46552

15th July 1993

Confidential

FINAL

MINUTES
OF THE 277TH MEETING OF THE COMMITTEE OF GOVERNORS
OF THE CENTRAL BANKS OF THE MEMBER STATES
OF THE EUROPEAN ECONOMIC COMMUNITY

HELD IN BASLE ON MONDAY, 14TH JUNE 1993

TABLE OF CONTENTS

PAGE

I **Approval of the minutes of the 276th meeting** 1

II **Monitoring of economic and monetary developments and policies in the Community**
1. Statement by Mr. Saccomanni, Chairman, Foreign Exchange Policy Sub-Committee 1
2. Discussion by the Committee 1

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 May and the first few days of June 1993** 3

IV **Adoption of an opinion of the Committee of Governors on fiscal developments in the Community** 4

V **Preparatory work for the move to Stages Two and Three of EMU**
(a) Issues relating to the conduct of the single monetary policy in Stage Three of EMU
1. Statement by Mr. Papademos, Chairman, Monetary Policy Sub-Committee 5
2. Discussion by the Committee 7
(b) Status of preparatory work 7

VI **Other matters falling within the competence of the Committee**
(a) Renewal of the bilateral swap agreements with Suomen Pankki 8
(b) Co-operation with EFTA central banks 8
(c) Meeting with Trade Union representatives 8
(d) Presentation of the Annual Report to the European Parliament 8

VII **Date and place of next meeting** 8

*****

List of participants attached

The *Chairman* opened the meeting by welcoming Mr. Costa Pinto who had been appointed a member of the Board of Directors of the Banco de Portugal and would be the first Alternate to Mr. Beleza. He also welcomed Mr. Guill in the absence of Mr. Jaans.

I Approval of the minutes of the 276th Meeting

The *Committee* approved the minutes of the 276th meeting.

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

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

The Monitoring Group had discussed two issues. Firstly, the procedural aspects of the last realignment and its implications and, secondly, the trend of interest rates in Community countries. With regard to the first issue, the Monitoring Group had noted that the central bank dealing rooms had first learnt about the Spanish decision to suspend intervention in favour of the peseta from news agencies and, in some cases, commercial banks. It was also felt that the central banks had not been adequately informed about the interventions undertaken by the Banco de España during the morning of 12th May. In the opinion of the Group, it was essential for the co-operation among central banks that the quality and timeliness of the data on intervention be maintained. With respect to the implications which the realignment would have on the markets' behaviour, it was felt that the suspension of intervention obligations during the day without prior notice had introduced an additional element of uncertainty, but it was too soon to determine what kind of market behaviour could evolve if further tensions were to develop in the ERM.

With regard to recent interest-rate changes, the Group had noted that the downward trend in a number of Community countries was taking place in the context of the relatively weak position of the Deutsche Mark. However, this should not be seen as evidence that Member States were decoupling their interest-rate policies from that in Germany. Although the rates in some countries, particularly in those whose currencies were in the narrow ERM band, had fallen below those in Germany, there was little scope for further decline in relative terms. Finally, concern had been expressed about the effect of the real exchange rate appreciation in ERM countries whose economies were in recession.

2. Discussion by the Committee

The *Chairman* thanked Mr. Rojo for his note dated 24th May 1993 describing the procedure followed in the recent realignment of the peseta. He suggested that the Alternates should be asked to consider the procedures followed, and the lessons to be learnt from the realignment, and to prepare an oral report which should be presented to the Governors either in July or September.

With regard to monetary policy in France, *Mr. de Larosière* said that the French authorities had continued its policy of gradually reducing official interest rates by following the downward trend in market rates. Official rates had been reduced eight times in two months in steps of 0.25 percentage point, including a reduction announced that morning; the Lombard rate now stood at 8.25%, and the intervention rate at 7.25%. Short-term interest-rate differentials vis-à-vis Germany were now negative: at one-month -18 basis points; at three-months -25 basis points; at six-months -25 basis points; and at one year, -12 basis points. The initial reaction of the markets to the recent interest-rate reduction had been favourable. The French authorities would continue with their cautious and prudent approach.

