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MINUTES
OF THE 280TH MEETING OF THE COMMITTEE OF GOVERNORS
OF THE CENTRAL BANKS OF THE MEMBER STATES
OF THE EUROPEAN COMMUNITY

HELD IN BASLE ON TUESDAY, 9TH NOVEMBER 1993

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The ***Chairman*** opened the meeting by welcoming Mr. Tietmeyer, Mr. Trichet and Mr. Schieber.

I Approval of the minutes of the 279th Meeting

The ***Committee*** approved the minutes of the 279th meeting.

II Exchange of views with Mr. Lamfalussy (incorporating item VI(6): "Terms and conditions of service of the EMI")

Mr. Lamfalussy thanked the Governors for recommending him as the first EMI President. Despite some hesitations, he had ultimately accepted. One of the reasons for this decision had been his commitment to the fundamental objective of European integration. In addition, while the preparation of the ESCB was a longer-term objective, a more immediate challenge for the EMI would be to devise monetary co-operation within the framework of the wide ERM band in order to safeguard the functioning of the Single Market. The widening of the band had provided a breathing space although it represented a potentially unstable situation since formal exchange rate constraints had been removed.

With respect to the transition from the Committee of Governors to the EMI, Mr. Lamfalussy suggested following the approach "changement dans la continuité". The consensus in monetary policy philosophy which had been built-up by the Governors should be continued in the framework of the EMI. However, the EMI was not expected simply to represent a continuation of the current Committee of Governors and the EMI should not be just an extended Secretariat; accordingly, some changes would need to be made to the current working methods. He encouraged the Governors to give some thought to these issues; the forthcoming EMI Council should consider how the necessary institutional changes should be implemented.

More urgently, however, the issue of the terms and conditions of employment of the future EMI staff needed to be resolved. A certain number of staff would be required at the beginning of 1994 to take in hand the logistics of setting up the EMI. It was in everyone's interests that the EMI should be a lean, but efficient, organisation which could count on experienced people from the outset; to be able to recruit the necessary staff, the conditions of employment needed to be decided by the Council of the EMI as quickly as possible.

The ***Chairman*** said that the report by the Heads of Personnel on the conditions of employment for the EMI staff had been discussed by the Alternates; there had been general agreement with the report's proposals except for the question of an expatriation allowance. If the Governors were to endorse the Alternates' recommendation to adopt the report as a basis for the terms and conditions, he proposed that a committee consisting of Mr. Lamfalussy, Mr. Rey, Mr. Baer and himself be established to prepare a few decisions relating to the staff to be recruited to spearhead the setting up of the EMI in Frankfurt. The decisions could then be taken by the Governors, together with Mr. Lamfalussy, in December.

Mr. Rey confirmed that the Alternates had endorsed the thrust of the proposals put forward by the Heads of Personnel although the question of an expatriation allowance needed to be discussed in greater detail. It was important for the Governors to agree with the future EMI President on a practical procedure which could be followed to determine the conditions of employment; the committee proposed by the Chairman might be the appropriate body to achieve this.

Mr. Tietmeyer said that the Bundesbank was willing to offer technical and legal assistance in the initial preparations for setting up the EMI.

The ***Chairman*** thanked Mr. Tietmeyer for his offer. The Mayor of Frankfurt and Mr. Tietmeyer had invited Mr. Lamfalussy and him, accompanied by Mr. Baer, to Frankfurt in early December to look at possible locations for the EMI. Furthermore, he proposed that it would be appropriate, not least for psychological reasons, for the EMI Council to hold its first meeting in Frankfurt in January. This would give all of the Governors the opportunity to look at possible sites. Thereafter, the EMI Council would for a limited time hold its meetings in Basle.

Mr. Tietmeyer said that it would be of value for the Chairman and Mr. Lamfalussy to have an informal meeting with the Frankfurt authorities as soon as possible to assist the preparation of the necessary technical arrangements. Furthermore, it would be important to demonstrate that on 1st January 1994 the EMI had been established; therefore, the January meeting of the EMI Council should be held in Frankfurt. A decision on the site of the EMI should be made as early as possible since the implementation of the decision would take several months. Visits to possible sites could be combined with the January meeting.

Mr. Lamfalussy said that the committee proposed by the Chairman would begin looking at possible sites in December and should be given a degree of freedom to assess how to proceed.

Mr. George said that an important factor to be taken into account when selecting a site would be the scale of the future operation; the proposed committee should give consideration to this and advise the Governors when they met in January.

The ***Committee*** endorsed the Chairman's proposal that a few decisions relating to the personnel which needed to be recruited urgently be delegated to a small committee. The salary structure and terms and conditions were to be considered at the Governors' December meeting and a formal approval by the EMI Council could be envisaged at the meeting to be held in Frankfurt in January.

