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(Translation)

MINUTES*

OF THE 227th MEETING OF THE COMMITTEE OF GOVERNORS
OF THE CENTRAL BANKS OF THE MEMBER STATES
OF THE EUROPEAN ECONOMIC COMMUNITY
HELD IN BASLE ON TUESDAY, 12th JULY 1988 AT 10 a.m.

Those present at the meeting were: the Governor of the Banque Nationale de Belgique and Chairman of the Committee, Mr. Godeaux, accompanied by Mr. Janson, Mr. Rey and Mr. Michielsen; the Governor of Danmarks Nationalbank, Mr. Hoffmeyer, accompanied by Mr. Mikkelsen; the President of the Deutsche Bundesbank, Mr. Pöhl, accompanied by Mr. Gleske and Mr. Rieke; the Governor of the Bank of Greece, Mr. Chalikias, accompanied by Mr. Papademos and Mr. Karamouzis; the Governor of the Banco de España, Mr. Rubio, accompanied by Mr. Linde and Mr. Durán; the Governor of the Banque de France, Mr. de Larosière, accompanied by Mr. Waitzenegger and Mr. Cappanera; the Governor of the Central Bank of Ireland, Mr. Doyle, accompanied by Mr. O'Grady Walshe and Mr. Reynolds; the Governor of the Banca d'Italia, Mr. Ciampi, accompanied by Mr. Dini and Mr. Masera; the President of De Nederlandsche Bank, Mr. Duisenberg, accompanied by Mr. Szász and Mr. Sillem; the Governor of the Banco de Portugal, Mr. Tavares Moreira, accompanied by Mr. da Costa Pinto; the Governor of the Bank of England, Mr. Leigh-Pemberton, accompanied by Mr. Loehnis and Mr. Arrowsmith; the President of the Commission of the European Communities, Mr. Delors, accompanied by Mr. Costa, Mr. Mingasson and Mr. Dixon; Mr. Kees, Secretary of the Monetary Committee; the Director General of the Luxembourg Monetary Institute, Mr. Jaans. Also present at the meeting were Mr. Raymond and Mr. Dalgaard, Chairmen of the Groups of Experts. The Secretary General of the Committee, Mr. Morelli, his Deputy, Mr. Bascoul, Mr. Scheller and Mr. Cook, and Mr. Bockelmann and Mr. Dagassan also attended.

The Chairman opened the meeting by proposing that the Committee should try to end its discussions at 11 o'clock so as to enable the Governors and the Director General of the Luxembourg Monetary Institute to hold an informal meeting with Mr. Lamfalussy and President Delors to consider the specific

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* Final text approved at the meeting on 13th September 1988, which incorporates some drafting changes.

steps which might be taken in preparation for launching the work of the Committee set up at the European Council meeting in Hanover.

I. Approval of the minutes of the 226th meeting.

The Committee unanimously approved the minutes of the 226th meeting, on the understanding that the editorial amendments suggested would be incorporated in the final text.

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

- Preparation by the "Dalgaard Group" and discussion by the Committee of Alternates;
- Statistical charts and tables.

A. Statement by Mr. Dalgaard

The "Monitoring Group" had devoted the greater part of its meeting to discussing the development of the dollar. Its sharp increase, of more than 5% in June, had been surprising; it had wiped out the fall which had occurred in the fourth quarter of 1987 and brought the US currency back to the level recorded during the first three quarters of 1987. The reasons for this rise were strong growth in the United States, the increase in US interest rates, the relatively satisfying trade balance figures of the past two months, and the perception that the authorities were, in fact, accepting a firming of the dollar. During the first week of July the dollar had faltered, weakening a little, only to firm again slightly.

Views on the recent performance of the dollar varied. The United States thought that its currency was still fragile and that the central banks should not exert downward pressure on it; the Federal Reserve had accordingly undertaken cautious, modest interventions aimed at discreetly replenishing its reserves. In Germany, and to a certain extent in other European countries, it was felt that the dollar's appreciation was unreasonable; it did not correspond to fundamentals, in particular the balance of payments and inflation differentials, and could therefore be followed by new fall. In addition, the decline of the Deutsche Mark was potentially detrimental in terms of inflation in Germany. The Deutsche Bundesbank had therefore been actively selling dollars, approximately 4.5 billion in total in June, and there had also been dollar sales by other European central banks. Moreover, interest rates in Germany and some other countries had risen. In Japan there did not seem to be much concern about the weakness of the yen, which had occurred later and had been less marked than that of the Deutsche Mark. For this reason the Bank of Japan had not intervened in the market and although market interest rates had increased slightly official rates had not been raised.

The "Monitoring Group" had drawn some conclusions from its analysis of the development of the dollar:

- the co-ordination of interventions in dollars was not satisfactory; the central banks had appeared to hold different views as regards the action to be taken in the markets; this had happened, for example, on 28th June, when concerted sales of dollars by several central banks had not been followed up by the Federal Reserve;
- the raising of interest rates in the United States, for purely domestic reasons, had led, via its effect on exchange rates, to an increase in rates in most European countries;
- in the short term the dollar's performance would continue to be strongly influenced by US foreign trade figures, but in the long term the persistence of a large current-account deficit could be expected to weaken the dollar.

Within the EMS exchange rate mechanism there had been no tensions but there had been some slight changes in the positions of certain currencies. The relative weakness of the Deutsche Mark had not been reflected in the fluctuation band but in substantial interventions and a rise in interest rates. Most of the other currencies had performed better. The Dutch guilder, for once, had suffered a brief bout of weakness attributable to the increase in German interest rates at a time when the money market in the Netherlands was too liquid to enable the central bank to influence interest rates. The situation had then returned to normal, with the guilder at parity with the Deutsche Mark and the interest rate differential vis-à-vis Germany almost zero. The Belgian franc had also been subject to some pressure in June when interest rate differentials had narrowed because Belgian rates had not been raised so as not to complicate the issue of a government loan. Rates had subsequently been raised and the Belgian franc had firmed. The French franc had remained very strong; there were continuing large capital inflows, mainly at long term and directed into both bonds and shares, with the share index recovering to its pre-October 1987 level, which was not the case everywhere. The Banque de France had preferred to maintain the same or a lower level of interest rates rather than let the exchange rate appreciate. The Danish krone had firmed within the band under the influence of continuing capital inflows attracted by relatively high interest rates. Danmarks Nationalbank had undertaken some intervention purchases and had lowered its interest rates. Market rates had also fallen, so that the differential vis-à-vis German rates had been narrowed in two months from 6 to 4 percentage points. The Italian lira had been stable, as had interest rates, and intervention purchases by the central bank had been modest. The Irish pound had benefited from capital inflows and favourable fundamentals, in particular inflation and the balance of payments, which had contributed to the firming of its exchange rate.

