

Confidential  
(Translation)

MINUTES  
OF THE 224th 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 APRIL<sup>1988</sup> AT 9.30 a.m.

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Those present at the meeting were: the Governor of the Banque Nationale de Belgique and Chairman of the Committee, Mr. Godeaux, accompanied by Mr. Janson, Mr. Rey and Mr. Michielsen; the Governor of Danmarks Nationalbank, Mr. Hoffmeyer, accompanied by Mr. Mikkelsen; the President of the Deutsche Bundesbank, Mr. Pöhl, accompanied by Mr. Gleske and Mr. Rieke; the Governor of the Bank of Greece, Mr. Chalikias, accompanied by Mr. Karamouzis; the Governor of the Banco de España, Mr. Rubio, accompanied by Mr. Linde and Mr. Durán; the Governor of the Banque de France, Mr. de Larosière, accompanied by Mr. Waitzenegger and Mr. Cappanera; the Governor of the Central Bank of Ireland, Mr. Doyle, accompanied by Mr. O'Grady Walshe and Mr Reynolds; the Governor of the Banca d'Italia, Mr. Ciampi, accompanied by Mr. Dini, Mr Masera and Mr. Saccomanni; the President of De Nederlandsche Bank, Mr. Duisenberg, accompanied by Mr. Szász; the Governor of the Banco de Portugal, Mr. Tavares Moreira, accompanied by Mr. Pêgo Marques and Mr Costa Pinto; the Governor of the Bank of England, Mr. Leigh-Pemberton, accompanied by Mr. Loehnis and Mr. Kirby; the Director-General for Economic and Financial Affairs of the Commission of the European Communities, Mr. Costa, accompanied by Mr. Mingasson; the Director General of the Luxembourg Monetary Institute, Mr. Jaans. 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. Cook, and Mr. Bockelmann and Mr. Dagassan also attended.

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\* Final text approved at the meeting on 10th May 1988, which incorporate some drafting changes.

I. Approval of the minutes of the 223rd meeting

The Committee unanimously approved the minutes of the 223rd 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 foreign exchange markets had been relatively stable since the Committee met in March, with the exception of the pound sterling. The US dollar had weakened slightly, but had remained within the range recorded in recent months; it had been supported by sustained growth in the United States and some increases in interest rate differentials. The future of the dollar remained uncertain, however; its immediate development would, of course, depend on the G-7 declaration and on February's US foreign trade figures, which would be published in two days' time. The yen had strengthened, vis-à-vis both the dollar and the European currencies. Some tensions had briefly emerged within the EMS during the first fortnight of March, affecting the French franc and Italian lira in particular. The Banque de France had responded to the pressures by intervening, allowing the franc to decline within the band and raising interest rates; the franc had subsequently very quickly recovered to its level of early March without further support. The Italian lira had also weakened somewhat at the beginning of March under the influence of various factors, including the Government crisis, the approaching French elections and the decline of the French franc, as well as the deterioration in the balance of payments. The Banca d'Italia had stabilised the exchange rate of the lira against the franc by means of substantial intervention selling (approximately \$2 billion).

The Deutsche Mark had been very stable; there had been no interventions by the Deutsche Bundesbank and interest rates had not moved at all. The fact that during the first few months of 1988 the German current-account

surplus had been more than offset by net capital outflows explained why Deutsche Mark interest rates were not falling. The Irish pound had been particularly firm in March and the Central Bank of Ireland had made purchases of foreign exchange. This firmness, despite a further reduction in interest rates, had been connected with the strength of sterling and encouraging economic fundamentals (low inflation, a healthy balance of payments and budgetary improvement).

In conclusion, the central banks had managed the EMS exchange rate mechanism flexibly and effectively.

Outside the exchange rate mechanism, the most significant development concerned sterling. In early March there had been very strong upward pressures and the Bank of England had intervened within the space of three days for an amount equivalent to \$2.5 billion; its interventions had been highly diversified, including purchases of almost ECU 1 billion. After the ceiling of DM 3 to the pound had been abandoned on 7th March, the authorities had continued to try to stabilise the exchange rate, in particular by twice lowering the base rate and continuing to intervene, although on a much smaller scale. The Spanish peseta had also been firm. The Banco de España had attempted to slow the inflows of funds by lowering interest rates and allowing the peseta to appreciate; it had risen by between 2 and 3% against the Deutsche Mark in the course of a month and some purchases of foreign exchange had been made. Since the beginning of March a stabilisation of the effective exchange rate of the Greek drachma had been achieved under the policy of disinflation being pursued by the authorities. In Portugal, there had been a reduction from 0.4 to 0.3% in the monthly rate of depreciation under the system of progressive devaluation of the effective exchange rate of the escudo.

#### B. Statement by Mr. Janson

The Alternates had had only a brief discussion of the main developments summarised by Mr. Dalgaard.

1. The Alternates had noted with satisfaction that the tensions within the EMS which had surfaced at the beginning of March had been effectively brought under control. The German Alternate had drawn his colleagues' attention to the large capital outflows from Germany which had more than offset net receipts in respect of current transactions; these outflows were preventing a fall in nominal interest rates and were keeping real rates high.

2. The Alternates had welcomed the dollar's continued stability. Although there had been a slight increase in March in comparison with February, the volume of interventions in support of the dollar was well below the level recorded in 1987.

With respect to the outlook for the dollar, it had to be borne in mind that the sustained pace of economic growth in the United States could give rise to doubts on the foreign exchange market concerning the effort being made to adjust the current-account imbalances. In this context, it was important that the central banks should not contribute to any downward pressure on the dollar by inappropriate intervention selling of dollars. On the contrary, the situation demanded that intervention policies be directed towards purchasing dollars when a national currency was tending to appreciate, while the way to defend a currency, in particular within the EMS, should be by selling currencies other than the dollar.

3. As far as sterling was concerned, the Alternates had welcomed the lowering of the UK base rate in two stages. The authorities had reaffirmed that they attached importance to the stability of exchange rates at their new level. But the dilemma remained. On the one hand, doubts persisted as to whether the size of the cut was enough to moderate the upward pressure on the UK currency. On the other, it was recognised that the economic situation in the United Kingdom continued to militate in favour of maintaining firm and anti-inflationary monetary conditions.

4. Finally, the UK Alternate had given a number of further explanations for the difference recorded in 1987 between the volume of the Bank of England's dollar interventions and the development of its reserves. This question had been discussed by the Governors at their March meeting.

The Chairman thanked Mr. Janson and Mr. Dalgaard for their statements and noted that the Governors had no particular comments.

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 March and the first few days of April 1988

The Chairman took note of the Committee's approval of the

"concertation report", which would be submitted as usual to the EEC Ministers of Finance.

IV. Adoption of the Committee's report to the ECOFIN Council on the Commission's proposals for full liberalisation of capital movements by the Community

The Chairman recalled that a first draft of this report had been submitted to the Alternates on 21st March; on the basis of their comments a second draft had been drawn up. The Alternates' discussions on Monday had resulted in a third draft, dated 11th April, concerning which Mr. Janson might like to make a few explanatory remarks.

Mr. Janson said that the Alternates had finalised the draft of the Committee's report to the Council on the Commission's proposals for full liberalisation of capital movements. The version which the Governors had in front of them showed the amendments made by the Alternates to the text distributed prior to the Basle meetings (2nd draft, dated 7th April 1988).