III Monthly monitoring of economic and monetary developments and policies in the Community and questions relating to the European Monetary System

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

The Monitoring Group had considered two questions: firstly, whether the ERM had overcome the tensions that had emerged since July 1993; and, secondly, whether the recent firming of interest rates in a number of Community countries indicated a turning point in the downward trend. With regard to the first question, the Group had noted that the tension that had affected the Belgian franc and the Greek drachma had abated although the Portuguese escudo had remained under some pressure. The width of the ERM band, which had reached a maximum of 8% in mid-September, was currently less than 5%, and interest-rate differentials between Germany and the average of the other

EMS countries had declined from 3% in September to less than 2%. Supporting intervention had ceased and some moderate foreign currency purchases had been made by the central banks of France, Greece and Italy.

Despite these developments, the Group had hesitated to declare that the episode of tension, which had reached a peak on 2nd August, had ended. The strengthening of the US dollar in the wake of the reduction in interest rates in Germany had helped to ease tensions in the ERM; however, this might prove temporary as the evolution of the US economy seemed not to warrant a tightening of monetary policy which would lend support to the US dollar. Moreover, even if part of the still large overhang of Deutsche Mark positions were to be unwound in the markets, the German currency was not likely to decline significantly as it would be supported by purchases by central banks wishing to replenish their official reserves. Under these conditions, the attainment of lasting stability in the EMS depended on the ability of individual countries to pursue cautious non-inflationary policies. Although no country was any longer confronted with a serious dilemma between monetary stability and economic growth, progress in the adjustment of imbalances, particularly fiscal consolidation, would be closely monitored by market participants.

With regard to the outlook for interest rates, the recent firming recorded in some EMS countries was the result of profit-taking sales of bonds, which had been triggered by the increasing yields in the US in anticipation of a pick-up in economic activity in that country. The Group had not considered that development to be the start of an upward trend in interest rates in view of the likely evolution of economic activity and inflation in most countries, including the US. While additional room for interest rate declines existed in some EMS countries, including Germany, that should be used with caution owing to the need to maintain a stability-oriented policy mix.

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

Three broad considerations had emerged from the Alternates' discussion. Firstly, it had been generally agreed that monetary policy must remain cautious, implying that interest rates should be lowered only when warranted by price, monetary and exchange-rate developments. This policy had so far been successful in conveying to the markets the message that the widening of the ERM band did not represent a fundamental change and that medium-term monetary policy strategies remained on course. The gradual easing of short-term interest rates had been accompanied by a decline in long-term interest rates to historically low levels, or to levels which could no longer be regarded as unsustainably high. However, while there were some signs of economic recovery, for example in France, this was not yet the case in Germany although the recession was bottoming out. The Commission representative had warned against too optimistic economic forecasts being made for 1994, especially as national forecasts each seemed to rely on a pick-up in foreign demand.

The pursuit of a cautious monetary policy stance had also made it possible to restore some calm in the exchange markets; the spread between ERM currencies had narrowed recently from about 8% to about 5%. However, although the markets seemed to be reassured by the determination of the monetary authorities to adhere to medium-term commitments, this approach was still challenged in international gatherings, including in the IMF, by non-Europeans, especially those from the United

States. It would be useful to consider how to improve non-Europeans' understanding of the Community's policy stance; the Monetary Committee had also been invited to consider this issue.

Secondly, the translation of the cautious policy stance into policy decisions depended on national developments and on prospective policy moves in other areas. In the UK, any room for manoeuvre on interest rates depended on the measures taken to tighten fiscal policy in the framework of the forthcoming budget. In Belgium, monetary policy had to remain cautious as long as the government continued its negotiations on a social pact aimed at restoring competitiveness, promoting employment and at re-balancing the social security accounts. In Greece, a strong statement by the new government on exchange-rate policy had been well received in the markets but, given the significant deterioration in the PSBR in 1993 and the uncertainties surrounding the 1994 budget, monetary policy would have to remain vigilant. In Portugal, concerns had arisen with regard to fiscal developments and inflation was still high; monetary policy remained geared to the aim of exchange-rate stability.

Thirdly, the current situation in the EMS presented the monetary authorities with new challenges in respect of the formulation of national monetary policy targets and the assessment of the compatibility of such policies. The Governors' monthly monitoring exercise had therefore become even more important with regard to discussing strategic, as well as practical, issues. At the same time, wider considerations, such as fiscal developments, competitiveness and other economic variables, needed to play a part in the assessment of current and prospective monetary and exchange rate developments. The forthcoming ex ante monetary policy co-ordination exercise would have to take into account the general policy setting. The next two months would provide important opportunities for strengthening co-operation in the field of economic policy in the form of a detailed screening of the state of convergence and the adoption at Community level of the broad guidelines for the economic polices of the Member States.