In all, the situation within the EMS had been calm and the central banks had demonstrated their willingness to use all instruments - the position of their currency within the band, interest rates and interventions - to stabilise the exchange rate.

The pound sterling had been rather volatile. The authorities had made frequent use of interest rates; following three 1/2-point decreases in May, rates had been raised by 1/2 point on five occasions between early June and early July in order to stabilise the exchange rate and above all to counteract inflationary pressures and signs of overheating. Upward pressure had been exerted on the Spanish peseta during the first three weeks of June, and the Banco de España had carried out some intervention purchases. The peseta had weakened towards the end of June but, as Spanish interest rates were still high, the situation should return to normal. The Greek drachma and the Portuguese escudo had continued to depreciate at a slow and orderly pace, and over the first half of 1988 as a whole these two currencies had remained more or less stable vis-à-vis the Deutsche Mark.

The use of the private ECU had increased, as could be seen from Table 3 of the concertation statistics. The total balances held by the central banks participating in the concertation procedure had amounted to more than ECU 6.2 billion at the end of June 1988, compared with approximately ECU 4 billion at the end of December 1987. In June the Banca d'Italia's holdings had risen appreciably following a government loan issue in ECUs, and the Central Bank of Ireland had acquired ECUs for the first time.

B. Statement by Mr. Janson

The discussion had been dominated by the recent rise in the dollar, which had amounted to almost 10% in two months. Could such a development be considered compatible with the Louvre Accords, and did it pose problems for EMS cohesion?

1. The Louvre Accords

While concerned about the rapid appreciation of the dollar, the Alternates of the G-7 member countries thought that this rise, and the varied reactions it had evoked, were still consistent with the flexible framework of the Louvre Accords. The different views which had been expressed in the markets and in the media were therefore unfounded.

Nonetheless, these Alternates did not think that it would be advisable to make the agreed arrangements more transparent. The fixing and publication of target zones would make speculation easier. However, they recognised that in the absence of formal or explicit exchange rate objectives the credibility of the Accords rested on a consensus among the participants as to the objectives to be attained, and required visible concerted action pursued with steadfast resolve. Recent developments did leave something to be desired in this respect when compared with the action undertaken at the start of the year, when it had been a question of halting the dollar's slide. It had to be said that the required consensus did not seem assured for the moment. In this pre-election period the US Administration seemed to welcome a strong dollar in the hope that it would remove the prospect of a further increase in interest rates.

The Alternates noted, however, that the fundamentals observed in the United States, in particular the current-account balance, made a rise in the dollar seem both inappropriate and extremely perilous.

The German authorities, for their part, considered the weakness of their currency undesirable on both domestic and external grounds. They believed that monetary conditions in their country called for a tightening of monetary policy. Defending the DM exchange rate could not therefore be based solely on interventions, even if these had the advantage of offsetting the impact on domestic liquidity of the large dollar purchases made in the past.

Some of the Alternates feared that to continue the policy of a progressive strengthening of the Deutsche Mark following the appreciation of the dollar was fundamentally incompatible and unconducive to restoring calm in the markets. In any event, it went against previous hopes of a decline in interest rates, seen as desirable from the point of view of the global economy.

2. Cohesion in the EMS

As far as the European Monetary System was concerned, the developments observed and the action undertaken with regard to both interventions and interest rates had not so far created tensions within the system. The Banque de France and Danmarks Nationalbank, which were faced with inflows of foreign capital, had even been able to lower their interest rates slightly. The Banque Nationale de Belgique had raised its rates because of the narrowing of the interest rate differential vis-à-vis the Deutsche Mark and had intervened in support of the Belgian franc.

Several Alternates, however, emphasised the need for close co-ordination of the policies implemented in the present circumstances. They feared that a sharper rise in interest rates in Germany and large-scale interventions would create problems in the functioning of the EMS.

The UK Alternate had stressed that the successive increases in the UK base rate had only brought this rate back to the level recorded in August 1987 and had to be seen in the context of the UK authorities' desire to stabilise sterling's exchange rate.

To conclude, the Governors were confronted with a difficult situation which necessitated choices of objectives and choices of instruments:

- should efforts to check the rise in the dollar be continued?
- was the interest rate the right instrument to achieve this?
- were there alternative solutions?

B. Discussion by the Committee

Mr. de Larosière pointed out that towards the end of 1987 France had built up a fairly wide interest rate differential vis-à-vis its neighbours and that there had therefore been some scope for reducing it, which had been done in two stages. Firstly, at the end of May, the key rate had been lowered by 1/4 point, but this had been offset by an increase in banks' compulsory reserves. In early July the firmness of the franc and inflows of capital had made it possible to reduce the tender rate by 1/4 point. The French authorities had thus acted cautiously, and a substantial interest rate differential remained vis-à-vis Germany; the key rate stood at 6.75%

and money market rates at between 7 and 7.25%, while German rates were between 4 and 4.5%. If the inflation differential between the two countries was taken into account, there was still a positive real differential vis-à-vis Germany of the order of 1 1/2 percentage points, which seemed appropriate. In addition, the fundamentals were rather favourable: from the outset the Government had made clear its wish to maintain strict control over the public finances, which had played a major role in the decision to lower interest rates; the growth of the money stock was moderate, that of all the aggregates was slowing down and the growth of M_2, the target aggregate, was well below the target's lower limit. It was clear, however, that if the foreign exchange market were to change the authorities would not hesitate to reverse the movement of interest rates.

Mr. Pöhl considered that the present situation had been described very well by Mr. Dalgaard and Mr. Janson and that there was little to add. He noted that it had been announced that the Deutsche Bundesbank would raise its rates, which it had done. The discount rate had been raised from 2.5 to 3%, the repurchase rate had been increased on two occasions and money market rates had gone up by more than 1 percentage point. The depreciation of the Deutsche Mark was not considered to be very reasonable, given Germany's huge current-account surplus. The action on interest rates together with large-scale interventions had not had much effect on exchange rates. The Toronto Economic Summit seemed to have evoked differing views as to what exchange rate grid was appropriate. The United States tended to favour an appreciation of the dollar, which would help combat inflationary pressures and avoid an increase in interest rates that in turn could only strengthen the dollar. The Japanese had been inclined to watch the situation and did not appear concerned about the fall in the yen and the rise in the dollar; they could be wrong and be faced increasingly with an inflation problem. The Governor of the central bank, however, seemed more cautious in this respect than the Minister of Finance.