On only one point had the Alternates been unable to reach agreement. This concerned the reference on page 6 to the proposal to create a recycling mechanism to accompany the liberalisation of capital movements. This insertion had been requested by the Banca d'Italia and reflected the ideas developed by its Governor at the Committee's meeting in March, and also those in Minister Amato's memorandum. Other Alternates were of the opinion that this proposal could not be isolated from the other ideas put forward and pointed out that there was a risk of raising false expectations by mentioning a proposal which had not yet been studied by the Governors.

Before opening the discussion the Chairman noted that, in their previous discussions, the Governors had not wanted to conceal the differences of opinion in their report, which thus reflected the, sometimes diverging, views represented within the Committee. If agreement was reached on the point submitted by the Alternates and if the report was adopted, it would then be completed in German, English and French and transmitted by telefax as soon as possible to the Governors so that they could pass it on to their Ministers. The Chairman added that he would give a short presentation on the report at the ECOFIN Council meeting on 18th April in Luxembourg.

Mr. Ciampi said that he very much wished to retain the concept of a recycling mechanism in the report but that another expression might be adopted, for example a "market operations facility managed by the EMCF". It was not really a question of setting up a new financing mechanism in addition to those which already existed, but of giving consideration to a financial mechanism which was novel in that its objective would be to offset shifts of funds occurring between EMS member countries and that it would be managed by the EMCF.

Mr. Hoffmeyer wondered whether there was anything to be gained by talking about recycling. If the markets did not react to shifts of funds, the central banks should intervene and acquire assets of partner countries. It did not seem possible to envisage a new financial mechanism. Credit mechanisms already existed and if they did not function or were inadequate action had to be taken through monetary policy. Tightening monetary policy brought about natural recycling via the markets.

Mr. Pöhl thanked the authors, and in particular the Alternates, for the high standard of the report. The term "recycling" prompted scepticism and called to mind the 1970s and the OPEC surpluses, even if it was not the same kind of recycling that was meant. The idea could be discussed in the appropriate fora, but it did not seem desirable to mention it in the report and so give it special treatment when many other proposals had been put forward which would also need to be discussed when the time came. It could perhaps be mentioned in the report that some Governors considered that the existing credit facilities should be extended in order to promote the process of liberalisation of capital movements, whereas other Governors thought the existing facilities sufficient.

Mr. Leigh-Pemberton expressed his support for Mr. Pöhl's view. It certainly was not necessary to mention one proposal specifically; that would confer on it some sort of priority, when it was in fact difficult to have a clear enough idea of its implications to include it in the report. The absence of any mention in the report would not, of course, mean that this proposal, along with others, would not be studied at a later stage.

Mr. Ciampi emphasised that the proposal for a recycling mechanism was the only one connected with the liberalisation of capital movements; the other proposals put forward, particularly those from the Ministers, which the Governors would also be examining, were concerned with longer-term and more ambitious objectives, such as the creation of a European central bank.

The idea of a recycling mechanism was thus rather specific; it would have to be analysed and evaluated on the basis of a full and detailed proposal which could be submitted later. In order to avoid the term "recycling", a vaguer formula might be used as Mr. Pöhl had suggested, but it would be preferable to preserve both the link with the liberalisation of capital movements and the novelty in the mechanism's management by the EMCF.

Mr. Duisenberg shared the views expressed by Mr. Pöhl and Mr. Leigh-Pemberton on the phrase in dispute; he suggested a new wording which, after amendments by Mr. Pöhl and the Chairman, resulted in the adoption of the following text: "In this connection the Governors would add that they will be embarking on an examination of various suggestions or ideas recently put forward by a number of EEC Finance Ministers and Governors, e.g. a proposal to introduce a new credit mechanism to be available when the liberalisation of the capital markets has been completed."

The Chairman noted the Committee's approval of the full text of the report to the Council with the amendment which had just been adopted; he added that the final text would be sent to the Governors by telefax that same day for forwarding to their Ministers.

Mr. Janson pointed out that the Governors would have to draw up the mandate to be given to the Raymond Group to continue the work, mentioned in the report to the Council, on the appropriate methods of strengthening monetary policy co-ordination. The Alternates had briefly discussed the question on Monday and it had been mentioned that those central banks most concerned might make some suggestions so that a draft mandate could be drawn up which would attempt, as far as possible, to satisfy specific requests; this draft would be submitted to the Committee of Governors at the meeting on 10th May.

Mr. de Larosière emphasised that monetary policy co-ordination was a very important issue and said that he would submit a draft mandate.

Mr. Ciampi agreed with Mr. de Larosière and noted that he had already brought up the subject at the March meeting. There should be no difficulties in drawing up a mandate; he added that the report to the Council on the liberalisation of capital movements merited the highest praise, which was due most particularly to the Committee of Alternates and to its Chairman.

Mr. Pöhl pointed out that, among the numerous proposals made, some fell exclusively within the jurisdiction of the central banks: those

which involved the EMS, for example, the legal basis of which was an agreement among central banks. It was essential, therefore, that such questions be discussed solely by the Committee of Governors.

Mr. de Larosière agreed with Mr. Pöhl, adding that his proposal was aimed precisely at bringing the issues of monetary policy co-ordination back within the forum of the Committee of Governors, which should deal with them in greater depth.

The Chairman recalled that the object was to define the mandate to be given to the Raymond Group to study ways and means of improving monetary policy co-ordination.

V. (possibly) Exchange of views on the items on the agendas for the international meetings in Washington

The Chairman pointed out that this item had been included in the agenda with the proviso "possibly", since experience had shown that very often the Governors had no wish or saw no need to have a special exchange of views on the questions on the agenda for the IMF meetings; he noted that the Committee did not have time to make an independent examination or have a special discussion of these questions.

VI. Other matters falling within the competence of the Committee

- The European monetary structure

The Chairman noted that the Alternates had turned their attention to this very important subject. At this stage it was essentially a matter of drawing up an inventory of the questions that should be examined in order to comply with the ECOFIN Council's request that the Committee study the various proposals and ideas put forward by a number of Finance Ministers, notably Mr. Balladur; in early January 1988 Mr. Balladur had presented a memorandum which had led to the mandate being given to the Committee.

A. Statement by Mr. Janson

A broad appraisal by the Alternates had shown the scope and complexity of the questions raised by the observations contained in the reference



documents. These questions lay within three different time horizons, though they were also closely linked:

- the analysis of the present functioning of the EMS;
- possible further adjustments to the system in its non-institutional phase;
- the ideas on the establishment of a European central bank, with a view to economic and monetary union.

#### 1. The analytical questions

The progress made in convergence in the battle against inflation had led to some new thoughts on the operation of the system and its alleged imperfections. Among these the most frequently cited were the lack of an engine for growth and the predominant position of one currency as a source of asymmetry.

The Alternates by no means wholly subscribed to the view that the operation of the system itself, or the macro-economic policy of a single country, was responsible for the modest pace of growth observed in the participating countries. That there was asymmetry in the operation of the system was not denied, at least in some respects, but it rested in large part on objective factors and could not be replaced artificially by a simplistic symmetrical structure.

