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Confidential

Final

MINUTES

OF THE 270th MEETING OF THE COMMITTEE OF GOVERNORS

OF THE CENTRAL BANKS OF THE MEMBER STATES

OF THE EUROPEAN ECONOMIC COMMUNITY

HELD IN BASLE ON TUESDAY, 10th November 1992 AT 9.30 a.m.

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List of participants attached

Before turning to the agenda, the Chairman said that, at their restricted meeting which had been held prior to the current meeting, the Governors had decided unanimously to elect a new Chairman for a term of one year from 1st January 1993; it was proposed that a candidate would be chosen at the Committee's December meeting. Secondly, Mr. Rey had been reappointed as Chairman of the Committee of Alternates for a further year from 1st January 1993. Thirdly, two letters addressed to the Chairman - one by Mr. Schlesinger introducing a Deutsche Bundesbank paper on monetary policy strategies for the European Central Bank and their implications, the other by Mr. Ciampi on exchange rate issues - were to be passed to the Alternates for consideration. Finally, by written procedure, Mr. Scheller and Mr. Viñals had been appointed senior professional members, responsible for the Secretariat and the Economic Unit, respectively, with effect from 1st October 1992.

I. Approval of the minutes of the 269th meeting

The Committee approved the minutes of the 269th meeting.

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

- preparation by the Foreign Exchange Policy Sub-Committee (monitoring)
- statistical charts and tables prepared by the Secretariat
- a note by the Economic Unit entitled "Recent ERM tensions: main developments and preliminary assessment"

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

The Monitoring Group had conducted its first review of the situation in the foreign exchange markets since the September EMS crisis and had focused on the repercussions and the outlook for the period ahead. The tension had not entirely disappeared. Although interest rates had recently declined in a number of countries, most notably in Germany, the differential between German interest rates and the average in other EMS countries remained higher in October than it had been in August 1992, although below the peak levels reached in September. Furthermore, with the notable exceptions of France and Denmark, little or no reflows of capital had been recorded in the countries affected by the crisis, i.e. Italy, the United Kingdom, Spain, Portugal, Ireland and Greece. Several factors had been cited to explain the current unsettled state of the markets, the most important being the belief that a further round of ERM adjustments might soon take place, possibly in connection with the re-entry of the Italian lira into the ERM. Such views had recently been reinforced by press reports that the Spanish authorities would not rule out a realignment of the peseta. Although those reports were inaccurate, their impact on the markets had been significant. Under such circumstances, market participants would manage their foreign currency exposures cautiously and would look for opportunities to profit from actual or expected exchange rate movements. Indeed, the ERM crisis had shown after many years of unsuccessful speculative attempts that currency speculation could be very profitable; this was influencing the behaviour of market participants although large losses had been incurred by speculators against the French franc. The expectation of a parity adjustment was weighing on the Spanish peseta, the Portuguese escudo and the Irish pound despite a relative calm in the markets in recent weeks. The Irish pound was seen as dependent upon the outlook for the pound sterling which was expected to continue to float for some time. In Spain, the possibility of a removal of the penalties recently introduced on certain types of capital movement represented a further source of uncertainty.

Another important factor was the uncertainty over the prospects for macro-economic adjustment and convergence in the Community. This was a crucial element affecting expectations about the Italian lira. Italy had made important progress towards correcting its fiscal imbalance and the lira had appreciated by about 8 percentage points in October despite declining interest rates. Inflation had decelerated to 5%, from 5.2% in September, and wages had grown at a moderate pace well below inflation. However, market participants were reserving their positions pending the final approval by the Italian parliament of the budget and the conclusion of the negotiations with the Community on the medium-term loan, as well as for clear indications about inflation and wage increases in the aftermath of the devaluation. In general, market participants appeared to consider that the ERM crisis and the uncertainties over the EMU process would weaken the adjustment that was underway in a number of countries, or make them less acceptable from a political point of view as in the case of Greece.

The credibility of a number of countries had been illustrated by the absence of tensions, as in Belgium and the Netherlands, or by the successful management of the crisis, as in France. However, the system as a whole had suffered from its inability to maintain consensus on the viability of the parity grid. An obstacle to the restoration of its credibility was the risk that currency speculation might again target EMS currencies in connection with events such as the Maastricht Treaty ratification process in the United Kingdom and Denmark, or the election in France. Market participants were closely watching the behaviour of Community authorities to see whether any concrete steps to strengthen the EMS were being taken.