In this situation, care should be taken not to raise interest rates too high and tighten monetary policy further, as this would adversely affect domestic demand, which was still not very strong. In Germany, for example, domestic demand was not very buoyant and, in addition, it would be affected by the tax increase. If the depreciation of the Deutsche Mark was added to this, it would encourage exports and therefore lead to a development contrary to what was required. The tax increase was regrettable in this context, even if the official argument was that it was necessary as a result of the budget compromise at Community level. It had to be hoped that the dollar would stop appreciating, as the higher it rose the greater the risk of it falling again, for instance after the US election. Moreover, international co-operation had not functioned very well over the last few weeks, and if the markets perceived this the credibility of the Louvre Accords would suffer, particularly as certain commitments had not been fulfilled: for example that of the United States to reduce the budget deficit (which would be higher in 1988 than in 1987) and that of Germany to encourage domestic demand whereas the opposite was being done in increasing taxes.

Mr. Ciampi noted that in Italy there had also been an increase in short-term market interest rates for external and domestic reasons. The global rise in interest rates had, indeed, been bound to have some influence; in addition, domestic demand was growing very strongly and the large public sector deficit was still posing a financing problem. Real growth was in excess of 3%, the growth of domestic demand was even stronger and, without giving too much cause for concern, a current-account deficit was developing that could reach 0.5% of GNP in 1988. Banks' lending was increasing very strongly, while their funding was growing only moderately. The authorities were insisting that the banks restore balance to their positions by lending cautiously rather than by raising interest rates.

At the Banca d'Italia's suggestion a significant innovation had been adopted by the Italian Treasury: it was the issue of Treasury bills by public auction but without setting a floor or base rate as before. It was therefore a true auction in which the Banca d'Italia intervened only if it thought it necessary to maintain control over liquidity or to prevent any destabilisation of the market. This innovation involved bills up to 3 months and the first auction, which had taken place on 11th July, had seen a slight increase in interest rates.

Mr. Ciampi expressed his concern at the situation which had arisen on the foreign exchange market. The observations made by Mr. Dalgaard and Mr. Janson were shared by the Banca d'Italia and, as Mr. Pöhl had said, it was important to maintain a sense of responsibilities for ensuring that inadequate international co-operation did not itself trigger other movements and that there was not a general increase in interest rates. Developments on the foreign exchange markets could have repercussions later on the EMS and its future. Close co-operation and constant consultation among the members of the Community therefore seemed indispensable and could also have a bearing on the decisions of the major international partners outside the EEC.

Mr. Leigh-Pemberton pointed out that the Bank of England had been concerned for some time about the level of UK interest rates, which it had considered too low in the context of domestic monetary conditions, and about sterling's exchange rate, which it had thought too high. Once sterling had eased the obstacle to raising interest rates had been removed, and they had in fact been increased on five occasions. This had been necessary as, unlike Germany, where domestic demand was not strong enough, in the United Kingdom it was too strong. One only had to look at the rapid growth of domestic credit and the deterioration in the current account. The volume of exports was rising but the growth of imports was much stronger and gave cause for some concern because it was more concentrated on consumer goods than on capital goods.

Mr. Leigh-Pemberton agreed with the comments that had been voiced previously regarding exchange rate co-operation; however, he expressed a slight reservation concerning Mr. Pöhl's remark that the Toronto Summit and the connected statements had not fulfilled his expectations. A lack of effective co-operation could not be replaced by statements, and it seemed preferable to see how action could be taken within the framework of the policy announced earlier, in particular on the occasion of the G-7 meeting held in December 1987.

Mr. Pöhl explained that he had not been calling for a new statement, which would certainly be of little value to the central banks' cause, but he regretted that the Ministers of Finance, meeting at the same time in Toronto, had given the impression that they would tolerate or even welcome an appreciation of the dollar. From this the market had concluded that the dollar would be allowed to rise, and the price for this mistake was now being paid, for example in higher interest rates.

Mr. Doyle pointed out that there was at present a negative differential of 2.5 percentage points between Irish and UK interest rates - an unprecedented situation in the long history of economic and monetary relations between the two countries. It had, of course, to be borne in mind that Irish economic performance had greatly revived: inflation had been brought down to an annual rate of 1.8%, the balance of payments on current account showed a surplus of approximately 3% of GNP and the public finances were improving to such an extent that the deficit for 1988 would certainly be lower than the Budget forecast. In these circumstances it had been possible to put downward pressure on interest rates, which had been reduced by some 6 points over the last nine months. However, it was uncertain how long Irish interest rates could remain so much lower than, and out of step with, UK rates.

The Chairman noted that there were no further comments; he pointed out that, as the Governors had agreed to hold another meeting with President Delors at 11.15 a.m., and seeing how late it was, the time available was perhaps too short to discuss the very interesting report prepared by the "Raymond Group" on developments in public finance and it might be wiser to postpone this discussion until the September meeting.

Mr. de Larosière suggested that Mr. Raymond should nevertheless make some brief comments, as usual, and that the discussion should be held in September.

The Chairman accepted this suggestion.

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 June and the first few days of July 1988.

The Chairman took note of the Committee's approval of the "concertation report", which would be submitted as usual to the EEC Ministers of Finance.

IV. Exchange of views on recent developments in public finance and policy implications.

The Chairman asked Mr. Raymond to introduce the note on public finance, adding that, as had been agreed, the Governors would discuss it at their next meeting.

Mr. Raymond explained that the note submitted to the Governors was one of a regular series produced by the Group of Experts; every year, for the July meeting, the Group prepared updatings of the tables on public finance which had originally been attached to the special reports drawn up in 1981 and 1982, together with an analysis of recent developments in public finance and their implications for economic policy.

1987 had seen a very slight reduction in both general government expenditure and borrowing requirements, including social security transfers, in the Community as a whole. However, this overall outcome fell short of earlier expectations and, as usual, masked very different individual country situations and developments.

