale, "electronic purses" could to a large extent replace bank-notes and thereby impinge on the responsibilities of central banks and affect the income from seignorage. He suggested that the Working Group on EC Payment Systems be asked to consider the matter in relation to the draft Statute of the ECB whereby the latter was given explicit authority over the functioning of the payment system. The Nederlandsche Bank had the responsibility to facilitate the functioning of the payment system in the Netherlands, but no authority to regulate or monopolise certain features of it. The Working Group should study the issues involved and make proposals, for example on whether the monopoly which was by law in most countries given to the central bank to issue bank-notes should be extended to "electronic bank-notes".

Mr. de Larosière supported the Chairman's proposal. A similar initiative led by the postal system was underway in France. Some of the banks were interested in that development and the Banque de France was participating in the meetings that were being held as an observer. Overall, he did not feel that the developments would have a great impact on bank-note circulation. It did not entail money creation, but rather a system of payments based on existing deposits; as such the public was unlikely to tie-up large amounts of money by purchasing multi-purpose prepayment cards. However, to the extent that it could have a consequence for the circulation of money, the Working Group should be asked to study the matter.

The Committee endorsed the Chairman's suggestion that the Working Group on EC Payment Systems be asked to study the issues involved.

6. **Technical assistance for eastern European countries**

Mr. Rey said that the Alternates' attention had been drawn to certain problems in the co-ordination of technical assistance given to East European countries. In particular, lack of co-ordination had recently been experienced in the context of the creation of the Interstate Bank of the CIS states. The Centre for European Policy Studies in Brussels had on behalf of the Commission approached Community central banks for the selection of experts whilst at the same time the IMF, which had helped to draw up the statutes of the Interstate Bank, was also involved in providing technical assistance with central bank help. The Alternates had recommended that the Governors and the Commission representative discuss ways of ensuring that there was a co-ordination of activities and had expressed the preference that the co-ordination of technical assistance remain in the hands of the IMF.

Mr. Christophersen said that the consultancy company which worked under DGI had approached some central banks on the question of technical assistance without having been authorised to do so; that would be made clear to the consultant. The Commission normally enjoyed a very good relationship with the IMF; indeed, a co-ordination group comprising the IMF, EIB, EBRD, the World Bank and the Commission had been set up three years previously and had held regular meetings and had co-financed training programmes.

Mr. Schlesinger supported the Alternates' view that the co-ordination of technical assistance to eastern European countries should be undertaken by the IMF.

VIII Date and place of next meeting

The next meeting of the Committee of Governors will take place in Basle on Tuesday, 9th March 1993.

MINUTES

273RD MEETING OF THE COMMITTEE OF GOVERNORS

9th February 1993

Those present were:

Chairman	Mr. Duisenberg
Banque Nationale de Belgique	Mr. Verplaetse Mr. Rey[1] Mr. Michielsen
Danmarks Nationalbank	Mr. Hoffmeyer Mrs. Andersen Mr. Hansen
Deutsche Bundesbank	Mr. Schlesinger Mr. Tietmeyer Mr. Rieke
Bank of Greece	Mr. Christodoulou Mr. Papademos Mr. Karamouzis
Banco de España	Mr. Rojo Mr. Linde Mr. Durán
Banque de France	Mr. de Larosière Mr. Hannoun Mr. Robert
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. Szász Mr. Boot Mr. Bakker
Banco de Portugal	Mr. Beleza Mr. Borges Mr. Gaspar
Bank of England	Mr. Leigh-Pemberton Mr. Crockett Mr. Foot
Commission of the European Communities	Mr. Christophersen Mr. Pons
Chairman of the Foreign Exchange Policy Sub-Committee	Mr. Saccomanni
Secretariat of the Committee of Governors	Mr. Baer Mr. Scheller Mr. Viñals

[1] Chairman of the Committee of Alternates