There was unanimous acknowledgement of the importance of the stability gains generated by the system's operation and of the need to consolidate them further. The Governors should perhaps decide how much further they wished to take their analysis of the very foundations of the system, with the primary aim of strengthening the Community consensus on its objectives and basic concepts.

#### 2. The non-institutional adjustments

Various proposals had been formulated to meet the challenges which the system would undoubtedly face in the short term. The report that would be submitted to the Governors could set out the measures suggested. Some of these, such as closer co-ordination of monetary policies, would at all events be examined in connection with the full liberalisation of capital movements.

A number of Alternates felt that the Governors should focus on defining their priorities in this respect and thereby underscore the system's capacity to evolve and progress and so strengthen itself. Other Alternates

considered that the recent strengthening as a result of the measures taken in Basle/Nyborg justified a pause in the tempo of initiatives.

### 3. European central bank

Some of the Alternates had observed that the European Summit would address the question of the European central bank, if only at the procedural level. It would rest not only with the Finance Ministers but also with the central banks to put their views. It would be useful to point out in this context that certain plans had already been the subject of Council Resolutions in the early 1970s. In pointing to these earlier plans it would also be possible to clarify the concepts underlying them and the reasons why they were not implemented.

The majority of the Alternates felt that it would be premature to give any undertakings at this juncture regarding the practical establishment of economic and monetary union and of a European central bank. This should not prevent the Governors from defining the prior conditions that would have to be met with a view to implementing these plans. A number of Alternates, representing in particular countries still at a less advanced stage of economic development and liberalisation, pressed for an examination of the priority tasks, notably as regards the allocation of resources within the Community.

Some of the Alternates noted that the establishment of the single market itself altered the face of the Community environment and invested it with a momentum of its own which made the establishment of economic and monetary union and its institutional concomitant, viz. a European central bank, both feasible and necessary.

#### B. Discussion by the Committee

Mr. Duisenberg made a number of comments with regard to procedure. The plans for a currency area and a European central bank were very important issues that should not be passed over by the Committee. The Governors should discuss them at their meeting on 10th May in order to be able to submit some ideas to the Ministers of Finance, who would be attempting to co-ordinate their views at the ECOFIN Council meeting in Lübeck a few days later. The European Council at the end of June was also expected to discuss these proposals.

There were two central questions. Firstly, who should be appointed to study the proposals? A panel of wise men had been suggested, but it would be distinctly preferable to delegate the work to the normal Community institutions, viz. the Committee of Governors and the Monetary Committee according to their respective spheres of competence.

Secondly, what should be the formal basis for the study? There was no doubt on this point: the basis should be the Resolution of 22nd March 1971 on the progressive establishment of economic and monetary union in the Community. This text, which was still in force, provided in particular that on completion of the process the Community should form a distinct monetary whole with a single currency and a Community-level organisation of central banks. It also called for decisions regarding the management of the union to be taken at Community level and for the necessary powers to be invested in the Community institutions. These institutions included the Committee of Governors and the Monetary Committee. The Governors should therefore recommend that the Resolution of 22nd March 1971 be adopted as the formal basis for the mandate to be given to the two Committees, in order to enable the Ministers of Finance to formulate a co-ordinated opinion for the European Council in June.

Mr. de Larosière agreed with Mr. Duisenberg's remarks, which showed the right course to be followed by the Governors, and observed that, in addition to considerations concerning a European central bank, the French proposals contained aspects more closely linked to the operation of the EMS narrow band. These aspects should not be incorporated in the mandate referred to by Mr. Duisenberg because they formed part of the permanent mandate of the Governors. The Alternates should continue to study these questions, in particular that of the symmetry of the exchange rate mechanism. The symmetry question had to do with the fundamental problem of inadequate co-ordination of general economic policies among the Community countries. If a situation were allowed to develop within the narrow band mechanism whereby the policy mix of certain participants led to permanent structural current-account surpluses while others were more or less in balance, tensions would emerge within the system. The response to this problem consisted in closer economic policy co-ordination with common objectives for economic policy and also for growth with stability. A more symmetrical intervention mechanism could play an important role once the member countries had reached a level of

anti-inflationary conduct that would justify more homogeneity within the exchange rate mechanism. This idea should be taken up in the work of the Alternates.

Mr. Pöhl said he was able to follow the ideas put forward by Mr. Duisenberg and Mr. de Larosière. There were several issues, such as those concerning the creation of economic and monetary union and the establishment of a European central bank; these were essentially political matters, and it was questionable whether the central banks should be concerned with them at this stage. On the other hand, the question of symmetry (or convergence) was more concrete and concerned the Governors more directly. As Mr. de Larosière had said, every effort should be made to maximise consensus and convergence with regard to broad economic objectives, including monetary objectives, and to harmonise economic and financial performances as far as possible. However, it was not desirable to aim for symmetry of exchange market interventions; the Deutsche Bundesbank remained opposed to the proposed diversification of monetary reserves within the EMS, but it had no objection to the Alternates being asked to consider the question of symmetry of objectives and policies as long as they did not confine themselves to intervention techniques and procedures.

The question of economic and monetary union and of a European central bank was still vague, and it would be better to await clarification at the political level. It was not certain that a decision would be taken on procedure at the European Council in Hanover at the end of June, even if the possibility of Mr. Genscher's ideas becoming German Government proposals could not be ruled out. Whatever the case, if it was decided to create an independent panel of wise men to study the question of the monetary structure of Europe, such a procedure would perhaps be acceptable as preparatory to the studies the Governors would be undertaking. Indeed, it was questionable whether the Governors ought to be the first to insist that they alone carry out an objective and full analysis of these questions.

Mr. Hoffmeyer noted that the Resolution of 22nd March 1971 did not constitute a binding legal text. There were other Resolutions or comparable texts that could obviously be taken into consideration, but it was important to bear in mind the degree of obligation attaching to the Community instruments one took as a basis. It was also important, in the matter of symmetry, to differentiate between, on the one hand, the fundamentals - for example, economic performances differed within the EMS, and Germany being the dominant economy its performance regarding e.g. growth would be reflected in the system - and, on the other hand, technical questions such as interventions;

these could obviously not be isolated from the impact of divergences in fundamentals between the participating countries; but the system was nevertheless symmetrical in that when the exchange rate limits were reached interventions had to be made by the two countries whose currencies were at opposite poles. Intra-marginal interventions, which had been greatly expanded, were at the discretion of the countries concerned.

Mr. de Larosière accepted that the EMS was symmetrical in the sense suggested by Mr. Hoffmeyer, but technically there was a difference between the two central banks intervening when their currencies were at opposite poles, since one intervened as a provider of credit whom the other had to repay. There was thus no total symmetry, and it would be useful if these technical matters were studied in greater depth.

Mr. Ciampi was of the view that the Governors were faced with a set of proposals that were of major importance and looked to a future that could be distant or nearer than one thought, it was impossible to say which. These proposals certainly had a political content, but one which was of direct concern to the central banks. They should therefore not remain inactive and silent, but should be realistic and concrete in the work to be undertaken. In adopting their report to the Council, the Governors had just endorsed the liberalisation of capital movements, which would occur fairly rapidly. This process implied a strengthening of monetary policy co-ordination, which should, obviously, take place in a broader context of common economic policies. The group of experts chaired by Mr. Raymond would be reporting to the Governors on this subject. It was also desirable to strengthen the role of the existing institutions that were under the Governors' authority. In this connection priority should be given to the EMCF; its importance and its operational potential should be exploited to the full in order to achieve greater cohesion of monetary policies. Such an approach, which did not find favour with everyone, would not mean neglecting the more distant and more ambitious future and would offer a concrete and ready-made basis on which to achieve progress. The work to be undertaken should therefore take into consideration the liberalisation of capital movements, the implications of this, viz. the strengthening of monetary policy co-ordination in the context of broader economic policy co-ordination, and an enhanced role for the existing institutions such as the EMCF.

