COMMITTEE OF GOVERNORS OF THE
CENTRAL BANKS OF THE MEMBER STATES OF THE
EUROPEAN ECONOMIC COMMUNITY

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The Commission of the European Communities is, as a general rule, invited to send one of its members as a representative to the meetings of the Committee of Governors.

* Replaced M. Rubio with effect from 18th July 1992.

** Replaced J. Tavares Moreira with effect from 4th May 1992.

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INTRODUCTION AND ASSESSMENT

This is the second Annual Report of the Committee of Governors, covering its activities and the monetary and financial conditions in the Community in 1992. The Report has been prepared in accordance with the Committee's mandate as laid down in the amended Council Decision of 12th March 1990.

The past year has been one of the most challenging for co-operation among the central banks of the EEC Member States. Monetary and financial developments, especially those linked to the turbulence in the exchange markets in the second half of 1992, have dominated the work and the discussions in the Committee. At the same time, following the signing of the Treaty on European Union in Maastricht in February last year, the Committee has taken the first steps to establish the conditions for the implementation of the Treaty in the monetary field and, in particular, to prepare the establishment of the European Monetary Institute (EMI) which will take over the tasks of the Committee of Governors when it is dissolved at the end of 1993.

1. MONETARY POLICY IN AN ENVIRONMENT OF EXCHANGE MARKET TENSIONS

As pointed out in last year's Annual Report, when reviewing monetary policy intentions for 1992 in its annual forward-looking assessment, the Committee of Governors concluded that the monetary policies envisaged by the national authorities were geared towards a further decline in inflation in the Community. Although the average rate of increase in consumer prices fell in the Community from 5.1% in 1991 to 4.3% in 1992, a more significant reduction would normally have been expected given the favourable external influences on inflation and the continued weakness of economic activity in the Community (see Table 1 and Chart 1). Output in the Community as a whole rose by only 1.1% in 1992, reflecting partly the unexpected prolongation of the downswing in the rest of the world, but also depressed domestic demand in most of the Member States.

At the time of the annual assessment of national policy intentions the Committee had noted a number of potential risks, some of which in fact soon materialised: in particular, hopes for an early recovery of economic activity faded; plans for fiscal consolidation proved often difficult to realise; and labour costs continued to rise at a rather rapid pace in some countries. Moreover, accelerating monetary growth and persistent domestic price pressures made it necessary to tighten monetary policy at the end of 1991 in Germany.

In the first part of 1992, monetary growth in the Community quickened and monetary aggregates deviated from their targeted paths in several countries. While interest-rate differentials remained small, the level of short-term interest rates tended to edge upwards. As economic activity remained sluggish, there were growing concerns about the

TABLE 1: ECONOMIC AND FINANCIAL INDICATORS FOR THE COMMUNITY

Item	1987-89 average	1990	1991	1992 (a)
	percentage change over the previous year			
Real GDP (b)	3.5	2.8	1.2	1.1
Consumer prices (c)	4.1	5.7	5.1	4.3
Compensation per employee (b)	6.1	7.6	7.1	5.7
	per cent of nominal GDP			
Current account balance	0.4	-0.3	-0.9	-1.0
General government financial balance	-3.6	-4.2	-4.7	-5.3
	per cent			
Short-term interest rate (b) (d)	9.6	11.8	11.0	11.2
Long-term interest rate (b) (e)	9.4	11.2	10.3	9.9

Source: National data; BIS.

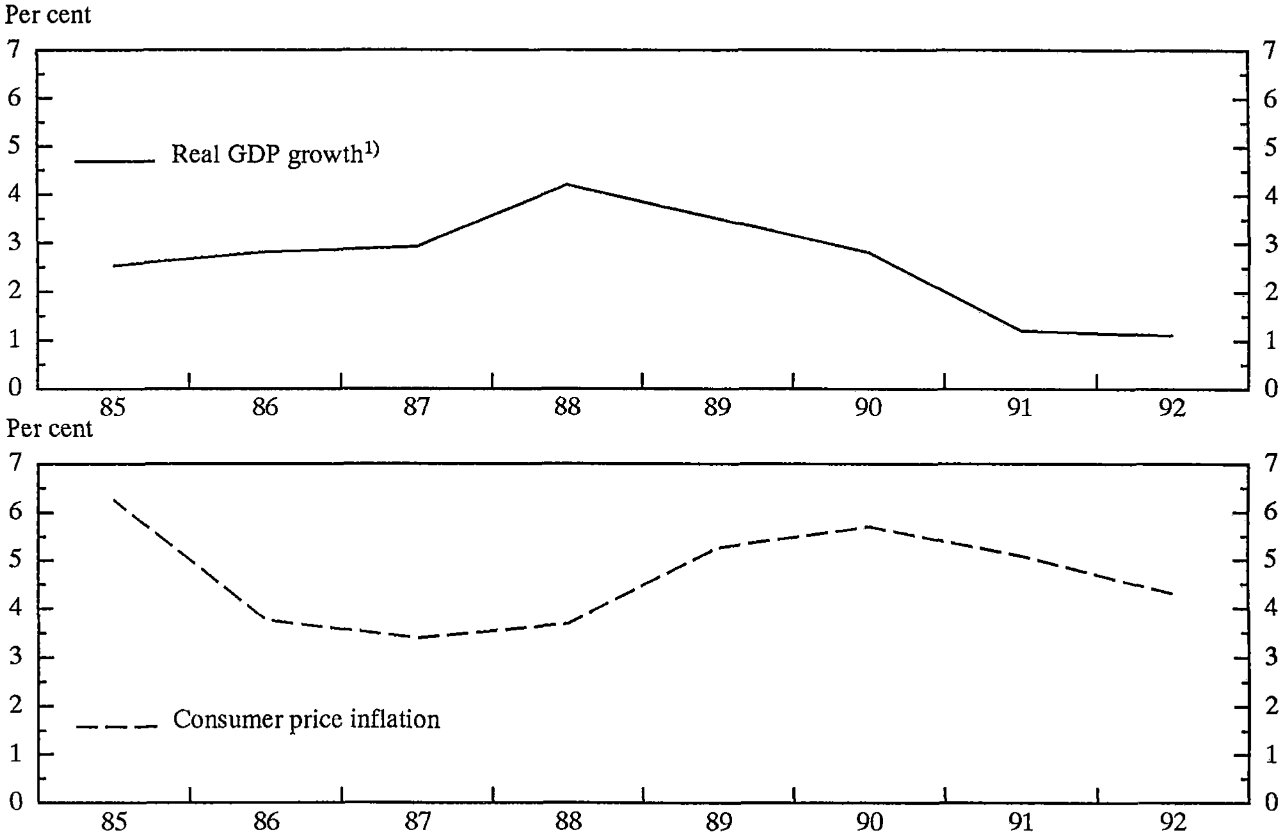
(a) Estimates. (b) Computed on the basis of 1989 GDP weights expressed in 1989 PPP exchange rates. (c) Computed on the basis of 1989 consumer spending weights expressed in 1989 PPP exchange rates. (d) 3-month domestic money market rate. (e) Government or public sector bond rate.

appropriateness of the monetary stance in countries where significant progress had been made in containing inflation and where unemployment was increasing rapidly.

A turning point was reached at the beginning of June 1992 when the narrow Danish rejection of the Maastricht Treaty triggered growing unrest in the exchange markets of the Community. Money market conditions quickly became more differentiated. In Germany, the monetary stance remained firm and market interest rates did not ease before mid-September on the occasion of the realignment of the Italian lira. In Belgium and the Netherlands, changes in the central banks' intervention rates closely mirrored the movements in German interest rates to maintain the tight currency links with the Deutsche Mark. All other countries participating in the Exchange Rate Mechanism (ERM) were faced with - at times very severe - downward pressure on their currencies during the second half of the year and raised official interest rates, though to varying degrees and at different times, as part of their strategies to counter the emerging exchange rate tensions.

The outcome of the Danish referendum in June was only a catalyst for the subsequent events which culminated in September 1992 in the most serious crisis of the European Monetary System (EMS) since its inception. In quick succession, two realignments were agreed and the obligation to respect the prescribed exchange rate margins was suspended for two currencies. Within a short period, the remarkable stability of exchange rate expectations of the past few years vanished and gave way to intense speculative behaviour. Initially, strong downward pressure was felt by currencies which appeared vulnerable in the light of domestic economic conditions. However, as tensions spread to other currencies, the situation in the exchange market also began to exhibit features of a speculative run with short-term, unwarranted exchange rate expectations feeding on themselves.

CHART 1: REAL GROWTH AND INFLATION IN THE COMMUNITY



[1)] Estimate for real GDP in 1992.

No doubt the growing market turbulence in the wake of the Danish vote was intensified by concurrent developments: the US dollar depreciated substantially against European currencies; unrest grew in the Nordic currency markets; and markets seemed to become more attentive to the responses of the authorities to exchange rate tensions which were perceived as insufficiently co-ordinated.

More fundamentally, the exchange market crisis must be ascribed to two factors. Firstly, the stability of nominal exchange rates in the ERM during the previous five years had not been exploited sufficiently to underpin the existing central parities by correcting economic imbalances and by more vigorous efforts towards greater economic convergence. On the contrary, owing to substantial budget deficits in a large number of Community countries, unbalanced policy-mixes had persisted and insufficient convergence to a low level of inflation had caused significant changes in international competitive positions. With signs of waning popular support for the Maastricht Treaty in the run-up to the French referendum, the markets' trust in the authorities' commitment to the existing central parities, and to the achievement of convergence in accordance with the Treaty's criteria, faded. The French referendum thus became a reference date for a possible realignment.

The second basic reason for the exchange market crisis was that, in the course of 1992, the prolonged weakness of economic activity and diminishing prospects for a recovery was increasingly felt to aggravate policy dilemmas for those countries where inflation had been reduced significantly and where labour market conditions had deteriorated sharply. In these cases, the level of nominal interest rates required to maintain the currency's central rate in the ERM was seen to be increasingly at odds with the needs of the domestic economy, especially as real interest rates rose with an improving outlook for inflation. The conflict between external and domestic objectives was highlighted by repeated calls for lower interest rates, both in the countries concerned and with respect to German rates, given the latter's importance for monetary conditions elsewhere in the Community. In Germany, however, it was felt that there was little scope for interest rate reductions, given price and wage developments and the fiscal stance. On the other hand, there were perceptions in markets that there were limits to the willingness of the authorities in some other countries to raise interest rates in the defence of central parities - especially where because of weak economic conditions and a high level of private and/or public debt the economies were very sensitive to changes in interest rates.

All Community countries where currencies were subject to downward pressures made use, in varying combinations, of three instruments: the scope for movements in the ERM fluctuation bands was widely exploited; intervention was undertaken on an unprecedented scale; and interest rates were adjusted, though to different extents and at different times. Some countries tightened the administration of existing exchange controls while in one instance measures were temporarily applied to penalise the short-selling of the domestic currency financed through swaps.

While the assessment of the recent turbulent events in the exchange markets has not yet been finalised, there is full agreement that the EMS, as an arrangement for the promotion of closer monetary co-operation leading to a zone of monetary stability, is beneficial to all Community countries and that the restoration and maintenance of the credibility of the System as a whole is a very important objective. In order to achieve this goal two requirements have to be fulfilled. Firstly, for central parities to remain credible, the underlying economic conditions have to be sound and need to be safeguarded convincingly by current and future macro-economic policies. The System must remain flexible, and exchange rate adjustments may be needed if major economic imbalances arise. However, a realignment is no panacea and does not, therefore, eliminate the need for supporting stability-oriented policies. Secondly, experience has shown that, in an environment of full freedom of capital movements, massive speculative exchange rate pressures may arise even in a situation when central parities are backed up by sound and stable domestic economic conditions. In such circumstances, the defence of exchange rates must rest on close co-operation consistent with the commitment of individual countries' monetary policies to price stability which is a precondition for lasting exchange rate stability. The institutional steps that are being taken in a number of Member States to increase the independence of their central bank could be a very helpful element in enhancing the credibility of monetary policy. Within these broad considerations, the Committee of Governors is continuing its discussions on the management of the EMS.

2. MONETARY POLICY ORIENTATIONS FOR 1993

When in December 1992 the Committee of Governors assessed national monetary policy intentions for 1993, not only was there a highly uncertain outlook for the world economy, and for growth and inflationary pressures in the Community, but renewed outbreaks of tension in the exchange markets indicated that more lasting calm had not yet been restored in the EMS. Real GDP in the Community was forecast to expand at roughly the same low rate as in the two preceding years, and despite the weakness of activity inflation was still expected to recede only moderately.

There was full agreement in the Committee of Governors that monetary policies must continue to be geared towards the medium-term goal of achieving and maintaining price stability throughout the Community. Monetary policy can only fulfil this objective if managed with a steady hand. As experience has shown, the benefits to economic activity from a premature easing of monetary conditions are quickly eroded and are soon outweighed by significant longer-term economic costs, which are difficult and painful to absorb. For this reason the Committee of Governors emphasised the need for a medium-term oriented monetary policy which ensures a further decline in inflation without restraining the room for a sustainable recovery of economic activity.

However, as stressed in last year's Annual Report, the effectiveness of the envisaged monetary stance hinges to an important extent on adequate support from fiscal policy and wage developments. There is an urgent need to improve the mix between fiscal and monetary policies in a number of Member States. Despite the less favourable economic prospects for 1993, sight should not be lost of the need for fiscal consolidation. This is particularly important in the light of the Maastricht Treaty, which states the need for fiscal discipline and establishes a reference value for the budget deficit of 3% of GDP to help assess the sustainability of the government's financial position. According to the latest published forecast by the European Commission, the budget deficit in the Community as a whole is projected to increase to 5¾% of GDP in 1993, up by half a percentage point on last year's already unsustainably high level. If the credibility of Member countries' policies and Treaty obligations are to be maintained and overburdening of monetary policies is to be avoided, the necessary measures towards budgetary consolidation must be taken now. In particular, in countries with excessive budget deficits, efforts to correct structural deficits must be intensified. In other countries, subdued economic growth should not result in increases in deficits beyond the normal automatic effects from declining revenues and higher social expenditure. Furthermore, while some Community countries succeeded in containing nominal wage growth in 1992, a significant moderation in wage increases is still needed where labour costs rise at a rapid pace. In addition, all Community countries must persevere with their efforts to reduce structural rigidities in labour markets. To promote the necessary policy adjustments, national convergence programmes have been set in most countries following discussions at Community level.

The importance of achieving quickly a better balance between fiscal and monetary policies, and of strengthening supply-side policies, was dramatically highlighted by the disappointing economic and financial developments in 1992. Decisive progress in these fields is required not only to strengthen the foundations for sustained growth but also to restore stable exchange rate relationships among Community currencies. While monetary policy remains the responsibility of the national authorities, the strengthening of monetary policy co-ordination within the Committee of Governors should also contribute to the re-establishment of the credibility of the ERM without which it will be much more difficult to narrow interest rate differentials on a lasting basis.

The recent realignments and movements in the exchange rates of currencies which have suspended their ERM commitment should have helped to correct the effects of past imbalances. However, the changes in exchange rates, and in particular the temporary floating of currencies, should not be misconstrued as having eliminated the constraints on domestic economic policies. The close integration of the Community economies, and the growing interdependencies arising from the completion of the single market for people, goods, services and capital, leave no alternative to co-operation and closely co-ordinated policies.

3. PREPARATORY WORK FOR THE MOVE TO STAGES TWO AND THREE OF ECONOMIC AND MONETARY UNION

In response to the invitation by the Council of the European Communities, the Committee of Governors has set in motion preparatory work to establish the conditions for the implementation of the Treaty of Maastricht in the monetary field. This work is focusing partly on the task of setting up the European Monetary Institute and partly on certain specific areas which are linked to the more distant goal of a single monetary policy but which require a considerable period of preparation.

The groundwork for the EMI has so far centred primarily on the tasks of this new institution. Some of these tasks overlap with responsibilities currently assigned to the Committee of Governors, such as the co-ordination of monetary policies, or to the European Monetary Co-operation Fund, such as the administration of the EMS mechanisms. In these areas, the objective is to ensure a smooth transition to the EMI. In addition, the Committee of Governors is currently considering how the EMI should best perform its operational functions. According to the EMI Statute, these include: functions currently undertaken by the EMCF; new functions such as the management of foreign exchange reserves as agent of and at the request of national central banks; and tasks related to the ECU.

With regard to preparatory work with a long lead time, the Committee of Governors has identified five major areas which deserve early attention: statistics, payment system questions, printing and issuing a European bank-note, accounting issues, and the establishment of information systems. For each of these specific projects new Working Groups have been established. The initial work of these groups is mainly of a fact-finding and stock-taking nature in order to prepare the ground for future decisions on how to create the necessary integrated infrastructures. Finally, preliminary work has also commenced with a view to clarifying the main questions relating to the principal features, instruments and operating procedures of the future single monetary policy.

* * *

The first chapter of the Report reviews economic developments and monetary policy implementation in 1992. In the second chapter, monetary policy instruments and procedures are described, while the third chapter surveys the institutional features of Community central banks. The final chapter reports on the activities of the Committee of Governors and the preparation for the move to Economic and Monetary Union.

I. ECONOMIC DEVELOPMENTS AND MONETARY POLICY IMPLEMENTATION

1. ECONOMIC BACKGROUND TO MONETARY POLICY

After a vigorous expansion in the late 1980s, economic growth in the Community slowed sharply in 1991 and remained sluggish in 1992. The weakness in activity reflected the impact of an unfavourable external environment combined with subdued domestic demand. On average, inflation in Community countries declined further in 1992 although the situation remains far from the medium-term goal of price stability. Moreover, the extent of the decline in inflation was rather limited in spite of the marked weakness in EC import prices and more modest output growth than earlier envisaged. The resilience of inflation stems largely from domestic sources, with particularly strong price increases in the sectors of the economy sheltered from international competition. While differences in inflation rates between Community countries narrowed further in 1992, this was in part attributable to a decline in the United Kingdom and to a rise in Germany, traditionally a low inflation country.