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

The Alternates' discussion had been stimulated by the note produced by the Economic Unit on recent events. With regard to managing the ERM in the months ahead, the current strong upward pressures on the US dollar were considered by some Alternates as a welcome correction in competitive relationships between Europe and the rest of the world, especially as it was accompanied by a long overdue rise in the Japanese yen. However, other Alternates had pointed to the risk that a further rise in the dollar might delay prospects for interest rate cuts in Germany and the rest of the Community. The dollar's rise had already eroded the effective appreciation of the Deutsche Mark and repeated calls for an interest rate cut in Germany could lead to a situation similar to the one before the crisis and could entail the same risks. With regard to the fragile situation in the EMS, there were market expectations that a further realignment could soon occur; there would be strong merit in having necessary consultations to ensure, if possible, simultaneity of any action.

The Alternates had also discussed how the Governors could respond to the invitation arising out of the Birmingham Summit to participate in the analysis of the recent financial turbulence. The mandate defined by the Summit was wide since it covered developments in the European and world monetary systems. Moreover, the European Council had invited ECOFIN, assisted by the Monetary Committee with the involvement of the Commission, to carry this work forward with the co-operation of the central bank Governors. The Alternates were of the opinion that the Governors should focus on the EMS. The G-10 countries would be undertaking a fact-finding exercise with regard to overall financial market developments and the

Commission would probably emphasise the economic aspects, namely the implications of a lack of convergence and of weak economic growth. Some overlap with the work undertaken by the Monetary Committee could probably not be avoided and it was felt important that the Governors' report should be made available soon enough to allow it to serve as an ingredient in the work being done elsewhere rather than the reverse. The Alternates therefore suggested that the Governors' analysis should be completed within three to four months. The lessons to be drawn from recent events should cover three main areas: the validity of the ERM as a system - many Alternates had underlined the merits of the system having survived such a severe crisis; the lessons for the operation of economic and monetary policy and instruments designed to manage the system; and the design of the mechanism itself, including procedures and consultations with regard to the viability of the parity grid. An examination of the rules should address the need for their correct implementation and whether changes, if any, were required. The process of implementing economic and monetary union should also be considered in the review.

The Alternates had felt that the Foreign Exchange Policy Sub-Committee could describe and analyse the recent exchange market developments in its annual EMS report and also examine the technical operation of the system in the field of intervention, financing and settlement. Questions had been raised, inter alia, with respect to: the conditions under which unlimited compulsory interventions at the limits could be regarded as acceptable irrespective of the relationship of the exchange rate to the fundamentals; and the transparency of the conditions under which ERM central banks granted each other bilateral swap facilities outside the EMCF. The Alternates, for their part, would concentrate on: policy issues relating to the improvement of convergence and to the exchange rate flexibility in the system, including not only the frequency of realignments but also the possibility of a temporary widening of margins; the conduct of monetary policy under increasing constraints; the scope for co-ordination of interest rate policies; and the co-ordination of policies between countries managing floating currencies and those remaining in the ERM. There were important and difficult linkages between these issues. On the one hand, more frequent realignments would not be needed if convergence proceeded faster whilst, on the other hand, interventions would not have reached the extraordinary amounts observed if exchange rates had been adjusted in due time.

Finally, the Alternates had felt that the Governors should respond to Chancellor Lamont's letter before the Edinburgh Summit stating that they were taking steps to study the issues raised by recent events and specifying the ground which the Committee intended to cover. The letter should make it clear that, without prejudging the study, it would be unwise to create expectations of major revisions in the rules governing the system.