Mr. Fazio said that the discount rate in Italy had been reduced by 0.5 percentage point to 10% on 11th June, following a reduction from 11% to 10.5% three weeks previously. Such gradual movements had followed the spontaneous downward trend of money-market interest rates; the secondary market prices of government bonds had firmed and the assignment rates of Treasury bills at auction had declined to around 9.2%, their lowest level for nearly six years. Inflationary pressures remained weak and the exchange rate had so far shown little reaction to the recent lowering of interest rates.

Mr. Hoffmeyer said that the Danmarks Nationalbank had calculated that the increase in the real effective exchange rate of the Danish krone following the ERM turbulences would last for approximately two years if the present policy was pursued. However, the political reaction in Denmark to the increasing rate of unemployment was for fiscal policy to become more expansionary; an increase in the public sector deficit from well over 3% to 4.5% could be foreseen as an unsatisfactory consequence.

Mr. Leigh-Pemberton referred to speculation that the new Chancellor of the Exchequer in the United Kingdom would pursue a policy of lowering interest rates. He felt that this view was incorrect. There would be no change in the government's attitude towards the United Kingdom's monetary policy and the prospects of a reduction in interest rates remained remote.

Mr. Schlesinger said that there was no room for German interest rates to be lowered; long-term rates had even increased by a small amount. Furthermore, monetary expansion, which in April had grown by an annualised rate of 7%, was outside of the target range for 1993 of 4.5% to 6.5%. With regard to public finance, Germany's situation had worsened. In addition to the budgetary programme that had been formulated for 1995 and subsequent years, the Federal Government was now aiming at reducing the deficit projected for 1994 by a further DM 20 billion; otherwise the federal deficit in 1995 would be higher than the level which was projected for 1993 (around 5% for the Federal Government, the state governments and the local authorities taken together, 6% if social security funds were included, and 7% including the Treuhandanstalt and the federal railway system). Thus, no room existed for any additional anti-cyclical measures to be taken by the government.

Mr. Christodoulou said that the Greek government had announced its intention to maintain its public sector deficit target although broadening the tax base, which was the principal element to ameliorate the country's revenues, continued to be difficult. For its part, the central bank did not intend to allow real interest rates in Greece to fall so as to ensure that its monetary targets were reached, although nominal interest rates would be allowed to decline as the rate of inflation fell.

Mr. Rojo said that after the general election in Spain there had been an improvement in the development of the peseta. Even after its devaluation two weeks prior to the elections, the Spanish currency had come under attack as a result of political uncertainties; however, the Banco de España had not intervened to support the currency. Following the elections, the Spanish government no longer had an overall majority and was in negotiations with other political parties with a view to forming a coalition; these were likely to take a further month to conclude. In the meantime, the Banco de España was maintaining its careful monetary policy stance. M3 was growing at an annualised rate of 4.5% and no major interest-rate changes would be made pending the announcement of the government's economic policy.

Mr. Beleza said that he supported the Chairman's suggestion that the Alternates be asked to prepare an oral report for the Governors on the procedures followed and the lessons to be learnt from the recent realignment. Monetary conditions in Portugal were currently much as they had been towards the end of February although problems were faced on the fiscal front; the deficit was currently higher than forecast with tax receipts declining by more than the slowdown in activity would suggest.

The *Chairman* said that de Nederlandsche Bank was following a policy similar to that in France. The strength of the Dutch guilder had enabled interest rates in the Netherlands to be lowered gradually. One, three and six-month rates were currently between 75 and 80 basis points lower than the equivalent rates in Germany, although this was regarded as a temporary phenomenon. On the basis of figures up to May 1993, the fiscal deficit was currently at a level close to 3% of GDP, but there were concerns that the fiscal position could deteriorate in the future both for cyclical and structural reasons.

Mr. Doyle welcomed Mr. Leigh-Pemberton's statement that the British authorities had no intention to reduce interest rates further. The move last January had caused considerable difficulties for Ireland. Irish interest rates were currently around an unprecedented 50 basis points below those in Germany. Official interest rates in Ireland had been reduced on twelve occasions since the end of January; as in France, the Irish authorities had been following downward movements in market interest rates rather than forcing them lower.