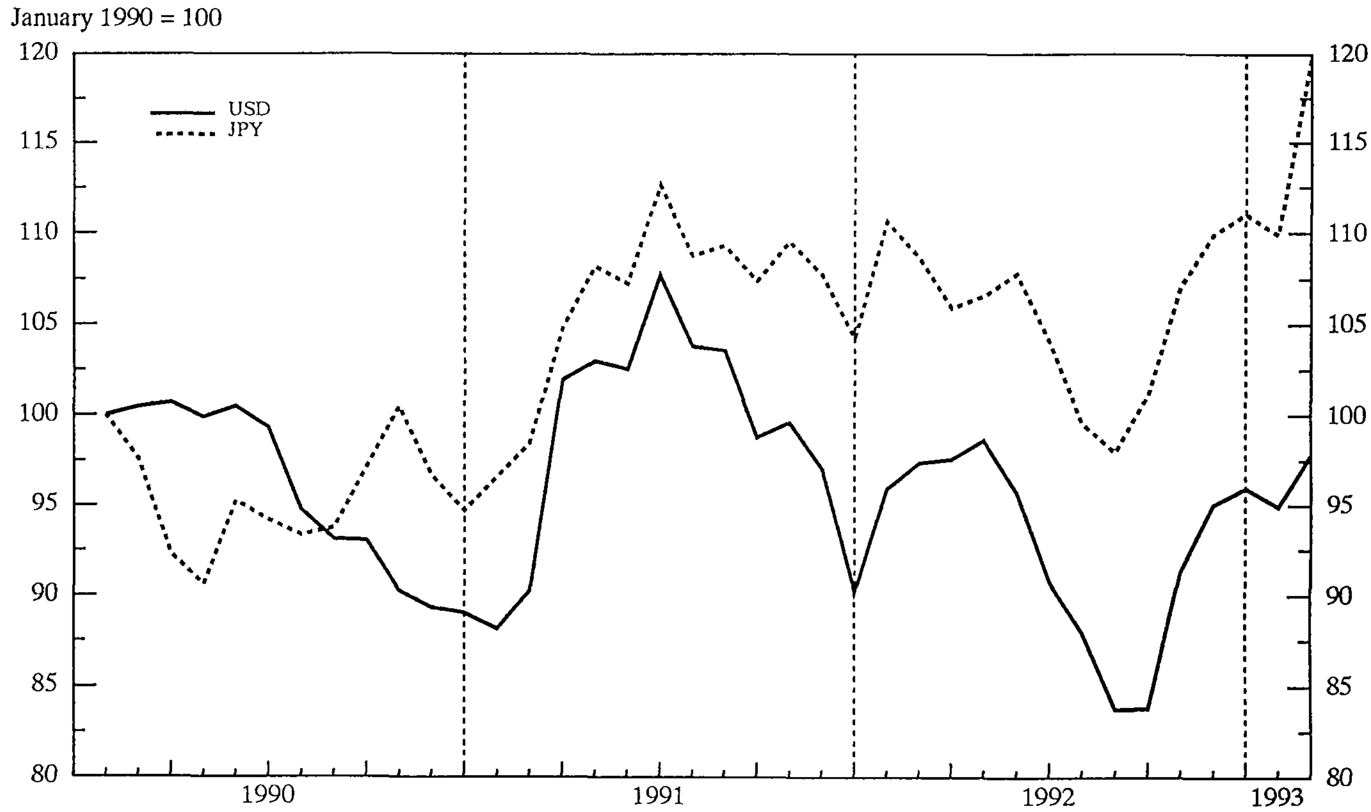
1.1 External environment

Growth in the Community's main export markets improved only slightly in 1992, disappointing earlier expectations of a stronger external stimulus. In the US, output continued to pick up, although the pace of growth was significantly less than is normal at this stage of the cycle and the recovery appeared fragile at times. In the light of the mixed signals regarding the strength and durability of the upturn, the Federal Reserve eased monetary policy on a number of occasions during the year. The uncertainties concerning the relative strength of the upswing in the US, and therefore the future path of interest rates, contributed to significant dollar volatility. Signs of strong growth in the early months of 1992 led to a marked rise in the dollar, but as the recovery faltered and US monetary policy was loosened further, the dollar depreciated vis-à-vis the Deutsche Mark by some 15% between end-April and end-August. Thereafter, the dollar firmed by about 14% up to the end of 1992, following evidence of a stronger revival in the US and the reductions in German interest rates in September (see Chart 2).

In Japan, growth decelerated significantly during 1992 with asset prices falling sharply. In response, monetary policy was eased further and a major package of expansionary budgetary measures was announced in August. EFTA countries, which absorb around one quarter of the Community's exports to the rest of the world, remained in recession in 1992, reflecting the impact of high real interest rates and of depressed global demand.

Non-oil commodity prices were little changed on average in dollar terms in 1992 while oil prices were also relatively soft. Weak raw materials prices, together with slack demand conditions, contributed to a deceleration in inflation internationally. In addition, the general appreciation of Community exchange rates against non-Community currencies over

CHART 2: EXCHANGE RATE OF THE US DOLLAR AND THE JAPANESE YEN VIS A VIS THE DEUTSCHE MARK



much of the year helped to dampen inflationary pressures in the Community. Indeed, import prices fell in six Member States, while in the others the rise was less than that of the GDP deflator.

1.2 Economic performance and convergence in the Community

GDP *growth* continued to be subdued in 1992, decelerating marginally to 1.1% in the EC as a whole (see Table R1 on page 34). The sluggishness of activity in part reflected the continuation of the global downswing noted above. In addition to the slowdown in external demand, domestic demand in the Community was also depressed as a result of a retrenchment in private investment and consumer spending. Consumer and business confidence deteriorated against a background of high real interest rates in most Community countries. A slowdown was particularly evident in Germany where, after a buoyant first quarter, activity in the western part of the country decreased over the remainder of the year while in the eastern part there was only a modest rebound. Slackening demand growth in Germany contributed to the protraction of the downturn elsewhere in the Community, in significant contrast to the strong boost to trade in the wake of unification. Of the other countries which had grown relatively rapidly in 1991, Spain and the Netherlands experienced a significant deceleration. In contrast, there was a modest upturn in France due mainly to a strong export performance, although growth remained well below potential.

Elsewhere in the Community, activity continued to be very weak. In particular, in the United Kingdom high levels of private debt combined with falling property prices contributed to a further contraction in output, albeit smaller than in 1991 (see Box 1 overleaf). The depressed economic environment in the Community adversely affected labour markets conditions and, as a result, unemployment increased in nearly all Member States touching 10% on average by the end of the year (see Table R2 on page 34). Although differences in growth performance between Community countries were somewhat less pronounced than in the previous year, the dispersion between the levels of actual and trend output widened further in 1992 (see Table 2).

TABLE 2: OUTPUT GAPS AND CYCLICAL DIVERGENCES

Item		Germany (western)	France	Italy	UK	Dispersion (a)
1 GDP relative to trend level	1989	100.9	101.8	101.2	102.9	0.9
(OECD estimates)	1990	103.5	101.6	100.9	102.1	1.1
	1991	104.7	100.3	99.9	97.5	3.0
	1992 (b)	102.9	99.7	98.6	94.1	3.6
2 Real GDP relative to Germany	1989	100.0	100.0	100.0	100.0	-
(1989 = 100)	1990	100.0	97.3	97.2	95.7	1.8
	1991	100.0	94.7	95.1	90.0	4.1
	1992 (b)	100.0	95.0	94.6	88.1	4.9
3 Real GDP growth rates	1989	3.4	4.7	2.9	2.1	1.1
	1990	5.1	2.3	2.2	0.6	1.9
	1991	3.7	0.9	1.4	-2.5	2.6
	1992 (b)	1.5	1.8	1.0	-0.6	1.1

Sources: National data, OECD.
(a) Unweighted standard deviation. (b) Estimates.

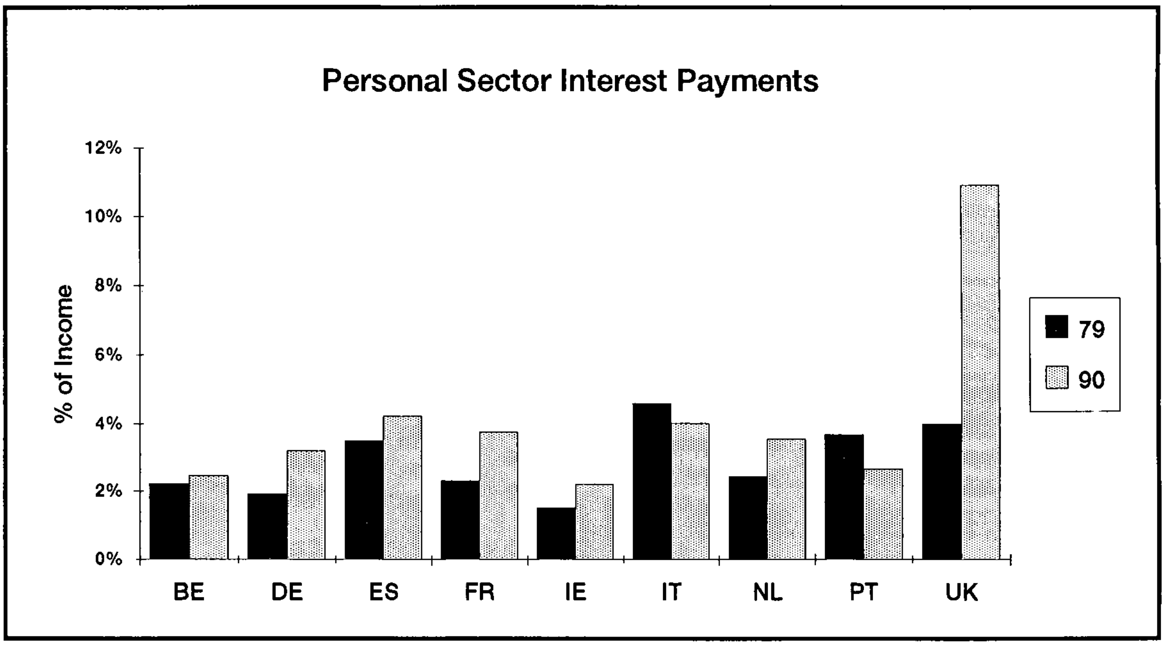
The average rate of *inflation* in the Community fell further from 5.1% in 1991 to 4.3% in 1992 (see Table R3). The relative resilience of inflation stemmed largely from increases in domestic costs and from price rises in the non-traded goods and services sectors of the national economies where competitive pressures are generally less powerful (see Box 2 on page 14). Although nominal wage growth moderated in the Community as a whole, it remained above 5% in most Community countries (see Table R4). In addition, profit margins continued to widen in a number of Member States. Furthermore, increases in indirect taxes or in charges for public services added to upward pressure on consumer prices, in particular in Germany, Greece, Spain, the Netherlands and Portugal.

The dispersion of inflation rates in the Community narrowed again in 1992. However, as in the previous year, this narrowing was partly due to an increase in Germany, where inflation averaged 4% in the western part of the country, as against 3.5% in 1991. In the eastern part, price increases were significantly higher following the adjustment of rents and other prices which brought them closer to market levels. In contrast, inflation fell substantially in the United Kingdom, from 5.9% to 3.7%, as the recession was prolonged and

Box 1: PRIVATE SECTOR INDEBTEDNESS IN EEC COUNTRIES

The structure of household and corporate balance sheets has important implications for the behaviour of consumer spending and investment and for the responsiveness of aggregate demand to changes in interest rates. Evidence suggests that there are significant variations in private debt levels across Community countries.

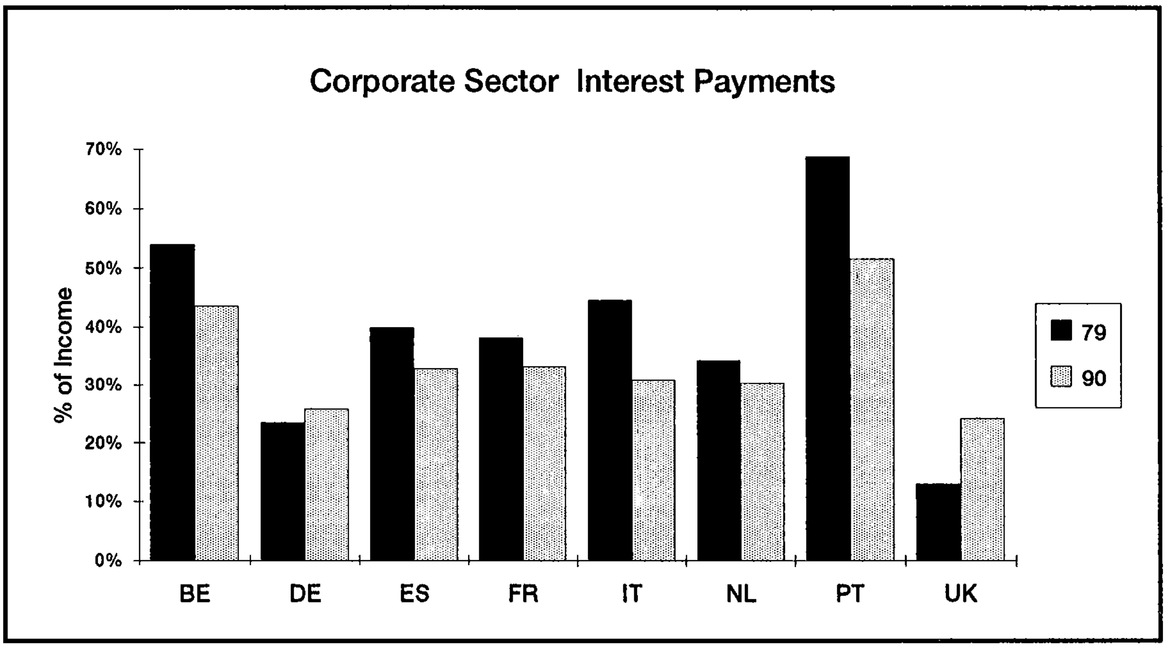
Levels of *personal sector* indebtedness in the UK are significantly in excess of those in other EEC countries. Having risen strongly in the 1980s against a background of financial deregulation, buoyant income expectations and strongly rising asset prices, personal sector debt in the UK amounted to 78% of *gross* income in 1990. Much of this short and long-term borrowing was at variable interest rates. In contrast, personal borrowing amounted to 45% of income in France and 37% in Germany. In both countries, most lending is long-term and at fixed rates. One consequence of the high personal sector debt ratio in the UK - which in 1990 was exacerbated by high nominal interest rates - is a level of interest payments relative to income well in excess of levels elsewhere in the Community and substantially above the levels recorded at the late 1970s (see graph below)[1].



On the asset side, movements in housing wealth - an important component of household wealth - have also varied considerably. In Germany, house prices have increased significantly in recent years, rising by about 30% since 1986. In France, prices have fallen somewhat in 1991 and 1992, after strong growth in earlier years. In the UK, the combination of high interest rates and subdued activity has resulted in sharp falls in house prices, which have declined by around 14% since the 1989 peak. Over 1 million households are now in a situation where the value of their property is less than the mortgage outstanding.

Continued...

In 1990, levels of indebtedness in the *non-financial corporate sectors* amounted to 332% of sector income in France, 206% in Germany and 144% in the UK. These variations reflect a number of economic and institutional characteristics, including the relative popularity of debt versus equity financing. There are sharp variations in ratios of interest payments to corporate income in Community countries (see graph below), ranging from 53% in Portugal to 24% in the UK. While these data provide useful information, it should be recalled that in most Community countries (excluding the UK and Ireland), the bulk of corporate borrowing is at fixed interest rates.



A number of conclusions are suggested by the data presented above. It appears that the combination of high debt and falling house prices in the UK has resulted in a less 'healthy' household balance sheet than in other EEC countries. This, together with the prevalence of variable rate lending, suggests that household expenditures are likely to be relatively more responsive in the UK to changes in interest rates. Moreover, it appears that efforts by households in the UK to strengthen their balance sheets by restraining expenditures and reducing debt have contributed to the weakness of activity. For other EEC countries there is little evidence that household balance sheet restructuring has made a significant contribution to the behaviour of consumption in recent years. In relation to the corporate sector, there are significant variations in the level of debt and interest payments, implying that the impact of interest rate changes varies significantly across Community countries. It is also worth noting that the widespread practice of fixed rate lending in many countries with high debt ratios may insulate both households and firms somewhat from the effects of changes in short-term interest rates.

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[1] In the above charts, data for Belgium and Portugal refer to 1979 and 1989; for Spain to 1981 and 1990; for Italy to 1980 and 1988.

Box 2: SECTORAL INFLATION TRENDS

A striking feature of recent price developments in most Community countries has been the wide divergence between inflation rates in the sectors producing goods traded on international markets and in those producing predominantly domestically consumed goods and services which are more sheltered from competition (see Table below).

Considerable progress has been made in recent years towards convergence on low inflation in the traded goods sector, in an environment of increasing competition in world markets. Tentative evidence suggests, however, that this may partly reflect a persistent squeeze in profit margins or in relative wages in some countries, which may prove difficult to sustain over the medium-term.

Inflation rates in the more sheltered sector are generally well above those in the traded goods sector, particularly in the countries with higher average inflation. Indeed, for the Community as a whole the differential between the two rates was around the highest level for ten years in 1992. Prices of non-traded goods typically rise faster than traded goods: productivity is generally lower, reflecting differences in production technology and in the degree of competition in the two sectors. Moreover, shifts in the pattern of demand towards greater consumption of services as income increases may also influence relative price movements. In some countries, however, the sizeable gap between the sectoral inflation rates, taken together with the greater resilience of inflation in the sheltered sector, suggests the presence of structural problems which are hampering the reduction of inflation. In these countries, policy measures to strengthen competition and raise productivity levels in the more sheltered sector would consequently enhance the effectiveness of monetary and fiscal policies in promoting price stability.

DIFFERENCE IN INFLATION TRENDS IN THE NON-TRADED AND TRADED GOODS SECTORS (a)

	percentage points					Memorandum Items: per cent	
Country	1990	1991	1992 (b)	Average 1982-1986	Average 1987-1991	Inflation in the non-traded goods sector 1992 (b)	Inflation in the traded goods sector 1992 (b)
Belgium	0.6	1.4	1.8	-0.7	0.1	4.2	2.4
Denmark	-0.1	1.4	3.3	0.9	1.3	3.5	0.2
Germany (western)	0.7	0.6	2.8	1.6	1.2	5.5	2.7
Greece	3.6	5.0	4.5	0.3	5.5	19.2	14.7
Spain	6.8	7.5	4.3	0.3	5.3	8.8	4.5
France	3.4	1.9	2.9	1.0	3.3	4.5	1.6
Ireland	2.0	1.5	1.4	2.8	1.5	3.9	2.5
Italy	5.4	4.9	4.7	4.5	4.2	7.5	2.8
Netherlands	1.5	2.6	1.5	1.4	1.5	4.1	2.6
Portugal	10.1	7.1	3.8	1.1	3.3	11.2	7.4
United Kingdom	1.6	3.4	3.5	1.4	2.0	7.3	3.8
EEC Average	3.1	3.2	3.4	1.8	2.8	6.6	3.2
EEC Dispersion (c)	2.3	2.1	0.9	1.4	1.5	2.4	1.9

(a) National proxies supplied by central banks. As proxies differ, cross-country comparisons and the aggregate estimate for the Community should be interpreted cautiously. For Luxembourg, no data are available. (b) Partly estimated. (c) Weighted standard deviation.

