

MINUTES*
OF THE 238th 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 SEPTEMBER 1989 AT 9.30 a.m.

Those present at the meeting were: the Governor of the Bank of Greece and Chairman of the Committee, Mr. Chalikias, accompanied by Mr. Papademos, Mr. Karamouzis and Mr. Brissimis; the Governor of the Banque Nationale de Belgique, Mr. Verplaetse, accompanied by Mr. Rey, Mr. Michielsen and Mrs. de Wachter; 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 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. Santini; the President of De Nederlandsche Bank, Mr. Duisenberg, accompanied by Mr. Szász and Mr. Benard; the Governor of the Banco de Portugal, Mr. Tavares Moreira, accompanied by Mr. Pêgo Marques and Mr. Amorim; the Governor of the Bank of England, Mr. Leigh-Pemberton, accompanied by Mr. Crockett and Mr. Price; the Vice-President of the Commission of the European Communities, Mr. Christophersen, accompanied by Mr. Carré and Mr. Schmidt; the Director General of the Luxembourg Monetary Institute, Mr. Jaans; Mr. Kees, Secretary of the Monetary Committee. Also present at the meeting was Mr. Dalgaard, Chairman of the Group of Experts. The Secretary General of the Committee, Mr. Morelli, his Deputy, Mr. Bascoul, Mr. Scheller and Mr. Giles, and Mr. Bockelmann and Mr. Dagassan also attended.

* Final text approved at the meeting on 14th November 1989, which incorporates some drafting changes.

I. Approval of the minutes of the 237th meeting

The Committee approved the minutes of the 237th 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 focused its attention on matters relating to the Italian lira and the Spanish peseta, after briefly discussing the situation of the dollar. After weakening slightly from mid-June onwards, the dollar had strengthened again since early August to a level of DM 2, almost the same level as the peak recorded in June. This trend was attributable to a number of factors, in particular the considerable confidence in the dollar, which stemmed perhaps from the fact that for two and a half years it had on average seemed more profitable to invest in dollars than in Deutsche Mark or yen. The interest rate differentials in favour of the dollar were relatively narrow, more so than early in the year, and thus were not the reason for the dollar's strength. The dollar was, however, supported by market expectations that the US economy would continue to grow and that monetary policy would therefore not be relaxed. As far as the short-term outlook was concerned, the possibility could not be ruled out that signs of an appreciable slowdown in the US economy or poor foreign trade figures might lead to a sharp fall in the dollar. This might then create problems for the EMS exchange rate mechanism, given that the ensuing deterioration in the balances of payments in Europe would not be sustained equally easily by the countries concerned. However, it seemed more likely that growth would continue in the United States and that interest rates would remain at their present level. Renewed upward pressure on the dollar could not be ruled out, and this would not be helpful to the adjustment process given the US fundamentals. Opinions differed as to possible courses of action. Some thought that it would be necessary for the central banks to

show that they wished to keep the dollar exchange rate below DM 2.03, its June peak, to prevent it from rising above that level again. Others considered that intervention had little likelihood of success if the Federal Reserve and the Bank of Japan, whose enthusiasm had so far only been lukewarm, did not participate wholeheartedly.

The heavy interventions by the Banca d'Italia had been discussed. Very strong growth in Italy coupled with too weak a fiscal policy necessitated a tight monetary policy and led therefore to high interest rates, which attracted capital. The Banca d'Italia had allowed the lira to appreciate slightly - by around 4% since autumn 1988 - which assisted price stability but was bad for competitiveness. This appreciation had been halted at a level corresponding roughly to the upper limit of the narrow band, which was in fact a way of shadowing the narrow-band currencies. Some experts had found that pursuing this policy was probably more difficult than actually being in the narrow-band system, where the fact that the rate could not rise further would limit expectations. The experts at the Banca d'Italia were not convinced by this argument. In fact, very substantial interventions - amounting to about US\$ 5 billion since early July - had been necessary to halt the decline of the lira, and the Banca d'Italia was aware that such interventions could not continue for long. It was expected, however, that fiscal policy would soon be tightened: the budget for 1990, which would be presented by the end of September, should contain measures in that direction, and others should already produce an effect in the fourth quarter of 1989. If this did occur, interest rates, and hence also the lira exchange rate, should weaken. This was precisely the reason why the Banca d'Italia did not wish to see a further appreciation of the lira now, when it was hoping that the rate might soon come down again. The Banca d'Italia would, however, reconsider its policy if the measures to tighten fiscal policy did not work out as planned.

The situation in Spain was in some respects similar to that in Italy: growth was buoyant, while fiscal policy was inadequate and therefore had to be augmented by a tight monetary policy. The high interest rates had at times resulted in very large intervention purchases (of the order of US\$ 27 billion in 1988 and 1989) and a substantial appreciation of the peseta (of around 10%). Lately, the situation had appeared more balanced. Interest rates were still high, but it was expected that they might gradually come down, for, over the months, fiscal policy had become less expansionary, and

measures to tighten it had been taken in July. Finally, it was expected that the Government would be re-elected at the forthcoming early election and that it would tighten fiscal policy. This was probably the reason why no significant intervention had been necessary since early August. Moreover, the Banco de España had contributed to this development by allowing the peseta to move very close to its upper limit, thereby reducing possible exchange rate gains and increasing potential losses. On 8th and 11th September interventions had been carried out at or near the limit in Copenhagen and Madrid. It was to be hoped that these interventions were exceptions and did not signal the beginning of new inflows of funds into Spain.

At the other end of the band the Danish krone was close to its limit with the peseta. The fundamental position in Denmark had not changed. The Danish krone was stable and had even firmed slightly against the Deutsche Mark; its relative weakness within the mechanism had lasted for some time, reflecting the sluggish growth of the economy, which called for interest rates to be as low as international conditions permitted. The Danish authorities had raised interest rates following the increase in Germany in order to maintain differentials; it would be more problematic if it were necessary to adjust to the very high level of Spanish interest rates.

The experience with the Italian lira and Spanish peseta showed that it was possible to retain some independence with regard to monetary policy for a while. Both countries had kept interest rates higher than the international situation required, thereby attracting inflows of funds, to which they had reacted by letting the exchange rate appreciate and carrying out substantial intervention purchases. It was obvious, however, that such a situation could not go on for very long. Both countries were fully aware of that: it appeared that the situation was now more or less under control in Spain and that it should improve in Italy with the new budget.

The "Monitoring Group" had also discussed intervention techniques and the choice of intervention currencies, particularly in connection with the interventions by the Banca d'Italia. Substantial purchases of dollars were clearly not advisable when the US currency was firm, while at first sight the obvious choice would be the Deutsche Mark, which the German authorities hoped would strengthen. However, the Deutsche Bundesbank had hesitated to agree to substantial purchases, arguing in particular that the Deutsche Mark was at the top of the narrow band, that the accumulated Deutsche Mark might be resold later at an awkward moment and that it would be

preferable to purchase weaker currencies, like the Danish krone. Some experts had remarked that the markets for these currencies were limited while that for the Deutsche Mark was very broad and could for that reason absorb sizable interventions without any major effect. In actual fact the Banca d'Italia had purchased Deutsche Mark, within the limits authorised by the Deutsche Bundesbank, roughly the same amount of dollars, thereby neutralising the effects on the US dollar/Deutsche Mark exchange rate, and smaller amounts of ecus, French francs and Danish kroner.

The Banco de Portugal had also purchased dollars, as it did regularly, but in larger amounts than usual (more than US\$ 1 billion in August).