3. Discussion by the Committee

Mr. Tietmeyer said that GDP in eastern Germany had grown by 9.5% in 1992 and by at least 6% during the first half of 1993, although the industries in that part of the country were finding it difficult to find new markets at a time of weak demand world-wide. On the other hand, western Germany, which was suffering from a combination of cyclical and structural problems, was still in recession; there were indications that the slowdown in economic activity had bottomed out although there were no clear signs of recovery. The considerable expansion of domestic demand between 1990 and 1992 resulting from German unification and the prevailing inappropriate exchange-rate structure had led German industrialists to take a series of wrong decisions, in particular with respect to wage concessions. As the situation, including the exchange rate, had changed since 1992, the industrial sector had realised that structural changes were necessary and had put these in hand with the result that unemployment was increasing. With regard to fiscal policy, it was hoped that the German parliament would approve the package that had been submitted to it; this would represent an important step towards consolidation. Wage settlements in the private sector were likely to be between 2% and 3%, whereas the German government had announced a zero percent pay round for civil servants. The downward trend in price increases had continued over the past few months; the annual inflation rate in October stood at 3.9%. However, at the beginning of 1994, there would be a rise because of tax increases, although it was hoped that the level would not exceed 4% again. Turning to monetary policy, the Central Bank Council's decision the previous Thursday had been taken in the light of the Bundesbank's expectations for the inflation rate and the growth of M3. German M3 had decelerated from an annual rate of 7.4% in July 1993 to 6.8% in September. With money market interest rates standing at 6.4%, there was currently some room for manoeuvre between the discount rate, which stood at 5.75%, and the Lombard rate at 6.75%. The recent cut in short-term rates had not had a negative impact on long-term rates; indeed, these had also declined. It would be in nobody's interest if a cut in German short-term interest rates were to lead to a rise in long-term rates. On 16th December, the Central Bank Council would discuss its monetary target for 1994; there would be no fundamental change in policy.

Mr. Trichet said that in July and August 1993 industrial output in France had grown by 3%. Private consumption had grown by around 2.1% in the third quarter of 1993 compared with the second quarter, which itself had been unchanged on the first quarter. These trends suggested that France had been in recession, in terms of a decrease in GDP, only during the fourth quarter of 1992 and the first quarter of 1993. France was now enjoying a sizeable foreign trade surplus and a surplus on its current account. The authorities had persuaded business managers that the cautious monetary policy being pursued was in the best interests of the French economy. The Banque de France had reduced short-term interest rates carefully in order not to jeopardise the decline of medium and long-term rates; the latter were now at their lowest levels for thirty years, and the one-month and three-month rates had been reduced from 12% and 12.5% in February 1993 to 7% and about 6.75%, respectively. In carrying out their monetary policy, the French authorities took into account: the rate of inflation; the situation in the exchange markets; and long-term interest rates. The whole spectrum of money-market interest rates in France currently lay within a range of 5.3%, for two-year rates, to 6.7% at the longest end. He noted that the yield curves in all ERM countries were inverted, which had led to comments by some non-EC countries that a residual anomaly existed in the ERM. A further decline in the inflation rate and in the rate of growth of monetary aggregates might correct the slant of the yield curve. France's main problem was to face the criticism about its monetary policy coming particularly from certain circles in the foreign exchange markets, which had taken a view on domestic developments and on the relationship between the French franc and other currencies, in particular the Deutsche Mark. Since the views expressed by these market participants nevertheless received widespread coverage, they had an impact on the attitude adopted by, inter alia, some countries' treasury departments; there might be a need for the authorities in the Member States to clarify their current policies. Finally, the French authorities were pleased with the responsible way in which ERM countries were making use of the wider ERM band; there was no need to consider urgently moving back towards a narrow band for the time being.

Mr. George said that recovery had not yet achieved respect in the United Kingdom. There had now been six quarters of continuous growth in total output in the United Kingdom, which had returned to around the trend level, together with a modest decline in unemployment. Furthermore, although changes had been made to the way in which certain statistical data was defined, it was felt that output might be growing faster than the data suggested. However, the principal uncertainty remained the sentiment which existed in the manufacturing sector. The UK authorities had made it clear that there was a limit to what domestic policy could do to address uncertainties which originated abroad; it would be encouraging if the recession had at least bottomed out in other Community countries. However, the current level of slack in the UK economy could start to increase again if the recovery did not continue at least at the present rate. A further uncertainty was related to the impact of the fiscal tightening which was underway. Some measures which had been introduced in the budget in March 1993 by the previous Chancellor were only now coming into force, and some changes in indirect taxation were not due to come into effect until spring 1994. It was expected that a further tightening through tax increases equivalent to around 1% of GDP would be announced in the budget at the end of November. The underlying rate of inflation was currently running between 3% and 3.5%, while the headline rate was substantially lower. However, the latter was accelerating sharply; taking into account the change in indirect taxes, it was possible that the inflation rate would for a short time exceed the top of the 1% to 4% target range next spring. The Bank of England, in its recent Inflation Report, expected that the inflation rate, excluding the indirect taxation effects, would be moving down towards 3% by the middle of 1995. For most of 1993, monetary policy had been regarded as appropriate, although there was currently a case for a modest easing, particularly in the context of the expected further fiscal tightening. The current wide ERM band implied a certain under-specification of policy, both at the national level and in terms of policy co-ordination among the Member States, compared with the previous situation in which policies were more clearly linked to the exchange rate. It would be an important part of the EMI's functions to ensure that monetary policy co-ordination is focused on internal stability.