Mr. Duisenberg was aware that, as Mr. Pöhl had indicated, there was as yet no German Government proposal properly speaking, but there

nonetheless remained some ground for concern with regard to what could happen outside the central banks in areas which affected them. Moreover, at the luncheon of the ECOFIN Council in February, Mr. Balladur had apparently stated that his memorandum circulated to his colleagues on 8th January was not simply a proposal for the establishment of a European central bank but concerned the fundamental objective of strengthening the EMS and promoting the process of monetary integration. The Chairman of the Committee, who had attended this luncheon, had sent a message to his colleagues to the effect that "the ECOFIN Council asked the Monetary Committee and the Committee of Governors to examine the observations and questions contained in the French Finance Minister's memorandum and to report to it on the subject with a view to a discussion ... in the month of June". Such a discussion could equally take place at the European Council at the end of June. It would therefore be desirable for the Committee of Governors to submit its views on these questions to the Ministers of Finance, who could in turn deliver an opinion to the Heads of State and Government.

Mr. de Larosière endorsed Mr. Duisenberg's ideas; in his opinion, without seeking to rush matters, it would be useful to set up within the Committee of Governors a small think tank/working group on the questions of monetary integration and the single currency. These questions were being raised more and more frequently, for example in the memorandums of several Ministers, in the Giscard-Schmidt Committee, and soon also in the Monetary Committee. It was therefore important that the Governors should not allow a vacuum to develop on their part; otherwise the ECOFIN Council and the European Council could take steps in June that the Committee might have cause to regret.

The Chairman said that the comments made with regard to procedure, in particular those by Mr. Duisenberg, were correct; the Governors could not stand aside from the discussions that were going to take place and could not do other than respond to the mandate they had been given.

On the other hand, the Governors also had to express an opinion on the questions of symmetry and convergence within the EMS and on the systemic faults that some discerned in the EMS, for example the fact that it generated low growth rates. The Governors should not allow the system to suffer a progressive loss of credibility and should not let the comments made in various circles concerning the inevitable or foreseeable consequences of the present operation of the system go unanswered. The Alternates should therefore prepare the groundwork for the exchange of views which the Governors

would have on these various issues in May in order to be able to submit some ideas to the informal ECOFIN meeting in May or the formal meeting in June.

Mr. Janson pointed out that the Monetary Committee would also be addressing these questions in the near future and that the Balladur memorandum was to be supplemented by a more technical note, as announced by Mr. Trichet. It was important that the Committee of Governors should also act.

Mr. Pöhl said he was not concerned by any activity or energy shown by the Monetary Committee and pointed out that the Governors were on a different level. Irrespective of the date of creation of the two Committees, the central banks were in any event senior to the Monetary Committee. There was an important fundamental issue at stake that went beyond this aspect of protocol, namely that these bodies, whatever they represented and even if there were legal grounds, should not deal with subjects that lay within the competence of the central banks. The EMS rested on an agreement between central banks and not between governments. This was a vital point for the Deutsche Bundesbank and meant that it would not participate in discussions in the Monetary Committee about, for example, official reserve diversification or the extension of the maturity of the swap operations for the creation of ECUs. The Monetary Committee could, of course, address institutional issues. In this connection, it was doubtful whether the EMCF was really the right institution to be chosen by the Governors, since, contrary to what Mr. Ciampi had said, the EMCF was not under the exclusive authority of the central banks but was a Community institution created by the Council of the European Communities that was dependent on other EEC institutions, in particular the Council.

Mr. Pöhl agreed with the idea that the Alternates should study two sets of questions. The first would relate to the practical ways and means of improving monetary policy co-ordination and to convergence, symmetry and the operation of the EMS. It should be established whether improvements were conceivable and feasible, but it was not absolutely necessary to reach conclusions by the time of the June meetings of the Community Councils. The second set of questions was of an institutional nature and would relate to the implementation of economic and monetary union and the establishment of a European central bank. This would call for an initial examination with a view to submitting to the Ministers and Heads of State a very provisional opinion limited to an outline of the general line of thought. This examination

should take into account only the ideas presented by governments or central banks and not the numerous articles, studies or declarations made by individuals, however prominent.

The Chairman noted that all the Governors were aware of the task that awaited them in the weeks to come and that they were agreed with regard to procedure and the timetable for the work.

VII. Date and place of the next meeting

The next meeting would be held in Basle on Tuesday, 10th May 1988 beginning at 10 a.m.



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

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MARCH 1988

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This report summarises developments on the exchange markets of the countries whose central banks participate in the concertation procedure<sup>1</sup> and briefly describes their interventions during March and the first few days of April 1988.

I. EXCHANGE RATE DEVELOPMENTS

The main features of the foreign exchange market during March 1988 were:

- a strengthening of the pound sterling against all other currencies;
- a tendency for the US dollar to weaken, the depreciation being somewhat more pronounced vis-à-vis the Japanese yen than against the continental European currencies;
- some short spells of nervousness in the EMS, which, however, did not result in major tensions and have since subsided.

The US dollar moved lower against major foreign currencies during March. Early in the month, signs of stronger-than-expected US economic activity raised questions about the outlook for further adjustment in external imbalances and continued price stability. Furthermore, doubts grew

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

about the Group of Seven's resolve to stabilise exchange rates generally, especially after sterling rose against the Deutsche Mark. Against this background, the dollar gained only temporary support from the release of the US trade figures that, for the third consecutive month, were better than expected. On balance, the dollar ended the month down about 6 per cent. against sterling, 3 1/2 per cent. against the Japanese yen, 2 1/2 per cent. against the Canadian dollar, and 1 1/2-2 per cent. against most of the continental European currencies.

Around mid-month some nervousness appeared in the EMS for the first time this year, with several currencies losing ground against the Deutsche Mark. However, the pressure quickly subsided and stability has returned to the system.

The Deutsche Mark firmed against the US dollar and the currencies participating in the EMS exchange rate mechanism, but lost ground vis-à-vis sterling and the Japanese yen. Its weighted index against fourteen industrial countries stood at 173.1 per cent. at the end of March (173.5 per cent. at end-February 1972 = 100).

In a thin market the French franc came under some pressure around the 10th of the month, mainly as a result of commercial demand for Deutsche Mark followed by short positioning. This resulted in a temporary drop in the exchange rate which helped to dissipate the disturbances and contributed to a more balanced market, allowing the franc to return to its levels of the beginning of March. The premium of the Euro-franc rates vis-à-vis the domestic interest rates, which never rose above half a percentage point, was practically zero at the end of the month.

In a quiet market the Dutch guilder continued to show a firm undertone which was reflected in a slight strengthening in the EMS band.