Overall, net purchases of dollars had been recorded for the July-August period despite the strong and rising trend of the dollar and despite concerted action to limit its appreciation. The experts had not come to any definite conclusion regarding this situation but considered that better co-ordination was necessary.

The experts had only been able to touch upon other important but perhaps less urgent issues. The continued high current-account surplus in Germany, for instance, was causing concern, especially since a reduction was not very likely in the near future, given the depreciation of the Deutsche Mark in real terms. The Deutsche Mark exchange rate was still dominated by capital outflows. After the abolition of the withholding tax long-term capital outflows had stopped, but there had been massive outflows of short-term capital to countries with relatively high interest rates, such as Italy. Had it not been for these outflows, the strength of the German economy should have led to a firming of the Deutsche Mark.

B. Statement by Mr. Papademos

The Alternates had focused their discussions on the policy problems and dilemmas faced by certain Community countries which were experiencing inflationary pressures as well as budget and/or current-account deficits and whose currencies were appreciating against those of countries with a low rate of inflation and a current-account surplus. The main reason for discussing this topic was the continued strength of the Italian lira and the Spanish peseta.

In Italy the monetary authorities, faced with an inappropriate policy mix, had had to accept high interest rates and the subsequent strengthening of the lira in the fight against inflation, but this was at

the expense of a deterioration in international competitiveness. The appreciation of the lira would have been even greater had the Banca d'Italia not intervened. Fiscal policy was inadequate for curbing the excessive growth of domestic aggregate demand, and monetary policy was overburdened, pursuing several separate objectives.

In Spain the appreciation of the peseta was also related to the tightening of monetary policy since July, which was aimed at moderating domestic demand growth and inflationary pressures. The Banco de España had allowed the peseta to reach the upper limit of the wide band against the Danish krone without any major interventions. The appreciation of the peseta was not, however, attributable to the policy mix to the same extent as in Italy, for the fiscal situation in Spain was developing favourably, with the public sector borrowing requirement projected to fall to 2.5% of GDP this year.

In connection with these developments a number of policy problems had been discussed by the Alternates: firstly, what could be done to improve the policy mix in certain countries; secondly, how long the seemingly paradoxical behaviour on the part of the exchange markets would last, i.e. whether the situation had become unsustainable; thirdly, the desirability of interventions as opposed to exchange rate changes; and, finally, the choice of intervention currencies.

With regard to the first issue, namely the policy mix, the Italian Alternate had noted that after the presentation of the new budget by the Government at the end of September, it was expected that fiscal policy would be tightened very soon. If the Government's budgetary programme were translated into effective measures, the market would be convinced that the public sector deficit would be brought under control, and this would allow some easing of monetary policy. Although the fiscal situation in Spain was not as serious as in Italy, efforts should be made to improve it. Budgetary reforms were expected if the present Government won the next election. More generally, the view had been expressed that governments which did not tackle fiscal problems adequately should be pressured into moving in the right direction. One Alternate, however, had pointed out that the relationship between budget deficits and current-account deficits was not one-to-one and that, consequently, fiscal austerity would not necessarily lead to an improvement in current accounts.

The Alternates had agreed that it was not possible to forecast accurately how long the exchange markets would continue to behave in a paradoxical fashion and that the markets did not yet consider the situation to be unsustainable, although it could become so in the long run. The markets might, however, suddenly change their views if they judged the economic imbalances to be potentially unsustainable, and it was thus felt, that corrective measures should be implemented as quickly and as smoothly as possible.

With regard to the desirability of interventions, it had been pointed out that if high-inflation countries allowed their currencies to appreciate further, countries with relative price stability would import inflation, and thus interventions could be considered desirable. Particular reference had been made to the Italian situation, and some had suggested that if the lira kept within the narrow band of the exchange rate mechanism, its appreciation would be limited. The Italian Alternate had questioned the idea that the lira's participation in the narrow band would solve the problem, given that capital flows in Italy related to the financing of a buoyant economy and were not speculative; he had agreed, however, that it was necessary to pursue a flexible intervention policy.

The Alternates had also discussed the choice of intervention currencies. One Alternate had wondered why the Deutsche Bundesbank was opposed to the use of the Deutsche Mark as an intervention currency when such interventions had no monetary effects and other countries outside the exchange rate mechanism could use the Deutsche Mark without restrictions. The German Alternate had stated that the Bundesbank did not prohibit the use of the Deutsche Mark as an intervention currency but only imposed limits on amounts. There were three main reasons for this policy. Firstly, when market forces were strong and put pressure on the exchange rate, the latter should be allowed to fluctuate in order to increase the exchange rate risk and thus discourage large capital flows. Secondly, if the Deutsche Mark was appreciating and other central banks had accumulated large quantities of that currency, it might be tempting to intervene to slow down the appreciation, which would run counter to fundamentals. Thirdly, if the peseta was near the top of the wide band, interventions in Deutsche Mark could create problems for currencies within the narrow band, and it would therefore be preferable to employ weaker currencies for interventions.

Finally, the Alternates had discussed the prospects for economic performance and policies in Germany, where, as they had noted, GDP was growing at a rapid pace while the trade surplus with the other Community countries was increasing and that with the United States was decreasing appreciably. A growing trade surplus could not be sustained indefinitely. A revaluation of the Deutsche Mark was one policy option, but an improvement in external adjustment would entail the curbing of domestic demand in countries such as the United Kingdom, Italy and Spain. If growth continued, measures would have to be taken to ensure that inflation was not rekindled. Despite the current moderate pace of inflation in Germany, macro-economic conditions were such that a resurgence of inflationary pressures should not be ruled out. Monetary policy should remain cautious in future, and a tightening might be required. Monetary growth was very close to the 5% target but would not be allowed to overshoot it this time. The present economic situation was in fact very different from that in 1986-87, because most countries, including Germany, were currently experiencing rapid economic growth and inflationary pressures. Responding to questions, the German Alternate had indicated that the recent change in the rediscount rate had no fundamental monetary implications and represented a technical readjustment. Capital flows had recently turned around, resulting in net inflows, but short-term capital outflows were substantial.

C. Discussion by the Committee

Mr. Pöhl wondered whether, in the situation that had just been described, Italy and Spain might not consider abolishing their restrictions on capital movements or at least speeding up their liberalisation. Such a policy would be more appropriate than excessive recourse to interventions, which created problems for countries whose currencies were relatively weak in the narrow band, such as Denmark.

Mr. Ciampi pointed out that the lira had strengthened in August and that the interventions had been intended to curb this appreciation, which would otherwise have been even greater. In a few months the lira had appreciated against the Deutsche Mark by 4% in nominal terms and 6% in real terms. The Banca d'Italia did not look for a strong lira, but a number of factors had contributed to its strengthening. It was necessary make the most of this development, and, in particular, the appreciation of the currency had been used to combat inflation and thus take the place of a fiscal policy that was not appropriate. Results had already been achieved in that the

rise in consumer prices, which in the space of one year had accelerated by 2 points to stand at 7%, had slowed down since August, and it was hoped that it would return to an annual rate of 6% within a few months. However, the strengthening of the lira obviously tended to depress the trade balance, and it was thus necessary to weigh up the pros and cons of a strong lira.

The Italian Government had committed itself to take fiscal policy action aimed at reducing the public sector borrowing requirement. This action, which should be approved by the Government by the end of September, was in two parts: the first concerned the 1990 budget, which should come into effect on 1st January 1990 after the adoption of the finance law by Parliament; the second related to measures which would be implemented as from 1st October 1989 with a view to curbing domestic demand, particularly consumption. A strong lira and a tight monetary policy were therefore exerting pressure both on the Government, forcing it to take action, and on firms, ensuring that they would exercise caution in the collective bargaining that would be commencing shortly.