3. Discussion by the Committee

Mr. Ciampi said that the events in September had severely injured the EMS and that the prestige and credibility of the central banks had also been diminished. For years, the Committee had been proud of the progress that had been made towards convergence which to a large extent had been due to the proper functioning of the EMS and which, for a long time, had been credible to the markets. The natural weaknesses of the system had been revealed: first, that implicit in the inconsistency, in the present period of transition, of full freedom of movement of goods and capital with monetary policy still in the hands of national authorities; second, a degree of cohesion among Member countries lower than expected. The Community central banks had generally given the impression that they were not capable or prepared to face up to such unexpected and large capital movements and that they had responded as individual institutions and not as part of a system, thereby running the risk of allowing the EMS to collapse. The System, not a given currency, was under attack, as had been shown by the fact that, in the period after the French referendum, when the French franc had come under pressure; the markets had felt that they could attack a currency despite the fact that the country's economic fundamentals were sound. It would be a great mistake to consider what had happened as an episode, at the end of which one could go back to normal, without analysing the events and without looking for remedies. He was worried that the timetable envisaged by the Alternates for analysing recent events was too long. Another storm could erupt before the study had been completed. A leap forward was needed in the management of the EMS; it was not a matter of inventing new rules, rather of interpreting and applying the existing ones properly. The Governors' work should be inspired by the common intention to set up EMU in a matter of a few years. The various governing bodies of the

System, including the Committee of Governors, should not only serve as a forum for the exchange of information, but should strive to pave the way for decisions, even if ultimate responsibility for them rested with the national authorities. It was for those reasons that he had drafted the note, the Chairman had indicated was to be passed to the Alternates, and in which the basic principles governing the EMS Agreement of 1987 had been recalled. It did not deal exhaustively with all the problems that confronted the Committee, rather it concentrated on the realignment procedures, the definition of, changes in, and ways of defending the parity grid. Agreement on the appropriateness of exchange rate parities should be reached jointly and should not be the result of an individual or isolated decision. Parities should be reviewed at regular intervals and be carefully monitored. All member countries must be prepared to defend the commonly agreed parities; it should be considered to what extent it was necessary to strengthen the tools that were available to achieve this. At the same time, individual countries must be prepared to consider a parity change if it appeared to the system as a whole that this parity was no longer appropriate. In order to avoid duplication in some aspects, there must be co-ordination between the analysis of the EMS to be undertaken by the Governors in response to the request of the European Council and the work on capital movements to be undertaken by the G-10 Deputies, chaired by Mr. Dini.

Mr. Leigh Pemberton said that it was very disappointing that sterling was once again outside of the ERM. However, it was the UK government's intention to re-enter the ERM as soon as possible. He believed that the body of political opinion in the United Kingdom against re-entry could be overcome if a convincing case could be made about the appropriate parity and the United Kingdom's counter-inflationary performance. The principal aim at present was to convince the markets that the counter-inflationary stance remained unimpaired. The Chancellor had set out his policy programme in a letter to a parliamentary committee; M0 remained a target indicator and M4 would also be closely monitored. In addition, the exchange rate and developments in the real economy, particularly asset prices, would be taken into account. There would also be monthly meetings between officials of the Bank of England and the Treasury based on regular monthly assessments by the latter of the inflationary position. Future changes in official interest rates would be preceded by joint meetings between the central bank and the Treasury and the change in interest rates would be accompanied by an explanatory statement. Finally, each quarter the Bank of England would issue its own statement on the inflationary situation; the public and the markets would thus be able to assess how the authorities were carrying out monetary policy. Such openness might make the role of the central bank be better understood and more influential. However, the Prime Minister's recent comments that government policy would concentrate more clearly on measures designed to promote growth and increase employment had been interpreted by the media as a shift from its counter-inflationary stance towards a dash for growth. Mr. Leigh-Pemberton had explained to a parliamentary committee that the government's change of emphasis was a realistic recognition of how depressed the UK economy was. As a result of sterling's recent depreciation the 2 percentage points fall in interest rates and the relaxation in monetary policy was justifiable although policies would need to be tightened when inflationary pressures seemed likely to re-assert themselves. The 'debt overhang' in the UK had had a depressing effect on personal and investment confidence and on the level of asset prices. The Chancellor's forthcoming Autumn Statement was likely to stress the government's determination to maintain the level of government expenditure previously indicated. Nevertheless, there would be a substantial fiscal deficit for the current year and a larger one for 1993. This could only be acceptable if it was understood to reflect mainly the automatic stabilisers and if fiscal policy was tightened as the UK economy recovered and new inflationary pressures emerged. There were likely to be further interest rate reductions before the end of the year, which would be acceptable given the depressed state of the economy. Much would rest on how well the Chancellor's statement was received in terms of his personal credibility and that of the government.