There was a group of countries in which the general government deficit amounted to at least 6% of GNP, a level at which it had in theory to be considered unsustainable in the long term. Within this group only three countries (Belgium, Spain and Ireland) had improved their position to any significant extent in 1987. Moreover, in the case of Spain the improvement was attributable to an increase in public revenue associated with dangers of overheating. Progress was slow or non-existent in Italy, Greece, Portugal and the Netherlands (the Netherlands having been adversely affected by the decline in energy prices). There were thus striking differences within the group of countries with high general government deficits.

The United Kingdom and France, where the deficits had been moderate as a percentage of GNP, had made efforts to reduce them, and the United Kingdom had even achieved a surplus. In Denmark and Luxembourg budgetary positions had deteriorated somewhat, but these countries remained in surplus.

Germany, urged by its partners on all sides to use the fiscal instrument to support economic activity, had allowed its deficit to rise by 1/2 percentage point of GNP, fiscal revenue having grown at a slower rate than GNP.

The public debt/GNP ratio had continued to rise for the Community as a whole, with the deficits added to an existing stock of public debt. However, the ratio had fallen in several countries: the three in budgetary surplus already mentioned and, very moderately, thanks to the revenue from privatisations, France.

Further progress towards fiscal adjustment was to be expected in the Community in 1988 if the plans which had been announced were to be believed. Regrettably, these plans would doubtless not greatly affect a number of countries whose budgetary positions were already in serious imbalance. It should, however, be noted that two statements had just been made by members of the Committee regarding Ireland and Italy which demonstrated that efforts were being made in the right direction in these countries.

In Germany a further deterioration of 0.5% of GNP was expected for 1988, before, it would seem, a pause in 1989 prior to the third and final stage of the tax reform.

This overall situation in the Community left a mixed impression. Nonetheless, another feature of developments in public finance was to be welcomed: with few exceptions, the deficits were financed less and less by direct borrowing from the central bank or by foreign currency borrowing from abroad, which in the note was referred to as direct base money creation. In other words, the public sector was making increasing, if not exclusive, use of the securities market to finance its deficit. However, the satisfaction with which this development could be greeted had to be qualified or tempered from the monetary analysis point of view in noting a trend towards a shortening of the maturities of new government debt. It was true that this development was in keeping with normal market operator behaviour: nominal interest rates were no longer on a declining but rather on a rising trend, which meant that some investors preferred to commit their funds only at short term. Despite the reservations to which shorter-term financing gave rise, it had to be noted in conclusion that the conflicts between fiscal and monetary policies had lessened in the Community in 1987.

The Chairman thanked Mr. Raymond for his brief, very concise but also very informative statement, which the Governors would discuss at their next meeting.

V. Follow-up to the European Council meeting in Hanover on 27th and 28th June 1988.

The Chairman noted that this item could be addressed at the meeting which the Governors would be holding very shortly.

VI. Other matters falling within the competence of the Committee.

There was no other business.

VII. Date and place of the next meeting.

The next meeting would take place in Basle on Tuesday, 13th September 1988, beginning at 10 a.m.

Committee of Governors of the
Central Banks of the Member States
of the European Economic Community

Annex

12th July 1988

Confidential

Translation

BRIEF REPORT ON

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

JUNE 1988

This report summarises developments on the exchange markets of the countries whose central banks participate in the concertation procedure[1] and briefly describes their interventions during June and the first few days of July 1988.

I. EXCHANGE RATE DEVELOPMENTS

The main features of the foreign exchange markets in June 1988 were:

- a continued strengthening of the US dollar against most currencies, with an acceleration at the end of the month;
- central bank action to contain the dollar's rise by concerted intervention sales of dollars, chiefly against Deutsche Mark;
- a raising of interest rates in most European countries;
- for the first time since the beginning of the year, a weakening of the yen and, more particularly, sterling vis-à-vis the other European currencies.

The US dollar continued to firm, rising more substantially during the second half of the month. The dollar benefited from the 14th June release of the US trade statistics for April as well as from reports on the

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1 The central banks of the EEC, Norway, Sweden, Finland, Switzerland, Austria, Japan, Canada and the United States.

domestic economy that appeared to indicate a moderation of inflationary pressures. Also, the Toronto summit communique and accompanying statements by several officials suggested that the G-7 monetary authorities would tolerate a further rise in the dollar. Towards the end of the month a number of central banks, in particular the Deutsche Bundesbank and the Federal Reserve, sold dollars against Deutsche Mark to limit the dollar's rise. The dollar closed the month 5 1/2% higher against the Deutsche Mark and 6 3/4% higher against the yen.

The EMS remained stable. There was some movement in currencies' relative positions in the wake of the appreciation of the Irish pound and the Danish krone which moved to the top of the band with a slightly wider spread vis-à-vis the Belgian franc.

The performance of the Deutsche Mark was mixed. It depreciated by 5.2% against the dollar despite occasionally substantial dollar sales by the Bundesbank. In contrast, within the EMS it was able to register slight exchange rate gains against most other currencies. It also improved its position vis-à-vis the pound sterling and Japanese yen. Overall, however, its index against the currencies of fourteen major industrial countries declined by 0.4%. Interest rates on the money and capital markets rose. The Bundesbank increased its repo rate in two stages of 1/4 percentage point each to 3.75% and its discount rate from 2 1/2 to 3% per annum on the last day of the month. The rises in interest rates had no visible effect on the valuation of the Deutsche Mark on the foreign exchange markets.

The French franc moved within narrow limits and continued to benefit from non-resident investment due to the buoyant bond markets. The strong position was bolstered by the announcement of a small retail price increase (+ 0.2%) in May and the holding of the trade deficit to Fr.fr. 1.4 billion in May and was not affected by the narrowing of the short-term interest rate differential vis-à-vis the major European currencies at the end of the month.

Due to very liquid money market conditions short-term guilder rates declined substantially during the month. Consequently the Dutch guilder weakened vis-à-vis all EMS currencies. The Nederlandsche Bank made some intervention sales and partially followed the rise of interest rates abroad by raising its discount rate and rate on advances by 0.25 percentage point to 3 1/2% and 4% respectively with effect from 1st July.

The Belgian franc was fairly stable at the beginning of the month, but weakened progressively during the second half, chiefly as a result of the narrowing of the interest rate differential vis-à-vis the major currencies, and the Banque Nationale intervened repeatedly in order to defend the currency. On the last day of the month the central bank supplemented this by raising its discount and lombard rates by 0.25 percentage point to 6 3/4% and 7% respectively following the general upward movement in interest rates.