Mr. Verplaetse said that after four quarters during which economic activity had declined, the second quarter of 1993 indicated an annualised rate of growth of 3%. The inflation rate was relatively low and the current account for the year could show a surplus equivalent to 3% of GDP, 50% larger than in 1992. However, the public sector deficit would probably remain the same as in 1992. There was a crisis of confidence in Belgium, where wages and salaries had increased by more than in western Germany, the Netherlands and France and account needed to be taken of the depreciation of sterling and the Italian lira.The only remedy might be found in non-monetary economic policy The Belgian government had set itself the objective of pushing real wage and salary levels down by 5%, equivalent to about 2.25% of GDP, during the period 1994 to 1996. The state of public finances implied a credibility problem; unless the public sector deficit was reduced and financial balance was restored to the social security system, the slightest rumour would cause difficulties for monetary policy. During the next three years, the Belgian government planned to cut the deficit by 1.5% of GDP, 75% of which would be achieved by reducing expenditure; although there was political consensus on the plans, negotiations had been in progress for the past two weeks with the social partners over how to implement them. Belgium suffered from structural as well as cyclical unemployment; once the plans were implemented, the price level should decline by about 2% and the employment situation might also improve to a similar degree. Belgium's monetary policy would have to remain cautious.

Mr. Fazio said that the Banca d'Italia had lowered its official interest rates on 21st October, following the reductions made by the Bundesbank. The decline in short-term rates had been preceded by a downward trend in medium and long-term rates and the Italian government had recently issued thirty-year bonds for the first time for many years. The inflation rate had been reduced to between 4% and 4.5% which, although still too high, was low compared with Italy's historical experience. Wage increases, which were currently below 3%, led the Italian authorities to expect a further improvement in the inflation rate. Italy's current account had improved during the first nine months of 1993 and would probably end the year in equilibrium. Monetary expansion had remained relatively strong; while lending to the private sector was modest, the greater part of the monetary expansion was accounted for by inflows of private capital. The level of banks' short-term indebtedness was reduced. Since the end of September, the net short-term indebtedness of the Italian banking system vis-à-vis the foreign sector had declined from US$ 120 billion equivalent to between US$ 65-70 billion equivalent. A weakness remained the Italian public deficit, although public sector wages currently seemed to be under control. It was hoped that the new budget, which was still under discussion, would be approved by the Italian parliament by the year end. The behaviour of savers and the underwriting of public debt in Italy remained stable, and there had been some downward adjustment in the level of short-term yields on public debt. The worst of the recession in Italy was felt to be over with a slight revival of activity likely by the year end, although the automobile sector was in crisis and the situation of public works and other types of public sector investment was affected by the episode of scandals.

Mr. Christodoulou said that, following the announcement of a general election on 9th September, the Bank of Greece had used all available instruments to stabilise the exchange market; stability had returned around 22nd/23rd October, about twelve days after the election. Interest rates were currently declining to around the levels that had prevailed before the general election had been announced. The Bank of Greece was being cautious in adjusting interest rates. The drachma's effective exchange rate had fallen by about 1% in September and had remained unchanged throughout October, despite the strengthening in the US dollar. The Greek foreign exchange market had been stabilised by reassuring statements on the new government's economic policy intentions and by some positive economic developments: the rate of inflation had decreased faster than expected during October to 12.3%; and the current account had recorded a surplus for the first eight months of the year compared with a substantial deficit in the same period in 1992. The new government's primary economic objectives were the deceleration of inflation and the containment of the public sector deficit; the latter was likely to amount to around 14% of GDP at the year end, compared with an initial target of 9% and a subsequently-adjusted target of around 11%. Several reasons accounted for this development: economic growth had been lower than forecast; fiscal policy had been relaxed in the run-up to the general election; tax revenues arising from the reform implemented in 1992, and from the increased excise taxes imposed in August 1992, had been substantially lower than expected; and privatisation had for the time being been put on hold. Strong measures were needed to control the fiscal trend. If the budget to be announced at the end of November was not sufficiently ambitious and credible, the progress made so far in reducing inflation and in improving the balance of payments would prove unsustainable. The expectation was that the medium-term prospects for the Greek economy would remain unchanged. The new government had announced a number of measures to curtail the public sector deficit but it needed to be seen whether these measures could actually be implemented. Greece's prospects would be helped by the public investment programme, which was assisted by Community structural funds. The Bank of Greece, whose monetary targets would not be changed, would continue to pursue a cautious policy.

Mr. Beleza made three points. Firstly, some uneasiness surrounded the forthcoming local government elections in Portugal. It was perceived that a poor result for the government might lead to a weakening of its policies. Secondly, the outturn of the 1993 budget was projected to be significantly worse than had been expected and the proposal for 1994 was regarded by the markets as being short of the desirable adjustment. Thirdly, most observers felt that the reduction in the inflation rate appeared to have stalled at around 6%; however, the expected continued slowdown in wage settlements would help in this regard. The Banco de Portugal intended to proceed cautiously and did not currently have any more room for manoeuvre than it had on 31st July.

Mr. Hoffmeyer said that the pressure on the Danish krone had been mainly caused by hedging operations carried out by non-residents. The current exchange rate system was close to clean floating; focus was now placed more on effective exchange rates than on the hard core currencies, which had hitherto been the corner-stone of co-operation.