At the beginning of the month the Belgian franc remained stable. The Banque Nationale de Belgique lowered its discount and lombard rates by 1/4 percentage point and furthermore bought a considerable amount of foreign exchange. Later in the month the position of the Belgian franc in the EMS deteriorated slightly.

The Danish krone weakened slightly and ended the month around the middle of the narrow EMS band.

Having strengthened somewhat at the beginning of the period, the Irish pound was relatively stable in the upper half of the EMS band during the remainder of the month. Over the period there were significant inflows

of foreign currency, which resulted in sizable net purchases of foreign currency by the Central Bank of Ireland.

The Italian lira was influenced by the renewed weakness of the dollar and the strengthening of the pound sterling. The uncertainties arising from the expiry of the ceiling on bank lending and, at the end of the month, from the release of balance-of-payments statistics, also affected the lira. The Banca d'Italia, as a consequence, ended up as a net seller.

Underpinned by expectations that interest rates would remain high, sterling experienced periods of heavy demand. Having risen above DM 3 on 7th March for the first time since September 1986, it strengthened appreciably, shrugging off a 1/2 percentage point cut (to 8 1/2 per cent.) in UK base rates and disappointing trade figures to end the month at its highs. Sterling's trade-weighted index rose by 4.6 per cent. to 78.1 (1975 = 100).

The Greek drachma rose by 1.8 per cent. against the US dollar while it depreciated by 0.4 per cent. against the ECU. In effective terms the drachma remained unchanged mainly as a result of the foreign exchange policy of the Greek authorities.

The Spanish peseta continued its appreciation during the period, especially in the second half of the month, ending 0.6 per cent. higher with respect to the EEC currencies in effective nominal terms and 2.9 per cent. against the US dollar. The Banco de España reduced further its key intervention rate for overnight funds by a 1/2 percentage point.

The Portuguese escudo depreciated by 0.4 per cent. in effective terms. Compared with the US dollar the escudo rose by 1.2 per cent. Since 1st March forward foreign exchange trading up to one year has been authorised. The previous maximum of six months was introduced in February 1987.

The Swiss franc weakened vis-à-vis the pound sterling by 4 per cent. and vis-à-vis the Japanese yen by roughly 1 per cent. As measured against most remaining currencies it registered a slight increase which was most pronounced vis-à-vis the US dollar at 1.7 per cent.

In March the Austrian schilling firmed vis-à-vis the US dollar by just under 1.7 per cent., with a monthly fluctuation of 2.1 per cent. Against the Deutsche Mark it fluctuated by 0.2 per cent.

The Swedish krona has remained strong within the index range mainly due to the relatively high interest rates. In the money market the

rate for six-month treasury bills increased by 25 basis points to 9.75 per cent.

The Norwegian krone remained fairly stable, as the market awaited Parliament's approval of the Government Bill on incomes and dividends, aiming at moderating nominal incomes settlements for 1988. The continued high level of domestic interest rates, together with a firming of oil prices, also helped to stabilise the currency. The krone appreciated by 1.7 per cent. against the US dollar and depreciated only slightly in effective terms.

The Finnish markka has continued to fluctuate within a narrow band. During the first part of the month widening interest rate differentials against the major foreign currencies led to increased short-term capital inflow.

In a continuation of the firming trend evident since late last year, the Canadian dollar ended the month around the US\$ 0.8100 level, an increase of 2.4 per cent. against the US dollar and 1.5 per cent. on a G-10 trade-weighted basis. The appreciation of the Canadian dollar was linked to the strong performance of the Canadian economy, the improved terms of trade, the stance of monetary policy and the resulting firmness in interest rate differentials vis-à-vis US securities which led to continued capital inflows.

The Japanese yen strengthened towards the end of March, appreciating by 3.4 per cent. against the US dollar and by 1.1 per cent. against the ECU. The yen's firmness was due mainly to strong overseas demand for Japanese stocks and market speculation that Japanese life insurance companies might accelerate dollar selling as the new fiscal year starts in April. The Bank of Japan stepped in the market in the latter half of the month to stem the sharp appreciation of the currency.

## II. INTERVENTIONS

### A. Interventions in US dollars

Net purchases of US dollars by central banks during March amounted to a net US\$ 2.5 billion, compared with US\$ 1.9 billion in February. Gross purchases amounted to US\$ 3.7 billion and gross sales to US\$ 1.2 billion. The main buyer was the Bank of Canada, the main seller the Banca d'Italia.

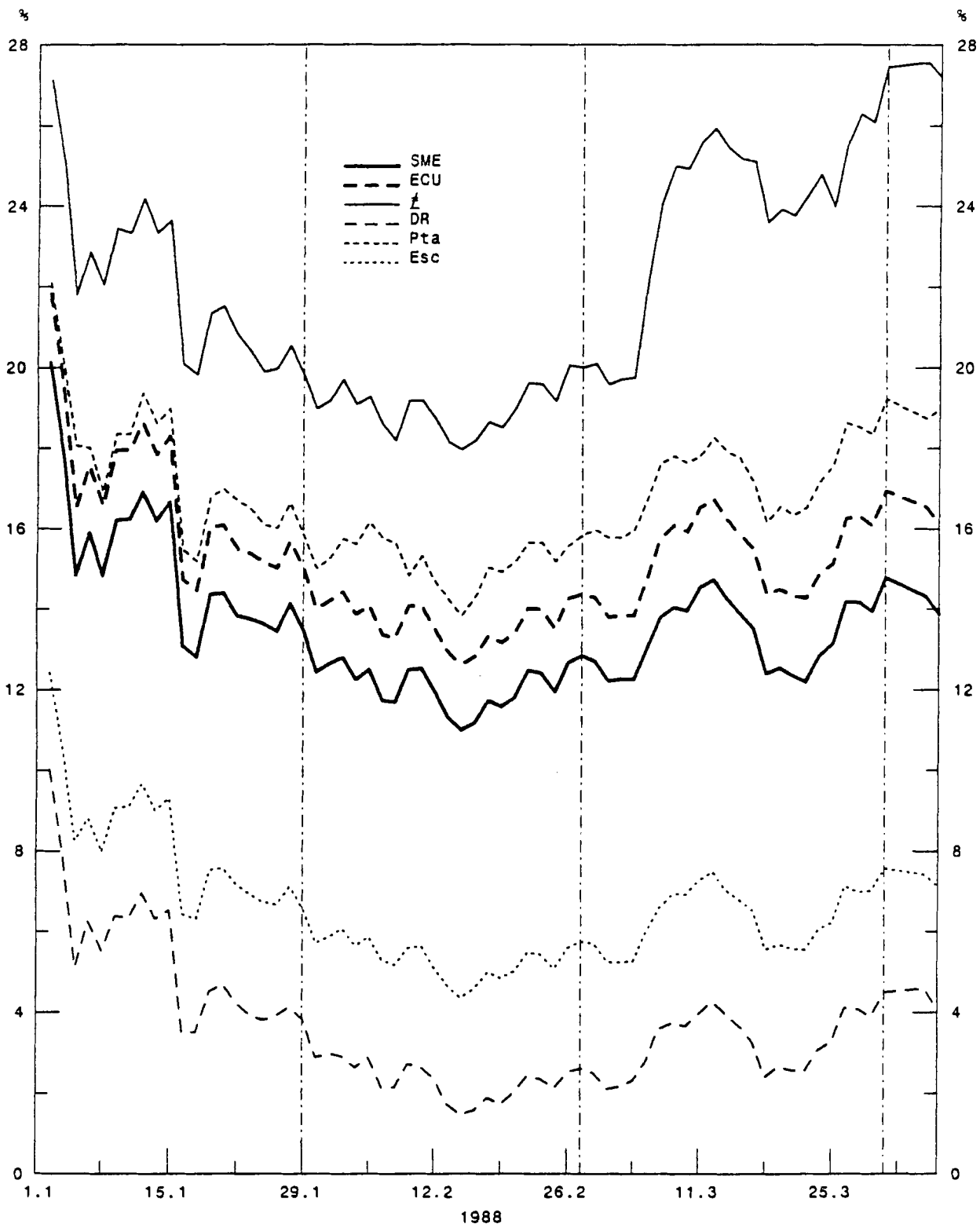
B. Interventions in Community currencies and the private ECU

