9th April 1991

Confidential

Final

MINUTES

OF THE 253rd 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 MARCH 1991 AT 10.00 a.m.

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I. Approval of the minutes of the 252nd meeting

The Committee approved the minutes of the 252nd meeting.

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

- Preparation by the Foreign Exchange Policy Sub-Committee (Monitoring) and discussion by the Committee of Alternates;
- Statistical charts and tables;
- A memorandum from the Monetary Policy Sub-Committee about major developments since the finalisation of Report No. 1

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

The most important reasons for the US dollar's rise of between 7% and 8% during the last month had been as follows:

- a positive outlook and finally victory in the Gulf war, which had led to expectations of renewed consumer confidence in the US;
- a recognition that contributions to the cost of the war would improve the balance-of-payments position and possibly the budgetary situation;
- a general expectation that US interest rates would soon rise while rates in Europe were expected to fall further;
- developments in the USSR.

The Monitoring Group had had some doubts, however, as to whether the problems in the US economy had been overcome; the budget deficit remained sizable, and there continued to be problems in real estate and in certain financial institutions. Furthermore, weak employment figures had led the Federal Reserve Board to lower the Federal funds rate, which could be taken as a sign that the upswing of the US economy had not yet started. The Board's action had led to a strong upward movement in the US dollar to DM 1.58. Some members of the Monitoring Group had felt that the US dollar was not yet too strong, although the Deutsche Bundesbank would have preferred a lower level of the Deutsche Mark against the dollar. On 11th March 1991 the Deutsche Bundesbank, a number of other European central banks, the Federal Reserve Board, and the Bank of Japan had effected concerted interventions in order to stem the upward pressure on the dollar.

In the ERM, the main development had been the widening of the spread between the Spanish peseta and the French franc to a level close to the limit. This had been caused primarily by the continued high level of interest rates in Spain coupled with large capital inflows, which had been boosted by expectations of lower interest rates and capital gains. The Spanish economy had continued to slow down. In France, market interest rates had fallen as economic growth slowed in that country too. The divergence between the French franc and the peseta had not given rise to significant interventions or tensions within the ERM. The Deutsche Mark/French franc rate had remained stable, as had the markets in other EC currencies.

2. Statement by Mr. Raymond, Chairman, Monetary Policy Sub-Committee

A recent meeting of the Sub-Committee had found that the situation had evolved somewhat differently from that predicted in the forecasts made in October 1990.

The price of energy had been much lower than had been expected and this could lead to a favourable movement in prices. The outcome of national account variables for 1990 had been in line with projections; however, since the beginning of the year, different views had evolved as to likely economic developments in 1991. The decline in inflation would be more rapid in those countries with the highest rates of inflation, especially Spain and the United Kingdom. This would have a positive influence on price convergence. Partly because of the impact of recent tax increases, however, prices could rise faster in Germany. It was anticipated that the rate of growth for the Community as a whole would be lower than had been expected in the autumn.

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

The new fiscal measures in Germany had provided a welcome adjustment in the policy mix but some upward movement in the rate of inflation could be expected in 1991. The adjustment in the industrial sector in the eastern part of Germany had been particularly painful and the decline in production would continue for the time being. All indicators had remained very strong in western Germany. However, the recent tax measures could dampen consumer spending and economic growth might slow somewhat in 1991. There had been a downturn in economic activity in France.

Reactions to the recent strong upward movement of the US dollar had been mixed. It had been regarded with concern in Germany, where the weakening of the Deutsche Mark in real terms had been viewed as particularly counter-productive under present circumstances. Others had attached greater weight to the strong competitive position which the US economy still enjoyed at the prevailing exchange rates, and doubts had therefore been expressed as to the appropriateness of stemming the rise of the dollar, especially in view of firstly, the fact that it was only a while ago that opposite signals had been given through concerted interventions and, secondly, the narrow range of dollar movements within which interventions had shifted from dollar purchases to sales. It had been possible to reconcile these views by arguing that concern over the appreciation of the US dollar should not focus so much on the level of the currency but rather on the speed of its upward movement, which might result in disorderly markets.