As far as intervention policy was concerned, Mr. Ciampi thanked the Bundesbank for the understanding it had shown in daily contacts but, as Mr. Papademos had indicated, it would be helpful for the experts to reconsider the question of the flexibility of interventions. The Banca d'Italia had diversified its interventions by including ecus and Danish kroner and had acted as if the lira had been in the narrow band. This was one way of putting pressure on the Government and of convincing public opinion that it was desirable to abandon the broader band and apply the narrow one.

Referring to the remark made by Mr. Pöhl, Mr. Ciampi cast doubt on the idea that bringing forward the liberalisation of short-term capital movements would remedy the situation. Indeed, one of the reasons for the current strength of the lira was precisely the liberalisation measures which had already been taken; there was thus reason to believe that liberalising monetary flows immediately, instead of with effect from 1st July 1990, would only attract more capital to Italy and would not therefore improve the situation. The markets had confidence in the Italian real economy, the lira and the EMS and did not expect any early realignment.

Mr. Rubio stated that, as Mr. Dalgaard had mentioned, fiscal policy had been tightened in Spain in recent months, which should enable the public sector deficit to be reduced to 2.5% of GDP in 1989 compared

with 3% in 1988 and 4% in 1987. The Government could be considered to have done what it could for the immediate future. Moreover, the Prime Minister had announced that the budget for 1990 would be tougher than the 1989 one and that an early election would take place at the end of October. However, fiscal measures alone would certainly not be able to solve all the problems, for the current public sector deficit was relatively moderate compared with other countries, and experience had shown that even with a smaller deficit, or even a surplus, the same problems existed in certain countries. Monetary policy had therefore also been brought into play and had been tightened. There were, however, limits for interest rates and reserve ratios, which could not be increased disproportionately. Last July the Banco de España had asked the banks to restrain the growth of their lending and to reduce the rate of increase from 22% in the first half to 12% in the second half of the year. It was still too early to predict the outcome of this action, but there was hope. In July there had already been a deceleration in the growth of broad money, and this movement had continued in August. The economy, which was clearly overheating, should therefore gradually calm down, and the curbing of demand should make it possible to lower interest rates and ease the tensions affecting the peseta.

In this context the liberalisation of capital movements would certainly not be a solution. The majority of capital imports were investments, and therefore the liberalisation of short-term capital movements would not have any effect. Capital exports might be encouraged, but the essential measures had already been taken in this area, and complete liberalisation of lending in pesetas to non-residents would surely not have any impact, given the very high interest rates. It should also be noted that interventions had become much more modest in August, which was reassuring.

In conclusion, Mr. Rubio did not think there were any alternative policies at the moment: efforts to check domestic demand should continue, and the right moment should be awaited before starting to bring down interest rates, which did not, however, seem possible before the election at the end of October.

Mr. Tavares Moreira said that the Banco de Portugal had indeed purchased dollars in July and particularly in August, when the total had exceeded US\$ 1.2 billion. The structural weaknesses and rigidities of the Portuguese economy were the reason for using the exchange rate as an instrument of adjustment. In fact, the escudo had appreciated considerably

in real terms despite the gradual devaluation which was being undertaken but which only partially offset the interest rate differential of approximately 7% vis-à-vis the Community average. Real interest rates were relatively low in Portugal and were even slightly negative in the case of rates on time deposits. The Banco de Portugal had resold on the market a large proportion of the dollars purchased to correct the composition of its currency portfolio. It was probable that the central bank would continue to purchase currencies, but it planned to diversify and revise its intervention policy and would keep the other central banks informed within the framework of the "Dalgaard Group".

The Portuguese authorities had recently taken an important measure to liberalise capital movements by henceforth authorising residents to purchase foreign securities. This measure would change a situation that had existed for about eighty years, but was not expected to have much effect in the short run.

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 July and August and the first few days of September 1989

The Chairman took note of the Committee's adoption of the "concertation report", which would be sent to the EEC Ministers of Finance in the usual way.

IV. Exchange of views on the preparation of the first stage of economic and monetary union

The Chairman drew attention to the draft letter to the Commission President Mr. Delors, which had been submitted to the Governors and which concerned the amendments which they proposed be made to the draft Council Decision approved on 28th July.

After remarks had been made by certain Governors, the text of the letter was amended slightly as follows:

- the article "the" was inserted before "stability" in Article 3, paragraph (1);
- the words "redraft of the" were inserted in point 2 of the letter before "1964 Council Decision";

- the omitted paragraph of the original 1964 Council Decision was reinstated in its initial wording, viz. "In carrying out its tasks, the Committee shall keep under review the trend of the monetary situation both inside and outside the Community" "Dans l'exercice de ses fonctions, le Comité suit l'évolution de la situation monétaire dans la Communauté et en dehors de celle-ci".

Mr. Christophersen stated that the Commission intended to adopt the formal proposals for the Decision the following week, at its weekly meeting on 20th September 1989, and he offered a number of remarks, in particular on the textual amendments proposed by the Governors. It was important to avoid conflicts between the various bodies, and it was therefore expedient to insert, in Article 3, paragraph (1), the words "within their competences", to indicate the existence of other bodies that were competent in the area of banking supervision. It was also appropriate to reinstate the idea contained in the present 1964 Decision that "the Committee shall keep under review the trend of the monetary situation both inside and outside the Community."

Mr. Christophersen referred to the report of the "Delors Committee" and the establishment by the Committee of Governors of three sub-committees, dealing respectively with monetary policy, foreign exchange policy and banking supervision. He understood that the Committee of Governors did, indeed, intend to set up these three sub-committees; a reference could have been made to them in the Council Decision, but it was sufficient for them to be included in the Committee's rules of procedure, provided that institutions such as the European Parliament or the Council of the European Communities, which might raise questions on this subject, could be notified thereof.

The Chairman reminded the meeting that on Monday the Governors had discussed certain matters relating to the preparation of the first stage of economic and monetary union. It was necessary to continue the exchange of views and, in particular, to specify the mandate to be given to the Alternates for the coming months. The most urgent matters appeared to be the organisation of the Committee of Governors and the rules of procedure. Mr. Ciampi had had a note circulated which was concerned primarily with an economic secretariat or research unit, and Mr. Hoffmeyer had transmitted a letter regarding the operating mechanisms for monetary policy co-ordination.

Mr. Pöhl pointed out that the Alternates should not confine themselves to the two documents referred to by the Chairman; they should draw up a list of the questions to be examined with a view to decisions which the Governors would in due course be taking in a wider context.

Mr. de Larosière agreed with Mr. Pöhl; the Alternates should not restrict themselves to taking into account the documents already distributed but should, on the contrary, look at all the problems arising and aim to provide a background for the Committee's discussion, probably in November, so that the Governors could provide the necessary guidelines. The questions appeared to be fairly straightforward. Firstly, it was necessary to examine the establishment of an economic research unit, its structure, its composition (number and qualifications of its members), its duties and how they would tie in with the existing duties of the groups of experts so as to ensure insofar as possible that they did not overlap, the work programmes to be undertaken, which authority the members of the unit would be attached to administratively, and the logistical role of the BIS. Secondly, it was necessary to study the suggestions put forward in Mr. Hoffmeyer's letter, which related more to the substance of what might be a more harmonious operating framework for monetary policy co-ordination. These ideas were very interesting: a number of EEC countries were using quantitative criteria for their monetary policy, and it would be useful to see how these criteria could be, if not harmonised, at least more closely related. Tables of equivalence could, perhaps, enable comparisons to be made.