<u>Mr. Schlesinger</u> said that there were two weaknesses in the assessment of the problems presented to the Committee. Firstly, frequent reference had been made to the absence of symmetry of policies. It was not helpful to concentrate the discussion exclusively on the problems of countries whose currencies had depreciated, since countries with strong currencies also had their problems and played an important role within the system. The Deutsche Bundesbank was very conscious of its responsibilities in the EMS. However, the compulsory interventions of DM 65 billion which had been financed by recourse to the VSTF might give rise to an exchange

loss of about DM 1 billion. Furthermore, the large inflows that had been experienced as a result both of intramarginal and compulsory interventions, amounting to a total of DM 92 billion, had made it difficult to control the German money supply. At the end of September M3 had increased by 11%, compared with 8.5% in August, and growth would be higher still in October. The second weakness in the assessment related to the way in which difficulties might be avoided in the future. The study should analyse the whole period from the time of the last realignment in 1987 to understand what had happened. During that period, the level of prices in some countries had increased by 15% overall whereas those in other countries had risen by 35%; under such circumstances the system could not remain stable. Politicians should be made to understand that one could not just wait until certain political events, such as the French referendum, had occurred before taking action, since the markets acted more quickly on expectations. It was not enough to say that fundamentally the EMS was a good thing; if a realignment was necessary, it had to be negotiated by all relevant parties, including the politicians, in person rather than over the telephone. He added that tension in the EMS could not be alleviated by requiring a country, the currency of which was strong in the exchange markets but which has inflationary problems at home, to cut its interest rates; that might lead to a further rise in its price level. The priority of price stability was essential according to the EMS-rules as well as to the Maastricht Treaty.

Mr. Duisenberg said that, once exchange rate relationships had lost their credibility in the markets, parities became increasingly difficult to maintain and more so once the credibility of the authorities to defend exchange rates by interest rate increases had been lost. He recalled that the Basle/Nyborg rules prescribed the flexible use of intramarginal interventions and interest rates, early realignments, and also abstention, if possible, from public statements on the exchange rate situation. It had been argued in the UK that increasing interest rates would be counterproductive since it would affect the acceptance of EMU; that was one way of saying that in present circumstances the UK could not continue to participate in the ERM since there was a conflict with the need to make flexible use of interest rates. Where a country's exchange rate and policy mix had been in line, as in the case of France, credibility had been affected by other factors, notably by events concerning the Italian lira and the pound sterling. The lesson had been that other participants had been ready to go to great lengths in their co-operation to save the system. What was needed was not so much to change the rules but to apply them in a more determined way.

Mr. Leigh-Pemberton replied that the interest rate instrument was an important element in the UK's policy response; however, at the time of the recent tensions, the state of the UK economy was such that interest rate increases would not have been economically or politically credible.

Mr. Duisenberg recalled that he had said at the time of the attack on the French franc that interest rates could not at the same time serve the needs of reviving a domestic economy which was in recession while also being used in defence of the exchange rate.

Mr. Leigh-Pemberton said that in the case of France, the markets had realised that the French economy could stand high levels of interest rate in support of the exchange rate, whereas they did not believe that the same was true for the UK.

Mr. de Larosière said that, the falling differential between US and European interest rates, mainly the result of a reduction in German interest rates, was favourable to a more stable exchange rate situation in Europe. Furthermore, long-term interest rates in the US had edged up owing to uncertainties about fiscal policy under the Clinton administration, whilst those in Europe had been declining. As a consequence, the dollar had risen to a more comfortable level although he agreed that it should not rise to the extent that it produced inflationary difficulties for European countries. His view of France's position during the recent EMS crisis was that nothing would have been possible had the economic fundamentals been wrong and had the French franc been at an uncompetitive level. Furthermore, the Deutsche Bundesbank's statement that there was no fundamental problem in the Deutsche Mark/French franc parity, and the significant lines of credit that the Deutsche Bundesbank had extended to the Banque de France, had been underpinned by the credibility of the fundamentals. This had enabled the French monetary authorities to take very resolute action in defence of the French franc. For example, the overnight interest rate had risen to more than 30% on one day and had stood at more than 20% on a number of days. The capital outflows which had been experienced had since been completely reversed, all short-term indebtedness entered into had been repaid and foreign currency reserves had been rebuilt. Interest rates were currently on a downward trend although this had been managed carefully so as to maintain maximum pressure on short French franc positions and to make them costly to hold. Interest rates were now lower than at the beginning of the crisis. He agreed with Mr. Duisenberg that it was not necessary to embark on a major reform of the ERM, rather the aim should be to improve anti-inflationary performances and insist on greater convergence. He shared Mr. Ciampi's view that the multilateral surveillance procedures should be improved.