Mr. Doyle said that the Irish pound had been stable since August and was now at less of a discount to the Deutsche Mark than any other currency that had been in the narrow ERM band at the end of July. This had been due to two factors. Firstly, the absence of intervention by the Irish central bank had made the commercial banks more cautious in their foreign exchange dealings. Secondly, latest estimates showed that the government's borrowing requirement would be considerably undershot by the year end; meanwhile the economy was growing at a healthy rate and the inflation rate was low. One and three-month interest rates were now below those in Germany and the long bond differential vis-à-vis Germany had fallen by around 25 basis points over the past five or six weeks.

The ***Chairman*** said that the recession in the Netherlands had bottomed out with the expectation of zero growth in 1993. The inflation rate had fallen to 1.9% and the government deficit had declined to 2.9% of GDP, both for the twelve months to October. These developments might partly explain the guilder's strength, despite the fact that short-term interest rates were around 30 to 40 basis points below those in Germany and capital market rates were similar to their German equivalents. However, the deficit would increase and remain above the 3% Maastricht criterion in 1994. While the first signs of a recovery could be discerned, this would be slow throughout 1994 with unemployment expected to rise further during the year, and possibly well into 1995.

Mr. Christophersen said that the Commission's autumn forecast would be published, together with the draft guidelines for macro-economic policy, before the ECOFIN meeting on 22nd November. The Commission's approach had been not to be too optimistic. It had been puzzled by the forecasts made by five German institutes whose estimates for growth in the Community as a whole for 1994 were 0.3 to 0.4 percentage point higher than that of the Commission, which itself was forecasting negative growth of 0.4%. Most Member States would record negative growth rates (of which: western Germany, -2.2%; and Germany as a whole, -1.6%); only Ireland and the United Kingdom would have positive growth rates of around 2%. The general view was that there would be a further lowering of German interest rates, followed by parallel movements in most of the other Member States. A restoration of private sector confidence would be mainly in the form of an upturn in investment in equipment rather than in construction, in respect of which capacity utilisation was currently around 75%. There was no expectation of a strong increase in private consumer demand since households were still in a process of consolidation and further increases in unemployment were expected. Most Community countries had been too optimistic in their forecasts for 1994 as inflation was still stubborn (the Commission only expected a modest decline from around 3.8% in 1993 to 3.2%) and real demand would hardly increase following tighter fiscal policies and wage moderation arrangements. In the absence of a real increase in demand from the rest of the world, and with only a gradual lowering of interest rates in the Community, companies were likely to defer making major investment decisions. The Commission's forecast for growth of around 1.3% in 1994 remained similar to the forecast made in June. The German economy was expected to grow by 0.5% (western Germany, zero growth) and Ireland by 3.3%, the United Kingdom by 2.5%, Denmark by 2.5% and the other Member States each around 1% to 1.5%. Following the introduction on 1st January 1993 of the new Community statistical system ("Intrastat"), it was no longer possible to measure the flow of trade at the frontiers. The Commission was currently studying with national statistical departments what the new system meant for a Community-wide assessment of economic activity. As far as 1995 was concerned, growth of 2.1% was forecast for the Community as a whole with positive growth rates expected in all Member States; however, the inflation rate was forecast to be around 3.2%. The ECOFIN Council had not yet discussed the Committee's letter dated June 1993, concerning excessive deficits. In this context, some Member States seemed to be faced with greater problems than had been foreseen: Portugal's deficit was expected to amount to more than 8% of GDP in 1994; the level of public debt in Italy as a percentage of GDP would increase in both 1994 and 1995; Greece's deficit might exceed its forecast of 15.4% of GDP; and difficulties also remained in France and Belgium. A number of Member States could be faced with the need to tighten fiscal policy at a time when economic recovery was weak.

The ***Chairman*** said that the Council would have to discuss the Committee's letter in the context of the excessive deficits procedure which was due to come into force on 1st January 1994.

Mr. Trichet recalled that, at the informal ECOFIN meeting in June 1993, the Commission had forecast growth of 2.4%, compared with the latest forecast of -0.4%. He suggested that, during periods of economic difficulty when the point reached on the economic cycle was uncertain, it might be better to forecast ranges rather than year end figures. In the current circumstances, in which the economies of a number of Member States were on the verge of an upturn, it did not seem appropriate to publish a pessimistic forecast which would have a psychological impact throughout the Community. With regard to France, the public sector finances would be reined back, and there was a considerable savings overhang. There was the potential for substantial growth in a number of Community countries but the difficulty was to win investors' and consumers' confidence in the medium and long-term growth prospects.

Mr. Tietmeyer agreed that the Commission's forecast might be too pessimistic and that account should be taken of its psychological effects. There was currently a lack of investment, especially in connection with uncertainties surrounding the GATT negotiations; it was necessary to create a realistic positive outlook, although the forecasts made recently by some German forecasting institutes were probably too optimistic. Mr. Christophersen had only mentioned the reduction of interest rates as being the key to economic recovery; other elements were also important. The Commission's pessimism had stemmed from its view that the next move in interest rates might not be downwards; this could be disputed. He asked that the Governors be informed about the nature of the programme which the Commission was preparing for the European Summit in December.

Mr. Fazio agreed with Mr. Trichet and Mr. Tietmeyer. The cost of labour had been contained and interest rates had declined in the Community. Although forecasts were uncertain, a revival of economic activity was becoming more probable; it was essential to give confidence to entrepreneurs in the sustainability of growth.