Mr. Ciampi endorsed the remarks made by Mr. Pöhl and Mr. de Larosière; he pointed out that the note which he had distributed did not claim to be a precise proposal or an exhaustive list of questions but simply a contribution which raised problems and posed questions which would have to be studied seriously. This note could also be considered as a contribution to the fundamental issues raised in Mr. Hoffmeyer's letter, in that it proposed an instrument which should serve to strengthen the way in which the Committee of Governors operated and its effectiveness.

Mr. Duisenberg, speaking in his capacity as President of the BIS, said that the BIS was prepared to co-operate and provide any assistance the Committee of Governors might desire in setting up its organisation.

On behalf of the Governors, the Chairman thanked Mr. Duisenberg for his remarks regarding the BIS.

Mr. Rubio also thanked Mr. Duisenberg for the initiative he had taken and pointed out that relations with the BIS were an important question, on which the Alternates should not decide in haste, for the Governors would have to discuss the matter among themselves, in conjunction with the other questions to be examined.

Mr. Jaans observed that in the preparatory work intended for the Committee's November meeting thought should also be given to the impact which the creation of an economic secretariat or research unit would have on the work of the Alternates and the Governors. Once there was an additional source of output, there arose the problem of how the committees concerned would assimilate the material and of whether the work of an economic secretariat might not be frustrated. The question of whether a two-hour meeting once a month would be sufficient in future therefore had to be addressed.

Mr. Hoffmeyer reminded the Governors that, on his initiative, a report by the "Group on the harmonisation of monetary policy instruments" dating from 1976 had been forwarded to them by the Secretariat and that this document should be taken into account by the Alternates.

Mr. Pöhl stressed that any decision to be taken by the Governors regarding organisational matters was conditional upon the ECOFIN Council's approving the text relating to the 1964 Decision as proposed by the Governors. If there were major changes to the drafts with which they were already familiar, even with regard to the text of the 1974 Decision on convergence, the Committee would have to review the question.

Mr. Christophersen said that he did not anticipate any difficulties regarding the 1964 Decision. At all events, any changes to the Commission proposal would have to be approved unanimously by the ECOFIN Council, and the Member States were unlikely to adopt a text which was at odds with the opinion of the Commission and that of the Governors.

V. Exchange of views on the items on the agenda of the international meetings held in Washington

The Chairman noted that there were no comments.

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

- Procedure concerning the review of the formal rules relating to the official ecu

The Chairman pointed out that on 8th September 1987 the Governors had agreed that the central banks would henceforth accept settlements in ecus of claims in the very short-term financing mechanism in excess of their obligation (50%) and up to 100%, as long as this did not result in an unbalanced composition of reserves and no excessive debtor and creditor positions in ecus emerged. It had also been agreed that, after two years of experience, the formal rules relating to the official ecu would be subject to review.

As this two-year period had elapsed, it was suggested that the review be undertaken in December and that the group of experts under the chairmanship of Mr. Dalgaard be asked to carry out the preparatory work in good time for the Committee's meeting, which was to be held on 12th December 1989. This schedule would enable the experts to complete this task in parallel with the annual review of developments in the use of the private ecu, which would also be on the agenda for the December meeting.

The Chairman noted the Committee's agreement with his proposal.

Before closing the meeting, the Chairman remarked that the Governors always relied heavily on the work and advice of the Alternates and that it was therefore sad to have to bid farewell to one of them, namely Professor Gleske, who was participating in a Committee meeting for the last time. He was happy to say, however, that contact with Mr. Gleske would not be lost as he had agreed to serve again as a member of the Board of Directors of the BIS.

The Chairman thanked Mr. Gleske on behalf of the Committee for the outstanding contribution which he had made over the past ten years and which had in fact spanned the last thirty years if account was taken of his close association during this long period with international and, in particular, Community monetary activities. All the Governors would cherish a vivid memory of the valuable wisdom and judgement which had always characterised Mr. Gleske's participation in the Committee's work.

VII. Date and place of the next meeting

The Committee's next meeting would be held in Basle on Tuesday, 14th November 1989 at 9.30 a.m.

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

JULY AND AUGUST 1989

This report summarises developments on the exchange markets of the countries whose central banks participate in the concertation procedure¹ and briefly describes their interventions during July and August and the first few days of September 1989.

I. EXCHANGE RATE DEVELOPMENTS

The main feature of the foreign exchange markets in July and August 1989 was a clear depreciation of the US dollar during July followed by an equally marked resurgence during August.

The US dollar declined on two occasions when market participants anticipated that further reductions in US interest rates would narrow favourable interest differentials. The first was at the beginning of July. The second, after a brief mid-month recovery, was in the latter half of July, bringing the dollar to the lows of DM 1.8430 and Yen 135.30 on 2nd August. Subsequently, the dollar trended higher as new economic statistics suggested that US economic growth was continuing at a more sustainable rate and price data brought into question how rapidly further downward adjustments of US interest rates might materialise. The US monetary authorities and foreign central banks intervened to resist the dollar's rise. Nevertheless,

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

the dollar moved back up to close the two-month period approximately 0.5% higher against both the Deutsche Mark and the yen.

Within the EMS there were no tensions and the respective positions altered moderately. The Spanish peseta, which entered the exchange rate mechanism in June, almost reached the upper limit of the wide band against the Danish krone. The Italian lira stabilised in the upper part of the narrow band as a result of massive intramarginal interventions of the Banca d'Italia during August.

While the Deutsche Mark firmed somewhat vis-à-vis most of the currencies officially quoted in the Federal Republic, its weighted index recorded a slight decline of 0.5% over the two months under review to stand at 173.7 at the end of August (1972=100). The end-June increase in key interest rates thus had no visible impact on the exchange rates. A weaker tendency was recorded against most of the European currencies, whose positive interest rate differential vis-à-vis the Deutsche Mark was considered to be sizable compared to the perceived exchange risk (sterling, Spanish peseta, French franc and Italian lira).

The French franc firmed progressively vis-à-vis most currencies of the EMS, showing an average rise of 0.7%. This development became more pronounced from mid-July onwards due mainly to securities purchases by non-residents and increased foreign exchange sales by exporters.

During the whole of July the Belgian franc was characterised by marked stability. In the course of August the Belgian franc tended to appreciate gradually vis-à-vis the Deutsche Mark and the Dutch guilder. However, at the end of the period under review a slight decline set in due to the narrowing of the interest differential between the Deutsche Mark and the Belgian franc. The Banque Nationale de Belgique pursued a cautious monetary policy, only lowering the rate on 3-month Treasury certificates once - by 0.05 percentage point to 8.45% on 1st August.

The position of the Dutch guilder vis-à-vis the Deutsche Mark underwent little change as both currencies remained in the upper part of the narrow EMS band.

The Danish krone remained stable and continued as the weakest currency in the EMS band. During the period as a whole interest rates declined slightly.

The Irish pound appreciated in the upper half of the EMS band during July, as, following the rise in official interest rates at end-June,

substantial net capital outflows gave way to modest net inflows. The currency remained steady in the upper half of the EMS band during August, with substantial capital inflows being offset by net purchases of foreign currency by the Central Bank.

In July, the Italian lira appreciated significantly, due to a seasonally favourable current account, reaching the upper limit of the narrow band. In August, as short-term capital inflows resumed, the Banca d'Italia intervened, purchasing large amounts of US dollars and various EMS currencies, in order to contain the upward trend of the lira and to keep it close to the top of the narrow EMS band.