The Danish krone strengthened further ending the month as the strongest currency in the EMS. Reflecting the strong krone the Central Bank made some intervention purchases and lowered its lending and deposit rates by 1/4 percentage point to 8 3/4% and 8% respectively on 16th June.

Continued sizable intervention purchases helped to maintain the Irish pound relatively stable within the EMS band for the first half of the month. Subsequently, having been allowed to firm towards the top of the band in response to continued inflows of currency, the Irish pound traded in a narrow range within the EMS band for the remainder of the month.

The Italian lira slightly improved its position in the EMS. The Banca d'Italia was a net buyer on the exchange market as Deutsche Mark purchases exceeded dollar sales.

Sterling weakened sharply, particularly following the publication of the record UK trade deficit for May. Despite four separate 1/2 percentage point increases in the clearing bank base rates (raising them to 9 1/2%) sterling bore the brunt of the return flows to the dollar which followed the improved US trade deficit in April. Sterling's trade-weighted index fell by 3.4 to 75.2 (1975=100).

The Greek drachma weakened vis-à-vis the US dollar by 5.6% while against the pound sterling it strengthened by 2.2%. Measured against the ECU the drachma remained almost stable and in effective terms depreciated by 0.4%.

The Spanish peseta remained firm during most of the period due to continued capital inflows which led in the second and third weeks of the month to substantial purchases of foreign currencies by the Banco de España. However, this tendency weakened in the last two weeks. In all, the EEC index ended 0.5% lower in effective nominal terms.

The depreciation of the Portuguese escudo in effective terms was 0.3%, in line with the exchange rate policy defined by the authorities. Due to the US dollar recovery during the second part of the month the escudo depreciated by 5.5% against this currency.

The Swiss franc weakened vis-à-vis the US dollar by 4.6%. Against most European currencies there was a firming of the rate of roughly 1%. In the domestic money market interest rates for all maturities rose by 1/2 percentage point. In view of the market trend the lombard rate was raised by 1/2 percentage point to 4 1/2% with effect from 1st July. The discount rate was left unchanged for the time being considering the fact that - following the introduction of the new liquidity regulations - discount policy is being reviewed in a fundamental manner.

The Austrian schilling weakened vis-à-vis the US dollar by 5.4%, the monthly spread amounting to 6.7%. Against the Deutsche Mark it fluctuated by a mere 0.1%. There were capital outflows induced by interest differentials. In line with the corresponding measures taken by other European central banks the discount rate was raised by 1/2 percentage point to 3.5% with effect from 1st July. In addition, the money market rate for short-term open market transactions was increased as from 22nd June by 1/4 percentage point to 3 7/8%.

The Swedish krona remained strong during the period. In the first week of June the Riksbank sold currencies as market participants, mainly foreign banks, covered part of their short positions in foreign currencies. The currency index has varied between 130.39 and 130.90.

Continued strength of the Norwegian krone and reduced credit expansion gave room for a further 0.5 percentage point reduction in Norges Bank's overnight lending rate to 12.8% with effect from 10th June. The currency index later showed relatively large fluctuations and central bank interventions took place on several occasions to stabilise the market. The krone weakened towards the end of the month and closed about 1% lower in effective terms.

In effective terms, the Finnish markka weakened by about 1%. Interest rate differentials vis-à-vis the major currencies continued to narrow.

The Canadian dollar ended the month having risen by more than 2% against the US dollar and almost 3.0% on a trade-weighted basis. Through most of the period the Canadian dollar appreciated, buoyed by the strong performance of the Canadian economy and significant short-term interest rate differentials which encouraged strong foreign interest in Canadian dollar-denominated securities and led to large net intervention purchases of US dollars. Towards the month-end the currency eased, reflecting the broad strength of the US dollar against the major overseas currencies.

The Japanese yen weakened sharply against the US dollar towards the end of June, depreciating by about 6% during the month. The yen's decline was attributable mainly to active dollar purchases by speculators overseas and domestic institutional investors against the background of the improved US external balance. Meanwhile, the yen depreciated by 0.7% against the ECU due to a reversal of long positions in yen against the Deutsche Mark.

II. INTERVENTIONS

A. Interventions in US dollars

Net sales of US dollars by central banks amounted to US$ 0.2 billion compared with net purchases of US$ 3.3 billion in May. Gross purchases amounted to US$ 4.6 billion, the main buyer being the Bank of Canada and, to a lesser extent, the Banco de España. Gross sales, which were generally carried out on a co-ordinated basis, totalled US$ 4.8 billion; the main sellers were a number of European central banks (particularly the Deutsche Bundesbank) and the Federal Reserve Bank of New York.

B. Interventions in Community currencies and in private ECUs

Interventions in EMS currencies and ECUs by Community central banks amounted to the equivalent of US$ 2.6 billion compared with US$ 4.3 billion in May. These interventions mainly consisted of purchases of Deutsche Mark by the Banco de España, the Banca d'Italia, Danmarks Nationalbank and the Central Bank of Ireland.

III. DEVELOPMENTS IN THE CURRENT MONTH, UP TO 8th JULY

The US dollar remained around its end-June levels, albeit with greater daily fluctuations against the yen than against the Deutsche Mark, the market for the latter being regularly controlled by Bundesbank interventions.