Mr. Christophersen said that the growth forecasts for 1994 and 1995 had not been changed from those made in June 1993, even though the majority of national experts had proposed that they be revised downwards. The forecasts, when presented, would be accompanied by some policy proposals aimed at improving the overall economic situation. In response to Mr. Tietmeyer's question concerning the forthcoming Summit, he said that the European Parliament had drafted a proposal to raise ECU 100 billion, and some senior national politicians had also made reference to similar proposals. For its part, the Commission had discouraged any such plans being drawn up. He recalled that, at the recent European Council meeting in Brussels, it had simply been decided to enlarge the scope of the existing "Edinburgh facility". The European Investment Bank had ECU 7 billion at its disposal, of which ECU 3.2 billion had so far been committed. It generally took two or three years from the moment an investment decision was taken to when the funds were disbursed. Any consideration given now to large-scale public investments would not affect employment levels before 1996. Emphasis should be put on structural adjustments so as to encourage economic agents to take investment decisions and for consumer demand to be stimulated. With regard to interest rates, a number of factors lay behind the Commission's analysis for 1994/95: most Member States seemed to expect an increase in intra-Community trade; and economic recovery in the United States, the implementation of the GATT agreement, and the enlargement of the Community to include some EFTA countries would all have a positive impact. However, there might be good reasons, such as a stubborn inflation and high public deficits, why national central banks might be cautious in reducing interest rates; investment decisions were therefore likely to be deferred until the future evolution of interest rates was clearer.

The *Chairman* said that he hoped that Mr. Christophersen's reservations about large investment initiatives and his concern about the development of the fiscal situation in the various Community countries would be reflected in the White Paper that was being prepared for the European Summit in December.

IV Adoption of the Committee's report to the EC Ministers of Finance on developments on the foreign exchange markets of the nineteen countries

participating in the concertation procedure during September and October 1993 and the first few days of November 1993

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

V Issues arising from the denomination and remuneration of VSTF balances

Mr. Saccomanni said that the Foreign Exchange Policy Sub-Committee had been discussing the question of burden-sharing in the VSTF since May 1993. At the request of the Governors in September, the implication of the decision taken on 2nd August to widen the ERM bands to ±15% had also been evaluated. While the conclusions of the report were rather straightforward, the following remarks were intended to provide some background information. Firstly, all central banks had actively participated in the discussions and several had presented proposals to solve the problem of excessive burden falling on creditor countries as a result of the ECU denomination of the VSTF balances. The Sub-Committee had agreed that the losses borne by creditor central banks, resulting from the operation of the current arrangements, had been excessive, even though 75% of the total losses had been incurred by debtor central banks. Secondly, the Sub-Committee had evaluated the performance of each of the proposals against the five criteria laid down by the Governors; in so doing, it had appeared that not all criteria were regarded as equally important. Predictability was difficult to achieve under any circumstances, and simplicity was of relative importance given that the current mechanism was not simple and that complex systems might be accommodated through computer programs. The other three criteria were crucial. Fairness was felt to be of paramount importance, mostly by creditor central banks, although all had agreed that something must be done to correct the unfair impact of the present arrangements. The criteria of ECU denomination and of multilateralisation had been regarded by some members as impinging on the very nature of the EMS; any major change in these features was likely to upset the balance of interest in the system and should be considered in the context of a general review of the system as a whole. The Sub-Committee had also been aware that, unless some of the fundamental features of the system were changed, it could prove difficult to prevent excessive losses for creditors. Thirdly, any changes that affected the working of the EMS would be subjected to careful scrutiny by market participants. The Sub-Committee had not re-opened the discussion on the events that had led to the EMS crisis, but most members had considered it important to ensure that the credibility of the system was not further undermined or that any new features did not prompt renewed market speculation. Some members had attached so much importance to this problem that they would prefer to keep the present arrangements unchanged unless there was a unanimous view that any new ones would be balanced and sustainable. Finally, although all of the proposals would perform under the new regime of wide band, it had been felt that the likely scenario of the operation of the VSTF had been fundamentally altered. The wide band did not preclude large interventions financed by the VSTF or realignments from taking place, but the probability of such events occurring was smaller than hitherto.

Mr. Rey said that the Alternates had considered the report to be excellent and well-balanced although one Alternate had expressed a reservation regarding the methodology used to measure the exchange gains and losses incurred by debtor and creditor central banks. It had not been possible to agree on a common formula considering that none would meet all five criteria and any significant change taken in isolation might adversely affect the market's perception of the ERM. With respect to the follow up, two options should be considered. According to the first option, the present arrangements would be maintained for the time being and the issue addressed at a later stage as part of a more comprehensive re-examination of the ERM's features. Alternatively, the matter could be kept under review with the aim of reaching a compromise solution in advance of a resurgence of unsettled markets. In this context, the Dutch Alternate had raised the additional issue of the usability of the ECU as a reserve asset under the new circumstances which involved large net ECU positions and a low probability of settlement obligations under the VSTF. If the Governors requested this issue to be examined, it might be linked to the question of denomination.