Mr. Verplaetse said that the monetary situation in Belgium lay between that prevailing in the Netherlands and Germany. The Belgian authorities were working closely with their counterparts in these two countries and still considered the Deutsche Mark to be the anchor. The most difficult problem in Belgium remained the fiscal deficit. The measures taken during the previous fifteen months had reduced this by more than 4% of GDP, although around three-quarters of this reduction would be absorbed by cyclical factors.

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 May 1993 and the first few days of June 1993

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

IV Adoption of an opinion of the Committee of Governors on fiscal developments in the Community

With reference to the draft opinion on fiscal developments in the Community which had been prepared by the Alternates, the ***Chairman*** asked whether any Governor wished to comment on the text. He suggested that the opinion should be sent to the Presidency for distribution to the members of the Council and that he would read it out at the ECOFIN Council meeting on 13th July and that the opinion could be made public.

Following interventions by ***Messrs. de Larosière, Leigh-Pemberton*** and ***Fazio***, the ***Committee*** agreed to amend the phrase at the bottom of the first page "and limit in many Community countries the scope for lowering official interest rates despite the weakness of economic activity" to read "and make it more difficult for some Community countries to lower official interest rates despite the weakness of economic activity."

Mr. Christophersen asked whether the opinion would be available to the Presidency before the European Council meeting on 21st and 22nd June. Some Member States might wish the European Council to adopt a more relaxed position on fiscal deficits. If the Governors' opinion were to be available before its meeting, it could impose some discipline on the way in which the European Council expressed its views about the policy mix.

Mr. Doyle said that the opinion would not get the attention it deserved at the European Council meeting because its agenda was already full. Furthermore, its impact would be reduced by the time that the ECOFIN Council convened in July if it had already been released ahead of the European Council meeting.

Mr. Fazio said that he was in favour of making the opinion available in advance of the European Council meeting.

Mr. Christodoulou said that he shared Mr. Fazio's view. The problem was so significant that it should be addressed at a high level as soon as possible. The issue was not one which could be resolved with one discussion and, therefore, it would be appropriate to bring it to the attention of the Heads of State in June and also to put it on the agenda of the ECOFIN Council in July.

Mr. de Larosière said that he did not feel that it was appropriate for the opinion to be made known at the Heads of State level without first having been discussed in the ECOFIN Council.

After a further short discussion, the ***Chairman*** suggested to send the opinion, together with an accompanying letter addressed to the Presidency dated 19th June 1993, requesting the circulation of the opinion of the members of the ECOFIN Council through its Secretariat ahead of the July meeting. This would allow Finance Ministers, if they wished to do so, to bring the Governors' opinion to the attention of the Heads of State and Governments before the European Council meeting on 21st and 22nd June 1993.

The ***Committee*** agreed with the Chairman's suggestion.

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

(a) Issues relating to the conduct of the single monetary policy in Stage Three of EMU

1. Statement by Mr. Papademos, Chairman, Monetary Policy Sub-Committee

In accordance with its special mandate, the Monetary Policy Sub-Committee had recently had a first exchange of views on the issues relating to the conduct of the single monetary policy in Stage Three of EMU based on papers prepared by five central banks and by the Economic Unit. Although a report was not foreseen before the autumn of 1993, this oral report prepared on the Chairman's own responsibility intended to brief the Committee on the progress made so far and some preliminary conclusions.

The discussions of the Sub-Committee had focused on four topics: the link between monetary policy strategy and the selection of instruments and procedures; the choice of monetary policy strategy; the definition of the monetary policy stance; and issues relating to instruments and procedures.

Firstly, members had argued that there was a link between the choice of monetary policy strategies and the selection of instruments and procedures; however, the link was not always very strong and depended on the strategy. For example, an exchange rate target had significant implications for the use of the interest-rate instrument, while in the case of the monetary target the relationship was weaker. Experience had shown that, in some cases, changes in the monetary policy strategy had also forced the adaptation of instruments while, in other cases, the move to a new strategy had taken place without changing tactics. It had also been noted that similar instruments and procedures were currently employed by central banks pursuing different intermediate targets. Regardless of the strength of the link, however, most members had agreed that the strategy should be chosen first before embarking on a detailed evaluation of alternative means of implementing policy.