The Spanish peseta firmed during the first part of July, after a round of monetary tightening, which consisted mainly of an increase of 0.75 percentage points in the intervention rate for overnight funds to 14.5% on 6th July and an increase of 1 percentage point in the reserve requirements to 19%. Later on, the peseta stabilised close to the upper limit of the wide band through the end of August. On the whole, it finished 1.3% higher against both the ECU and the US dollar.

Sentiment towards sterling improved considerably during July as UK economic data tended to confirm the growing impression that the UK economy was cooling. However, rumours that the Bank of England had been restraining the rise sparked a sudden fall at the beginning of August and, as the feeling developed that UK interest rates had peaked, the pound dipped to mid-month lows. Well-publicised official support arrested the decline and attitudes towards sterling became more positive towards the end of the period. This was despite disappointing UK trade figures for July which, with the help of prompt overt intervention, were quickly seen as probably an aberration. Sterling's trade-weighted index rose by 1.4% to 91.5 (1985=100).

The Greek drachma fluctuated within a wide range against the US dollar, while it remained relatively stable versus the ECU. On balance, it depreciated both against the US dollar and the ECU by 0.3% and 0.4% respectively. In effective terms, the drachma depreciated by 0.2% in July and by 0.1% in August.

Net inflows of capital, together with the objectives defined by the authorities for the exchange rate policy of the Portuguese escudo, resulted in large net purchases of foreign currency by the Banco de Portugal. The escudo depreciated by 0.5% in effective terms and by 0.2% against the US dollar in the course of these two months.

The Swiss franc depreciated slightly against all major currencies. Compared to the US dollar it lost roughly 1%. Measured by the trade-weighted index it depreciated by 1.2%. The Euromarket rates stagnated at a high level of around 7.25%.

The Austrian schilling weakened vis-à-vis the US dollar by 0.4%. Against the Deutsche Mark it fluctuated in both months by 0.1%. In July there were fairly large capital inflows.

The Norwegian krone showed a slightly weaker tendency and ended the period 0.2% weaker in effective terms. Norges Bank intervened on several occasions buying or selling foreign exchange in order to limit the short-term fluctuations.

High interest rates and the decision to abolish the main parts of the foreign exchange control from 1st July led to a strong demand for the Swedish krona for most of the period under review. The krona strengthened as the Riksbank's index fell from 130.50 to 130.15 and the Riksbank was forced to intervene on several occasions.

The Finnish markka remained relatively stable close to the strong end of its fluctuation band until mid-August. Towards the end of the month it eased slightly and the short-term interest rates rose by almost one percentage point.

The Japanese yen appreciated against the US dollar to Yen 138.40 in July due to expectations of lower US interest rates. However, these expectations faded somewhat in August reflecting the so-called "soft landing" of the US economy. This pushed the yen down to Yen 144.28 in August. The Bank of Japan entered the market at various times, selling US dollars against Japanese yen to shrug off the dollar-bullish momentum. Meanwhile, the yen depreciated slightly against the ECU throughout July and August.

The Canadian dollar appreciated to a 9-year high of US\$ 0.8548 in early August, before easing back to close the month at US\$ 0.8484. Over the period, the currency strengthened by 1.5% against the US dollar. Attractive Canadian/US interest rate differentials and expectations that Canadian monetary policy would remain firm brought about strong foreign investor demand for Canadian securities as well as renewed activity in Euro-Canadian issues. Late in the period, the publication of a worse-than-expected current account figure for the second quarter caused the currency to ease.

II. INTERVENTIONS

A. Interventions in US dollars

Dollar interventions resulted in net purchases both in July and August, totalling US\$ 0.9 billion compared with net sales of US\$ 15.5 billion in June. The net figure was the result of gross purchases of US\$ 6.5 billion and gross sales of US\$ 5.6 billion.

The most important buyers were the Banco de Portugal and the Banca d'Italia. Major sellers were the Bank of Japan and the Federal Reserve Bank.

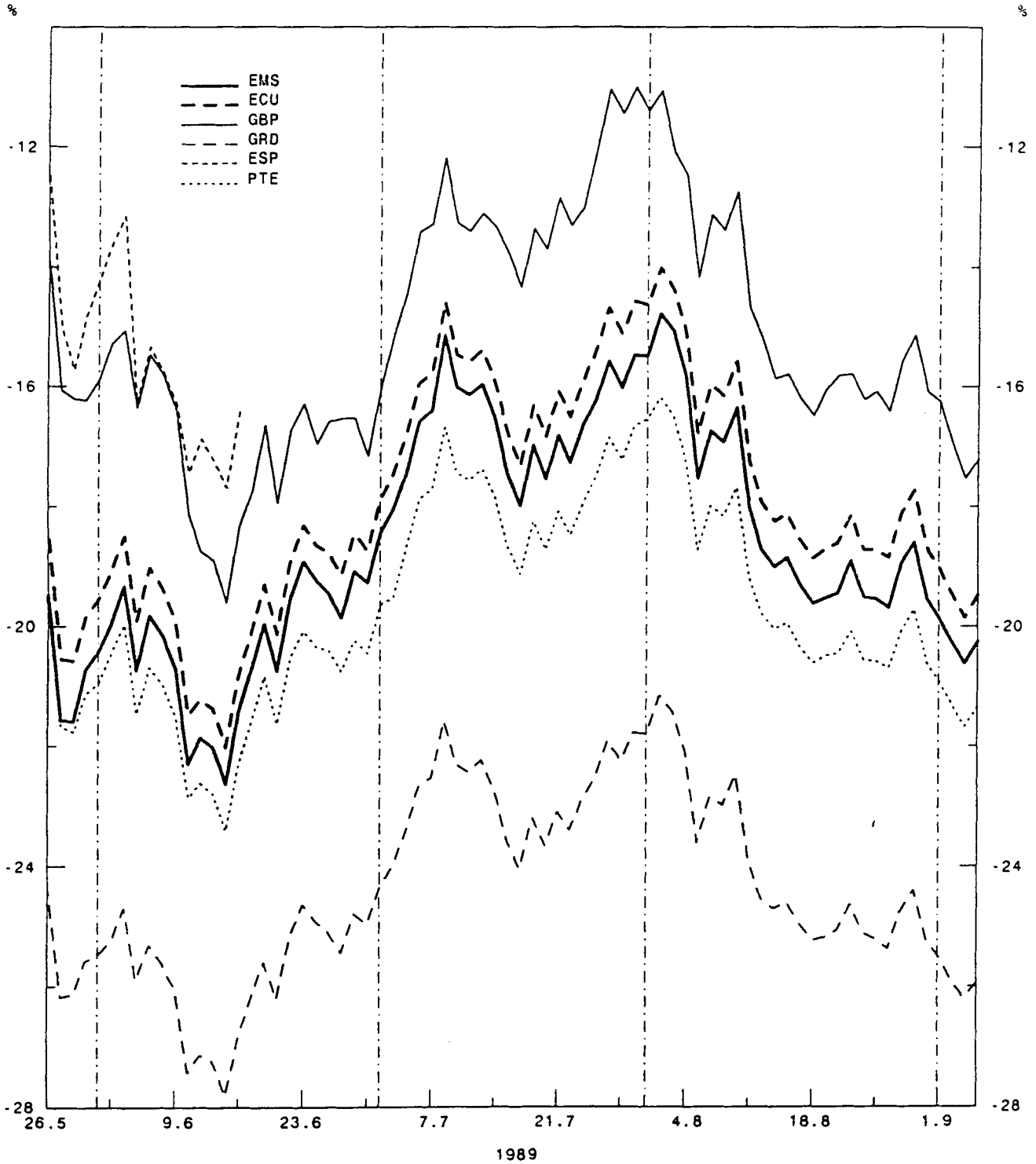
B. Interventions in Community currencies and in private ECU's

Interventions in EMS currencies and private ECUs corresponded to US\$ 3.5 billion in July and August compared to US\$ 0.4 billion in June. Most of the interventions were Deutsche Mark purchases primarily carried out by the Banca d'Italia; there were also some purchases of French francs and Danish kroner. Substantial purchases of private ECU were carried out by the Banca d'Italia and the Banco de España.