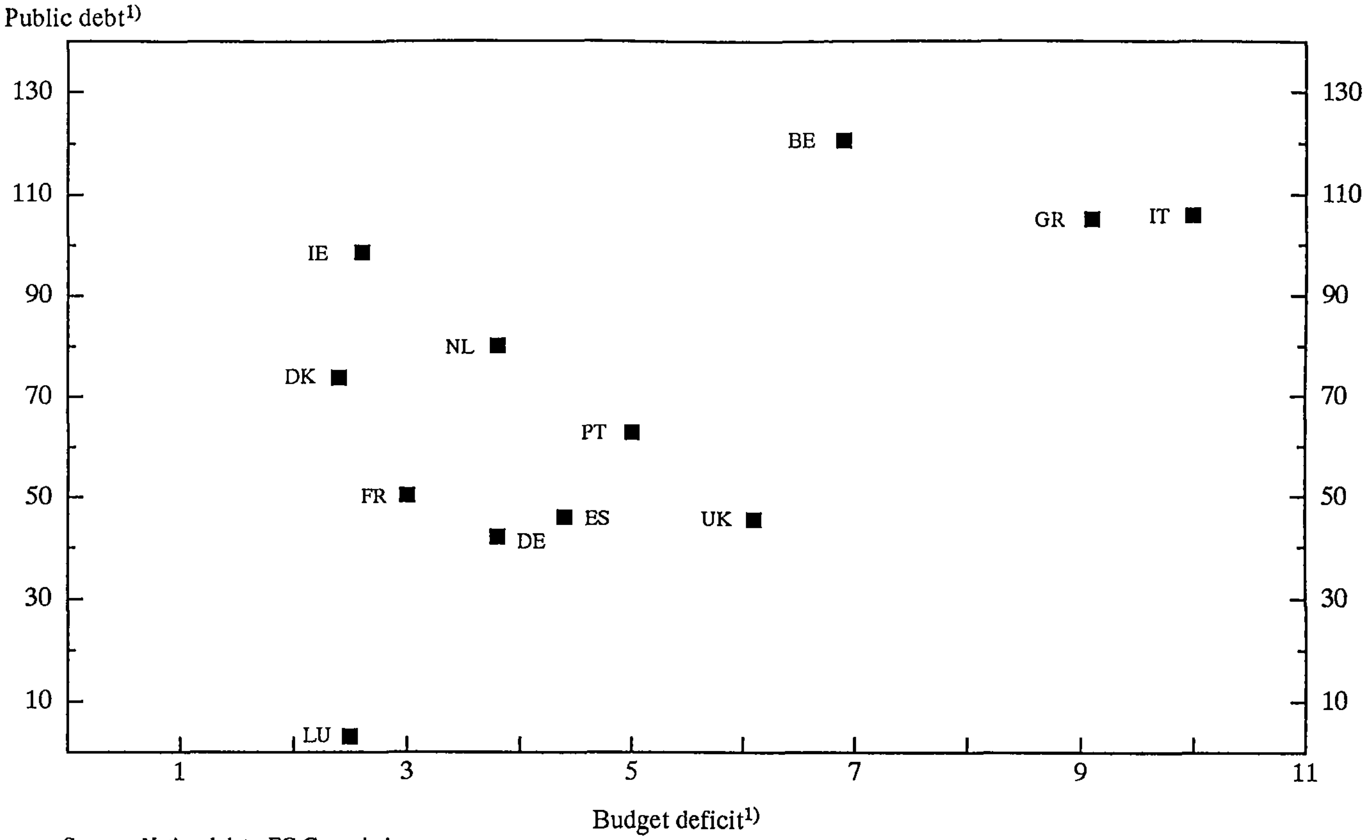
as unemployment rose sharply. Of the other countries with relatively high inflation in 1991, there were also significant reductions in Greece, Italy and Portugal, but the rate of price increase was unchanged in Spain, with the 3 percentage points rise in the rate of VAT offsetting an improvement in the inflation rate before tax. In the remaining countries, where in recent years inflation has been relatively low, a slight decline was recorded.

For the Community as a whole, *public finances* deteriorated in 1992, with the overall ratio of general government borrowing to GDP rising to 5.3% from 4.7% in the previous year (see Table R5). The increase in the budget deficit was particularly striking in the United Kingdom, where the deficit more than doubled to over 6% of GDP, mainly as a result of adverse cyclical influences on revenue and expenditures but also reflecting a discretionary boost by the authorities. In Germany, the deficit was broadly unchanged at nearly 4% of GDP, with the ongoing costs of unification continuing to fuel budgetary pressure. In addition, there was significant borrowing by state-linked entities, such as the Treuhand, totalling some 2% of GDP in 1992. The slowdown in German growth is adding to the difficulties of rebalancing the policy mix. In Italy, although some reduction in the budget deficit was achieved, the fall was much less than originally planned partly due to adverse cyclical factors. In view of the urgent need to restore sound public finances, a major package of budgetary measures was approved towards the end of the year. Although many of the measures are of a structural nature, further retrenchment will be needed in the medium-term to achieve an adequate degree of fiscal consolidation. Elsewhere in the Community changes in the level of public sector deficits were more muted. Of the other countries with high deficits, reductions in the level of borrowing were recorded in Greece, Spain and Portugal, while there were modest increases in Belgium, Denmark, France, Luxembourg and the Netherlands. In the countries with high levels of public debt, debt-GDP ratios rose in Belgium, Greece, Italy and the Netherlands, but dropped further in Ireland (see Chart 3).

After the marked narrowing in *current account* imbalances in earlier years, the dispersion across Member States in 1992 was a little wider than in the previous year, albeit remaining at a relatively low level by recent historic standards (see Table R6). In most countries, current account balances were little changed. Notable developments in 1992 were a further rise in the surplus in Denmark and Ireland, a move into slight surplus in France and the near elimination of the deficit in Portugal, and a widening in the deficits in Greece, Spain, Italy and the United Kingdom. Overall, the Community's current account deficit vis-à-vis the rest of the world remained unchanged, at 1% of GDP.

By the end of 1992, all Community countries had abolished controls on capital movements in line with Community legislation, except Greece which has a derogation.

CHART 3: GENERAL GOVERNMENT BUDGETARY POSITIONS 1992
(per cent of nominal GDP)



Sources: National data, EC-Commission.

1) Estimates. Figures may not be consistent with the principles on definitions underlying the Excessive Deficit Procedure in the Maastricht Treaty which are still under discussion with a view to being harmonized.

2. MONETARY AND EXCHANGE RATE DEVELOPMENTS

Monetary policies in 1992 were set to promote a further decline in inflation, in line with the common objective of the monetary authorities in the Community to foster convergence towards price stability.

Although national economic conditions in the Community continue to vary considerably, with a substantial divergence in cyclical positions and in cost and price pressures, the growing financial interdependence among ERM members has significantly reduced the scope for monetary policy differentiation. Given the pivotal role of German monetary policy in shaping monetary conditions in the Community, the restrictive stance required to contain strong inflationary pressures in Germany has set the general tone of monetary conditions throughout the area. In countries with low or rapidly falling inflation and weak economic activity, this has worsened the conflict between internal and external policy objectives, as the policy stance necessary to preserve exchange rate stability has often been tighter than desired given domestic economic conditions.

In the second half of the year, policy dilemmas were exacerbated by unprecedented tensions in the ERM as market participants became increasingly concerned that exchange rate adjustments might prove inevitable given the lack of adequate convergence and the perceived policy conflicts confronting governments. The defence of parities in the presence of speculative attacks at times became the overriding concern in the setting of national monetary conditions. Policy responses to exchange rate pressures led to a substantial widening of interest-rate differentials vis-à-vis Germany. The greater freedom to set monetary policies in line with domestic conditions in Italy and the United Kingdom, following the suspension of ERM participation in mid-September was used to reduce short-term interest rates. In the United Kingdom, rates were cut to well below German levels while in Italy the reductions led to a marked narrowing of the differential with German rates.

In this section, the monetary stance is assessed first through a brief description of developments in monetary aggregates and of the broad trends in interest rates. Attention then moves to exchange rate developments, which, as noted above, have exerted a major influence on the evolution of national monetary conditions in 1992.

2.1 Monetary developments

Monetary aggregates

In the Community, the growth of broad money aggregates had slowed considerably during 1990 and 1991, reflecting the tight stance of monetary policy and the deceleration of nominal demand growth. After an upturn in the pace of money expansion in the first half of 1992 in a number of countries, there were renewed signs of an underlying slowdown later in the year as nominal spending continued to slacken. In most countries setting quantified objectives, outturns were within or close to the target ranges (see Table 3). In contrast, broad money grew strongly in Germany in 1992, particularly in the autumn, and the target was overshot significantly. For the year as a whole, monetary growth in the Community was similar to 1991 (see Table R7).

In Germany, monetary growth continued to accelerate in 1992, mainly as a result of rapid credit expansion. The widespread availability of interest-rate subsidies, particularly those granted for investment in eastern Germany, contributed to the strong credit demand. The exceptional demand for currency, and the incentive to hold short-dated liquid assets because short-term rates exceeded long term yields (an inverted yield curve), also exerted expansionary influences on the monetary aggregate. In the second half of the year, the huge capital inflows associated with the exchange market crisis led to a further increase in the growth of the money supply, although this movement was partially reversed in November and December.

In the other countries setting monetary targets, developments were influenced by a variety of special factors. Portfolio shifts were important in France, where the money supply was temporarily boosted by the increase in the return on the interest-bearing assets included in the broad aggregate relative to the assets excluded, and in Spain, where in contrast portfolio movements were directed towards assets outside the definition of the broad aggregate. In Italy, credit demand in the first half year was strong, ultimately linked to the high fiscal deficit; credit to the private sector decelerated sharply in the second half, reflecting the rise in interest rates and slower economic growth. In Portugal, there were particularly large capital inflows in the period before ERM entry in April. In the United Kingdom, the narrow money aggregate remained in the target range during 1992, while broad money growth fell to historically low rates reflecting the stagnation of domestic activity. In all these countries, however, considerable downward exchange rate pressures were experienced in the second half-year which were typically accompanied by capital outflows, dampening monetary growth.

TABLE 3: MONETARY AGGREGATES: TARGETS AND OUTTURNS (a)

A. Countries setting targets for money supply growth

Country	Target Variable	1991		1992		1993
		Target	Outturn	Target	Outturn	Target
Germany	M3	3-5 (b)	5.2	3.5-5.5	9.4	4.5-6.5
Greece	M3	14-16	12.3	9-12 (c)	15.0	9-12
Spain	M3	-	-	7-11 (c)	4.3 (f)	4-7
	ALP	7-11	12.1 (10.8) (d)	8-11 (c)	5.1 (f)	4.5-7.5
France	M3	5-7	3.8	4-6	5.9	4.0-6.5
Italy	M2	5-8	9.0	5-7 (c)	5.9	5-7
Portugal	M3	-	-	12-15 (c)	16.0	-
	L-	12	19.1	12-16	12.5	-
United Kingdom	M0	0-4	2.3	0-4	3.8 (g)	..

B. Countries setting targets for the domestic source of money supply growth

Country	Target Variable	1991		1992		1993
		Target	Outturn	Target	Outturn	Target
Denmark	DMC (e)	4-7	1.4	4-7	-9.1	-
Netherlands	Banks' DMC (e)	7-8	11.2	7-8	10.6	-

Source: National data.

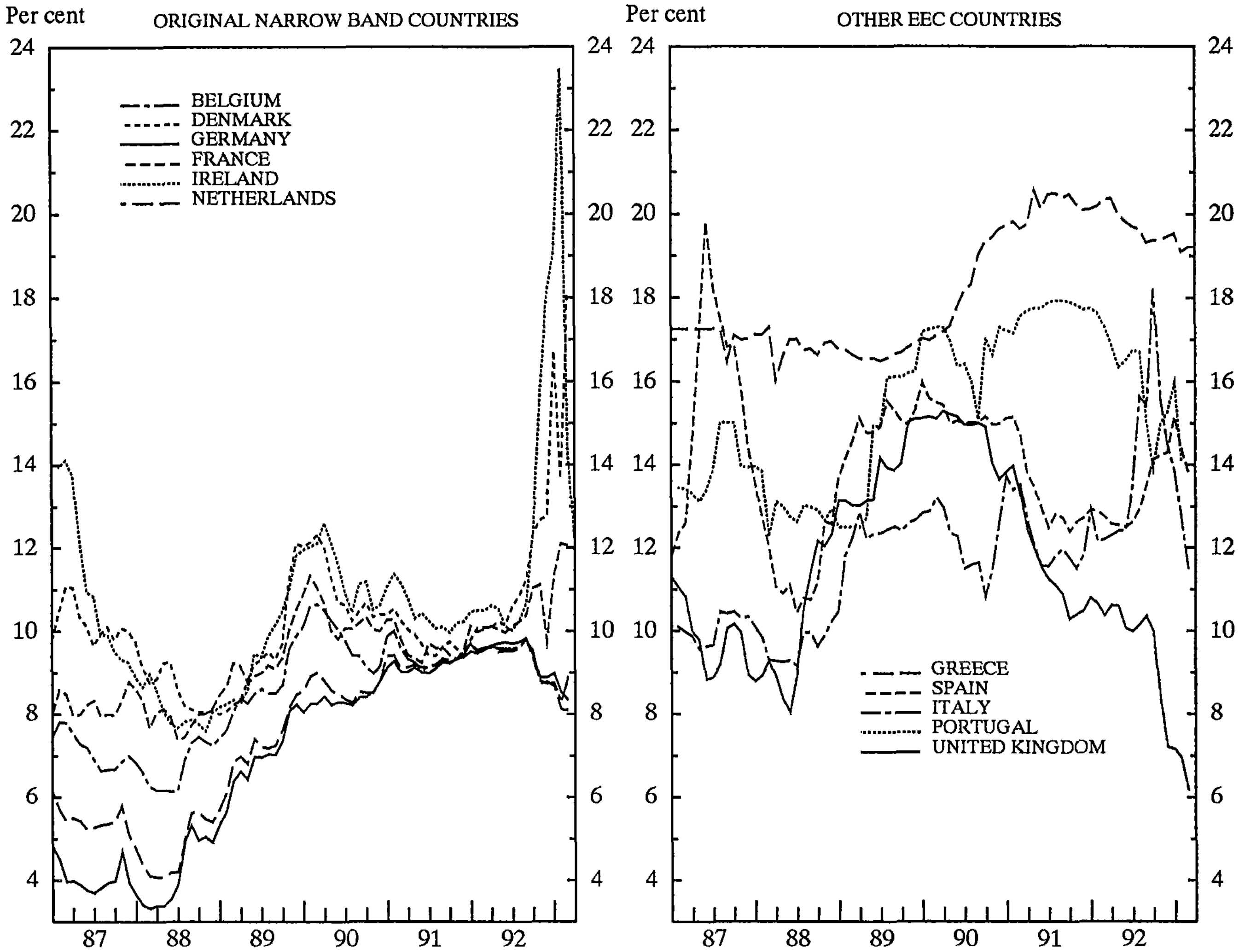
"-" target not set.

(a) Targets are set for a calendar year (4th qtr./4th qtr. or Dec./Dec.) except in the UK (March/March). The outturn columns report the corresponding growth rates of the respective variables. No monetary target is set in Belgium, Ireland or Luxembourg, nor for 1993, in Denmark, the Netherlands and Portugal. **(b)** Revised from 4-6% at the mid-year target review. **(c)** Target refers to a revised definition of the aggregate. **(d)** Figures in parentheses show the 1991 outturn for the revised definition used in 1992. **(e)** Domestic money creation (Denmark: growth in "Lending to residents in domestic currency + Stock of bonds denominated in domestic currency - Special deposits". Netherlands: growth in "Lending to domestic private sector + long-term lending to domestic government - domestic non-monetary liabilities"). **(f)** Taking into account extraordinary financial shifts in January 1992, the respective figures were: M3: 5.5% and ALP: 6.4%. **(g)** Annualised change March-December 1992.

Interest rates

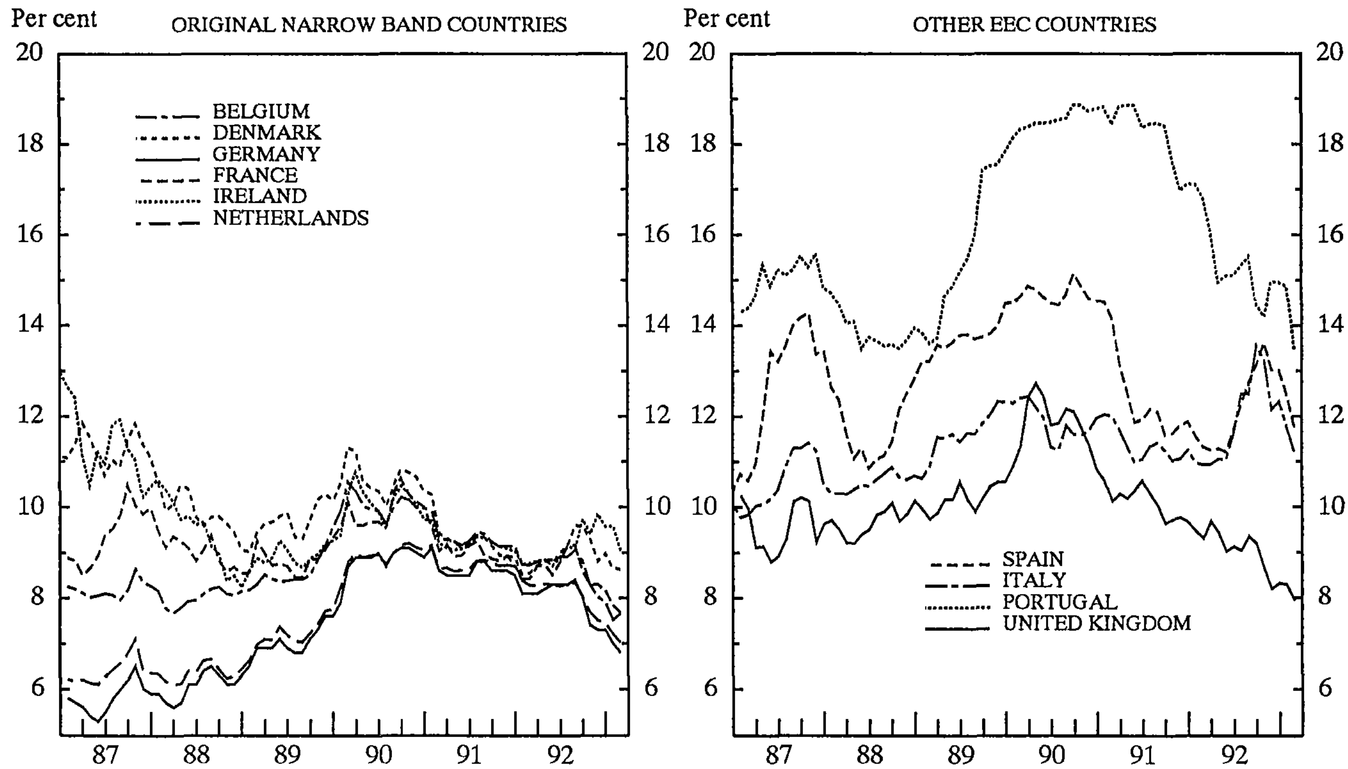
In the early months of 1992, short-term interest rates in the Community were generally higher than in the second half of 1991 (see Chart 4). In December 1991, interest rates had been raised in Germany to counter rising inflationary pressure. With the exception of the UK, the upward move in German interest rates prompted similar moves in all countries participating in the ERM in order to preserve exchange rate stability. Nevertheless, the rise was at variance with the prevailing conditions of weak economic activity and low or rapidly

CHART 4: SHORT-TERM INTEREST RATES[1)]



1) 3-month domestic money market rate. For Portugal the 3-month treasury bills rate has a break in May 1989 when treasury bills became subject to a 20 % tax rate.

CHART 5: LONG-TERM INTEREST RATES[1)]



1) Government or public sector bonds. For Portugal secondary yields on indexed public bonds, which became subject to a 20 % tax rate in September 1989. For Greece no long-term interest rate is available.