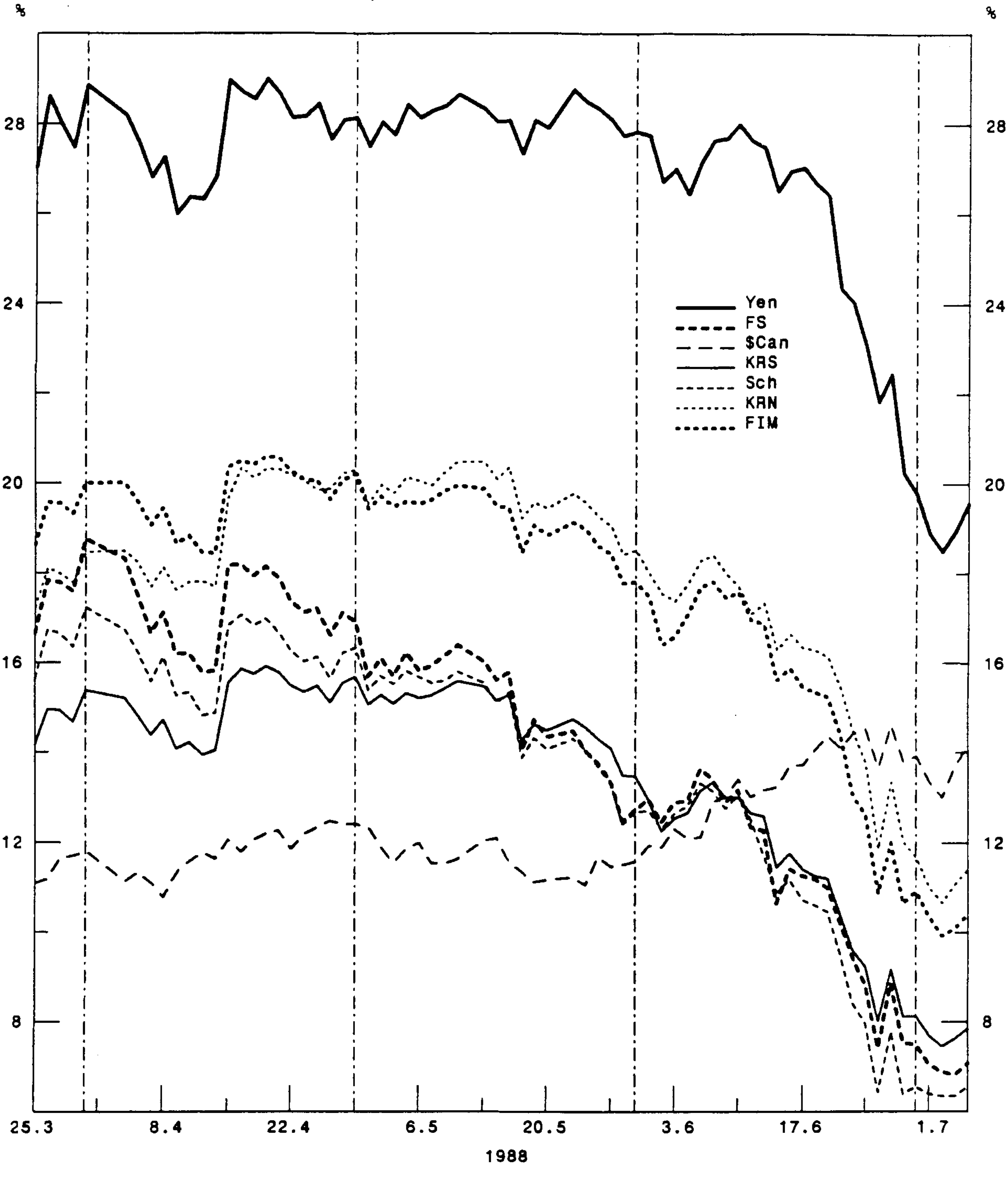
The pound sterling, stimulated by a further 1/2% increase in interest rates (to 10%), and the Japanese yen strengthened. The stability in the EMS continued.

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

* Voir page suivante.

8.7.1988

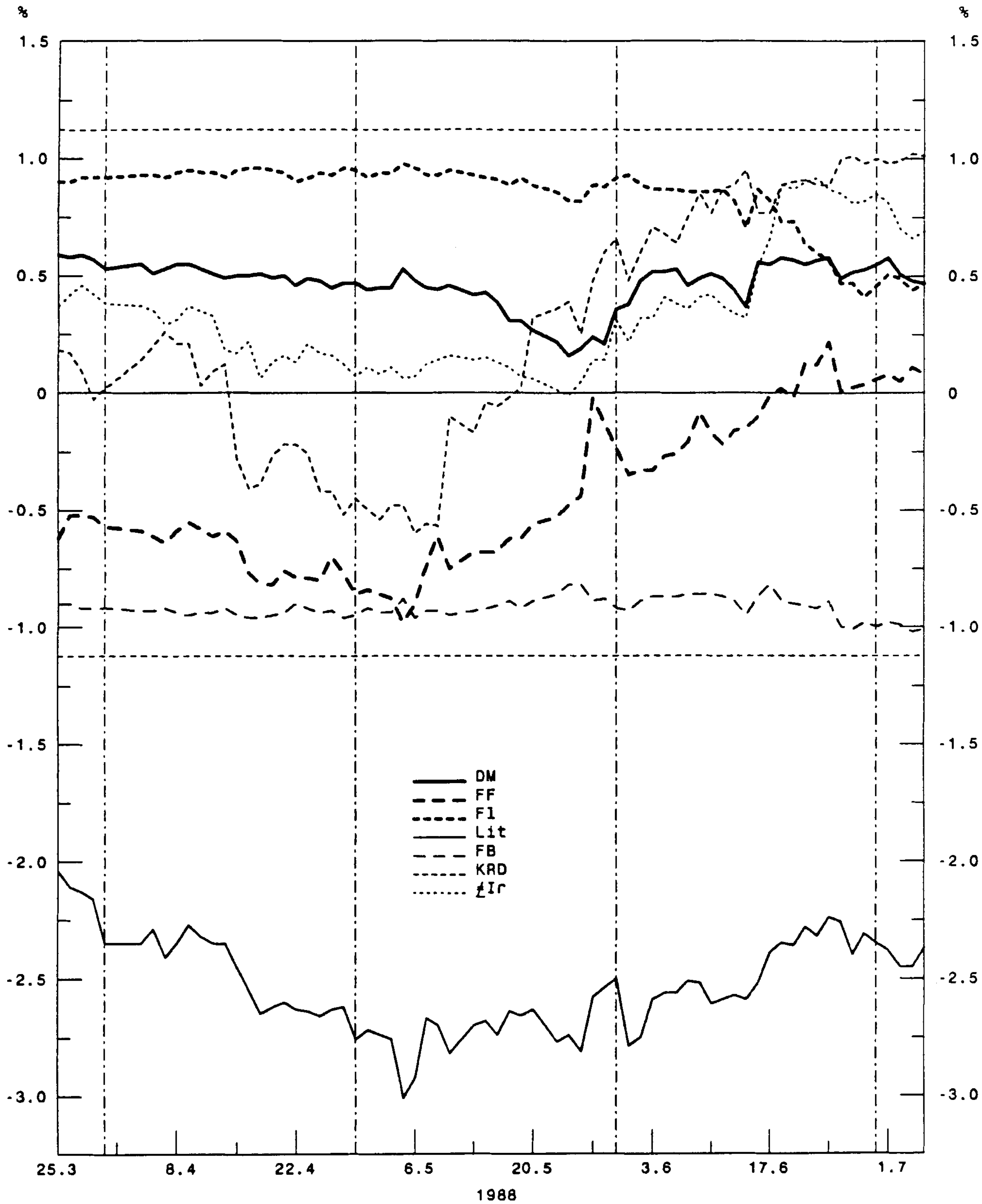
EVOLUTION DES MONNAIES DES BANQUES CENTRALES HORS CEE PARTICIPANT A LA CONCERTATION, SUR LA BASE DES COURS RELEVES LES 31 DECEMBRE 1986 VIS-A-VIS DU $EU*