With regard to Mr. de Larosière's comment that no defence of the policy was possible if the fundamentals were wrong, Mr. Doyle said that unfortunately the converse did not hold true. In Ireland's case, there was nothing wrong with the fundamentals - there was a balance of payments surplus of nearly 8% of GDP, government borrowing was less than 2.5%, and the inflation rate in the twelve months to August was 2.8% - and yet the Irish pound had come under severe pressure. That had been a question of market perception. In response to the crisis, the Irish authorities had employed all of the Basle-Nyborg instruments: massive intramarginal interventions had been undertaken; the currency had fallen to the bottom of the narrow ERM band; the Very Short-Term Finance facility had been used; and interest rates had been increased considerably. Finally, use was made of existing exchange controls but the Irish government had also indicated that all capital controls were to be abolished on 1st January 1993. The pressure on the Irish pound had stemmed from the market perception that it was inextricably linked to sterling; no difficulties had been experienced until the day that sterling had left the ERM. Whilst a significant proportion of Ireland's exports, which were concentrated in three or four labour-intensive sectors, went to the United Kingdom, it was not a very large figure in relation to total external trade. The Irish government was determined that the Irish currency should not be dragged down by sterling. The recent crisis had shown that because of market psychology arbitrary pressures could still arise irrespective of sound fundamentals. In addition, with deregulation and the lessening of exchange controls, the whole international financial scene had changed, yet the Basle-Nyborg Agreement had not been amended to take account of that; this needed to be corrected. The other lesson that had emerged from the recent experience was that use of the full width of the ERM band did not alleviate but rather exacerbated market pressures as the currency was seen as a candidate for devaluation. The lesson to be drawn from the crisis was that it was in every Member State's interests to support and maintain the system and that it was not just a matter of interest of those whose currencies were under pressure. There had to be co-ordination of action to prevent one currency after another being attacked and there must be some way of coping with pressures before reaching the margin; otherwise the system would not survive. Finally, he agreed with Mr. Duisenberg that the authorities should exercise restraint with regard to making remarks in public.

Mr. Rojo said that the rules and procedures of the ERM should be improved and a collective view should be taken on the problems which different national economic policies created for the working of the system. He did not believe that in the recent past monetary policies had been the major factor; the problems had been largely the result of an inadequate combination of monetary and fiscal policies. The Governors should consider how additional pressure could be exerted upon national governments to correct inappropriate policy mixes. This view should be transmitted to the ECOFIN Council.

The Chairman invited Mr. Christophersen to give his view on the prospects for the Edinburgh Summit.

Mr. Christophersen said that, firstly, the Commission would urge the ECOFIN Council to improve the rules and procedures for carrying out multilateral surveillance which needed to be done more rigorously. Secondly, the convergence process had to be strengthened. For example, the lack of convergence in Italy had undermined the monetary policy pursued by the central bank; the Italian economy was therefore exposed and weak at the times when pressures built up. Thirdly, with regard to the ERM, some unwelcome measures such as capital restrictions had recently been taken in some countries which would hopefully soon be abolished. With respect to procedures to be followed in the future, it was important to be cautious in the way exchange rate questions were to be handled. The UK presidency had initially proposed that the Community Finance Ministers should attend the Birmingham Summit. However, the Commission and some governments had advised against that as it would create expectations and give the markets a fresh possibility to focus on a specific date. The first half of 1993 would in any case present new difficulties prompted by market speculation over a second Danish referendum. Caution should therefore be adopted against creating expectations and public statements should not refer to fundamental changes in the system but rather to technical improvements. He added that, as a result of negotiations which were likely to commence early in 1993, five new currencies would probably join the EMS within two or three years, most of which would wish to participate in the narrow ERM band. It was important to consider how their smooth entry could be achieved. Finally, early in December, the Commission was due to present its growth forecast for the Community for 1993; this would be between 1% and 1.5% although it was not unlikely that growth would be less than 1%. Much would depend on developments in Germany and the UK. The UK presidency was likely to propose that the Commission be invited to present ideas for reviving growth. He did not believe that an easing of monetary policy would be sufficient to promote growth, but on the other hand, there was not much margin for any fiscal stimulus since a number of Member States needed to tighten their fiscal policies. Apart from Italy, Belgium, Greece and Spain also had little room for manoeuvre. The automatic stabilisers could to a certain extent be allowed to work but the only real option was to reallocate available resources to public investments. On the revenue side, the only possibility would be to create room for some fiscal incentives financed by public savings. The co-ordinated improvement of policies was necessary to get the marketplace to work more efficiently, to achieve a greater degree of competition, and to reduce the dependency on state aid.