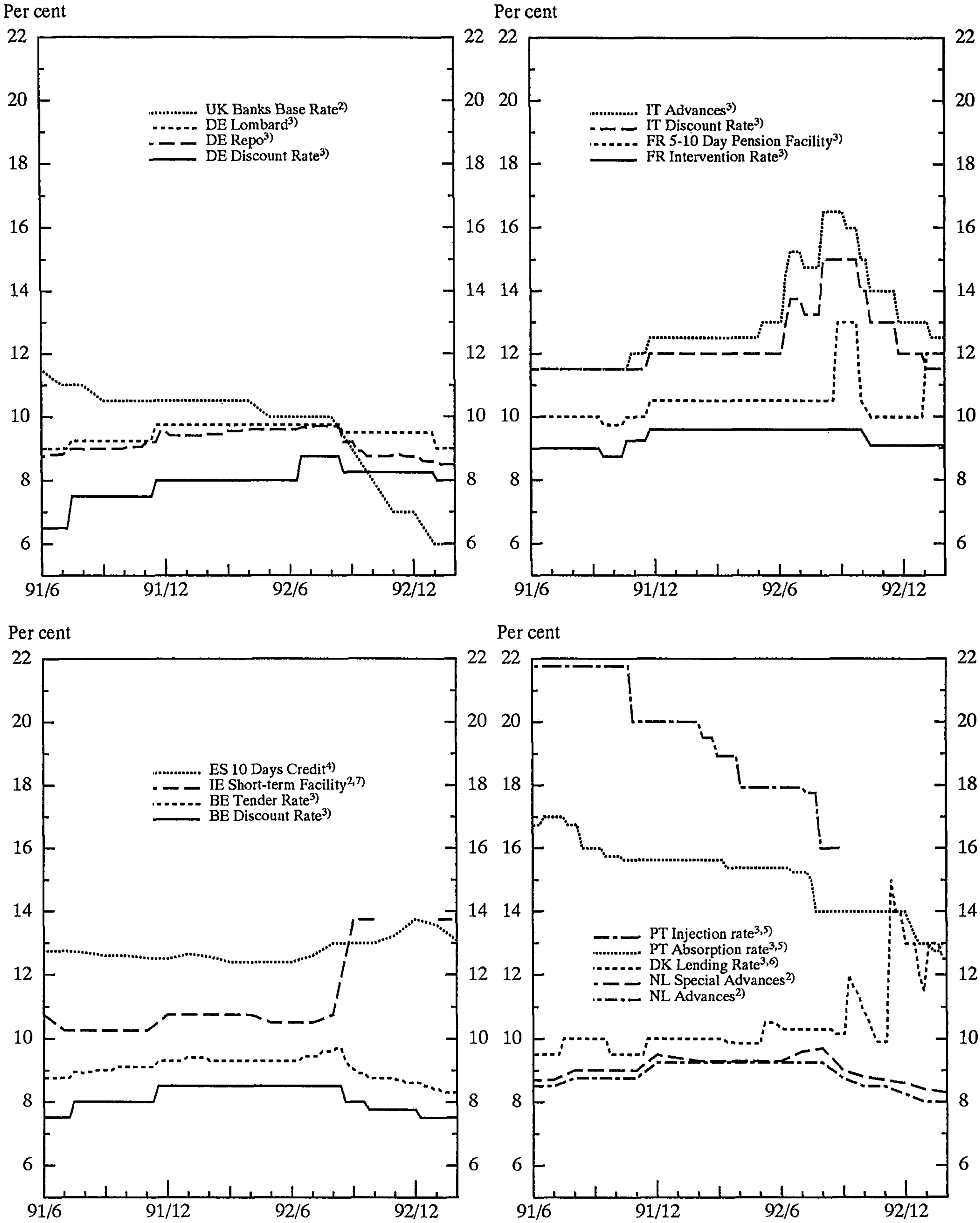
falling inflation in several countries. Thus, in the spring, when exchange rate conditions permitted, there were small reductions in official interest rates in a number of countries, and in France reserve requirements were cut to reduce the cost of credit. Consequently, short-term interest rate differentials against the Deutsche Mark continued to narrow following the trend of the previous years. However, as differentials had already fallen to historically low levels, there was little room for any additional decline in interest rates given that market participants considered that German rates tended to set the floor to rates in the Community, on the assumption that the Deutsche Mark would remain the hardest currency. In this period, long-term rates generally declined a little, leading to steeper inversions of the national yield curves (see Chart 5).

Conditions changed in the summer months. In July, the Bundesbank signalled its concern about the continued acceleration in monetary growth and the persistence of inflationary pressure by raising the discount rate by 0.75%, while leaving the Lombard and repo rates unchanged to limit the impact on other Community countries (see Chart 6). Money market rates in Germany rose only marginally, but the markets apparently interpreted the Bundesbank's decision as a sign that there were no prospects of an early lowering of interest rates in other ERM countries. Indeed, over this period the difficulty in pursuing internal and external policy objectives intensified as market confidence in the preservation of central exchange rate parities diminished. Against the background of broadly unchanged interest rates in Germany, the Netherlands and Belgium, short and long-term market interest rates rose in the other Community countries reflecting the additional currency risk. Official interest rates were raised in some countries, most substantially in Italy where exchange rate pressures were most acute.

In the late months of 1992, the strains developed into a major exchange rate crisis which is described in detail in the following section. Monetary conditions were tightened in the countries where currencies faced downward pressure, although the degree and the timing of such tightening varied from country to country. The rise in short-term market interest rates was accompanied by an increase in long-term rates. In contrast, monetary conditions eased slightly in the countries where currencies were under upward pressure as exchange rate appreciation was expected to dampen external influences on inflation. Between the first realignment and the end of September, short-term market rates in Germany fell by around 1%, with similar reductions in Belgium and the Netherlands. Long-term interest rates in these countries fell in line with short-term rates and dropped to their lowest level since 1989. In this period, interest-rate differentials within the Community widened considerably at both the short and long ends.

After the departure of sterling from the ERM, official interest rates in the United Kingdom were reduced in successive steps by 4 percentage points from the level prevailing before the exchange rate turmoil. Slow monetary growth, falling property prices and subdued economic activity were seen as indications that monetary conditions could be eased without

CHART 6: OFFICIAL OR KEY INTEREST RATES[1)]



1) For reasons of scaling no rate for Greece is shown. The maximum overdraft rate was 30 % since July 1990. It has been changed two times up to end of February 1993: on 18th of September 1992 to 40 % and on 23rd of October 1992 to 35 %.

2) End of month data. 3) End of week data. 4) Monthly average data.

5) Rates on regular operations (one week). The injection rate was suspended on 21st of September 1992.

6) From April 1992 borrowing rate on certificates of deposit.

7) From 23rd of November 1992 to 5th of February 1993 the facility was suspended and replaced by special advances at an overnight rate. Up to the end of 1992, the overnight rate was changed six times: on 23rd of November to 30 %; on 26th of November to 100 %; on 2nd of December to 30 %; on 7th of December to 20 %; on 15th of December to 16 % and on 23rd of December to 14 %. In January 1993, the rate was changed six times: on the 6th to 50 %; on the 7th to 100 %; on the 12th to 30 %; on the 14th to 15 %; on the 25th to 14 %; on the 27th to 100 %. On 1st of February it was changed to 14 %.

jeopardising the medium-term goal of price stability. Long-term yields fell much less, and as a result the yield curve became positively sloping. Official rates were cut by a broadly similar amount in Italy from the exceptional levels reached prior to the initial realignment of the lira, but in contrast to the UK, market rates remained around the levels of early 1992.

2.2 Exchange rate developments

Underlying factors

The ERM had experienced a period of five years without a general realignment. Tensions had occurred from time to time but they had been successfully countered by the authorities. Exchange rate stability was maintained in spite of a number of factors which might have been expected to generate more severe strains within the mechanism in recent years. In particular:

- further convergence towards a low level of inflation proved difficult to achieve. Relatively high rates of price and wage growth, in combination with unchanged nominal exchange rates, resulted in significant losses in international competitiveness in some Community countries;
- cyclical divergences became more pronounced. Economic activity in most Community countries was very weak in 1991 and has shown little sign of recovery since then. In contrast, strong economic growth continued in Germany after unification and has slowed down sharply only in 1992;
- after German unification, a sharp rise in demand, fuelled by a major increase in the budget deficit, and strong wage growth, led to a build-up of inflationary pressure which was countered by a tightening of the monetary stance. The unbalanced policy mix pushed German interest rates up and thus reduced the scope for other ERM participants to lower their rates in response to domestic economic conditions;
- fiscal consolidation fell short of expectations in many Community countries. As a result, substantial differentiation in fiscal stances persisted, leading to an overburdening of monetary policy;
- wide fluctuations occurred in the exchange rates of the dollar and the yen. Volatility in international currency markets often tends to exert pressures on intra-Community exchange rates given the differences in the importance of extra-Community trade to the individual Member States and the differences in the depth and liquidity of national financial markets and in the importance of Community currencies in international portfolios.

Prior to June 1992, the impact of these factors on exchange rates had been outweighed by market confidence in the commitment of the authorities to the hard currency option. Markets expected that the process towards EMU would foster economic convergence in the Community through domestic adjustment measures and, thus, that imbalances would be eliminated without the need for a realignment in the ERM. However, a change in market sentiment occurred after the outcome of the Danish referendum. Rising uncertainty surrounding the French referendum on 20th September raised further doubts regarding the ratification of the Maastricht Treaty, the completion of EMU and thus of the effective implementation of convergence measures. Market attention concentrated more and more on existing imbalances and policy dilemmas which endangered the prospects for economic convergence.

Market operators focused initially on the currencies of countries where such imbalances and dilemmas were most acute, although pressures subsequently extended to other currencies. In an environment where financial market integration and deregulation provided scope for capital movements of an unprecedented size, the tensions developed into a major exchange market crisis, leading to three realignments in the late months of 1992 and the suspension of the pound sterling and the Italian lira from the ERM. A fourth realignment was agreed in early 1993.

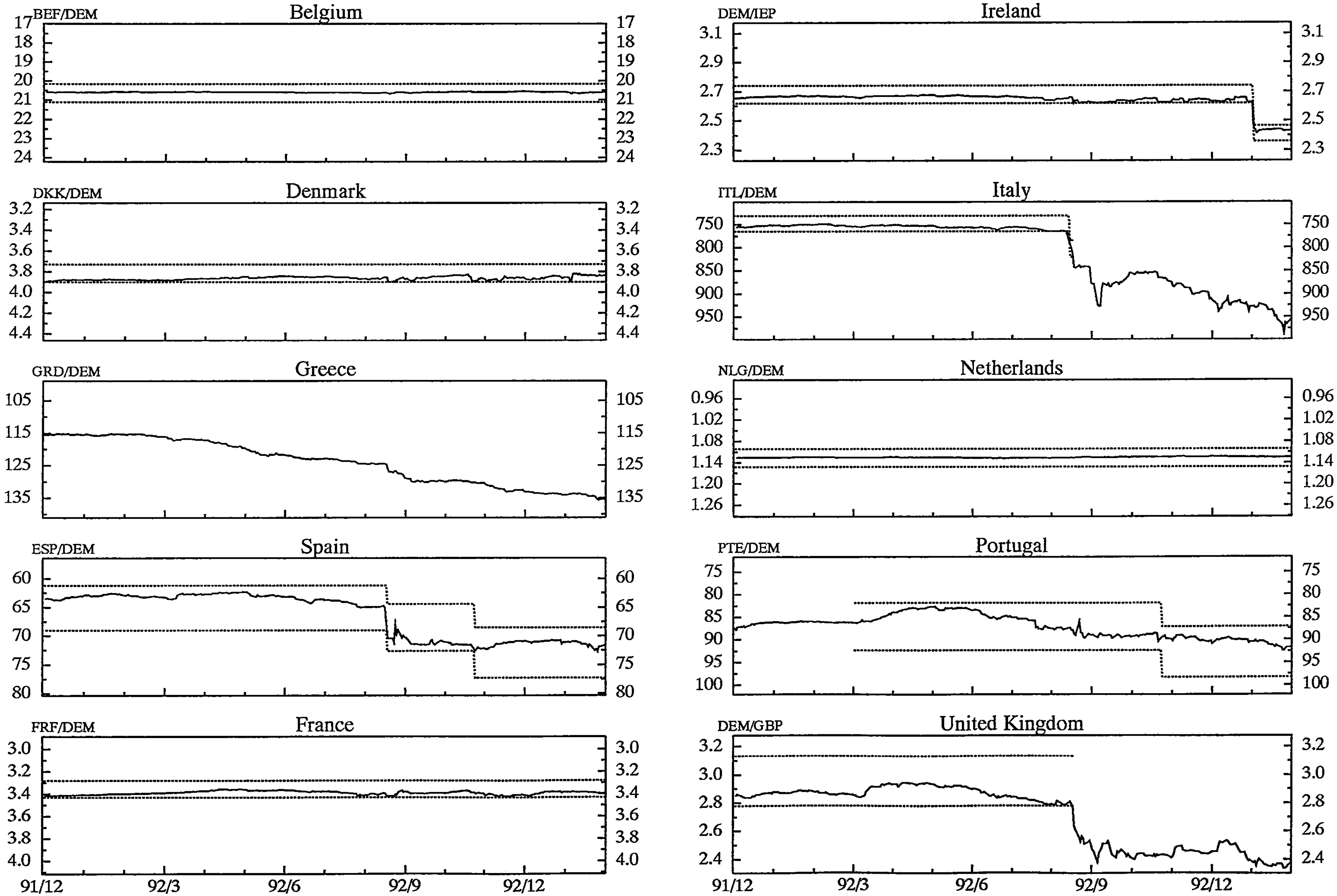
Exchange rate movements

In the early months of 1992, the situation remained relatively calm in the ERM. Participation in the mechanism was extended on 6th April when the Portuguese escudo joined the wide band. For most of the period, the British pound was in a relatively weak position against the Spanish peseta and, shortly after its entrance, also against the Portuguese escudo, but markets did not seriously test the lower limit. In the narrow band, the Deutsche Mark, the Belgian franc and the Dutch guilder moved from the upper part towards the centre and the French franc strengthened from near the bottom of the band (see Chart 7).

Conditions changed dramatically following the Danish referendum on 2nd June. The change in market sentiment led to a distinct shift in investors' preferences. In the months between the Danish and the French referenda, downward pressure focused, in particular, on the Italian lira, which fell to the floor of the narrow band despite heavy intramarginal intervention and increases in interest rates. In addition, the three currencies of the wide band depreciated markedly against the Deutsche Mark, the Belgian franc, and the Dutch guilder, although the Portuguese escudo and the Spanish peseta remained for most of the time close to the top of the band while the pound sterling was close to its lower limit. At the same time, pressures developed also on the Nordic currencies which were unilaterally pegged to the ECU.

The approaching French referendum and the possibility of a negative outcome suggested by a number of polls cast new doubts on the prospects of EMU. The fixed date of the referendum provided a catalyst to exchange rate pressures as market participants considered that a realignment was almost inevitable in the event of a "no" vote. Repeated official statements (on 28th August by the ECOFIN Council and on 5th September at the conclusion of the informal ECOFIN meeting in Bath) that a realignment would not be the appropriate response to the prevailing strains failed to have a lasting impact on market expectations. Tensions were heightened by the sharp drop in the US dollar in the summer months and the suspension of the ECU peg of the Finnish markka on 8th September.

CHART 7: EXCHANGE RATES VIS A VIS THE DEUTSCHE MARK[1)]



1) The dotted lines represent upper and lower limits of the ERM bands, when they were applicable. The scale of each chart is normalized to a fluctuation of 35 per cent.

Pressures continued to be most severe on the Italian lira, linked partly to delays in putting together the long-awaited structural fiscal adjustment measures. Despite a significant increase in Italian official rates and a rise in very short-term market rates above 30%, the Italian lira had to be supported repeatedly by heavy intervention at the margin against the Deutsche Mark, the Belgian franc and the Dutch guilder. The situation became unsustainable. A devaluation of 3.5% of the Italian lira and a revaluation of 3.5% of the other currencies was decided on 13th September. This step was accompanied by a small cut in official interest rates in Germany which was followed by Belgium and the Netherlands.

These exchange rate and interest rate measures were not sufficient to convince the markets that the new parity grid was sustainable. On 16th September, the pound sterling, the Spanish peseta and the Portuguese escudo came under intense pressure, and the Italian lira was again under severe strain. In the United Kingdom, interest rates were raised twice on this date but this proved ineffective in stemming the tide, as the new interest rate level was considered unsustainable by the market under prevailing domestic economic conditions, and the pound sterling had to be supported by large interventions at the fluctuation margin. At the end of the day, British membership of the ERM was suspended and the interest rate increases were reversed. On the same day, the Spanish peseta fell by some 4% but remained above the permitted floor. An emergency Monetary Committee meeting was held in the evening of 16th September, at which the Italian authorities announced that they would temporarily abstain from intervention in the foreign exchange market. Against a background of continuing tensions in the ERM, and in particular in view of the new situation created by the withdrawal of the British pound and the Italian lira, the Spanish authorities requested a 5% devaluation of the peseta which was agreed at the same meeting.

After the second realignment, in the run-up to the French referendum, tensions spread to other currencies, with strong fundamentals, namely the French franc, the Danish krone and the Irish pound. As a result, authorities intervened in foreign exchange markets and tightened monetary conditions, in some cases very sharply. As tensions continued, and even increased after the French referendum, the French and German authorities issued a joint statement that no change in the French franc/Deutsche Mark central rate was justified. Backing this statement, the Banque de France raised a key interest rate by 2.5 percentage points and brought about a sharp upward movement in short-term market interest rates, and the Deutsche Bundesbank and the Banque de France conducted concerted intra-marginal intervention operations. At the same time, since tensions in the peseta market had resurfaced, the Spanish authorities decided to introduce temporarily measures penalising the short-selling of pesetas financed through swaps. Portugal and Ireland strengthened the administration of their existing exchange controls.

Pressures eased somewhat in October and early November. A strong recovery of the French franc and the Danish krone, reflecting reflows which more than offset previous outflows, allowed a marked reduction in interest rates in both countries. There were, however, only limited reflows in the case of the other currencies under strain.

Major exchange rate tensions re-emerged following the decision of the Swedish authorities on 19th November to suspend the peg of the Swedish krona to the ECU. This led to further large increases in official interest rates in Denmark, while market rates rose in Ireland and France. On 22nd November, agreement was reached to devalue the central parities of both the Spanish peseta and the Portuguese escudo by 6%. Following this move, official interest rates were raised in Spain and Portugal to signal the commitment to the new central parities and the peseta and the escudo strengthened again, moving towards the top of the wide band. At the same time, Spain removed the measures penalising capital movements, and soon thereafter all capital controls were abolished in Portugal.

Tensions increased in the narrow band on 10th December following the decision by Norway to abandon the unilateral currency peg to the ECU but central parities were successfully defended in the remainder of the year.

In early January 1993, the French franc and the Irish pound came under further pressure. The renewed attack on the French franc was rather short-lived, with pressures easing after the release of a new joint statement from the French and German authorities, supported by an increase in the Banque de France repurchase agreement rate. Against this background, and following a sharp rise in official interest rates, the Irish pound also firmed.