Developments in the ERM had been broadly satisfactory. The position of the peseta vis-à-vis the French franc had been closely monitored and neither the Spanish nor the French central banks had been overly concerned with the developments. Strong capital inflows, linked to high interest rate differentials, together with foreign direct investment, had placed the peseta under considerable upward pressure. In France market interest rates had fallen in response to favourable inflation prospects and a downturn in economic activity. Largely for psychological reasons, it had been felt that it would not be appropriate to allow the respective currencies to reach their intervention limits. In Italy, although the most recent inflation and PSBR figures had been uncomfortably high, it was felt that there might be some room for easing monetary conditions in the near future. In the United Kingdom the Bank of England had reduced interest rates in two steps and had made it abundantly clear to the market that a further cut would be undertaken only when it was considered to be consistent with exchange rate stability within the ERM.

It had been noted that the Monthly Statistical Series now contained data relating to Norway and that henceforth the document would be made available regularly to Norges Bank.

4. Discussion by the Committee

Mr. Leigh-Pemberton said that the authorities had been pleased with the effects of interest rate cuts in the United Kingdom. There was still some sensitivity about the depth of the recession; the possibility of further reductions in interest rates would be linked not only to the position of sterling within the ERM but also to domestic considerations. This could lead to a shift in priorities and more emphasis being placed on counter-inflationary policies.

The Chairman, speaking in his capacity as President of the Deutsche Bundesbank, observed that money market rates in Germany had actually fallen following the rise in the official rates at the beginning of February. No tensions had resulted within the EMS as a consequence of the move. Interest rate differentials had narrowed and there had been no expectations in the market of a realignment. He noted, however, that for domestic reasons interest rates in certain countries might have to rise as part of an anti-inflationary strategy; this could lead to a strengthening of the respective currencies. The future economic outlook for Germany was uncertain but, on the whole, he expected an upward correction of recent growth forecasts. The present transfer of resources within the Community as a result of the situation in Germany was seen as beneficial to the latter's trading partners.

Although the tax increases in Germany had been unavoidable the Chairman was unsure whether the most appropriate solution had been found. The public sector deficit would remain high (5% of GDP in 1991), as receipts from the recent tax increases would be used to meet additional expenditure. Germany would be likely to continue to have a substantial public sector deficit for the foreseeable future, and this could well have consequences for the value of the Deutsche Mark in the longer term.

Mr. de Larosière said that there had been a significant slowdown in the French economy; consumption was low and monetary aggregates were contracting and unemployment was rising. Inflation was under control and wage increases had been moderate. On the whole, the policy mix would appear to be correct; monetary policy was strict and fiscal policy was non-stimulatory and the money market was geared to an expectation of declining interest rates, largely because of the recession. However, these expectations had not yet been acceded to by the Banque de France, which had maintained a policy of tight liquidity. In any event, keeping the French franc's position in the ERM stable was a primary objective. In this context, Mr. Rubio was thanked for his very co-operative attitude.

Mr. Ciampi said that in Italy the economy had been slowing and this had been particularly evident in the industrial sector. The greatest concerns, however, related to the public sector deficit and the rate of inflation. The target deficit for 1991 had been Lit. 130 trillion; current forecasts, however, suggested that this amount would be exceeded by Lit. 10-12 trillion. The Government would therefore be called upon to redress the situation. Interest rates and inflation, which was now likely to be in the region of 6-7% for 1991 compared with the forecast of 4.5%, contributed to increases in the public sector deficit. Under such conditions, there was a danger that inconsistencies between fiscal and monetary policies would be exacerbated.

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 February and the first few days of March 1991

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

IV. Economic and Monetary Union

The Chairman said that the Chairman of the personal representatives of the Finance Ministers of the IGC had invited the Governors to complete the draft Statute, except for the transitional provisions. If completion was delayed for any reason, the Chairman felt that it might be used by some as a pretext for introducing changes into the Statute. It was expected that the Statute would be examined by the IGC towards end-April.

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

The Alternates had felt that the completion of the draft Statute by end-April would be appropriate on both tactical and substantive grounds. Some concern had been expressed that the standing of the draft Statute had not been fully appreciated, and it was deemed advisable that the Governors transmit their final contribution to the IGC as soon as possible.