The ***Chairman*** suggested that the issue be kept under review and examined early in 1994.

Mr. Tietmeyer agreed with the Chairman's suggestion on the understanding that a solution was actively looked for and that the current arrangements would not be left unchanged indefinitely.

Mr. Trichet also supported the Chairman's suggestion, but he felt that it would be unwise to change the system at this juncture. Since the lessons drawn from the episodes of tension had led to a change in the commonly agreed doctrine in monitoring the ERM, which had applied between the mid-1980s and 1992, criticisms which had previously been valid might no longer be so.

The ***Committee*** agreed that the issues should be kept under review and revisited early in 1994.

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

1. Secondary Community legislation for the start of Stage Two

The ***Committee*** adopted the draft opinions, which had been prepared by the Secretariat and amended by the Alternates, on the proposal for legislation relating to the consultation of the EMI (Article 109f(6) in conjunction with Article 109f(8) of the Treaty) and on the provision of statistical data for the establishment of the key for the EMI (Article 16.2 of the Statute). The opinions would be sent to the Council and a copy would be released to the EFTA central banks.

Mr. Christophersen thanked the Committee for its work in facilitating the completion of the secondary legislation. It was hoped to get an opinion from the European Parliament in the following week and that the ECOFIN Council would adopt the legislation before Christmas.

2. Regulatory and non-regulatory obstacles to the use of the private ECU

Mr. Saccomanni said that the Sub-Committee's report on this topic was a survey of the ECU environment rather than a basis for a decision-making process. The starting point had been the Commission's White Paper on removing the legal obstacles for the use of the ECU, which the Sub-Committee had updated to include the correct interpretation of specific national regulatory provisions. Views had differed with regard to the implications of regulatory and non-regulatory obstacles for the development of the ECU and the prescriptions to be followed in the light of the provisions of the Treaty on European Union on the transition to a single currency. There was a fundamental difference between those who considered the present ECU to be a forerunner of the future single currency and those who believed that the single currency would be quite different to the current private ECU. No attempt had been made to reconcile these divergent views although the area of disagreement appeared to have been reduced. Firstly, the Sub-Committee members had reconfirmed that both positive and negative discrimination towards the ECU should be avoided, although the implications of this had not yet been fully realised in the member countries. Secondly, there was recognition that the ECU market had reached a size and importance which implied that national monetary authorities had responsibility for the smooth functioning and maintenance of orderly conditions. Finally, the Sub-Committee had agreed unanimously that tangible content should be given to the task of facilitating the use of the ECU conferred on the EMI by the Treaty.

The ***Committee*** took note of the report and agreed to release it to the EFTA central banks.

3. Determination and implementation of the Single Monetary Policy in Stage Three

The ***Committee*** agreed to defer this item until its December meeting.

4. Technical strategies for the EMI and the ESCB

Mr. Barroux said that most of the recommendations in the report of the Working Group on Information Systems calling for early decisions concerned the installation of the EMI in its future location. Firstly, having collated details of users' requirements, it appeared that those identified for the start of Stage Two could be accommodated on the PC-based platform planned by the Secretariat. Secondly, at the request of the Working Group on Statistics, access to the BIS Data Bank Services should be retained for the EMI; a telecommunication link between the EMI and the BIS would need to be established and the current technical platform would have to be supplemented with a data server which would hold an extract of the BIS Data Bank. Thirdly, it was important to recruit, no later than early 1994, the skilled manpower which would be in charge of disconnecting the Secretariat's present infrastructure from the BIS and installing it at the EMI's future location. Fourthly, the use of the Telenorma teleconference system was expected to grow over time; the Working Group urged the Governors to plan for its replacement by a secure and more efficient system. Fifthly, although the Working Group, assisted by its sub-group and the Secretariat's telecommunications expert, had implemented a set of procedural rules applying to CEBAMAIL, an evaluation of its stability should be made in the first half of 1994 to assess whether it would be possible to open the system to non-central bank EC institutions or non-EC central banks. For the longer term, the main recommendations of the Working Group could be summarised as follows. Firstly, since the EMI's functions had not yet been precisely defined, it had been difficult to determine the needs for information and communication systems although some broad requirements had been identified: an information system for a dealing room; an information and communication system for the possible interconnection of national real time gross settlement systems; an accounting system for the ECB/ESCB; and a file transfer system. Secondly, with regard to the technical strategy to be implemented in the EMI, and to facilitate information exchanges between the national central banks and the EMI, the Working Group had devised the following principles: the technical infrastructure should be based on open systems and international standards to make their usage cost-effective; the exchange of information should be based on a set of agreed standards and a decentralised architecture; and the implementation of new systems would necessitate agreement on a methodology (including procedures for cost and project control), and require development time and the necessary technical staff. Most of the work in respect of building the EMI's information and communication systems lay ahead; it was the Working Group's opinion that a group similar to it had a continuing role to play. The Working Group had suggested a possible future work programme on which the EMI Council would need to decide. It was important that a decision be made soon so as to avoid any interruption in the progress of work in the coming months.