In late January, however, a further cut in interest rates in the United Kingdom and a sharp drop in the pound sterling rekindled intense pressure on the Irish pound. Official interest rates in Ireland were raised once more to exceptional levels, but with consequences for market rates that were perceived as unsustainable in the light of domestic conditions, and a 10% devaluation of the Irish pound was agreed on 30th January.

A few days later, the Danish krone came under renewed attack. A combination of collective support through intramarginal intervention by several Community central banks, a rise in Danish interest rates and a cut in official interest rates in Germany helped to restore calm in the market. Capital subsequently reflowed into the Danish krone.

In the first weeks following their withdrawal from the ERM, both the Italian lira and the pound sterling depreciated sharply. After falling to record lows against the Deutsche Mark at the beginning of October, both currencies recovered ground although market conditions remained volatile subsequently. At the end of 1992, the lira had lost 12% and the pound 13% against the Deutsche Mark compared to market exchange rates on 16th September. In the first two months of 1993, both currencies came under further downward pressure.

The turbulence in the ERM also affected the Greek drachma. In September 1992, pressures on the drachma were considerable, leading the Bank of Greece to raise its official lending rate from 30% to 40%, to intervene heavily in the foreign exchange market, and to tighten capital controls, while the speed of depreciation of the Greek currency accelerated. As tensions eased, the official lending rate was reduced and the imposed capital controls were lifted.

The sharp movements in nominal exchange rates in the latter part of 1992 have substantially modified competitive positions within the Community (see Table 4). In those countries which recorded the largest losses of intra-ERM competitiveness in the period before

TABLE 4: INDICATORS OF CUMULATIVE COMPETITIVENESS CHANGES (a)

	per cent							
	Relative to other EC countries (b)		Relative to industrial countries		Relative to other EC countries (b)		Relative to industrial countries	
Country	Producer Prices	Unit Labour Costs (c)	Producer Prices	Unit Labour Costs (c)	Producer Prices	Unit Labour Costs (c)	Producer Prices	Unit Labour Costs (c)
	1987-August 1992				1987-December 1992 (e)			
Belgium	4.0	5.6	1.3	2.7	0.9	1.9	-0.3	0.3
Denmark	3.6	6.4	-0.5	3.8	-1.9	4.1	-4.9	1.9
Germany (western)	1.7	0.5	-3.8	-5.5	-4.3	-6.6	-5.5	-8.6
Greece	n.a.	n.a.	-10.2	-15.6	n.a.	n.a.	-10.8	-13.4
France	7.9	13.3	3.3	7.2	3.1	8.1	1.7	5.1
Ireland	6.4	35.7	1.3	27.9	-0.6	26.6	-1.9	23.6
Italy	-3.0	-7.0	-6.3	-9.8	11.1	5.7	8.2	4.6
Netherlands	1.5	5.2	-1.4	1.9	-2.6	2.1	-3.9	0.1
	Since ERM entry (d) - August 1992				Since ERM entry (d) - December 1992 (e)			
Spain	-2.1	-7.5	-8.1	-13.8	4.2	-2.2	0.5	-6.2
Portugal	n.a.	-4.6	n.a.	-6.9	n.a.	-9.5	n.a.	-9.5
United Kingdom	-1.7	-0.4	-4.0	-1.7	8.3	13.2	8.7	13.2

Source: BIS, except for the Spanish and Italian data, which were provided by the respective central banks.
(a) Negative numbers indicate losses. (b) Excluding Greece. (c) Manufacturing sector. (d) Spain: June 1989; Portugal: April 1992; United Kingdom: October 1990. (e) Estimates.

the crisis, recent depreciations have more than fully offset the losses in Italy since the last realignment in 1987; have led to a significant improvement in the competitive position of the United Kingdom relative to the entry point of the pound sterling in October 1990; while in Spain competitiveness has approached the levels prevailing when the peseta entered the ERM in June 1989. In most other ERM countries, the exchange rate appreciation by the end of the year returned competitiveness closer to 1987 levels, although France continued to show gains, and Germany losses, in intra-Community competitiveness relative to this date.

Policy responses to the ERM crisis

The 1987 Basle-Nyborg Agreement calls on the monetary authorities to exploit the scope for a more active, flexible and concerted use of three instruments to counter tensions in the ERM: interest rate changes; exchange rate movement within the band; and official intervention in foreign exchange markets. However, when exchange rates are out of line with fundamentals and the implementation of corrective domestic policies is not possible, realignments become necessary.

Interest rates were used to counter recent tensions, although the size of the changes and the speed of response differed from country to country and from occasion to occasion. In some countries, the scope for interest rate increases in response to exchange rate pressure was limited, because higher interest rates were seen either to aggravate the severity of the recession - as in the United Kingdom where the bulk of lending is at short-term rates - and/or to add to the difficulties of achieving fiscal consolidation where large stocks of short-term government debt existed - as in Italy. In Ireland, interest rates were increased sharply and repeatedly to levels which ultimately became unsustainable. The defence of the existing central parities through interest rate increases did not in the end prove feasible in these three cases. In countries facing upward pressure on their currencies, domestic price developments, in particular in Germany, restricted the scope for adjusting interest rate policy. Official interest rates in these countries were cut slightly in mid-September, and short-term market rates rapidly declined by about 1%, without, however, bringing about a significant reduction in foreign exchange tensions.

During the crisis, in some instances *exchange rate movement within the band* resulted in stabilising speculation which helped to dampen pressures. In other situations, however, exchange rate tensions were exacerbated when currencies hit the lower limit. When there was a concern that a movement to the lower margin could be interpreted by market participants as weakening the credibility of the central parity, interventions were made within the margins.

Intervention - both within and at the margins - was undertaken in unprecedented amounts, reflecting the massive capital movements which occurred in an environment of almost fully liberalised capital transactions and a high degree of financial integration within the Community. The effectiveness of intervention depended on the degree of support from other instruments, in particular interest rate changes. At times, simultaneous intra-marginal intervention by several central banks proved helpful. The scale of intervention had important monetary consequences, exerting a contractionary impact on the money supply where currencies were subject to downward pressure, and an expansionary effect where the opposite occurred.

The virulence of the tension in the ERM during the autumn of 1992 led some countries to take temporary measures of varying types to discourage capital outflows to protect their currencies from speculation especially when this took the form of "short sales". In all cases the measures were phased out by the end of the year.

When the efforts of the authorities to stabilise exchange markets proved unsuccessful, a realignment became unavoidable. The unprecedented occurrence of four realignments in five months emphasised the difficulty facing the authorities in restoring calm in the markets. This may be related to perceptions in the market that policy measures to counter tensions were being taken on a piecemeal basis, with insufficient attention devoted to the restoration of the credibility of the parity grid as a whole.

3. ECONOMIC PROSPECTS AND MONETARY POLICY ISSUES

When, at the end of 1992, the Committee of Governors conducted the ex-ante co-ordination exercise to assess the appropriate thrust of monetary policies in the Member States and to examine national monetary policy intentions for 1993, forecasts of economic developments in the Community were surrounded by a large margin of uncertainty. In addition, tensions in the exchange markets had not yet abated.

3.1 Economic prospects

According to the latest forecasts by international institutions, *economic activity* in 1993 within the Community is likely to receive only a modest stimulus from external demand. An upswing in world trade is expected, though the pace of the recovery is likely to remain quite slow. In the United States, there are clear signs that a more sustained upturn will unfold in 1993, while in Japan the recent expansionary fiscal and monetary measures should help a recovery to get underway in the course of the year. A moderate upswing may also take place in EFTA countries, although this is closely dependent on developments within the Community in the light of the strong trade links between the two blocs. Against this background of slow growth in activity, world trade prices are likely to remain relatively soft in national currency terms.

The modest boost from world demand is expected to be counterbalanced by weak domestic spending given the low level of business and consumer confidence in the Community at the end of 1992. As a result, economic growth within the Community in 1993 may dip below 1%.

The overall fiscal deficit is likely to remain large in 1993. Reductions in budget deficits are expected in some Community countries which had relatively high levels of public debt or deficits in 1992 - in particular, in Belgium, Greece, Spain, Italy and Portugal - although the prolongation of the cyclical downswing may make progress towards fiscal consolidation more difficult. In contrast, both the operation of automatic stabilisers and the implementation of some discretionary measures may lead to higher budget deficits in other countries, most notably in the United Kingdom and France. In Germany, the fiscal deficit is likely to increase relative to GDP, although some consolidation measures were announced in January 1993.

In the ex-ante exercise, some easing of *cost pressures* during 1993 was judged likely in the Community as a whole. As output is expected to remain below potential and labour market conditions to remain slack, wage moderation should reduce labour cost pressure. External price influences may also be relatively favourable on average, although the rebound in the dollar in late 1992 will limit the benefit if it is sustained. Moreover, a rise in import prices will occur in the countries where currencies have depreciated and increases in indirect taxation or in public sector administered prices may add to inflationary pressure in some countries, for instance in Germany, where indirect taxes were increased in early 1993.

3.2 Monetary policy issues

Monetary policy orientations for 1993

When the ex-ante co-ordination exercise was conducted by the Committee of Governors in December 1992, the assessment of national monetary policy intentions for 1993 was made more difficult by major uncertainties in the economic outlook and by remaining instability in the ERM. However, precisely when uncertainties prevail it is of the utmost importance that monetary policy provides an anchor of nominal stability, which constitutes a prerequisite for a sustainable recovery of economic activity. For this reason, the Committee emphasised the need for maintaining a medium-term oriented monetary policy which ensures a further decline in inflation in the Community.

Among the ERM countries setting monetary targets, the continuity of the anti-inflationary monetary stance in Germany is reflected in a target for M3 growth in 1993 of 4.5% to 6.5% (see Table 3 on page 18). The small increase compared to last year's target of 3.5% to 5.5% takes account of various factors: a somewhat higher estimated potential economic growth in eastern Germany; a larger decline envisaged in the trend in the velocity of circulation of money; and price rises due to administrative measures, primarily in eastern Germany. In France, monetary policy in 1993 will continue to focus on maintaining the current central parity of the franc within the ERM and on the control of inflation. For these reasons, the target for M3 growth was set at 4% to 6.5% for 1993, similar to the 4% to 6% objective in 1992. The upper limit of the range was increased slightly to take account of the outlook for a non-inflationary upturn in the French economy. In Spain, the target range for "ALP" growth in 1993 (liquid assets held by the public) has been fixed at 4.5% to 7.5%. The decrease from the range of 8% to 11% set in 1992, partly reflects the moderate prospects for economic growth and the need to achieve a further reduction in inflation, as well as a rate of growth of the velocity of circulation of ALP which is expected to be closer to its historic trend.

In the other ERM countries, monetary policy is predominantly aimed at achieving price stability by targeting the exchange rate vis-à-vis the Deutsche Mark. In Denmark, the central bank has a supplementary target for the growth of the domestic source of the money supply. However, in present circumstances of stagnating economic activity and unprecedented currency unrest, adherence to the supplementary target has been of minor importance. With effect from 1993, a monetary target is no longer set in the Netherlands, and in Portugal the authorities have discontinued posting targets for "L-" (total liquidity held by non-financial residents) and M3. Traditionally, quantitative monetary targets have not been set in Belgium, Luxembourg and Ireland.

In the countries which have temporarily suspended the participation of their currencies in the ERM, the target range of the growth of M2 in Italy was set at 5% to 7% for 1993, as was the case in 1992. Monetary policy is aimed at providing economic agents with a stable framework and at preventing the recent depreciation of the lira from contributing to inflation. In the United Kingdom, the authorities have adopted a new monetary policy framework since the suspension of sterling's membership of the ERM, with an explicit inflation objective of 1% to 4% for underlying inflation, falling to 2% or less in the medium-term. A wide range of indicators will be used to assess potential inflationary pressure, including narrow and broad monetary aggregates, asset prices and the exchange rate.

Finally, in Greece, the monetary policy stance will remain restrictive. The non-accommodating exchange rate policy will continue. Moreover, real interest rates will remain high in 1993, with nominal interest rates not being reduced at a faster pace than the deceleration of inflation. An M3 growth target of 9-12% has been set to guide policy.

Challenges facing monetary policy

Given the numerous uncertainties remaining in the international and domestic economic environment, the national authorities of Member States face considerable challenges in the conduct of their monetary policies. In particular, exchange rate stability has to be restored in a situation in which there is the risk of a prolongation of the economic slowdown throughout the Community. In addition, in countries where currencies have recently been devalued or where participation in the ERM has been suspended, monetary policy must remain vigilant to avoid the dangers of a pick-up in inflationary pressures which would not only erode the hard-won anti-inflationary gains of past years but also risk unsettling the more balanced pattern of international competitiveness among Member States resulting from recent exchange rate adjustments.

As already stressed in last year's Annual Report, the achievement of macro-economic policy objectives hinges critically not only on an appropriate national monetary policy but also on adequate support from fiscal policy and wage developments. For these reasons, the process of fiscal consolidation must continue in those countries with excessive budget deficits and/or public debt levels. In other countries, weaker economic activity should not lead to increases in the deficit beyond those accounted for by automatic fiscal stabilisers. In addition, while in some Community countries nominal wage growth has moderated in 1992, a substantial further reduction is still necessary where labour costs rise at a rapid pace. Given the crucial role played by labour markets in the economy, all Community countries should implement without delay the necessary structural measures to improve market flexibility. Finally, in those countries where the presence of non-competitive practices in certain markets for goods and services hampers the achievement of faster disinflation, the appropriate supply-side policies should be promptly introduced.

To conclude, it is of the utmost importance to improve the balance between fiscal and monetary policies and to strengthen supply-side policies in Community countries. As the disappointing economic and financial developments in 1992 have highlighted, decisive progress in these fields is required not only to lay the foundations for sustained economic growth, but also to restore credibility in the ERM and to achieve the degree of convergence and market flexibility which are necessary for the successful completion of the EMU process.

4. DEVELOPMENTS IN THE PRIVATE ECU MARKET

The private ECU has remained essentially a financial instrument. Its use in the banking sector and in securities markets continued to grow in 1992, albeit at a slower pace than in previous years (see Table 5). At the same time, the private ECU was very actively traded in foreign exchange and futures markets. However, these developments were not accompanied by any significant expansion in its use for non-financial transactions which remained very limited.

The period under review was characterised by two distinct phases. In the first half of 1992, the private ECU market continued to grow steadily after the agreement of the Maastricht Treaty in December 1991. After mid-year, however, there was a marked slowdown in the wake of the difficulties faced in the ratification of the Treaty and the subsequent tensions in the ERM. Greater interest and exchange rate volatility in the Community increased significantly the risks attached to ECU-denominated investments. Market participants either shifted into traditionally strong currencies or tried to hedge their ECU exposure, as reflected in the sharp increase in the turnover in the ECU futures market in London and Paris.

This pattern of market developments was reflected in both the banking and the bond sectors of the market. In contrast to 1991, the overall level of lending in private ECUs expanded only moderately. While interbank claims increased somewhat, bank lending to non-banks remained broadly unchanged over the first nine months of 1992. Banks' liabilities in ECUs vis-à-vis banks and non-banks increased significantly until end-June but contracted slightly in the third quarter of the last year. The decline in ECU liabilities of the banking sector is mainly attributable to the reduction of deposits held by central banks. This was partly the result of exchange market intervention in private ECUs - central banks' reserves in private ECUs fell from ECU 30.6 billion at end-June 1992 to ECU 21 billion at end-September 1992 - but also reflected the impact of diminishing bond issuing activity of public authorities and the concurrent decline in the flow of new deposits by central banks.

The turnaround in market developments after mid-1992 was particularly pronounced in the securities segment of the ECU financial markets. As demand for ECU securities dried up in the second half of 1992, a premium emerged in the market long-term ECU bond yield relative to the theoretical ECU yield. This development made new ECU issues relatively expensive and thus reduced the attractiveness of borrowing programmes, which accordingly were curtailed. As a consequence, the private ECU fell from the third to the sixth place in the rank of currencies which are used for international bond issuance. The cutback in ECU bond issues was substantial. However, owing to low levels of redemption, the amount of outstanding ECU-denominated bonds increased slightly over the period under review. In contrast, the stock of short-term instruments denominated in private ECU decreased as a result of a contraction in the Euro-note and Euro-commercial paper sector.

TABLE 5: ECU FINANCIAL MARKETS

Item	ECU billion outstanding (end of period)					
	Dec.90	Dec.91	Mar.92	Jun.92	Sep.92	Dec.92
International Bonds	54.9	75.1	82.8	86.7	86.6	83.6
Domestic Bonds	35.1	40.2	42.7	43.1	44.0	43.3
Treasury Bills	8.4	6.9	7.1	6.9	6.9	7.9
Euro-commercial paper and notes	6.1	9.2	11.6	10.7	8.6	7.6
Bank Assets (a)	148.4	188.3	190.7	192.6	198.4	n.a.
- vis-à-vis non-banks (b)	34.1	59.2	56.0	58.1	59.2	n.a.
- vis-à-vis banks (c)	114.3	129.1	134.7	134.5	139.2	n.a.
Bank Liabilities (a)	147.2	187.4	200.1	204.2	199.4	n.a.
- vis-à-vis non-banks (b)	22.3	28.5	33.1	35.5	35.0	n.a.
- vis-à-vis banks (c)	124.9	158.9	166.9	168.7	164.3	n.a.
Memorandum Item: Central Banks' holdings of private ECUs	27.1	28.8	32.2	30.6	21.0	19.2

Source: BIS.

(a) Due to the extension of the reporting area there is a break in series in 1991, and figures for 1990 and 1991 are not comparable. **(b)** Identified non-banks only. **(c)** Residual (including central banks).

Despite these difficult conditions, the ECU market showed resilience. In particular, it demonstrated its ability to adapt to the sharp fluctuations of its component currencies, as witnessed by the relatively rapid return to a small spread between the market value and the theoretical value of both the ECU exchange rate and interest rates. In early 1993, there was a resumption of issuance in the ECU bond market.

The foreign exchange market survey, carried out in April 1992 in the major financial centres, showed an increase in the use of the private ECU. As compared to April 1989, when the previous survey took place, the private ECU was involved in one side of 3% of all transactions against 0.9% three years earlier. Within the Community, transactions involving the private ECU accounted for between 5% and 10% of total turnover in most Member States.

REFERENCE TABLES

TABLE R1: REAL GDP

Country	percentage change over the previous year 1987-89 average	1990	1991	1992 (a)
Belgium	3.6	3.4	1.9	0.8
Denmark	0.7	2.0	1.2	1.0
Germany (western) (b)	2.8	5.1	3.7	1.5
Greece	2.4	-0.1	1.8	1.5
Spain	5.2	3.7	2.3	1.0
France	3.9	2.3	0.9	1.8
Ireland	5.5	8.3	2.5	2.4
Italy	3.4	2.2	1.4	1.0
Luxembourg	6.1	4.6	2.7	2.5
Netherlands	2.5	3.9	2.3	1.4
Portugal	4.9	4.2	2.4	1.8
United Kingdom	3.7	0.6	-2.5	-0.6
EEC: (c)				
Average	3.5	2.8	1.2	1.1
Dispersion (d)	0.8	1.6	2.0	0.8
ERM Original Narrow Band: (c)				
Average	3.2	3.8	2.3	1.6
Dispersion (d)	0.8	1.4	1.3	0.3
United States	3.6	0.7	-1.3	2.0
Japan	4.9	5.2	4.4	1.5

Sources: National data; EC Commission.
(a) Estimates. **(b)** For 1992, corresponding figures are: 6.1% for eastern Germany and 1.9% for the whole of Germany. **(c)** 1989 GDP weights based on 1989 PPP exchange rates. **(d)** Weighted standard deviation.