Leaving aside the transitional provisions, completion of the Statute would involve work in three areas; Article 32 (Income Allocation), Chapter VII (General Provisions) and Article 40 (Simplified Amendment Procedure). The Secretariat would produce a detailed study on income allocation, which would be examined by an ad hoc working group, chaired by the Secretary General, prior to the matter being discussed again by the Committee of Alternates. The draft provisions for Chapter VII were already available and agreement on the outstanding issues should not present major problems. The central banks would send the Secretariat observations on the simplified amendment procedure. Proposals on the above issues would be available for discussion at the Governors' meeting in April.

2. Statement by Mr. Christophersen, EC Commission

The IGC on EMU had made good progress; however, there were about six or seven outstanding substantial problems. With regard to the final stage of EMU, one important issue was how to co-ordinate macro-economic policies. Another issue had been budgetary discipline, particularly the definition of what constituted an excessive deficit and the imposition of sanctions. There had also been questions relating to a "shock absorber" in the form of a financial assistance mechanism which could be used when a Member State's economy had been strongly affected by external developments. It would be necessary to define such a mechanism and its relationship to the balance-of-payments financing facility. With respect to the monetary side, it would appear that most Member States were prepared to consider the Statute as presented by the Committee of Governors. There remained a few points which had to be clarified, i.e. concerning the division of competences with regard to exchange rate policies vis-à-vis third countries. Regarding transitional arrangements, there had been the issues of convergence (i.e. definition and timing), macro-economic adjustment policies (i.e. transfer of resources and the use of derogations) and the creation of "the" or "a" monetary institution.

The IGC on Political Union had not been prepared as thoroughly as that on EMU and, at this stage, remained slightly confused. There had been the question of the principle of subsidiarity and the possible assumption by the Community of new tasks (i.e. health, culture, defence, foreign policy, etc.). To facilitate the work, the Commission had submitted a draft Treaty to the IGC. Mr. Christophersen felt that the IGC on Political Union should be restructured in order to enable a positive outcome to be achieved during the Dutch Presidency; however, there was a degree of uncertainty surrounding the whole conference.

3. Discussion by the Committee

The Chairman thanked the Secretariat for the valuable summaries of the IGC meetings. He said that the Committee should, firstly, aim - insofar as possible - to complete the draft Statute and, secondly, recommend that the Statute - in its entirety - should become a Protocol to the Treaty; this latter point should be communicated to the President of the Council.

Mr. Christophersen said that the Commission would be in favour of the Statute being annexed to the Treaty in the form of a Protocol. However, for legal and political reasons certain provisions should also be included in the Treaty itself, even though the Protocol would have the same legal status as the Treaty and be regarded as primary Community law.

Mr. de Larosière agreed with Mr. Christophersen about the status of the Statute. The simplified amendment procedure should apply only to certain specified Articles. He fully agreed with finalising the Articles and discussing the matter in April, following consideration by the

Alternates. He felt that there would be less risk of challenging the concept underlying the System if an embryonic ESCB were established in Stage Two rather than a compromise solution. The integrity of the approach should be protected from the outset. This view was also shared by Mr. Ciampi.

The Chairman concluded that the Statute should be completed at the next meeting. Furthermore, an attempt should also be made to remove the square brackets from the text. It was agreed that the Statute should be viewed as a consistent and cohesive instrument and annexed as a Protocol to the Treaty. With regard to the transitional arrangements, he thought that it would be dangerous to establish an institution prior to a formal agreement to move to Stage Three.

The Committee endorsed the report by the Chairman of the Alternates.

V. Examination of the report prepared by the Banking Supervisory Sub-Committee on issues raised by the EC Commission's Discussion Paper entitled "Making Payments in the Internal Market" (COM(90)447)