Secondly, with respect to the strategy the ECB could follow, agreement had emerged that the range of options could be narrowed down to the adoption of intermediate targets for monetary or credit aggregates on the one hand, and a strategy which focused directly on the final policy objective of price stability on the other. There had been no support for an intermediate interest-rate or exchange rate objective. The latter had been considered especially undesirable in a large monetary union since it might be inconsistent with the commitment to the goal of price stability. Most Sub-Committee members had supported the adoption of a strategy based on intermediate monetary targets, which need not exclude the close monitoring of other indicators. It had also been argued that, at the beginning of Stage Three, it would be desirable to combine a monetary target with a direct inflation objective. More generally, there had been consensus that the monetary policy strategy should be simple, transparent, easily explainable to the public and should help insulate the ECB from external pressure. It had also been stressed that a strategy based on intermediate targets should be carried out in a medium-term framework and be implemented in a pragmatic way without following mechanical rules.

The deliberations of the Sub-Committee had pointed to potential difficulties in choosing the strategy at the beginning of Stage Three because of uncertainties about the prevailing financial structure and market conditions, as well as about the initial number of countries participating in monetary union. In such an uncertain situation, there would be an increased risk of deviations of monetary aggregates from monetary targets which would seriously impair the credibility of the ECB. Thus, some members had argued that a monetary target should initially be managed with greater flexibility in order to achieve the final inflation objective. The Sub-Committee had been aware of the dilemma that existed between flexibility and the need to gain credibility right from the start of Stage Three. Also important was the question of how to maximise the transfer of credibility from national central banks in Stage Two to the ECB.

Thirdly, the Sub-Committee had discussed possible definitions of the single monetary policy stance. A complete equalisation of interbank interest-rate levels in all member countries had been regarded as too ambitious, especially at the beginning of Stage Three. It would be more realistic to ensure that changes in interest rates due to monetary policy measures or liquidity shocks were the same in each country, regardless of their origin and some initial differences in interest-rate levels. A crucial condition for a single monetary policy stance would be the existence of cross-border arbitrage possibilities for banks. This condition would have strong implications for the linkage between national payment systems. The formulation of the precise features of a sufficiently interlinked payment system would be dealt with by the Working Group on EC Payment Systems, but the Sub-Committee had underlined the importance of keeping in close contact with this Group's work.

Finally, a preliminary exchange of views had taken place on the type of instruments and procedures which the ECB could use, the extent to which harmonisation should take place, the degree of decentralisation of operations and the scope of discretion for national central banks in the implementation of a single monetary policy. Members had stressed that these questions were interlinked. Although there had been general agreement that short-term interest rates were the most likely main operating targets of the ECB, there had been differences about the efficiency of specific instruments and procedures. With respect to instruments, the Sub-Committee had discussed the advantages and disadvantages of reserve requirements. On the one hand, some members had emphasised their usefulness for interest-rate control through their effects on the size and stability of the demand for central bank money and for money supply control through the influence on the difference between the yields on monetary and non-monetary assets. On the other hand, other members had noticed the negative implications of non-remunerated reserves for financial intermediation and had pointed to alternative means of stabilising central bank money.

With regard to other instruments, there had been broad agreement that market operations would serve as a main instrument for liquidity control and that the ESCB should provide a standing financing facility. Alternative views had been expressed, however, about the relative importance of open market operations and financing facilities. This issue was related to the degree of decentralisation of operations and had been discussed in terms of two benchmark models. According to one model, monetary policy would be conducted with very frequent fine-tuning operations by the ECB and hence there would be no need for reserve requirements and standing facilities. This, however, would imply a high degree of centralisation, with open market operations being executed by the centre with a small number of counterparts. According to the second model, open market operations would be carried out at less frequent, but regular, intervals and would be complemented by standing facilities and reserve requirements. This would enable a high degree of decentralisation, but would also have implications for the extent to which instruments were harmonised.