To conclude, the Chairman said that the analysis of the EMS crisis should be completed in three months and that a draft letter to be sent by the Chairman to Mr. Lamont would be circulated to the Governors for comment before being despatched.

III. Adoption of the Committee's report to the EEC Ministers of Finance on developments in the foreign exchange markets of the nineteen countries participating in the concertation procedure during September and October 1992 and the first few days of November

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

IV. Preparatory work for the move to the final stage of EMU

The Committee considered the note, prepared by the Secretary General, of the meeting held on 15th October of the chairmen of the Sub-Committees and Working Groups.

1. Synopsis of work programmes and co-ordination of preparatory work

The Committee endorsed the Alternates' view that the synopsis of the work programmes should primarily serve to enhance the transparency of the preparatory work, but that this work would have to be carried out in a flexible manner. This implied also that issues might have to be brought to the attention of the Committee of Governors outside of the envisaged reporting dates. The Committee also agreed with the suggested procedures aimed at ensuring co-ordination of the preparatory work. The extent to which the number of reports due to be received by the Committee in 1993 would overburden its regular meetings would need to be kept under review.

2. Working methods of the Sub-Committees and Working Groups

Mr. Rey said that the Alternates had endorsed the proposal for establishing an estimate of operational expenses for 1993 to be incurred by the individual sub-committees and working groups. It was stressed that this procedure was not designed to allocate a budget to each sub-committee/working group, rather to have an oversight of the budgetary needs of each and to avoid a proliferation of sub-groups. The Alternates recognised that the working methods should be handled flexibly by the respective chairman according to need but that it would be desirable to maintain the principle of prior authorisation by the Governors for the establishment of permanent sub-groups. A sub-group should be considered to be permanent if it was expected to meet more than twice over a twelve-month period. Furthermore, a proposal for creating a sub-group should not be considered within the Sub-Committee or the Working Group.

The Committee agreed with the views expressed by the Alternates.

3. Additional staffing of the Secretariat

Mr. Rey said that the Alternates had also endorsed the proposal to recruit a rapporteur for the Foreign Exchange Policy Sub-Committee and two statistical experts. The latter two would support two task forces of the Working Group which would be created to assume responsibility for the work which was currently being undertaken in the framework of EUROSTAT in the field of money and banking statistics and the balance of payments capital flows and stocks. The Alternates had recommended that the request for a telecommunications expert to assist in the work of the Working Group on Information Systems should be postponed until the Governors' December meeting since further background details to the request were awaited from the Working Group's chairman. Furthermore, the Alternates had suggested that the request for a second rapporteur for the Working Group on EC Payments Systems should be deferred until a later stage.

With regard to the request for a technical expert to assist the Working Group on Information Systems, Mr. de Larosière said that such an expert appeared to be necessary if the group's work was to be accomplished.

The Committee endorsed the Alternates' recommendations. It agreed with the recruitment of a rapporteur for the Foreign Exchange Policy Sub-Committee and two statistical experts and decided to review the question of the recruitment of a telecommunications expert at the December meeting on the basis of further clarification by the Alternates.