1. Statement by Mr. Quinn, Chairman of the Banking Supervisory Sub-Committee

Mr. Quinn said that, in spite of the wide range of responsibilities amongst its members, the Sub-Committee had reached a high degree of consensus in responding to the Governors' mandate. The Sub-Committee had neither endorsed nor criticised the aspirations of the Commission in the field of retail payments, and no common view had been established as to whether there was a role for the Commission and other public bodies, nor had agreement been sought as to whether the initiative to propose changes in the field of retail payments should fall to the public or private sector. Whilst discussing the Commission's paper a number of instances had arisen where it had been felt that the Sub-Committee did not have the necessary expertise readily to hand and, in this context, it was recommended that further work in this area should be undertaken by the newly formed ad hoc working group on payment systems. With regard to the establishment of the Commission's Consultative Group, the Sub-Committee had recommended that the central banks, through the Committee of Governors, should be represented by delegates drawn from both the Banking Supervisory Sub-Committee and the ad hoc working group on payment systems. To give the representatives the necessary authority and standing, it had been proposed that, subject to discussion of the matter with the Commission, the Chairmen of the Sub-Committee and the working group should submit proposals for nominations via the Committee of Governors. Should the Committee endorse the Sub-Committee's report, it had been suggested that a brief letter be sent to Sir Leon Brittan confirming that there was a role for central banks in the field of retail payments and suggesting that it would be appropriate for the Committee of Governors to be represented on the Consultative Group.

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

Mr. Rey said that the Alternates had endorsed the report and conclusions of the Banking Supervisory Sub-Committee and the proposed draft letter to Sir Leon Brittan.

3. Discussion by the Committee

Mr. Christophersen said that the Commission much appreciated the contribution made by the Committee of Governors to the work in this field and welcomed the active participation of the Committee of Governors in the Commission's proposed Consultative Group.

The Committee endorsed the contents and conclusions of the Banking Supervisory Sub-Committee's report.

Following an invitation from the Chairman, Mr. Quinn gave a brief resumé of the work of the Sub-Committee. It had been in existence for a little over a year; the work had developed extremely positively and the Sub-Committee was fulfilling its co-ordinating role. It had considered a wide range of activities; a brief description was given of the Sub-Committee's work in the field of the draft Statute of the ESCB, financial conglomerates, implementation of the Second Banking Co-ordination Directive and the principle of home country control.

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

1. Expenses incurred by the Committee of Governors in 1990 and estimated expenses for 1991

(a) Statement by Mr. Hoffmeyer, Chairman of the Committee on Financial Matters

Mr. Hoffmeyer said that in accordance with the rules relating to financial matters, the Committee had examined the statements on expenses for 1990 and projections for 1991. Costs incurred on behalf of the Committee of Governors had increased from a little more than Sw.fr. 2 million in 1989 to over Sw.fr. 4 million in 1990 and were projected to be Sw.fr. 5 million in 1991. Much of this increase had been caused by expanded activity. The Committee had made the following observations:

- average salaries of professional staff (Sw.fr. 165,000 pa) had been in line with the estimation of the Committee of Governors; average salaries for supporting staff had ranged between Sw.fr. 50,000 and Sw.fr. 70,000 pa;
- the prices for services and materials provided by the BIS had been analysed and compared with market prices, where possible. They appeared to be at or below market levels;
- forecasts for 1991 would seem to be reasonable;
- discussions on possible cost savings would be undertaken.

The Committee on Financial Matters recommended that the Committee of Governors and the Board of Governors of the EMCF approve the financial statement and the reimbursement of expenses as proposed by the Secretariat and that the projections for 1991 be accepted.

(b) Discussion by the Committee

The Committee approved the report and recommendations of the Committee on Financial Matters.

2. The Community loan to Greece

Mr. Christophersen said that the Commission had been involved in the series of economic reforms initiated by the Greek Government in the summer of last year. At the time, the Commission had been asked whether the Community would provide a balance-of-payments loan. Following the preparation of the draft budget for 1991, the Commission had started negotiations and the Monetary Committee had subsequently examined the entire issue. A requirement of the Monetary Committee had been that any loan should be accompanied by detailed conditions concerning targets and objectives. Mr. Christophersen described the salient features and terms of the package.

Mr. Christophersen raised the question of the Commission's recent ecu-denominated bond issue to support the loan to Greece. The Commission had not been completely satisfied with the issue because it had immediately followed the ecu 2 billion loan issued by the Italian Government. He asked whether it would be possible to establish an early-warning system to provide greater awareness of what was in the pipeline for issues on the market.

Mr. Chalikias said that the Community loan had been necessary on account of large amortisation payments of external debt and to support a three-year stabilisation programme. The conditions attached to the loan would be demanding and it would require substantial efforts to meet them. He outlined briefly the economic and monetary situation in Greece. One of the major problems facing the Greek authorities was the size of the public sector deficit.