A number of members had suggested that, at the start of Stage Three, there might be a greater role for national central banks than later on, owing to the need to cope with possible friction arising from an initial imperfect integration of money markets. The appropriate degree of decentralisation and discretion later in Stage Three should depend upon the prevailing conditions and could not be easily judged on the basis of existing differences. It had been stressed that the decentralised use of instruments and procedures should not lead to conflicting signals which would hamper the conduct of a single monetary policy. Although members had been aware of the political aspects involved in the final choice of the degree of decentralisation and discretion, the discussion had suggested the possible existence of a trade-off between subsidiarity and efficiency in the implementation of monetary policy.

In conclusion, the Sub-Committee had been cognisant of the fact that the primary responsibility for the preparation of the single monetary policy lay with the EMI while the ultimate decisions would be taken by the ECB. Moreover, owing to uncertainties about the prevailing financial structure at the start of Stage Three, only preliminary or conditional answers could be given to a number of questions. Nevertheless, the Sub-Committee members had stressed the need to proceed with the clarification of various issues relating to the single monetary policy strategy and its implementation as early as possible. In particular, since changes in policy instruments and procedures should be made gradually, the possible need for such changes on the way to Stage Three should be identified promptly.

2. Discussion by the Committee

Mr. Schlesinger said that the monetary policy strategy and the instruments to be adopted upon the introduction of a new currency regime must be stronger than those prevailing in each of the member countries. Otherwise, if Stage Three began with weaker instruments and targets so as to provide for "flexibility" and "discretion", it would not be successful.

Mr. de Larosière said that Mr. Papademos' oral report had raised a number of interesting questions which would need to be pursued. He noted that the Federal Reserve system had started out on a decentralised basis but had moved towards greater centralisation. He understood Mr. Schlesinger's point that Stage Three should begin on a strong footing and that if too much was left to national discretion the whole process could falter. However, in a "subsidiary-type" system, as had been agreed in the Maastricht Treaty, some discretion and decentralisation had to be accommodated, at least at the start. Greater centralisation was likely to occur as the system evolved.

(b) Status of preparatory work

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

VI Other matters falling within the competence of the Committee

(a) Renewal of the bilateral swap agreements with Suomen Pankki

With reference to the letter which each central bank had received from Suomen Pankki requesting the renewal of the bilateral swap agreements which would expire on 31st July 1993, the ***Chairman*** said that the Foreign Exchange Policy Sub-Committee was due to discuss this matter that day and would prepare a recommendation in time for the Governors' July meeting.

(b) Co-operation with EFTA central banks

As a follow-up to the Governors' agreement with the EFTA central banks to have exchanges of views between the Chairman of the Committee and the governors of these central banks from time to time, the ***Chairman*** said that he intended to have a meeting with EFTA central bank governors following the Governors' meeting in July to discuss questions relating to the preparatory work for Stage Three of EMU.

(c) Meeting with Trade Union representatives

The ***Chairman*** informed the Committee that he intended to meet representatives of the central banks' trade unions in the near future to apprise them of matters of interest to them.

(d) Presentation of the Annual Report to the European Parliament

The ***Chairman*** said that he had accepted an invitation by the European Parliament to present the Committee's Annual Report to a plenary session of the European Parliament in Strasbourg on 14th July.

VII Date and place of next meeting

The next meeting of the Committee will take place at the BIS in Basle on Tuesday, 13th July 1993.

******

To mark the occasion of Mr. Leigh-Pemberton's retirement, the ***Chairman*** congratulated him on his elevation to the peerage and thanked him for the contribution which he had made to the work of the Committee during his ten years in office. He mentioned in particular the independent position demonstrated by Mr. Leigh-Pemberton in the framework of the "Delors Committee". ***Mr. Leigh-Pemberton*** said that he was a great devotee of the future of an increasingly united Europe. He thanked the Chairman and his colleagues on the Committee for their understanding of his - sometimes difficult - position. He also thanked the Secretary General and his team for their expert and efficient support to the Committee.

277TH MEETING OF THE COMMITTEE OF GOVERNORS
14th June 1993

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. Fazio Mr. Dini Mr. Santini
Institut Monétaire Luxembourgeois	Mr. Guill
Nederlandsche Bank	Mr. Szász Mr. Boot
Banco de Portugal	Mr. Beleza Mr. Costa Pinto Mr. Gaspar
Bank of England	Mr. Leigh-Pemberton Mr. Crockett Mr. Clark
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