Interventions in EMS currencies and ECUs by Community central banks amounted to the equivalent of US\$ 5.3 billion, compared with US\$ 2.2 billion in February. These interventions mainly consisted of purchases of ECUs, French francs and Deutsche Mark by the Bank of England and Deutsche Mark by the Banco de España on the one hand, and of sales of Deutsche Mark by the Banca d'Italia on the other hand.

THE FIRST FEW DAYS OF APRIL

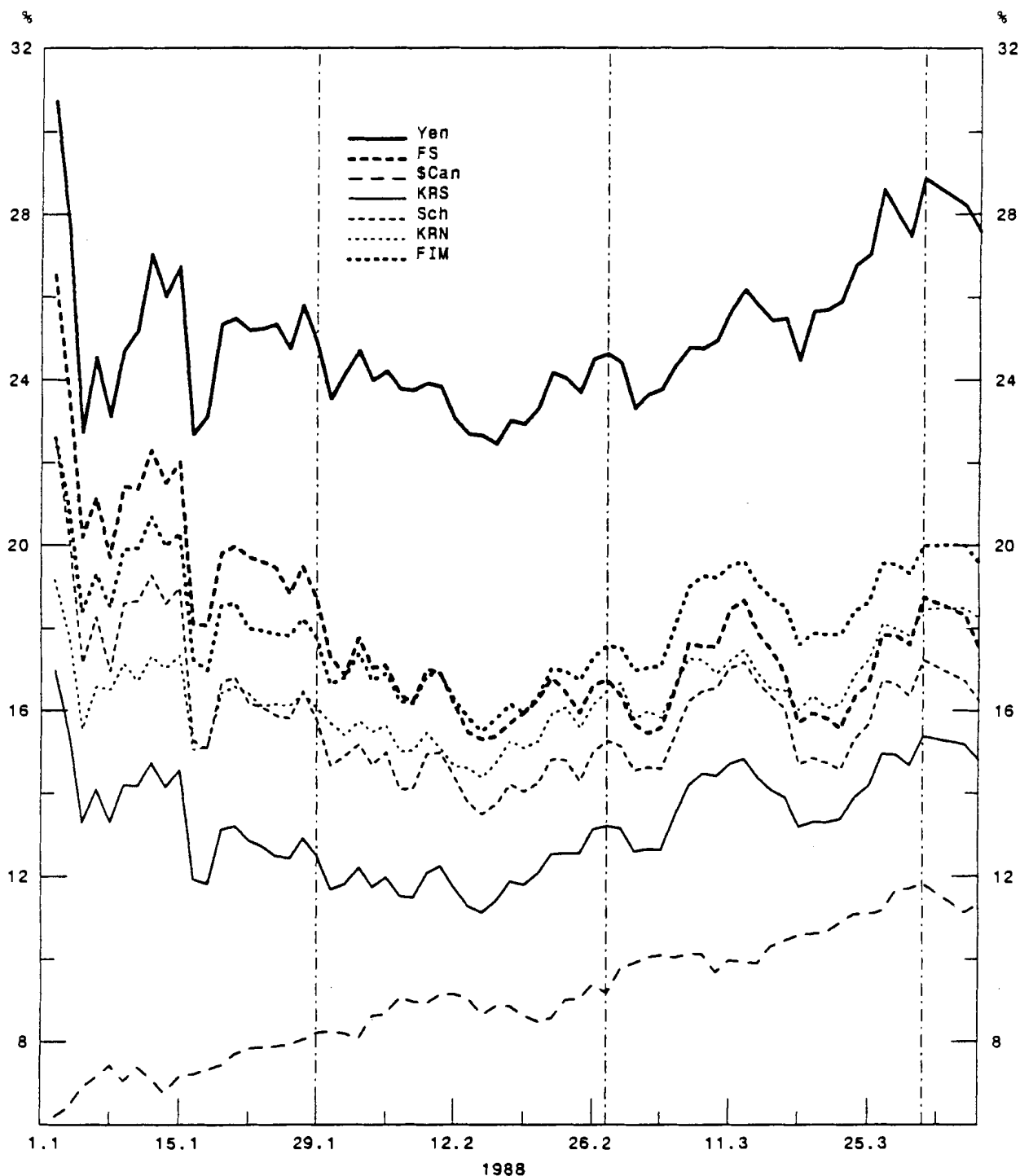
On balance the US dollar recovered some of the ground it lost in March. Expectations that the G-7 countries will reaffirm their commitment to stable exchange rates during their forthcoming meeting and that the US trade figures over February will show a reduced deficit, contributed to this development. The firm tendency for sterling continued and UK base rates were again cut by 1/2 percentage point (to 8 per cent.). Conditions in the EMS remained unchanged.