III. DEVELOPMENTS IN THE CURRENT MONTH UP TO 8TH SEPTEMBER

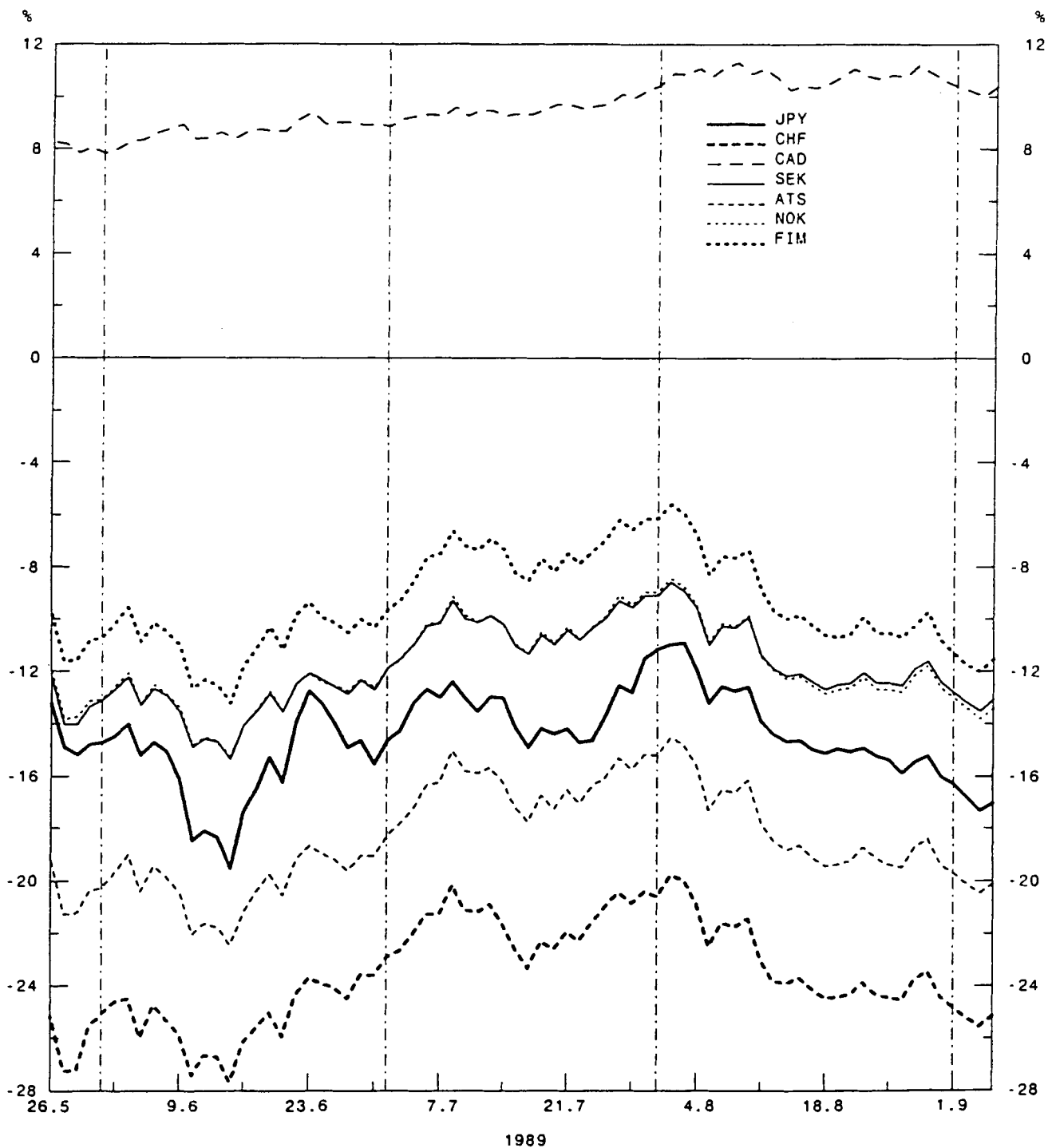
The release of positive US labour market statistics resulted in a further firming of the dollar despite some intervention sales.

EVOLUTION OF THE ECU, THE MIDDLE RATE OF THE CURRENCIES PARTICIPATING IN THE EXCHANGE RATE MECHANISM OF THE EMS, AND THE CURRENCIES OF THE EEC CENTRAL BANKS WHICH DO NOT PARTICIPATE IN THAT MECHANISM, ON THE BASIS OF THE EXCHANGE RATES PREVAILING ON 31ST DECEMBER 1987 AGAINST THE USD*



* See next page.

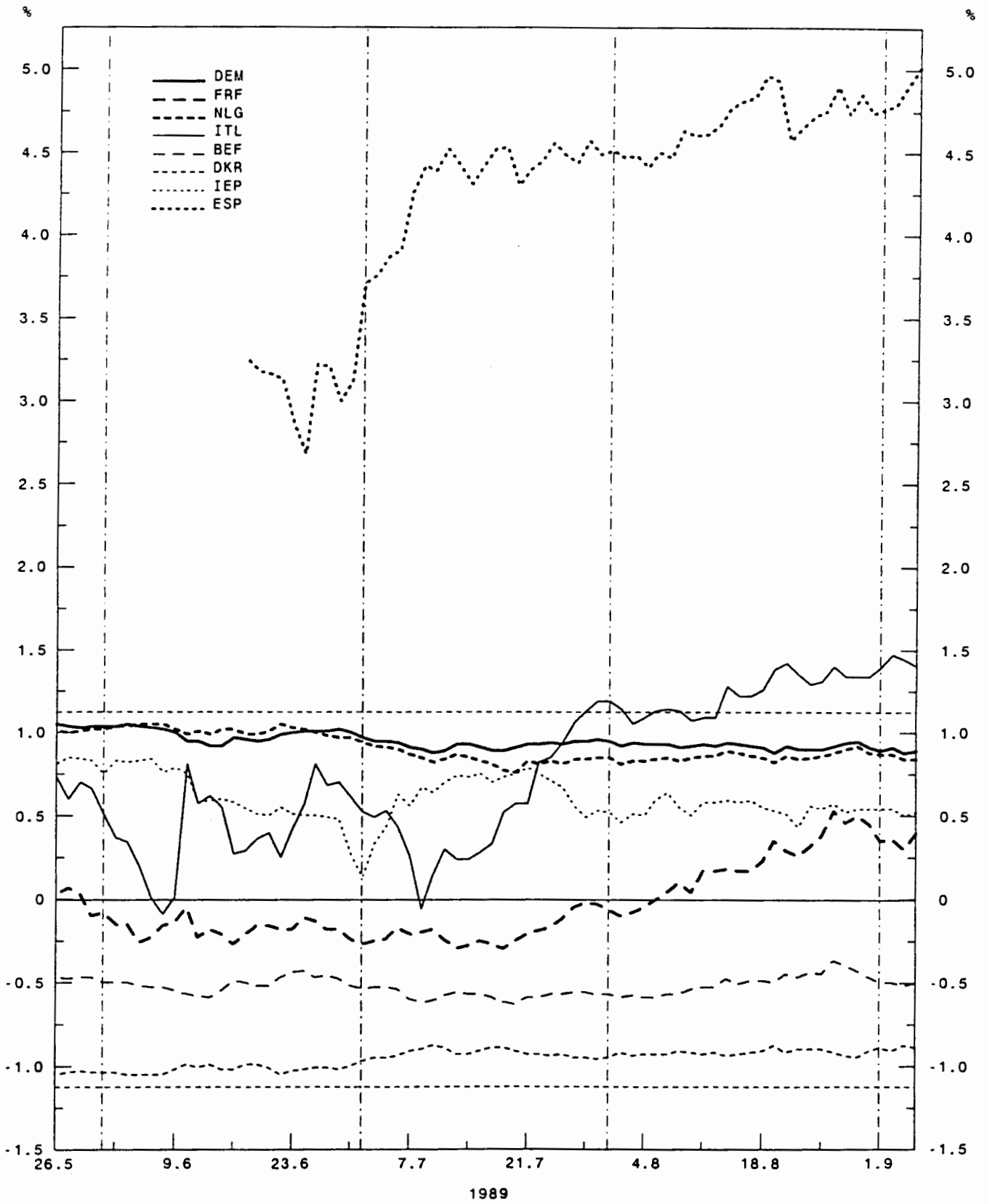
EVOLUTION OF THE CURRENCIES OF THE NON-EEC CENTRAL BANKS
PARTICIPATING IN THE CONCERTATION, ON THE BASIS OF THE EXCHANGE
RATES PREVAILING ON 31ST DECEMBER 1987 AGAINST THE USD*