4. Relationships with third parties

Mr. Rey said that the Alternates had agreed with the proposal to leave the decision to establish working relationships of a technical nature (with international institutions, banks, banking associations and similar bodies) to the individual sub-committees/working groups provided that the Committee of Governors was informed before any links were established. However, as far as the participation of observers from the EFTA countries was concerned, unless there was a clear legal basis for such co-operation, which was the case for the Working Group on Statistics, it was desirable that such requests should be submitted to the Governors and not be dealt with by individual sub-committees/working groups themselves.

The Committee approved this proposal.

V. Follow-up to the special session of the European Council of 16th October 1992

This item was dealt with under item II.

VI. Issues relating to the European Monetary System

The Chairman recalled that the revised principles governing prior agreement on interventions in Community currencies and the Instrument amending Article 16.1 of the EMS Agreement had been accepted by the Governors at their September meeting. Since it had been inopportune to make public at that time the changes in the EMS operating procedures, the formal signing of the Instrument had been postponed until the current meeting. Given the mandate of the European Council (see item II above), a public statement on EMS operating procedures could still give rise to confusion and misunderstandings. It was therefore proposed to adopt formally the final texts and to inform the Ministers of Finance via the Présidency, but to abandon the idea of a press communiqué.

Mr. Schlesinger said that the decision to amend Article 16.1 of the EMS Agreement had been taken in the light of experiences which had been made up until the beginning of September 1992 and had not taken into account events since then. The amended rules had been devised on the basis of magnitudes of interventions which had been far less than those which had been experienced since the beginning of September.In recent weeks, exchange market interventions of an unprecedented magnitude had been necessary, involving obligatory sales of Deutsche Mark of DM 65 billion. Under the amended rules which were before the Governors, Germany would be obliged to accept unlimited amounts of official ECUs from debtor countries; the use which could be made of these ECU assets was felt to be very limited. Without wishing to make any particular proposals, Mr. Schlesinger felt that the solution to the questions raised by recent developments should be sought in an examination of the way in which the EMS functioned, including consideration of whether a more flexible stance was required towards changing parities, and a review of the rules on interventions. The amendment to Article 16.1 should therefore be reviewed in the light of recent experiences and the decision to sign the amendment be deferred pending the outcome of the review of the EMS.

Mr. de Larosière said that he was dismayed by this announcement. The amendment which was currently before the Governors was the result of discussions which extended back some five and a half years and which had already been subject to a number of delays. He felt that the Governors should honour the decision made at their September meeting.

Mr. Ciampi said that he understood Mr. Schlesinger's point but emphasised that an agreement to allow a 100% settlement in ECUs had been reached five years ago and he saw no reason why there should be any further postponement of the formal decision.

Mr. Schlesinger said that he understood the views expressed by his colleagues but pointed out that the agreement which the Governors had reached in September had been correct in the light of experiences up to that date; however, the experience since then had been quite different.

He wondered whether other central banks would be prepared to accept assets amounting to ECU 14 billion in their balance sheets.

Mr. de Larosière said that the agreement to increase the use of official ECUs in the settlement of outstanding liabilities to 100% had been the result of negotiations in which other Committee members had made concessions in other areas. He added that there existed the clause in the EMS Agreement whereby official ECUs held by a creditor country could be mobilised, for example in exchange for US dollars, if the need arose. He was therefore unhappy about calling into question the agreed principle that a debtor country might settle its Very Short-Term Financing operations by up to 100% in official ECUs.

Mr. Schlesinger felt that possibilities of using official ECUs were rather limited. He emphasised that he was asking only for the postponement of the formal decision and was not ruling out that the agreement reached in September could be accepted by the Deutsche Bundesbank. However, there was a question of principle involved and it would therefore be wise to reconsider the issue in the wider context of the recent exchange market turbulence and with particular regard to the maximum amount of obligatory interventions which a creditor country would be forced to accept in the future.

Mr. de Larosière suggested that, if a question of principle was involved, this should have come up in the discussions over the previous few years. However, the events which had occurred in the foreign exchange markets in September had not changed the basic principles. He would not wish the members to have engaged in negotiations which had led to concessions being made by all central banks only to have a question of principle emerging at the last moment which would change the agreements made; this would only lead to a problem of confidence. He asked that Mr. Schlesinger reconsidered his position and agreed to sign the amendment.

Mr. Duisenberg said that he had been involved in the discussions since the beginning and although he had never been very enthusiastic about accepting the proposal to extend the settlement obligations to 100% in official ECUs, he was prepared to abide by the agreement. He could accept a postponement in the signing of the amendment although that would not change his intention to sign.