TABLE R2: UNEMPLOYMENT RATES (a)

Country	percentage of civilian labour force 1987-89 average	1990	1991	1992 (b)
Belgium	10.0	7.6	7.5	8.2
Denmark	6.6	8.1	8.9	9.5
Germany (western) (c)	6.1	4.8	4.2	4.5
Greece	7.5	7.0	7.7	7.7
Spain	19.1	16.3	16.3	18.4
France	9.9	9.0	9.5	10.0
Ireland	17.0	14.5	16.2	17.8
Italy	10.9	10.0	10.0	10.1
Luxembourg	2.1	1.7	1.6	1.9
Netherlands	9.2	7.5	7.0	6.7
Portugal	5.9	4.6	4.1	4.8
United Kingdom	8.7	7.0	9.1	10.8
EEC:				
Average	9.7	8.3	8.7	9.5
Dispersion (d)	2.7	2.6	3.3	3.7
ERM Original Narrow Band:				
Average	8.1	7.2	7.1	7.4
Dispersion (d)	2.2	2.2	2.8	2.9
United States (e)	5.7	5.5	6.7	7.3
Japan (e)	2.5	2.1	2.1	2.1

Source: Eurostat.
(a) Standardised definition. **(b)** Estimates. **(c)** For 1992, unemployment rates (national definition) are: 14.3% for eastern Germany and 7.7% for the whole of Germany. **(d)** Weighted standard deviation. **(e)** Percentage of total labour force.

TABLE R3: CONSUMER PRICES

Country	percentage change over the previous year 1987-89 average	1990	1991	1992 (a)	12 months to: Dec.91	Dec.92 (a)
Belgium	2.0	3.5	3.2	2.4	2.8	2.4
Denmark	4.4	2.6	2.4	2.1	2.3	1.5
Germany (western) (b)	1.4	2.7	3.5	4.0	4.2	3.7
Greece	14.5	20.4	19.5	15.8	18.0	14.4
Spain	5.6	6.7	5.9	5.9	5.5	5.3
France	3.2	3.4	3.1	2.8	3.1	2.0
Ireland	3.1	3.2	3.2	3.0	3.6	2.3
Italy	5.4	6.5	6.4	5.3	6.1	4.8
Luxembourg	1.6	3.7	3.1	3.2	2.6	2.9
Netherlands	0.4	2.5	3.9	3.7	4.9	2.6
Portugal	10.5	13.4	11.4	8.9	9.6	8.4
United Kingdom	5.6	9.5	5.9	3.7	4.5	2.6
EEC: (c)						
Average	4.1	5.7	5.1	4.3	4.8	3.7
Dispersion (d)	2.5	3.4	2.6	2.0	2.2	2.0
ERM Original Narrow Band: (c)						
Average	2.1	3.0	3.3	3.3	3.7	2.8
Dispersion (d)	1.0	0.4	0.3	0.6	0.7	0.8
United States	4.2	5.4	4.3	3.0	3.1	2.9
Japan	1.0	3.1	3.3	1.7	2.7	1.2

Sources: National data; BIS.
(a) Partly estimated. **(b)** In 1992, consumer prices rose by 11.1% in eastern Germany. In the twelve months to December 1992, the rate of consumer price inflation was 2.8% in eastern Germany. For the whole of Germany, figures are not constructed. **(c)** 1989 consumer spending weights based on 1989 PPP exchange rates.
(d) Weighted standard deviation.

TABLE R4: COMPENSATION PER EMPLOYEE (a)

	percentage change over the previous year			
Country	1987-89 average	1990	1991	1992 (b)
Belgium	3.1	5.8	6.8	5.7
Denmark	5.6	3.6	3.8	2.7
Germany (western) (c)	3.0	4.8	6.0	5.4
Greece	16.1	18.4	15.0	12.6
Spain	6.8	8.7	8.0	9.0
France	4.5	5.2	4.3	4.1
Ireland	5.1	4.7	5.7	6.2
Italy	8.6	10.5	8.8	4.7
Luxembourg	4.9	7.0	4.4	5.1
Netherlands	1.7	3.3	5.2	5.1
Portugal	12.9	17.3	17.7	14.0
United Kingdom	8.6	9.8	8.2	6.1
EEC: (d)				
Average	6.1	7.6	7.1	5.7
Dispersion (e)	2.9	3.2	2.4	2.0
ERM Original Narrow Band: (d)				
Average	3.6	4.8	5.3	4.8
Dispersion (e)	1.0	0.6	0.9	0.8
United States	4.2	4.9	5.1	2.4
Japan	3.7	5.3	4.4	3.2

Sources: National data; EC Commission.
(a) Whole economy; in nominal terms. (b) Estimates. (c) For 1992, corresponding figures are: 35.4% for eastern Germany and 9.7% for the whole of Germany. (d) 1989 GDP weights based on 1989 PPP exchange rates. (e) Weighted standard deviation.

TABLE R5: GENERAL GOVERNMENT FINANCIAL BALANCES (a)

	per cent of nominal GDP			
Country	1987-89 average	1990	1991	1992 (b)
Belgium	-7.0	-5.8	-6.7	-6.9
Denmark	0.8	-1.5	-2.2	-2.4
Germany (c)	-1.9	-3.1	-3.9	-3.8
Greece	-14.9	-17.4	-15.4	-9.1
Spain	-3.1	-3.9	-4.9	-4.4
France	-1.6	-1.4	-1.9	-3.0
Ireland	-4.4	-2.5	-2.4	-2.6
Italy	-10.5	-10.9	-10.2	-10.0
Luxembourg	2.2	3.3	-1.5	-2.5
Netherlands	-6.0	-4.4	-3.5	-3.8
Portugal (d)	-8.1	-6.1	-5.7	-5.0
United Kingdom	0.2	-1.3	-2.7	-6.1
EEC:				
Average	-3.6	-4.2	-4.7	-5.3
Dispersion (e)	3.9	3.9	3.1	2.5
ERM Original Narrow Band:				
Average	-2.3	-2.7	-3.2	-3.6
Dispersion (e)	1.8	1.3	1.3	0.9
United States	-2.0	-2.5	-3.4	-4.8
Japan	1.5	3.0	2.4	2.2

Sources: National data; EC Commission.
(a) Figures may not be consistent with the principles on definitions underlying the Excessive Deficit Procedure in the Maastricht Treaty which are still under discussion with a view to being harmonised. (b) Estimates. (c) Up to 1989 western Germany only.
(d) Borrowing requirement. (e) Weighted standard deviation.

TABLE R6: CURRENT ACCOUNT BALANCES

	per cent of nominal GDP			
Country	1987-89 average	1990	1991	1992 (a)
Belgium-Luxembourg	2.2	1.9	2.5	2.3
Denmark	-1.7	1.0	1.7	3.3
Germany (b)	4.4	3.0	-1.2	-1.3
Greece	-3.1	-5.3	-2.1	-2.7
Spain	-1.2	-3.4	-3.2	-3.4
France	-0.5	-0.8	-0.5	0.2
Ireland	-0.5	0.1	3.4	5.7
Italy	-0.7	-1.3	-1.8	-2.0
Netherlands	2.5	3.8	3.0	2.6
Portugal	-0.3	-0.3	-1.0	-0.2
United Kingdom	-2.9	-3.1	-1.1	-2.1
EEC:				
Average	0.4	-0.3	-0.9	-1.0
Dispersion (c)	2.6	2.5	1.4	1.7
ERM Original Narrow Band:				
Average	2.0	1.5	-0.2	0.1
Dispersion (c)	2.3	1.8	1.4	1.6
United States	-2.7	-1.4	0.2	-1.0
Japan	2.8	1.3	2.5	3.2

Sources: National data; EC Commission.
(a) Estimates. (b) Up to 1989 western Germany only. (c) Weighted standard deviation.

TABLE R7: BROAD MONETARY AGGREGATES (a)

	4th quarter/4th quarter percentage change			
Country	1987-89 average	1990	1991	1992 (b)
Belgium	10.2	5.7	9.8	(c) 9.2
Denmark	3.1	8.1	5.6	1.3
Germany (d)	5.9	5.6	5.2	9.4
Greece	23.9	15.7	10.6	16.9
Spain	15.2	10.8	11.4	4.9
France	8.9	8.2	3.9	5.9
Ireland	6.8	16.7	5.2	8.3
Italy	8.1	9.6	8.3	5.9
Luxembourg	21.3	25.1	2.1	9.0
Netherlands	8.9	6.7	5.7	6.3
Portugal	16.1	15.6	14.7	13.4
United Kingdom	17.1	12.1	6.2	3.7
EEC: (e)				
Average	10.6	9.3	6.9	6.5
Dispersion (f)	4.6	3.4	2.8	2.5
ERM Original Narrow Band: (e)				
Average	7.7	6.7	5.1	7.3
Dispersion (f)	2.0	2.3	1.0	1.8
United States	4.8	4.0	3.0	1.9
Japan	10.6	9.2	3.1	-0.2

Sources: National data; BIS.
(a) The following aggregates have been selected: Belgium: M4H; Denmark: M (=M3H); Germany: M3; Greece: M3; Spain: ALP; France: M3; Ireland: M3E (= M3H); Italy: M2 (=M3H); Luxembourg: M3H; Netherlands: M3H; Portugal: L-; United Kingdom: M4; United States: M2, Japan: M2+CD. EEC and ERM figures have been calculated for M3H (harmonised aggregate). (b) Partly estimated. (c) 3rd quarter/3rd quarter percentage change. (d) Up to 1989 western Germany only. (e) 1989 GDP weights based on 1989 PPP exchange rates. (f) Weighted standard deviation.

II. MONETARY POLICY INSTRUMENTS AND PROCEDURES IN COMMUNITY COUNTRIES

There is unanimous agreement among Community central banks that monetary policies should pursue the final goal of achieving and maintaining price stability. There are, nevertheless, differences in the way national monetary policies are implemented. In some countries, an intermediate objective is set for money supply growth or its domestic source, while in other countries monetary policy is predominantly determined through the pursuit of an exchange rate target. In the United Kingdom, the authorities have adopted an explicit inflation objective since the suspension of sterling's membership of the ERM. In spite of these differences, however, money market interest rates are an important, or even the key, *operational target* in the daily conduct of monetary policy in all Community countries. Moreover, increasing resort to market oriented techniques has in recent years promoted convergence in the monetary instruments and procedures which Community central banks use to influence short-term market rates (see Annex I for a description of major changes since the start of Stage One).

Table 6 presents a summary of the principal monetary instruments and procedures in Community countries. It shows that, at present, open market operations are the main monetary instrument in most Member States. However, differences across countries persist, in particular regarding the use of reserve requirements, the significance of standing facilities offered by the central banks (such as the discount window, other forms of direct lending, and deposit facilities) and the frequency of central bank operations in the market. Also, Community central banks may use different strategies to signal their policy intentions.

1. PRINCIPAL INSTRUMENTS

Central banks influence money market interest rates by setting the terms on which they accommodate the demand of commercial banks for central bank reserves, which are needed either to fulfil clearing obligations or to meet statutory reserve requirements. There may be situations, however, in which central bank reserves are in excess of banks' demand. In such cases, central banks influence short-term market rates by setting the terms on which they offer deposit facilities, issue short-term debt or sell assets.

In many countries, *reserve requirements* help to induce or enlarge the demand for central bank reserves. Moreover, when reserve requirements have to be fulfilled only on average over a period, as is normally the case in Community countries, this allows the banking system to cope with temporary liquidity shortages or surpluses in the market without central bank intervention and thus may reduce the variability of very short-term interest rates. Reserve requirements, however, impose an implicit tax on bank intermediation when they are not remunerated at market rates and thus may encourage financial disintermediation or

TABLE 6: MONETARY POLICY INSTRUMENTS AND PROCEDURES

Item	BELGIUM	DENMARK	GERMANY	GREECE	SPAIN	FRANCE	IRELAND	ITALY	NETHERLANDS	PORTUGAL	UK
PERMANENT RESERVE REQUIREMENTS FOR MONETARY POLICY PURPOSES	NO	NO	YES	YES	YES	YES	YES	YES	NO	YES	NO
- Size (% of GDP) (a)	-	-	2.7	3.9	2.0	0.1	1.8	8.0	-	16.1	-
- Remuneration	-	-	No	Partly	No	No	Below market rates	Partly	-	Partly	-
STANDING FACILITIES (b)											
- Lending facilities at below or close to market rates (rate)	□ (below market)	-	☒ (below market)	-	-	-	-	☒ (close to market)	■ (below market)	-	-
- Deposit facilities	□	□	-	-	-	-	☒	-	-	-	-
- Marginal refinancing	□	-	□	☒	□	□	☒	☒	□	□	☒
OPEN MARKET OPERATIONS											
1. Types (b)											
- Outright transactions (c)	□	■	□	☒	-	☒	-	☒	□	■	■
- Reversed transactions in domestic securities	■	■	■	□	■	■	■	■	■	☒	☒
- Foreign currency swap transactions	☒	□	□	□	□	-	■	☒	□	□	-
2. Frequency of operations (d)	■	☒	□	☒	☒	☒	■	☒	□	☒	■
3. Auction procedures (b)											
- volume tender	■	■	□	-	□	-	-	-	■	☒	-
- interest rate tender	□	-	■	□	■	■	■	■	-	☒	■

- Not applicable or not used
(a) Amount outstanding at the end of 1992.
(b) Importance in providing (or withdrawing) liquidity to (or from) the market: □ Low ☒ Intermediate ■ High
(c) These include issues of certificates of deposit by the central bank in the cases of Denmark and Portugal, and unsecured overnight loans in the case of Greece.
(d) □ About once a week ☒ Several times a week ■ More than once a day

delocalisation. To prevent this, some Member States prefer either to remunerate at market rates, or not to impose reserve requirements for monetary policy purposes, and to use other arrangements to induce a liquidity shortage in the market, when necessary.

Standing facilities are offered by central banks at pre-announced rates and may be used at the initiative of individual commercial banks. These facilities continue in many cases to play an important role in regulating money market conditions and signalling the intentions of the monetary authorities. Lending facilities at below market interest rates provide a significant proportion of the supply of central bank money only in the Netherlands - through ordinary advances on current account - and in Germany - through the rediscounting of trade bills. In a majority of Community countries, such facilities do not exist or are not extensively used. Deposit facilities are offered in a few countries to mop up liquidity surpluses and sometimes set a lower limit to very short-term market rates. Finally, most central banks offer an overdraft facility to finance end-of-day clearing imbalances. The facility is typically granted at a penalty rate and often provides an upper limit to very short-term market rates.

Over the last decade, a common feature of monetary policy management in the Community has been the increasing recourse to *open market operations* instead of standing facilities. Today, most Community central banks favour open market operations, as these are conducted at their own discretion and make use of market mechanisms in distributing liquidity and giving policy signals.

Outright open market transactions are carried out in most Community countries but are a major policy instrument only in the United Kingdom, Denmark and Portugal. Over half of the Bank of England's operations in the money market are outright purchases of bills with various maturities. Since April 1992, the Danmarks Nationalbank has issued certificates of deposit on a regular basis, with the interest rate on the certificates steering market rates. The certificates may be repurchased by the central bank when there is a need to supply liquidity. In Portugal, liquidity surpluses in the market are usually drained by the issue of central bank securities. Since the substantial reduction in reserve requirements in the spring of 1993, the Deutsche Bundesbank has issued liquidity paper in the form of Treasury discount paper. This paper may be sold to non-banks as well as banks.

Reversed transactions in domestic securities have become the main instrument for regulating money market conditions in most Member States. Purchase and resale transactions ("repos"), which comprise the purchase of securities under a contract providing for their resale at a specified price on a given future date, are used to supply reserves, while the mirror image, sale and repurchase agreements ("reverse repos") are used to absorb liquidity. The attractiveness of such operations stems from the fact that they can be implemented quickly and have no significant effect on the prices of the assets used in the operations. Also, the central bank retains the initiative in setting the amount, timing and duration of the contract, and in deciding whether to renew it or to let it unwind upon maturity.

Foreign exchange swap transactions (a combination of a spot and forward transaction) may be used as an instrument of domestic money market policy, without a direct impact on exchange rates. They can be very flexible in terms of maturity and volume. In Ireland, where they can be settled on the same day, these transactions are a major monetary instrument. The instrument is used at times in other Community countries, in particular when the central bank wishes to sterilise the impact of large foreign reserve flows on domestic liquidity conditions.

2. PRINCIPAL PROCEDURES

Monetary policy procedures vary across Community countries, in particular according to the frequency of central bank operations, the setting of the volumes of the transactions and of the interest rates, and the selection of counterparties to the operations.

The *frequency* of open market operations is often linked to their maturity. It may also reflect the financial environment, in particular the importance of reserve requirements. In the United Kingdom, for instance, in the absence of reserve requirements, the central bank may intervene in the money market several times a day. By contrast, in Germany, where reserve requirements play an important role in stabilising the demand for central bank reserves, the central bank typically intervenes only once a week. In France, the frequency of central bank intervention in the market has recently tended to increase, partly as a result of cuts in reserve requirements. The frequency of operations may also in some cases reflect the degree of control which the central bank wishes to exercise over short-term market interest rates.

In the case of standing facilities, interest rates are pre-announced by central banks and volumes are determined by banks' demand, although generally subject to some limits. In the case of open market operations, various auction procedures enable central banks to set *interest rates and/or volumes* more flexibly. "Volume tenders", with banks bidding only for volumes supplied by the central bank at a pre-set interest rate, help to make monetary policy intentions explicit and to stabilise market expectations. "Interest rate tender" techniques, in which banks submit bids covering both the volume and the rate, give a greater weight to market forces in interest rate determination. Most Community central banks tend to use one approach, although some may exploit the advantages of the different types of auction depending on the circumstances.

Experience varies across Community countries regarding the extent to which central bank operations are conducted with all money market participants or only with a few intermediaries. In the United Kingdom and Belgium, the desire for operational efficiency has led the central bank to conduct most market operations with a few specialised *counterparties*. Most other Community central banks in principle operate with all market participants. Large banks or market makers, however, may be selected in some countries when the central bank wishes to bring about a rapid change in market interest rates through fine-tuning operations.

3. SIGNALLING MONETARY POLICY INTENTIONS

Central banks convey policy signals to the market mainly through their "key" interest rates (see Chart 6 on page 21). These are often the rates applied to standing facilities but may also be those at which central banks provide or withdraw liquidity through open market operations. Some Community central banks rely primarily on a single key rate both to steer market rates and to give policy signals, as is the case in Ireland. Others employ several rates which may give more flexibility both in the conduct of operations and in the provision of policy signals. In some cases, one rate provides an upper limit or a lower limit to market rates, while a second rate serves to guide them. In other cases, two rates may set a corridor for short-term market rates, the latter being steered through money market interventions by the central bank, as is the case in Belgium.