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



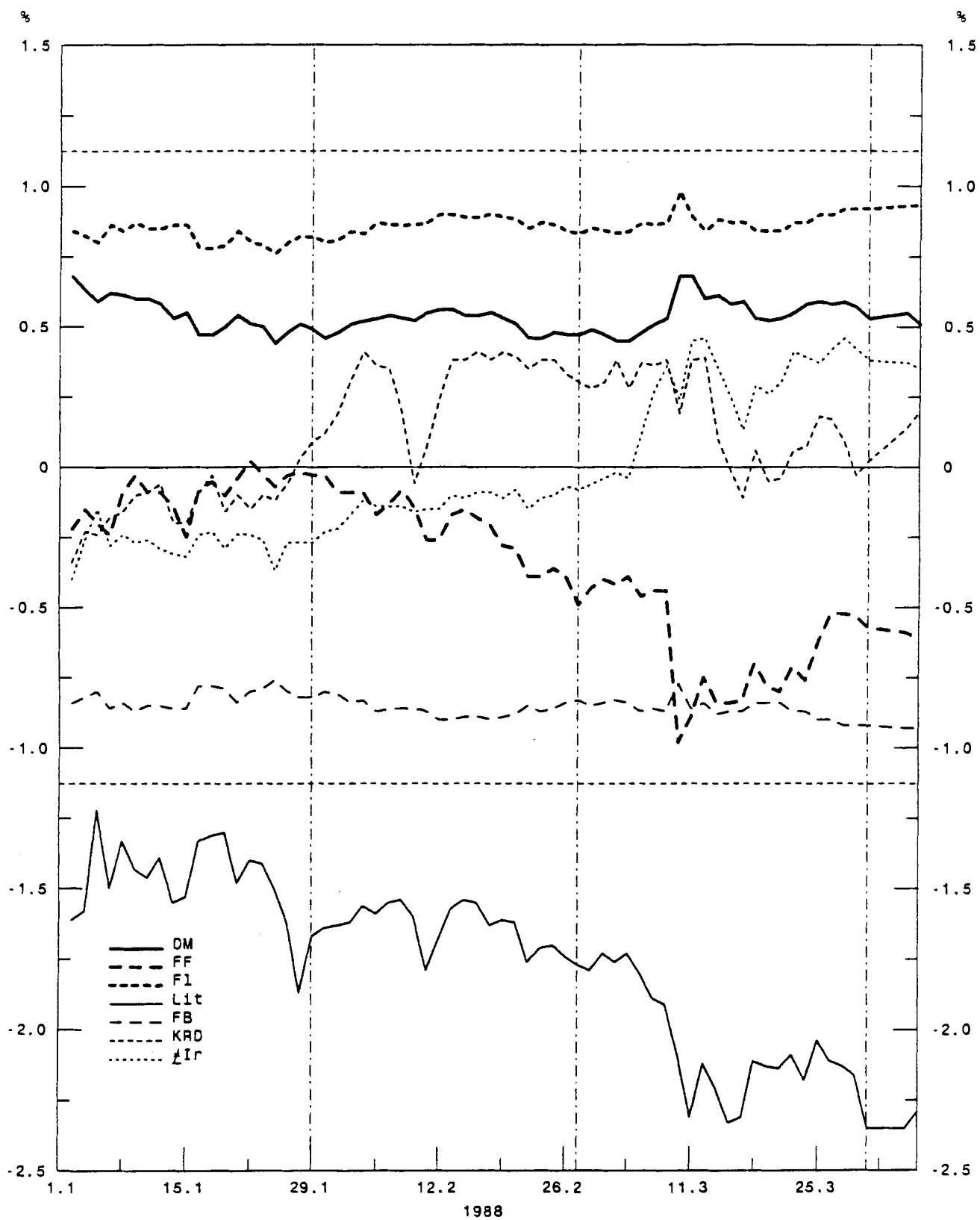
\* Voir page suivante.

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



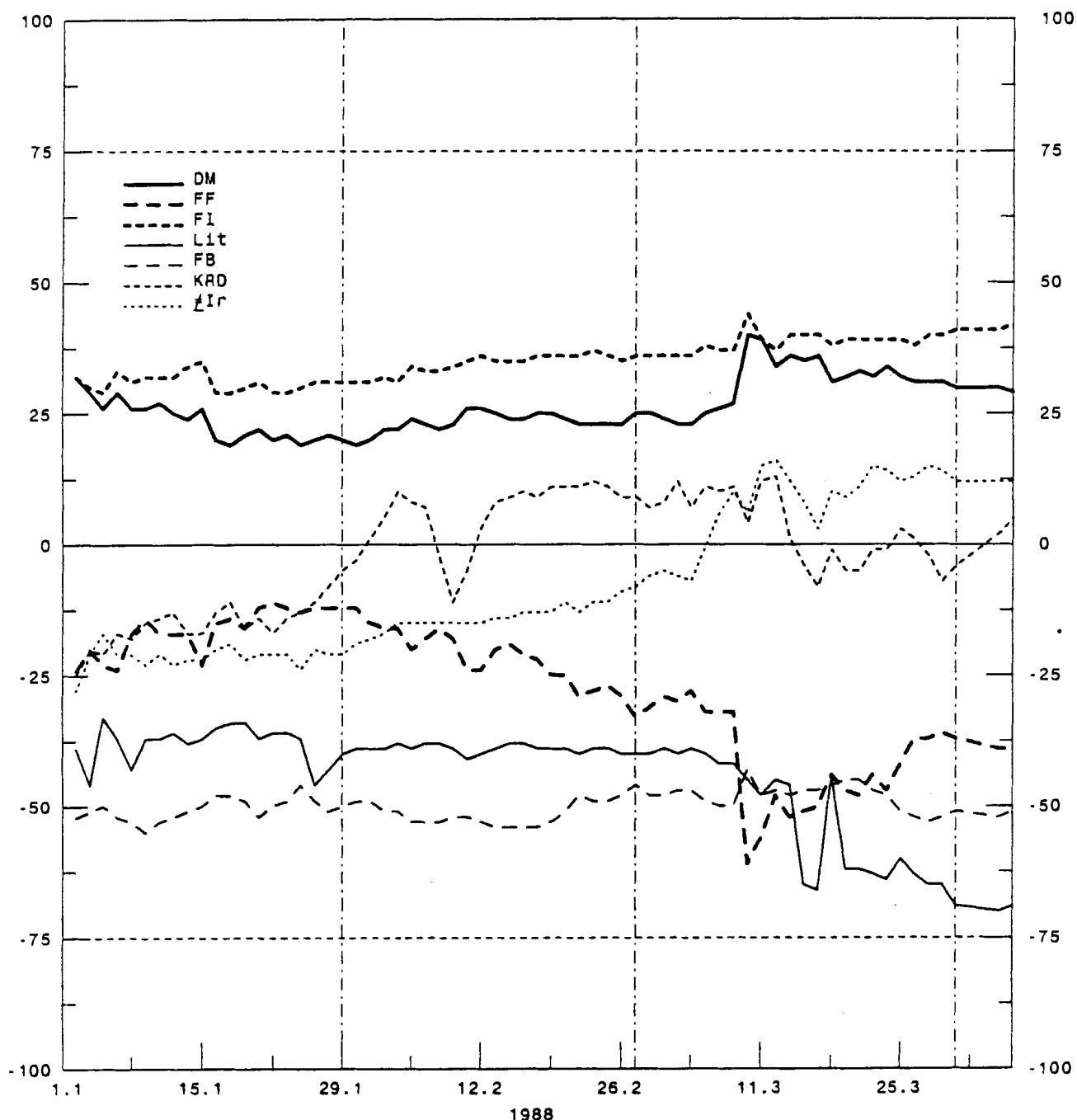
\* ECU 0,93425; £ 0,6773; DR 138,7601; PTA 131,8700; ESC 146,0995;  
FIM 4,7925; \$Can 1,3805; FS 1,6215; Yen 159,7993; KRS 6,7750; KRN 7,3975;  
Sch 13,6520; cours médian des monnaies participant au SME 0,92913. Le  
cours médian des monnaies participant au SME représente la moyenne jour-  
nalière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