The Committee agreed to postpone the signing of the amendment and to refer the matter to the Committee of Alternates for study.

VII. Monetary policy strategies for the European Central Bank and their implementation

This item had been dealt with during the restricted session of the Committee of Governors (see the Chairman's introductory remarks at the beginning of the meeting).

VIII. Other matters falling within the competence of the Committee

1. Expenses incurred on behalf of the Committee in the second quarter of 1992 and revised projections for 1992

With reference to the statement of expenses drawn up by the Secretariat relating to the second quarter of 1992, Mr. Doyle, speaking on behalf of the Committee on Financial Matters, said that expenditure had exceeded by just under 7% the pro rata estimate derived from the initial annual projection. The main reason was that more meetings than originally foreseen, had been held during the second quarter. This underlined the Chairman's earlier comments about the importance of keeping a tight control on the number of sub-groups since one of the largest expenditure items were attendant interpretation and travelling costs. Of greater significance was the revised projection for the year as a whole: the annual expenditure was likely to exceed the initial estimate by approximately 25% reflecting the increased number of meetings of sub-committees and those of the new working groups, the costs relating to increased staff in the Secretariat, the increased use of interpreters and costs relating to the publication of the "Blue Book" and the Committee's Annual Report. This overrun had come as no surprise given the widening of the scope of the Committee of Governors' work. The Committee on Financial Matters would review the projections for 1993 with the Secretariat to ensure that they were well-founded and would filter any problems as they emerged; however it would not necessarily be in a position to judge which projected meeting might be regarded as unnecessary.

2. Meeting with the Heads of Personnel of the EEC central banks

Mr. Rey recalled that, at their meeting in April 1992, the Governors had invited the Alternates to commence the preparatory work on the staffing policies of the EMI. Following a preliminary exchange of views, in which some broad principles had been set out, the Alternates had asked the Heads of Personnel of the central banks to examine the practical implications of these guiding principles. In a meeting which had been chaired by the Secretary General in October, the Heads of Personnel had considered that a number of issues such as salary structure and social benefits, and other aspects including an internal grievance procedure, staff representation and a code of conduct, raised a number of technical questions which required more detailed examination. Subject to the approval of the Governors, the Heads of Personnel stood ready to undertake the necessary technical work. They proposed to do so without becoming a formal working group of the Committee. This approach would not entail costs for the Committee of Governors; however, there was a question of whether the cost of interpretation for meetings by the Heads of Personnel in the context of this work could be borne by the Committee in accordance with the practice established for sub-committees and working groups. The Alternates had suggested that the proposals of the Heads of Personnel should be approved whilst emphasising that no new working group should be established and that the Heads of Personnel should refrain from building an elaborate sub-structure. Subject to this, the Alternates had recommended that the Committee of Governors authorised the reimbursement of the cost of interpretation.

The Committee approved the Alternates' recommendation.

IX. Date and place of next meeting

The next meeting of the Committee of Governors will take place in Basle on Tuesday, 8th December 1992.

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Before closing the meeting, the Chairman welcomed Mr. Robert as Mr. Cappanera's successor as Director General of the Foreign Department of the Banque de France.

270th MEETING OF THE COMMITTEE OF GOVERNORS

10th November 1992

Those present were:

Chairman of the Board of Governors of the EMCF	Mr. Hoffmeyer
Banque Nationale de Belgique	Mr. Verplaetse Mr. Rey* Mr. Michielsen
Danmarks Nationalbank	Mrs. Andersen Mr. Hansen
Deutsche Bundesbank	Mr. Schlesinger Mr. Tietmeyer Mr. Rieke
Bank of Greece	Mr. Christodoulou Mr. Papademos Mr. Karamouzis
Banco de España	Mr. Rojo Mr. Linde Mr. Durán
Banque de France	Mr. de Larosière Mr. 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 Mr. Boot
Banco de Portugal	Mr. Beleza 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 Foreign Exchange Policy Sub-Committee	Mr. Saccomanni
Secretariat of the Committee of Governors	Mr. Baer Mr. Scheller Mr. Viñals

* Chairman of the Committee of Alternates