Central banks can also indicate policy intentions by changing procedures, in particular the auction procedure or the maturity of market operations. For instance, some central banks may switch from interest rate to volume tenders to stabilise market expectations, or to reinforce the impact of adjustments in official interest rates, as did the Deutsche Bundesbank in September 1992.

III. INSTITUTIONAL FEATURES OF COMMUNITY CENTRAL BANKS

1. STATUTES AND INDEPENDENCE

The Treaty on European Union lays down a clear mandate for the European System of Central Banks (ESCB) to maintain price stability. To fulfil this mandate, it is important that the decision-making authorities of the ESCB are not subject to directives from other bodies which could stand in conflict with this objective.

In consequence, the ESCB Statute lays down a number of provisions to ensure that the System will be independent in the performance of its assigned tasks. In particular, the Statute specifies that the ECB, the national central banks and any member of their decision-making bodies shall act without receiving instructions from national or Community authorities. Moreover, the Statute guarantees that members of the decision-making bodies are provided with assured tenure to fulfil their duties. In addition to the provisions specifying the political or institutional independence, the economic or practical independence of the System is confirmed by the functional, operational and financial provisions embodied in the Statute.

In accordance with Article 108 of the Treaty, each Member State shall ensure, at the latest at the date of the establishment of the ESCB, that its national legislation including the statute of its national central bank is compatible with the Treaty and the Statute of the ESCB.[1] Article 109e(5) stipulates that the process leading to the independence of central banks should start during the Second Stage. The prohibition on central banks extending overdrafts or any other type of credit to the public sector provided for in Article 104 of the Treaty will apply as from the start of Stage Two (see Article 109e(3) of the Treaty).[2]

A number of countries have decided to begin the process leading towards full central bank independence. Against this background, the following section presents a brief summary of the current institutional features of national central banks in the Community (see Table 7). This description concentrates on the main aspects whereas Annex II offers a more extensive summary of national features.

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1 This provision does not apply to the United Kingdom as long as it does not participate in the third stage of EMU (see Sections 5 and 11 of the Protocol on certain provisions relating to the United Kingdom). Furthermore, the Decision taken by the Heads of State and Government at their Edinburgh Summit meeting on 11th/12th December 1992 implies that Denmark (which has given notification that it will not participate in Stage Three of EMU) will retain its existing powers in the field of monetary policy according to its national laws and regulations, including the powers of Danmarks Nationalbank in the field of monetary policy.

2 Subject to Section 11 of the Protocol on certain provisions relating to the United Kingdom which grants the government the right to maintain its "ways and means" facility with the Bank of England as long as the United Kingdom does not participate in Stage Three of EMU.

TABLE 7: INSTITUTIONAL FEATURES OF COMMUNITY CENTRAL BANKS

Item	NATIONAL BANK OF BELGIUM	DANMARKS NATIONAL BANK	DEUTSCHE BUNDESBANK	BANK OF GREECE	BANCO DE ESPAÑA	BANQUE DE FRANCE
PRINCIPAL STATUTORY OBJECTIVE	None, although safeguarding the currency implicit	To maintain a safe and secure currency system	To safeguard the currency	To control currency in circulation and credit	To safeguard the value of the currency	To oversee money and credit
LEGAL AUTHORITY FOR : 1 - Exchange Rate Regime 2 - Setting targets for monetary growth 3 - Changing key interest rates	 1 - Government 2 - Central Bank (no target set at present) 3 - Central Bank	 1 - Government 2 - Central Bank (no target set at present) 3 - Central Bank	 1 - Government 2 - Central Bank 3 - Central Bank	 1 - Government 2 - Central Bank 3 - Central Bank	 1 - Government 2 - Government 3 - Central Bank	 1 - Government 2 - Joint with Government 3 - Joint with Government
RESPONSIBILITIES: 1 - Execution of monetary and exchange rate policy 2 - Issue of currency 3 - Payment system services 4 - Bank of banks and government 5 - Supervision of financial institutions 6 - Safeguard financial stability 7 - Official reserve management	 1 - Yes 2 - Yes 3 - Yes 4 - Yes 5 - No 6 - Yes 7 - Yes	 1 - Yes 2 - Yes 3 - Yes 4 - Yes 5 - No 6 - Yes 7 - Yes	 1 - Yes 2 - Yes 3 - Yes 4 - Yes 5 - No 6 - Yes 7 - Yes	 1 - Yes 2 - Yes 3 - Yes 4 - Yes 5 - Yes 6 - Yes 7 - Yes	 1 - Yes 2 - Yes 3 - Yes 4 - Yes 5 - Yes 6 - Yes 7 - Yes	 1 - Yes 2 - Yes 3 - Yes 4 - Yes 5 - Yes 6 - Yes 7 - Yes
GOVERNING BODIES	- Governor - Board of Directors - Council of Regency - Board of Censors - General Council	- Board of Governors - Board of Directors - Committee of Directors - Royal Bank Commissioner	- Central Bank Council - Directorate - Managing Board of Land Central Banks	- General Council	- Governor - Deputy Governor - General Council - Executive Council	- Governor - Deputy-Governors (2) - General Council
APPOINTMENT OF GOVERNOR By: Term:	 - Crown on proposal of the Government - 5 years (renewable)	 - Crown on proposal of the Government - No fixed term	- Federal President on proposal of Federal Government after consultation of Central Bank Council - Normally 8 years, minimum 2 years (renewable)	 - Government on proposal of General Council - 4 years (renewable)	 - Crown on proposal of President of Government - 4 years (renewable)	 - Council of Ministers - No fixed term
PLANNED CHANGES	Legislation to prohibit "monetary financing" and to ensure central bank independence on monetary policy decisions adopted in March 1993	None	None	Consideration of proposals to increase the independence of the central Bank in the near future and to make the Statute more compatible with the Maastricht Treaty	Draft law recently submitted to Parliament which introduces all the provisions of the Maastricht Treaty relating to central banks	Government is committed to modifying the central bank statutes but no official proposal has yet been made

TABLE 7 (CONT'D): INSTITUTIONAL FEATURES OF COMMUNITY CENTRAL BANKS

Item	CENTRAL BANK OF IRELAND	BANCA D'ITALIA	INSTITUT MONÉTAIRE LUXEMBOURGEOIS	NEDERLANDSCHE BANK	BANCO DE PORTUGAL	BANK OF ENGLAND
PRINCIPAL STATUTORY OBJECTIVE	To safeguard the integrity of the currency	None, although safeguarding the currency implicit	To promote the stability of the currency	To safeguard the value of the currency	To maintain internal monetary stability and the external solvency of the currency	None, although safeguarding the currency implicit
LEGAL AUTHORITY FOR: 1 - Exchange Rate Regime 2 - Setting targets for monetary growth 3 - Changing key interest rates	1 - Government 2 - Central Bank (no target set at present) 3 - Central Bank	1 - Government 2 - Joint with Government 3 - Central Bank	1 - Government 2 - Not applicable 3 - Not applicable	1 - Government 2 - Central Bank (no target set at present) 3 - Central Bank	1 - Government 2 - Central Bank (no target set at present) 3 - Central Bank	1 - Government 2 - Government 3 - Joint with Government
RESPONSIBILITIES: 1 - Execution of monetary and exchange rate policy 2 - Issue of currency 3 - Payment system services 4 - Bank of banks and government 5 - Supervision of financial institutions 6 - Safeguard financial stability 7 - Official reserve management	1 - Yes 2 - Yes 3 - Yes 4 - Yes 5 - Yes 6 - Yes 7 - Yes	1 - Yes 2 - Yes 3 - Yes 4 - Yes 5 - Yes 6 - Yes 7 - Yes (together with the Italian Exchange Office)	1 - Yes (partly) 2 - Yes 3 - No 4 - No 5 - Yes 6 - Yes 7 - Yes	1 - Yes 2 - Yes 3 - Yes 4 - Yes 5 - Yes 6 - Yes 7 - Yes	1 - Yes 2 - Yes 3 - Yes 4 - Yes 5 - Yes 6 - Yes 7 - Yes	1 - Yes 2 - Yes 3 - Yes 4 - Yes 5 - Yes 6 - Yes 7 - Yes (as agent for the Government)
GOVERNING BODIES	- Board of Directors	- Governor, Director-General, 2 Deputy Director-Generals (Directorate) - Board of Directors	- Management - Council	- Governing Board - Supervisory Board	- Governor - Board of Directors - Board of Auditors - Advisory Board	- Court of Directors
APPOINTMENT OF GOVERNOR By:	- President on proposal of Government	- Board of Directors with approval of Government	- Grand-Duke on proposal of Council of Ministers	- Nominated by joint meeting of Governing Board and Supervisory Board and appointed by Crown on proposal of Council of Ministers	- Council of Ministers on proposal of Minister of Finance	- Crown on proposal of Prime Minister
Term:	- 7 years (renewable)	- Life	- 6 years (renewable)	- 7 years (renewable)	- 5 years (renewable)	- 5 years (renewable)
PLANNED CHANGES	A bill incorporating the changes in the central bank legislation will be placed before Parliament by the end of 1993	- Draft bill on: abolition of any form of advances to the Treasury and power to set the compulsory reserve ratio - Other institutional changes required to fulfil the Maastricht Treaty are under examination	A draft bill to effect the changes in legislation required by the Maastricht Treaty is in preparation at the IML	Amendments to legislation required by Stage Two likely to be tabled before Summer 1993	Amendment to prohibit the underwriting of Treasury Bills. Institutional changes required to fulfil the Maastricht Treaty will be made within the prescribed time schedule	None. Changes will be needed if UK participates in Stage Three

2. OBJECTIVES AND TASKS OF CENTRAL BANKS

Not all Community central banks have a clear statutory objective in the monetary policy field. Nevertheless, there is a common agreement among them that the principal goal of policy is to safeguard the value of the currency, or in other words to pursue price stability. Even in the cases where this is not a statutory obligation, this is taken to be a fundamental monetary policy responsibility.

The principal tasks of Community central banks are relatively similar. All central banks have responsibility for executing monetary policy and foreign exchange operations. In addition, Community central banks typically issue bank notes, act as the bank for commercial banks, provide services to the government as a fiscal agent, manage official reserves, and have responsibilities with respect to payment systems. Central banks also generally have an explicit mandate to safeguard financial stability. Most central banks have legal responsibilities for banking supervision, but Belgium, Denmark, and Germany are exceptions.

3. THE CONDUCT OF MONETARY AND EXCHANGE RATE POLICY

In spite of the broad similarity in the principal tasks, there are substantial differences in the extent of central bank responsibility for the formulation and implementation of monetary policy.

Monetary policy formulation and implementation

The degree of practical independence of the central bank in the formulation of monetary policy, for example such as the setting of quantified intermediate objectives, varies considerably. It depends not only on legal provisions but also on historical traditions and practices which have evolved over an extended period. National experiences vary across a spectrum: ranging from those where there is complete discretion for the central bank, as in Germany; to intermediate cases where there is considerable autonomy in practice, but where the government may have some rights, either legally or through custom, to influence or to initiate decisions; through to cases where the government has primary responsibility for policy formulation and where the central bank plays an advisory role.

A key component of central bank independence is the degree of freedom to change official interest rates. From a legal viewpoint, most Community central banks have the power to alter key rates. However, in some countries there is an important distinction between legal rights and customary practice to the effect that governments are closely involved with key decisions. In the United Kingdom, for example, the government has traditionally been responsible for policy formulation, though acting in consultation with the central bank. In France, monetary policy decisions are taken jointly with the government.

Central banks generally have considerable autonomy in selecting the mix of monetary policy instruments and in the techniques used in money market operations. In Germany, for example, the set of available instruments is enshrined in the central bank statute; within this legal framework there is complete freedom to use the instruments flexibly. A broad caveat applies to the use of reserve requirements in Community countries. As reserve requirements have fiscal implications if they are not remunerated at market rates, there is often government involvement, for example in determining the maximum rate which can be applied, and in specifying the financial instruments subject to the obligation.

Exchange rate regime

Most Community countries participate in the Exchange Rate Mechanism and in several countries - Belgium, Ireland, Luxembourg, the Netherlands and Portugal - the exchange rate is the only intermediate target for monetary policy.

The power to decide whether or not to participate in exchange rate arrangements, such as the EMS, resides with the government in all Community countries. This also applies to decisions on changes in central parities. However, central banks are often assigned considerable operational freedom in the day-to-day operation of exchange rate policy. For example, most central banks have the discretion to undertake foreign exchange intervention on their own authority; exceptions are France, where the Banque de France monitors the fluctuation of its currency, according to the general directions of the Ministry of Finance; and the United Kingdom, where the Bank of England acts as an agent of the Treasury.

Role of political authorities

In several countries there are currently legal provisions which may limit the independence of central bank decision-making, but in practice these powers have never been invoked. For example, in the Netherlands, the Minister of Finance has the authority to give directions to the central bank, although there are strict safeguards controlling this privilege, including an appeals procedure and a provision enabling the central bank to publish its opinion. In Belgium, the statutory power of the government commissioner and the Minister of Finance to suspend or to veto central bank decisions was abolished, as far as the basic tasks of the Bank are concerned, in March 1993. In Germany, decisions on policy changes may be delayed by two weeks at the request of the Federal Government, although, thereafter, the decision of the Bundesbank rests supreme.

In other central banks, too, there are official censors or commissioners appointed by governments, whose broad function is to monitor the observance of legal obligations. Formal powers differ, however: in France, for example, the censor sits on the General Council and can raise objections to decisions, in which case the matter is reconsidered; whilst in Greece, the non-voting government commissioner can veto decisions only if he judges them to be contrary to national law.

Government representatives sit on the General Council of the central bank in Spain, and have equal voting rights to other members.

4. APPOINTMENT PROCEDURES FOR CENTRAL BANK GOVERNORS

The political authorities play an important role in the appointment of members of the principal governing bodies of Community central banks. A full description of national procedures is presented in Annex II. For simplicity, this section concentrates on the appointment of central bank Governors, who will be members of the Council of the EMI and of the Governing or General Council of the ECB.

Central bank Governors are normally appointed either by the Head of State on a recommendation from the government or by the government itself. The principal exceptions are Italy, where the appointment is made by the Board of Directors, although with government approval, and the Netherlands, where nominations for Governor are made by the central bank, although formal appointment is by the Crown. In Germany, the Central Bank Council is officially consulted on nominations.

Terms of office differ considerably. At one extreme, there is no fixed term in Denmark and France and, in principle at least, appointments can be revoked at any time. At the other end of the spectrum, the term of the Governor is unlimited in Italy. In the remaining central banks, the term of office normally ranges from four years in Greece and Spain to eight years in Germany (terms in Germany can be shorter than this, but no less than two years). Appointments in these countries are renewable. Current practices can be compared to the provisions in the ESCB Statute which specify that the term of office of national central bank Governors shall be at least five years (although terms can be renewed). Members of the Executive Board of the ECB will be appointed for eight-year, non-renewable terms.

5. PROSPECTIVE CHANGES IN CENTRAL BANK LEGISLATION

As noted above, changes must be made to central bank legislation. Before the start of Stage Two national legislation must conform with the Treaty provisions prohibiting "monetary financing" of budget deficits. Before the start of Stage Three all central banks must be made independent.[3]

In Belgium, new legislation to this effect was adopted in March 1993. In a number of countries, national central bank statutes are currently being carefully re-examined and proposals for changes are under discussion. In some cases, deliberations are at an advanced stage: in Spain, draft legislation has been submitted to Parliament, which should enter into force on 1st January 1994. In Greece, draft legislation has been prepared and it is expected to be submitted by the government to the Parliament for approval during 1993.

[3] See preceding footnotes 1 and 2.

IV. ACTIVITIES OF THE COMMITTEE OF GOVERNORS AND PREPARATION FOR THE MOVE TO EMU

1. ACTIVITIES OF THE COMMITTEE OF GOVERNORS

Last year, the Annual Report provided a detailed description of the functions and tasks of the Committee of Governors, and its organisational structure. The regular activities described in this section cover a wide range of topics: the co-ordination of monetary policies; overseeing the operation of the EMS; the monitoring of the private ECU market; banking supervisory issues; and relationships with non-Community countries.

An additional task in 1992 resulted from the mandate of the Council of the European Communities to prepare the move to the second and third stages of EMU. The preliminary work in this field, which is described in Part 2 of this chapter, required an adaptation of the organisational structure of the Committee.

In performing its tasks, the Committee maintained close contacts with other Community bodies and established links with the banking community in some areas of activity.

1.1 Co-ordination of monetary policies

The mandate of the Committee of Governors calls on the Committee to promote the co-ordination of monetary policies "with the aim of achieving price stability as a necessary condition for the proper functioning of the European Monetary System and the realisation of the objective of monetary stability". This task is carried out within a common framework for the monitoring of monetary policies which was introduced at the beginning of Stage One of EMU in mid-1990.

Within this framework, the Committee regularly examined monetary and economic trends in the Community at its monthly meetings. A more detailed forward-looking analysis ("ex ante exercise") took place in the autumn, before the national authorities took final decisions on the intermediate objectives of monetary policies. The Committee assessed, in particular, whether the intended guidelines for national monetary policies, as reflected in the setting of intermediate targets, were consistent with the objective of downward convergence of inflation rates throughout the Community. The forward-looking assessment carried out in December 1991 was supplemented by an "ex post" surveillance exercise undertaken in the spring which compared economic and monetary developments with earlier projections. The causes of deviations were examined and the need for any adjustment of policies was reviewed.

The "ex ante" and "ex post" exercises make use of a set of commonly agreed and mutually consistent indicators. Community-wide economic aggregates play an important role. To ensure the broad consistency of the national projections underpinning the forward-looking appraisal, common assumptions on economic and financial prospects outside the Community were agreed by national central banks. The analytical foundations of the monitoring framework are frequently reviewed and improved. This ensures that the adopted approach remains appropriate given the rapid changes in the economic and financial environment. In this context, attention has recently been paid, for example, to developments in cross-border monetary holdings, as these assets are not included in traditional monetary aggregates (see Box 3).

In addition, the Committee of Governors studied in detail, developments in public finance in Community countries and their implications for the conduct of monetary policies. This report, which is produced annually, was transmitted to the Ministers of Finance.

1.2 Overseeing EMS developments

One of the principal activities of the Committee of Governors is to oversee the operation of the EMS. This activity includes the regular monthly monitoring of current exchange market and interest rate developments and the analysis of all factors, including policy measures, which affect the functioning of the EMS exchange rate mechanism.

Following the move to Stage One of EMU in mid-1990, the monthly monitoring exercise has been supplemented by an annual examination of the functioning of the EMS. The review for 1992 focused on the recent turmoil in the foreign exchange markets (see Chapter I). In addition, the Committee is currently assessing which lessons might be drawn from the recent events, in accordance with the invitation from the European Council given at its special meeting of 16th October 1992 in Birmingham.

1.3. Monitoring the private ECU market

Since 1984, developments in the private ECU market have been examined on an annual basis. The surveys assess the monetary implications of the use of the private ECU by national and Community authorities as well as by the private sector, and review the legal and administrative framework supporting this use. In addition, the Committee has studied the functioning of the ECU clearing system and is currently monitoring the implementation of reforms which the ECU Banking Association agreed to undertake in February 1992. These reforms should bring the system to a level of soundness consistent with the requirements set out in the report of the G-10 Committee on Interbank Netting Schemes in 1990 (the so-called "Lamfalussy Report").