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



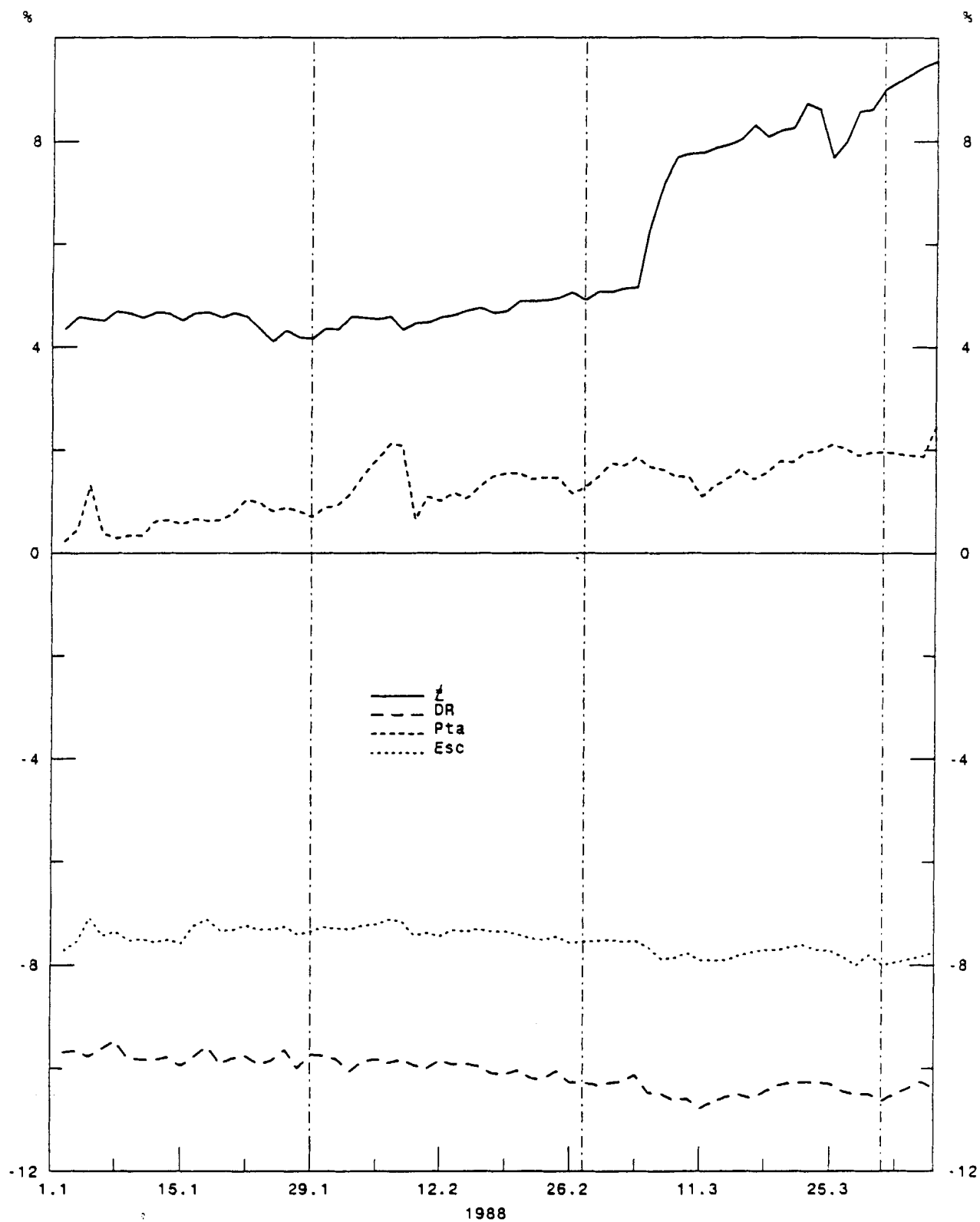


## EVOLUTION DE L'INDICATEUR DE DIVERGENCE\*



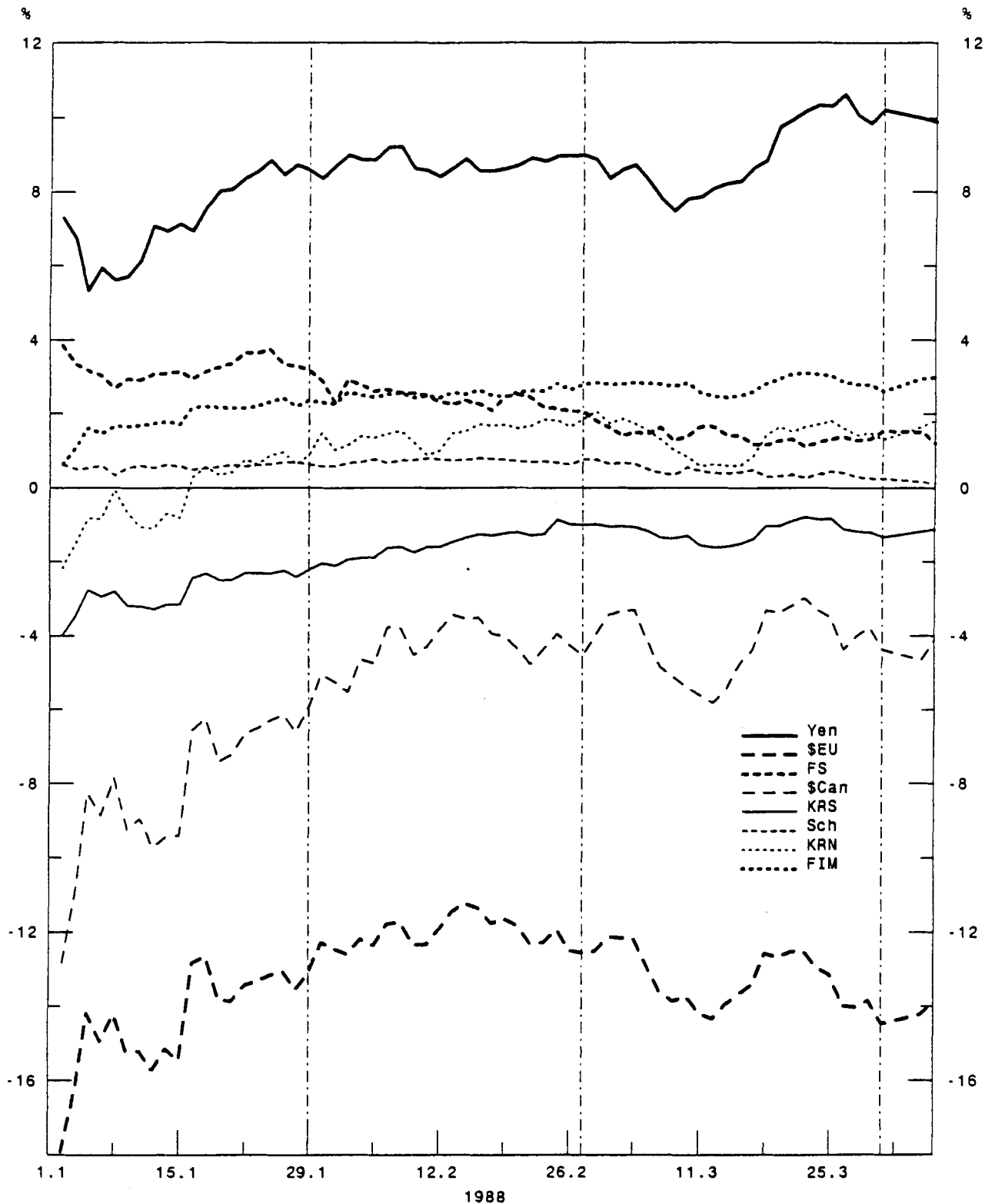
\* L'indicateur de divergence a pour but de mesurer, sur une base comparable pour toutes les monnaies participant au mécanisme de change européen, la position d'une monnaie vis-à-vis de son cours-pivot ECU. L'écart maximal de divergence est le pourcentage maximal par lequel le cours de marché de l'ECU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

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



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

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



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