* ECU 0,767254; GBP 0,5346; GRD 126,2002; ESP 107,8498; PTE 130,0242; FIM 3,945; CAD 1,302; CHF 1,2775; JPY 121,4501; SEK 5,795; NOK 6,233; ATS 11,129; middle rate of the currencies participating in the EMS 0,77324. The middle rate of the currencies participating in the EMS represents the daily average of the exchange rates of those two currencies which have the largest divergence from their current bilateral central rates, with a maximum fluctuation of 2.25%.

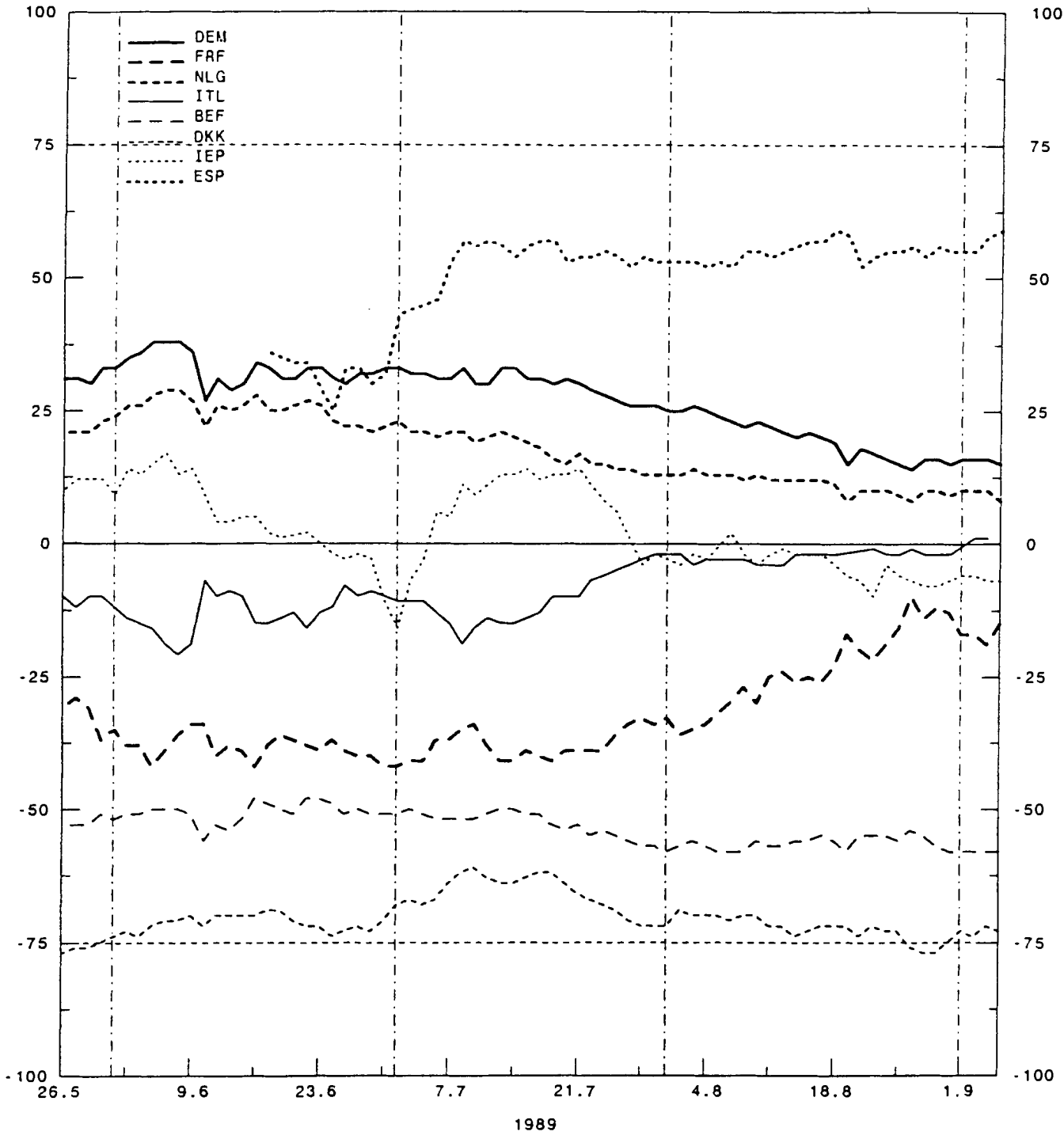
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MOVEMENTS IN THE EMS PARITY GRID