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

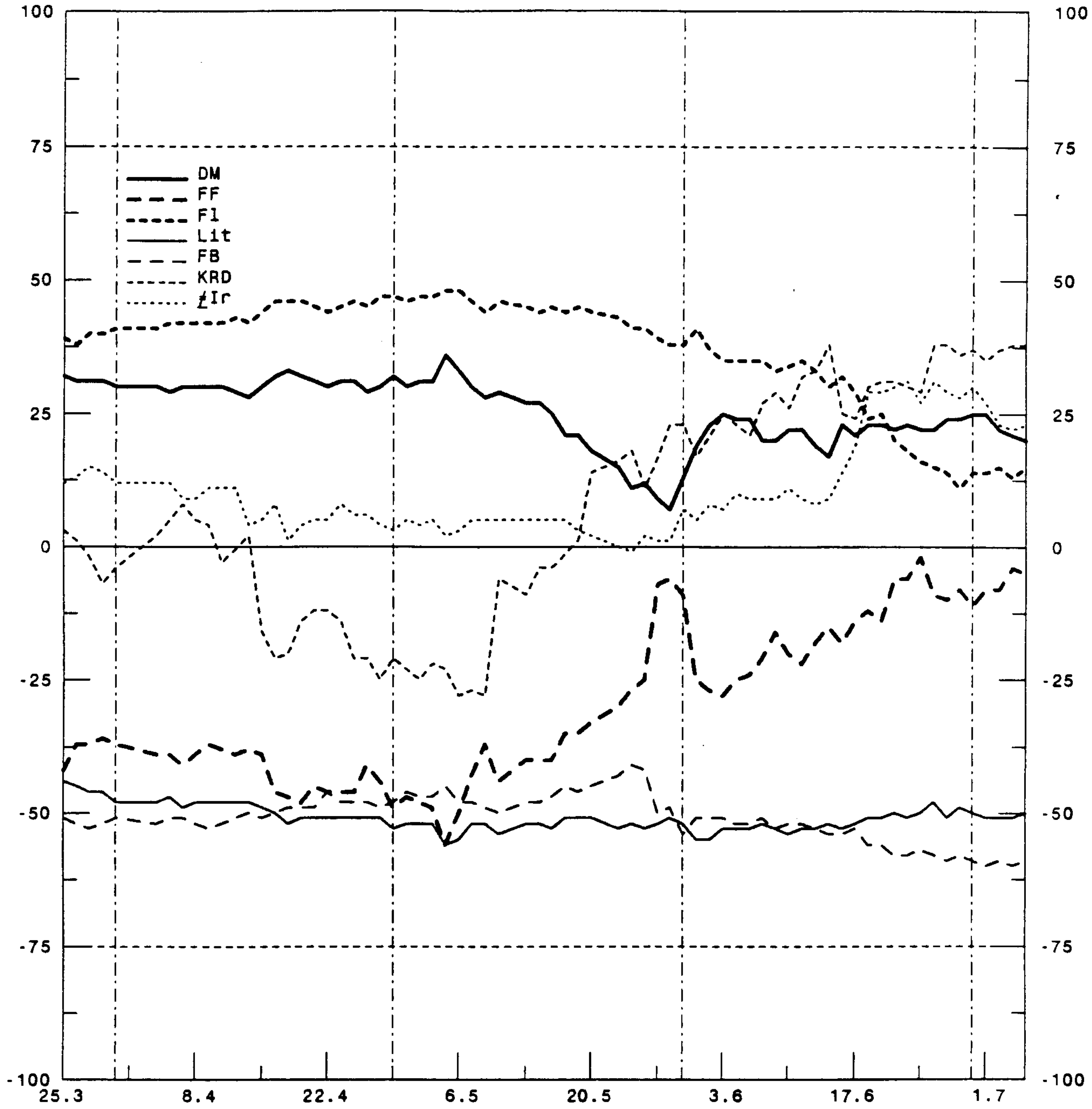
8.7.1988

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



8.7.1988

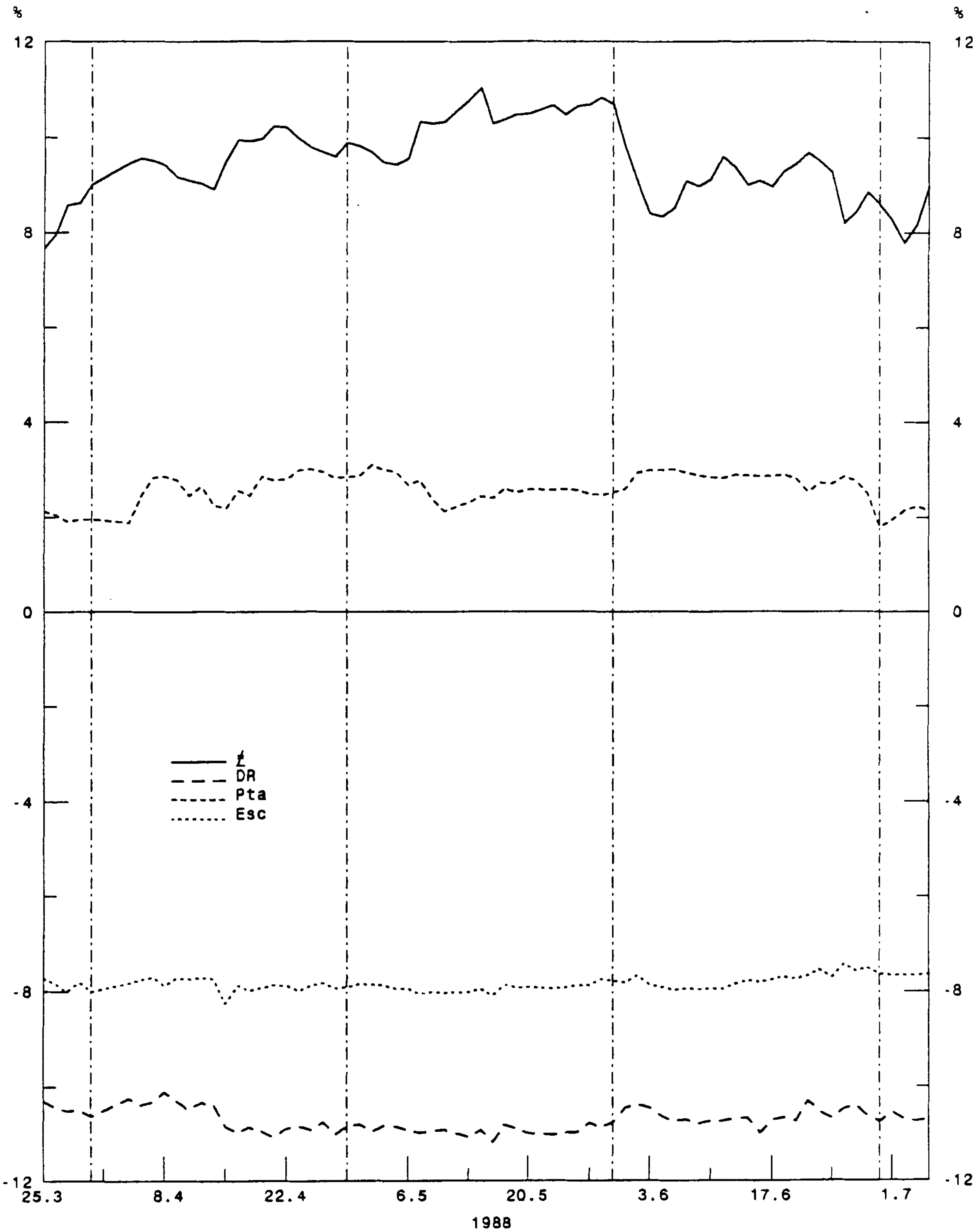
EVOLUTION DE L'INDICATEUR DE DIVERGENCE*



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

8.7.1988

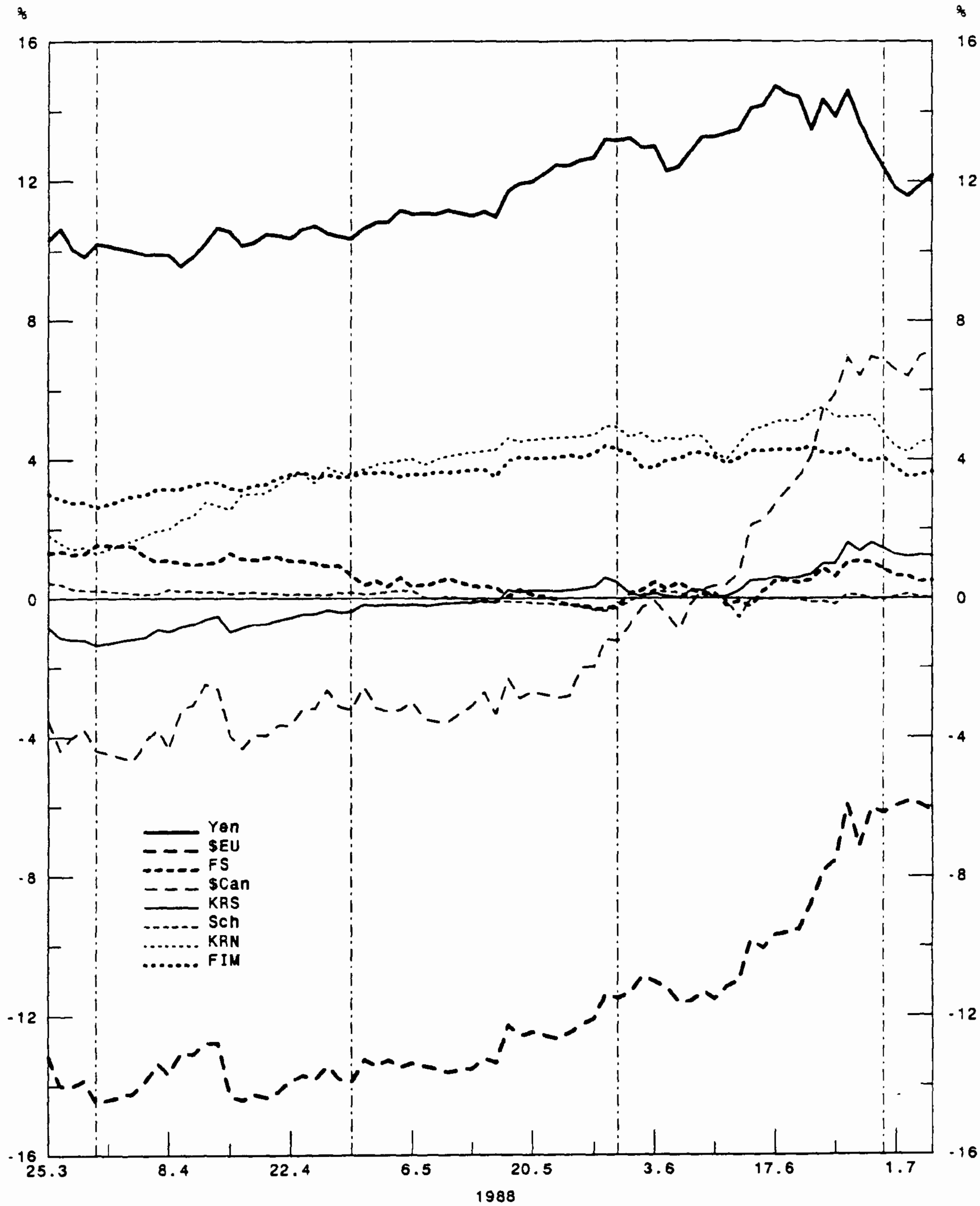
EVOLUTION DE LA LIVRE STERLING, DE LA DRACHME, DE LA PESETA ET DE L'ESCUDO PAR PAPPORT A L'ECU SUR LA BASE DES COURS DU MARCHE RELEVES LE 31 DECEMBRE 1986*



* £ 0,724942; DR 148,526; PTA 141,151; ESC 156,382.

8.7.1988

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



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

8.7.1988