Mr. Rey said that the Alternates had agreed with the substance of the report and had felt it important that account be taken of the unavoidable long time lag foreseen in implementing the EMI's information and communication systems. Endorsement of the report should include the proviso that the involvement of the Working Group in the follow-up work was subject to decisions yet to be taken on the EMI's structure and the future framework for co-operation between the EMI and the national central banks. Nevertheless, the Governors' attention was drawn to the importance of the continuing existence of the sub-group of CEBAMAIL administrators. The Alternates had recommended that the report be made available to EFTA central banks.

Mr. Tietmeyer queried whether non-EC central banks were to be linked to the EMI.

Mr. Barroux said that there had so far been requests from the central banks in Canada, the United States and Japan for access to CEBAMAIL. However, the CEBAMAIL system should not be opened to other participants before it had been fully stabilised.

The ***Committee*** noted that an early decision on the technical infrastructure and the further development of the Telenorma teleconference system would need to be taken by the EMI Council, and that a decision on opening the CEBAMAIL system to other participants should not be taken before a positive evaluation of the system's stability. It was agreed that the current CEBAMAIL sub-group should have a permanent character and that a new mandate for the Working Group would be needed in common with the Sub-Committees and the other Working Groups. The Working Group's report should be made available to the EFTA central banks

5. Elaboration of the accounting method for the EMI

The ***Committee*** endorsed the proposals made by the Working Group on Accounting Issues and agreed that the further activities of the Working Group should not prejudice the future organisational structure of the EMI. The report should be made available to the EFTA central banks.

6. Terms and conditions of service of the EMI

This issue had been dealt with under Item II of the agenda.

VII Other matters falling within the competence of the Committee

1. Expenses incurred on behalf of the Committee in the third quarter of 1993 and the cost of CEBAMAIL

Mr. Doyle said that expenditure in the third quarter had considerably undershot the projections; expenditure for the year as a whole was likely to be well below expectations. With regard to CEBAMAIL, he mentioned that the Secretariat had received a bill from the BIS amounting to SFr. 145,000 in respect of the transmission costs between November 1991 and April 1993. The analysis made by the Secretariat suggested: that running costs had been higher than expected, reflecting "teething problems" which could be expected when a new system was installed; the malfunctioning of the system at a certain stage; and, most importantly, the changing requirements of the users. The current running costs of CEBAMAIL per page of users' message were about half of those suggested by the recently received bill, but were still greater than the cost per page of the telefax system. However, that took no account of the relative merits of CEBAMAIL in terms of speed, simultaneity of dispatch and quality of copies obtained by the recipient. Further cost control measures being put in place would considerably reduce the running costs; one of these measures, however, required a modest outlay by some central banks. The Committee on Financial Matters had felt that, once CEBAMAIL was running as efficiently and economically as possible, a review should be carried out into what role it should play in the EMI. The Working Group on Information Systems should be asked to consider whether the benefits arising from CEBAMAIL were commensurate with the extra costs involved compared with the telefax system.

The ***Committee*** agreed that the EMI Council should return to this issue early in 1994.

2. Madame Bourdon's letter to the EC central bank Governors

The ***Committee*** agreed that the Chairman should answer Madame Bourdon's letter dated 21st October 1993 on behalf of the Governors, stating that they were not prepared to support her idea of creating a Grand Prix and of holding vote-travel exhibitions on central bank premises. The ***Chairman*** added that he intended to clarify with the Dutch Minister of Cultural Affairs whether the decision taken to make room available for an exhibition in Amsterdam was final.

VIII Date and place of next meeting

The next meeting of the Committee would take place at the BIS in Basle on Tuesday, 14th December 1993.

280TH MEETING OF THE COMMITTEE OF GOVERNORS
9th November 1993

Chairman	Mr. Duisenberg
Banque Nationale de Belgique	Mr. Verplaetse Mr. Rey[1] Mr. Michielsen
Danmarks Nationalbank	Mr. Hoffmeyer Mrs. Andersen Mr. Hansen
Deutsche Bundesbank	Mr. Tietmeyer Mr. Schieber Mr. Rieke
Bank of Greece	Mr. Christodoulou Mr. Papademos Mr. Stournaras
Banco de España	Mr. Rojo Mr. Linde Mr. Durán
Banque de France	Mr. Trichet Mr. Hannoun Mr. Robert
Central Bank of Ireland	Mr. Doyle Mr. Coffey Mr. Reynolds
Banca d'Italia	Mr. Fazio Mr. Dini Mr. Santini
Institut Monétaire Luxembourgeois	Mr. Jaans
Nederlandsche Bank	Mr. Szász Mr. Bakker
Banco de Portugal	Mr. Beleza Mr. Costa Pinto Mr. Gaspar
Bank of England	Mr. George Mr. Crockett Mr. Clark
Commission of the European Communities	Mr. Christophersen Mr. Pons
Chairman of the Foreign Exchange Policy Sub-Committee	Mr. Saccomanni
Chairman of the Working Group on Information Systems	Mr. Barroux (part of meeting)
Secretariat of the Committee of Governors	Mr. Baer Mr. Scheller Mr. Nierop

Mr. Lamfalussy attended the discussion under Item II of the agenda.

[1] Chairman of the Committee of Alternates