3. <u>The Committee on Monetary, Financial and Balance-of-payments Statistics</u>

<u>Mr. Rey</u> said that a Committee on Monetary, Financial and Balance-of-payments Statistics had been created by a Council Decision dated 25th February 1991. The Committee would be chaired by a central banker. A link with the Committee of Governors had been established through Article 4 of the Decision, which stated that one representative of the Committee of Governors could attend meetings of the Statistical Committee as an observer; it was recommended that the Secretariat represent the Committee of Governors. To ensure an appropriate exchange of information, the Secretariat should report regularly on the meetings; these reports would be sent to the Alternates, with copies to members of the Monetary Policy and Foreign Exchange Policy Sub-Committees. The Secretariat would act as a conduit for suggestions from the Committee of Governors to the Statistical Committee. At the same time, the Alternates would inform the representatives of their respective central banks on the Statistical Committee of any action taken by the Committee of Governors. The Governors' attention was drawn to a recital of the Decision, which stated:

> "Whereas due examination of whether the Committee's tasks will meet the needs of the future European Central Bank System should be carried out in the framework of the achievement of Economic and Monetary Union".

This recital would safeguard the competence of the future ESCB in the statistical field (as specified in Article 5 of the draft Statute).

4. <u>Community programme in the field of telematics systems</u>

<u>Mr. Rey</u> said that the Alternates had had an exchange of views on recent steps taken by the Commission in connection with the implementation of a research and development programme in the field of telematics. DG XIII of the Commission had invited central bank representatives to a panel meeting in February with a view to drafting a work plan with respect to projects relating to EMU and the future ECB. The seven experts who had attended had made it clear that, at that juncture, they were unable to identify applications without consulting the Committee of Governors.

At that time, central banks had not been ready to commit themselves to participation in a pilot project or its financing. The Alternates had agreed that central banks should themselves decide whether they would wish to continue to participate in further discussions about the project proposed by the Commission. These central banks should, however, keep the Committee of Alternates informed of developments. If and when the Commission had specific proposals, it should address them preferably to the Committee of Governors. The Commission's representative on the Committee of Alternates had been requested to inform DG XIII of the outcome of its discussion. The Alternates had felt that it would be appropriate to co-ordinate the activities of central banks in the technological field at Community level. In this respect, they considered that the Committee of Governors would be the appropriate forum.

Mr. Christophersen said that the discussion at the level of the Alternates would be conveyed to DG XIII and he would ensure that there was no misunderstanding or confusion.

VII. Date and place of next meeting

The next meeting of the Committee of Governors would take place in Basle on Tuesday, 9th April 1991 at 9.30 am.

253rd MEETING OF THE COMMITTEE OF GOVERNORS

12th MARCH 1991

Those present were:

Chairman of the Committee of Governors	Mr. Pöhl
Banque Nationale de Belgique	Mr. Verplaetse Mr. Rey Mr. Michielsen
Danmarks Nationalbank	Mr. Hoffmeyer Mrs. Andersen
Deutsche Bundesbank	Mr. Tietmeyer Mr. Hartmann
Bank of Greece	Mr. Chalikias Mr. Papademos Mr. Karamouzis
Banco de España	Mr. Rubio Mr. Linde Mr. Durán
Banque de France	Mr. de Larosière Mr. Lagayette Mr. Cappanera
Central Bank of Ireland	Mr. Doyle Mr. Coffey Mr. Reynolds
Banca d'Italia	Mr. Ciampi Mr. Dini Mr. Santini
Institut Monétaire Luxembourgeois	Mr. Jaans
Nederlandsche Bank	Mr. Duisenberg Mr. Szász
Banco de Portugal	Mr. Tavares Moreira Mr. Borges Mr. Bento
Bank of England	Mr. Leigh-Pemberton Mr. Crockett Mr. Foot
Commission of the European Communities	Mr. Christophersen Mr. Pons
Chairman of the Monetary Policy Sub-Committee	Mr. Raymond
Chairman of the Foreign Exchange Sub-Committee	Mr. Dalgaard
Chairman of the Banking Supervisory Sub-Committee	Mr. Quinn
Secretariat of the Committee of Governors	Mr. Baer Mr. Giles Mr. Monticelli