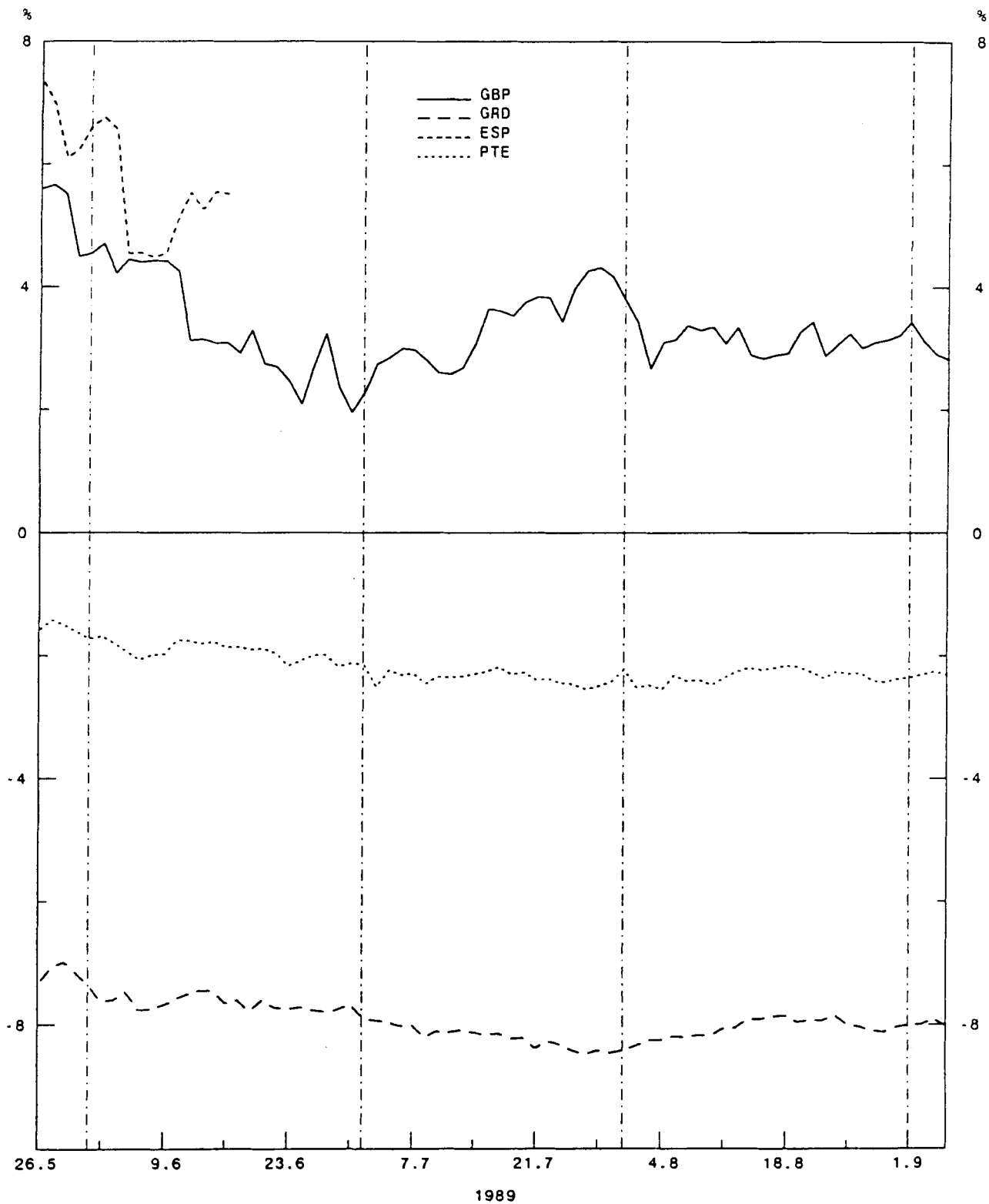
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EVOLUTION OF THE DIVERGENCE INDICATOR*



* The divergence indicator provides a uniform measure of a currency's position in relation to its ECU central rate. The maximum divergence spread is the maximum percentage by which a currency's market rate against the ECU may appreciate or depreciate in relation to its ECU central rate; it is expressed as +/-100, the divergence threshold being +/-75. The data which has been used to draw this graph are the ECU rates against the different currencies, adjusted to eliminate the effect of the fluctuation of the Italian lira, the Spanish peseta, the pound sterling and the Greek drachma outside the 2.5% margin against the other currencies participating in the EMS.

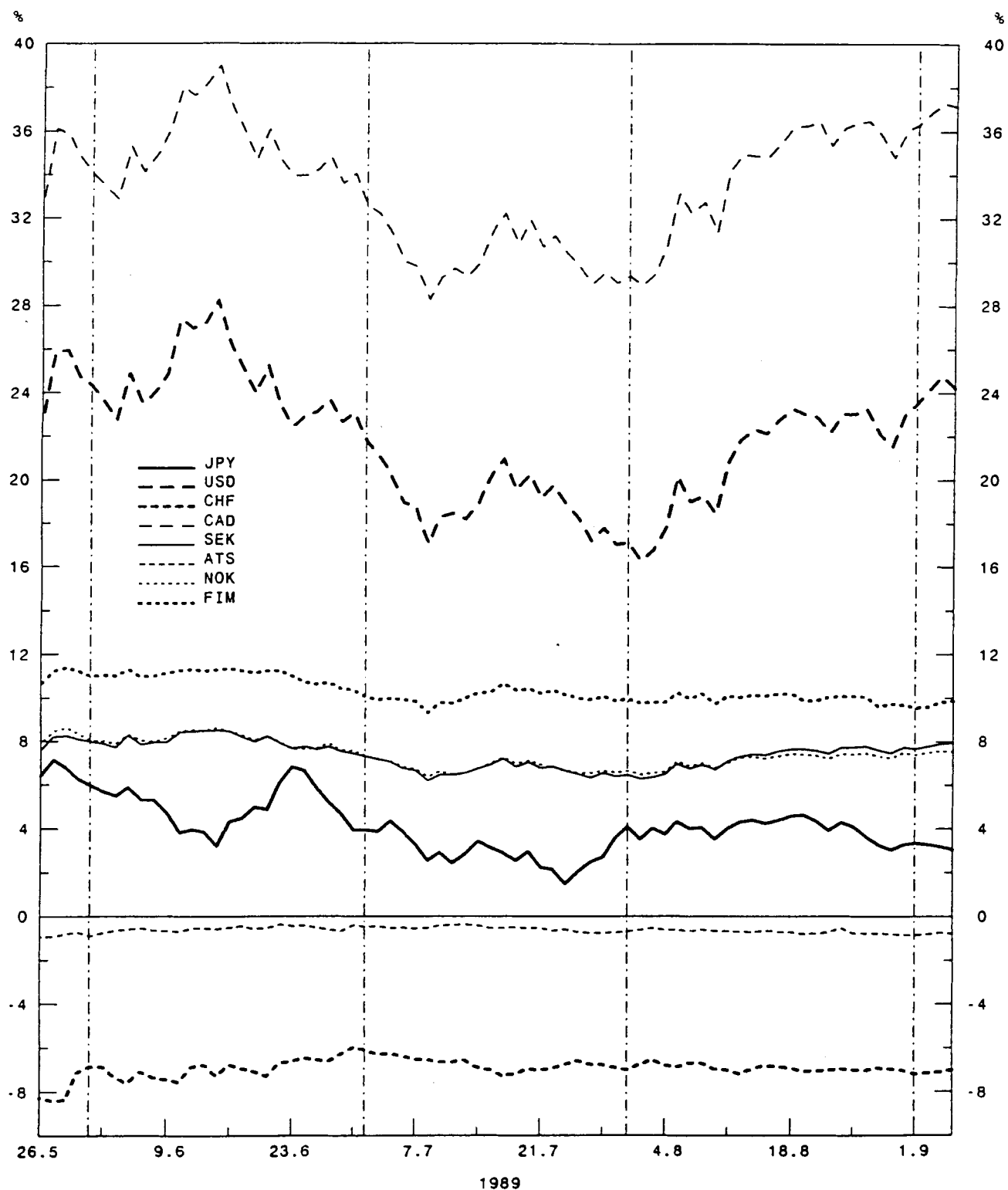
EVOLUTION OF THE POUND STERLING, THE GREEK DRACHMA, THE SPANISH PESETA AND THE PORTUGUESE ESCUDO, ON THE BASIS OF THE MARKET RATES PREVAILING ON 31ST DECEMBER 1987 AGAINST THE ECU*



* GBP 0,696793; GRD 164,483; ESP 140,566; PTE 169,467.

7.9.1989

EVOLUTION OF THE CURRENCIES OF THE NON-EEC CENTRAL BANKS
PARTICIPATING IN THE CONCERTATION, ON THE BASIS OF THE EXCHANGE
RATES PREVAILING ON 31ST DECEMBER 1987 AGAINST THE ECU*



* USD 1,30335; CAD 1,69696; CHF 1,66503; JPY 158,292; SEK 7,55292; NOK 8,12378; ATS 14,5050; FIM 5,14172.

7.9.1989