1.4. Issues in the field of banking supervision

In the past year, the Committee has concentrated on three issues in the banking supervisory area.

Firstly, considerable attention was devoted to the implications of the Second Banking Co-ordination Directive establishing the Single Market in the banking sector, which came into force on 1st January 1993. Under this Directive, credit institutions authorised in

Box 3: CROSS-BORDER HOLDINGS AND MONETARY ANALYSIS

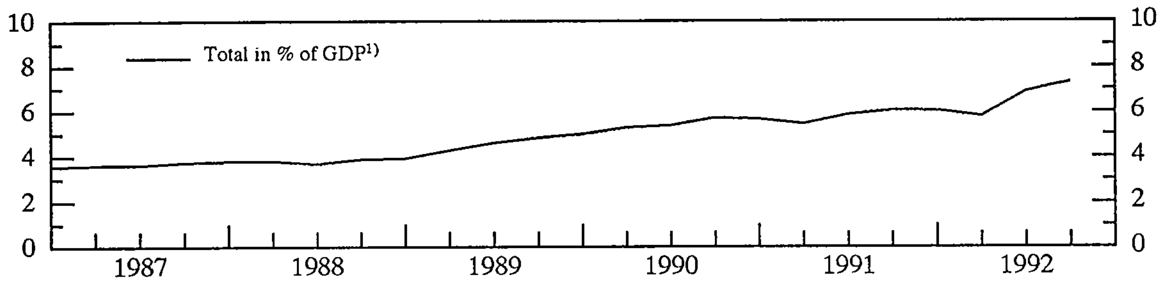
Cross-border holdings (CBHs) may be defined as deposits of the non-bank sector held with banks located in countries other than those in which the holders are resident. Several reasons may underlie the decision to keep money abroad These include the avoidance of actual or expected domestic regulations, such as reserve requirements or capital income taxation; the reduction of transaction costs; and the diversification of country risk on monetary assets.

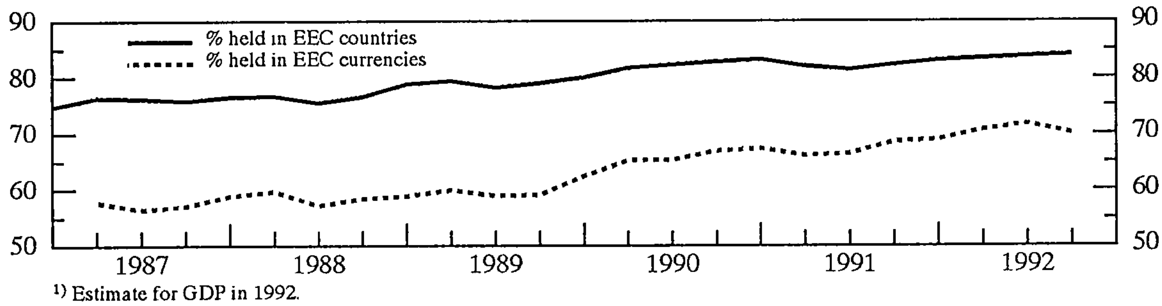
Economic and financial integration has led to a steady increase in CBHs held by Community residents, as shown by the graph. However, there are significant national differences both in the size of CBHs and in their pattern of growth. These differences are linked to particular features of national financial systems, such as the importance of financial vehicles, and the impact of domestic regulations. In relation to national GDP, residents in Belgium, Germany, Ireland, Netherlands and the UK hold proportions of CBHs above the Community average.

The graph also shows the percentage of CBHs which Community residents hold with banks located within the EEC and the proportion of the total which is denominated in Community currencies (excluding Danish krone, Greek drachma, Spanish peseta and Portuguese escudo for which data are not available). The high value of both these proportions throughout the sample stems from the particularly close integration among Community countries in the financial and monetary sphere.

Despite their rapid expansion in recent years, CBHs still represent a relatively small proportion of Community residents' monetary assets. Traditional monetary aggregates have consequently maintained their usefulness in monetary analysis. However, as financial integration progresses further, CBHs may become increasingly important in the future.

EEC NON-BANK RESIDENTS CROSS-BORDER DEPOSITS





[1] Estimate for GDP in 1992.

any Member State have acquired the freedom to establish branches and to provide services throughout the Community without the need for further authorisation in the host State. In accordance with the fundamental principle of home country supervision, the responsibility for supervision rests with the authorities in the Member State where the credit institution has been authorised. The effective implementation of this principle requires the strengthening of the existing co-operation between the supervisory authorities of the "home country", on the one hand, and of the country hosting foreign branches, on the other. To this end, bilateral agreements are being concluded to determine the practical guidelines covering the supervision of branches of credit institutions established in other Member States.

Secondly, the Committee of Governors defined a series of principles which could be applied to monitor and supervise conglomerates containing a bank. The Committee also considered the potential for regulatory arbitrage arising from the organisation of activities within a conglomerate and the extent to which the lack of transparency of the group's structure could increase the difficulties of assessing risks on a group-wide basis. The Committee agreed to encourage discussions between bank supervisors and other supervisory authorities in order to study the possibilities of collaboration and of a convergence in the respective approaches. The results of the Committee's deliberations were passed to the EC Banking Advisory Committee and the Basle Committee on Banking Supervision to assist them in carrying these discussions forward.

Thirdly, in common with a number of other groups, the Committee of Governors has also been considering the lessons to be learned from the case of the Bank of Credit and Commerce International (BCCI). Particular attention is being paid to the Bingham Inquiry Report and to the implications of the Basle Committee's paper "Minimum standards for the supervision of international banking groups and their cross-border establishments" for EC legislation.

In addition, the Committee of Governors is studying the following issues: the merits and limitations of the central credit registers which currently exist in several Member States and how the information they contain might be shared among the respective banking supervisory authorities; and the evidence for financial fragility and the problems which this causes for supervisors.

1.5. Co-operation with other Community bodies

The Committee of Governors has maintained close contacts with several Community bodies.

Firstly, on several occasions the European Parliament was informed of the work of the Committee of Governors. In April 1992, the Chairman of the Committee gave evidence to the European Parliament Committee on Economic and Monetary Matters and Industrial Policy on the preparatory work for the move to the second and third stages of EMU. The Sub-Committee on Monetary Affairs was also briefed on the activities of the Committee of

Governors. In December 1992, the Chairman presented the Committee's first Annual Report to the European Parliament in a plenary session.

Secondly, the Chairman attended several ECOFIN Council meetings devoted either to the multilateral surveillance of member countries' economic policies or to other issues related to the Committee's activities. In addition, the Governors participated in the informal meetings of this Council, which provided an opportunity to express views on the mix between monetary, fiscal and other economic policies as well as on questions relating to the EMS and monetary relationships with third currencies. Furthermore, the Council was informed of progress made by the Committee of Governors in the preparations for the later stages of EMU. In December 1992, the Committee was consulted when the Council re-examined certain provisions in its Directive on the liberalisation of capital movements.[4]

Thirdly, close co-operation with the Commission of the European Communities has continued. Commission representatives attended the meetings of the Committee of Governors and of the Committee of Alternates, as well as meetings of the Sub-Committees and Working Groups. The Committee of Governors is represented by delegates from national central banks in the Commission's Consultative Group on issues relating to payment systems.

Fourthly, the Committee of Governors has contributed to the work of the Committee on Monetary, Financial and Balance-of-Payments Statistics which was created by a Council Decision in February 1991. A member of the Secretariat has permanent observer status on this Committee. In April 1992, the Committee of Governors was consulted on the Proposal from the Commission on the Community Statistical Programme for the next five years.

Finally, the Committee of Governors has continued to follow closely the work of the Monetary Committee. Links with this Committee are ensured by the central bank representatives, who are, in most cases, the Alternates of the Governors.

1.6. Relationships with central banks outside the Community

Under the aegis of the Committee of Governors, information on developments in exchange markets is regularly exchanged between Community central banks and the central banks of the United States, Japan, Canada, Norway, Sweden, Finland, Austria and Switzerland. This so-called "concertation procedure" also provides for the pooling of relevant data, including intervention and other official foreign exchange transactions.

In accordance with an undertaking dating back to 1984, regular consultations on matters of common interest have been held with the central bank of Norway. The bilateral swap agreements which were concluded in December 1990 between the Community central banks and Norges Bank were renewed at their maturity on 31st December 1992 for a further one year period. In July 1992, arrangements for similar consultations were agreed with

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[4] The so-called "monetary safeguard clause" provided for by Article 3 of Council Directive (88/361/EEC) of 24th June 1988 which was subject to review before 31st December 1992.

Suomen Pankki, the central bank of Finland; at the same time, the Community central banks and the Finnish central bank also concluded bilateral swap agreements. As in the case of Norway, these swap facilities give Suomen Pankki access to short-term funds for the implementation of its exchange rate policy and are governed by uniform terms and conditions. All agreements were maintained notwithstanding the fact that Finland (in September 1992) and Norway (in December 1992) suspended the peg of their respective currencies to the ECU.

Against the background of the implementation of the European Economic Area (EEA), the Committee has also made arrangements for technical co-operation with the central banks of the EFTA countries in the statistical field.

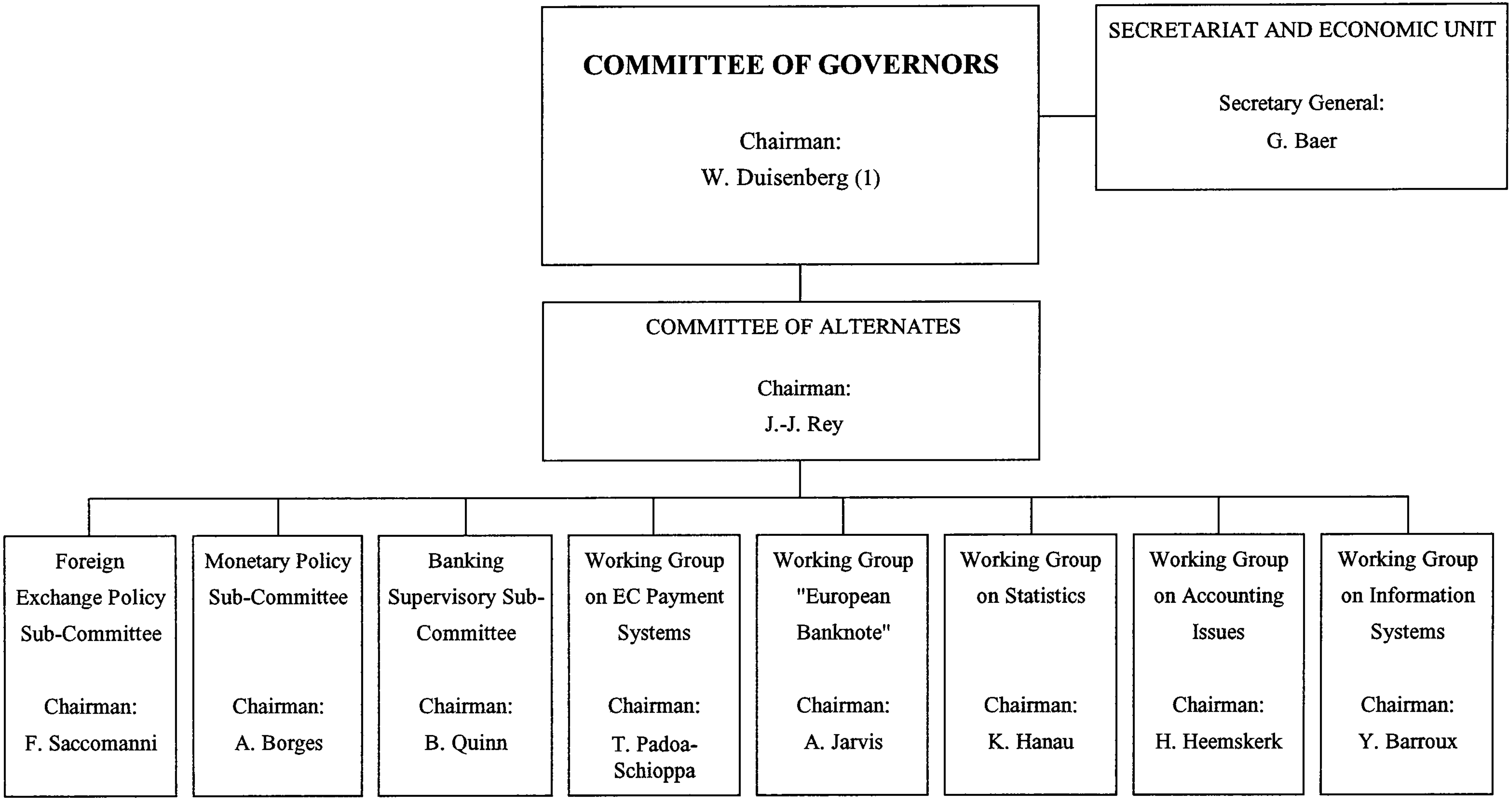
1.7. Changes in the organisational structure of the Committee

The Committee of Governors is assisted by the Committee of Alternates, the Sub-Committees and Working Groups as well as by the Secretariat and the Economic Unit. The organisational structure created at the start of Stage One of EMU was described in the first Annual Report. This structure was strengthened further in 1992 to help lay the foundations for the move to the second and third stages of EMU.

The Committee created four new Working Groups in the following areas: Issuing and Printing a European Bank-Note; Statistics; Information Systems; and Accounting Issues. Furthermore, the Committee decided to extend the mandate of the Working Group on EC Payment Systems which had been created in 1991 on an ad hoc basis. The task of the Working Groups is to prepare the discussions in the Committee of Governors in the respective areas on the basis of mandates from the Committee itself. The meetings of the Working Group on Statistics are also attended by a representative of the central banks of the EFTA countries. To support this Working Group, two task forces are being created in the fields of money and banking statistics and of balance-of-payments capital flows and stocks statistics, to carry forward work which is currently performed under the auspices of the Commission of the European Communities (Statistical Office).

The preparatory work has also necessitated an enlargement of the Secretariat and of the Economic Unit to meet the increased demand for secretarial and analytical support. The number of staff thus increased from nineteen in April 1992 to twenty eight in April 1993. To facilitate internal management, two positions of senior professional staff members have been created. They head the Secretariat and the Economic Unit, respectively and report to the Secretary General. The present organisational structure of the Committee of Governors is shown in Chart 8.

CHART 8: ORGANISATION CHART FOR THE COMMITTEE OF GOVERNORS OF THE CENTRAL BANKS OF THE EEC MEMBER STATES



(1) Replaced E. Hoffmeyer with effect from 1st January 1993.

2. PREPARATORY WORK FOR THE MOVE TO THE SECOND AND THIRD STAGES OF EMU

2.1. The timetable and general principles

The Treaty on European Union stipulates that the Committee of Governors and the European Monetary Co-operation Fund (EMCF) will be superseded by the European Monetary Institute (EMI). Subject to the ratification of the Treaty, the Institute will be established and will take up its duties at the start of Stage Two on 1st January 1994. The objective of the EMI is to contribute to the fulfilment of the conditions necessary for the transition to the third and final stage of EMU. To this end, the EMI will, in particular: strengthen further the co-ordination of national monetary policies; make the preparations required for the establishment of the ESCB, for the conduct of a single monetary policy and the creation of a single currency in the third stage; and oversee the development of the ECU.

In accordance with the Treaty, the necessary regulatory, organisational and logistical framework for the ESCB to perform its tasks has to be specified by the EMI by the end of 1996 at the latest. The thorough preparation of this framework will require considerable time. A very broad agenda must be settled to ensure that the single monetary policy can be effectively conducted from the first day of the final stage. Issues to be addressed relate not only to the setting up of the ESCB and the definition of its "modus operandi", but include also questions linked to the technical requirements necessary for the realisation of a unified money market within the common monetary area. In some fields, the elaboration of concepts and the implementation of conclusions are expected to be particularly time-consuming. These include: the conceptual underpinnings of the single monetary policy and the methods for its implementation, including the choice of the appropriate monetary policy tools; the preparation of the bank notes denominated in ECU; the interconnection of the payment systems within the single monetary area; the creation of a consistent statistical base; and organisational aspects of the ESCB such as the harmonisation of accounting methodologies and the establishment of the information systems infrastructure. Rather than await the establishment of the EMI, it was considered prudent to commence preliminary work as soon as possible in these areas alongside the preparation for the start of Stage Two.

As a first step, the Committee of Governors identified all the issues which should be examined at an early stage and established a work programme until the end of 1993. Thereafter, working methods were defined and the Committee's organisational structure was adapted. Special mandates were given to the existing Sub-Committees, Working Groups were created in specialised areas and the Secretariat and Economic Unit were enlarged. The substantive work started in the second half of 1992; most of this work has so far been of a fact-finding nature, creating a basis for the detailed consideration of options at a later stage. As in the past, the Committee (and subsequently the EMI) will report regularly to the Community authorities on the progress made. The public will be kept informed through regular and special publications. A dialogue with the banking industry has started in the area of payment systems and will be continued.

2.2. Preparation of Stage Two

Establishment of the EMI

Preparatory work has so far centred on the principal tasks which the EMI will assume on 1st January 1994.

Firstly, the EMI will strengthen monetary policy co-ordination with a view to ensuring price stability. Closely co-ordinated national monetary policies will be a crucial element in the smooth transition to the single monetary policy. The co-ordination of monetary policies in the EMI will build on the current monitoring framework and the Committee is examining how existing procedures may be improved further while paying due regard to the principle that the responsibility for monetary policies remains with the national authorities in Stage Two.

Secondly, the EMI will have the mandate to "facilitate the use of the ECU and oversee its development, including the smooth functioning of the ECU clearing system". The Committee of Governors is currently discussing the likely requirements of the EMI in order to comply with this mandate.

Thirdly, work is being carried out to clarify technical aspects of the EMI's operational functions. The tasks currently performed by the EMCF will be supplemented by new ones. The EMI will take over from the EMCF the administration of the EMS mechanisms (the very short-term financing mechanism, the short-term monetary support mechanism, the issuance of ECUs for the purpose of implementing the EMS Agreement) and the administration of borrowing and lending operations concluded by the Community under the medium-term financial assistance mechanism. New operational tasks include the management of foreign exchange reserves as an agent for, and at the request of, national central banks. This activity will be governed by rules to ensure that there is no interference with national monetary and exchange rate policies.

Finally, the Committee is considering the institutional, organisational and technical features of the new institution. First studies have been undertaken on the EMI's staff policy (including the outline of the terms and conditions of employment). In the field of information and telecommunications, the Committee is planning the transfer of the technical infrastructure of the Secretariat to the EMI. This will guarantee the continuity of services rendered to the central banks. In addition, the Committee is considering how best to meet the increased needs for telecommunication systems in Stage Two.

Prohibition of central bank financing of the public sector

Article 104(1) of the Treaty on European Union prohibits overdraft facilities or any other type of credit facility with the ECB or with the central banks of the Member States in favour of "Community institutions or bodies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States" as well as the purchase of debt instruments directly from them by the ECB or national central banks. These provisions are designed to eliminate the risk that central banks (and the future ECB) are put under pressure to provide financial assistance to the public sector which would render the conduct of monetary policy more difficult and could jeopardise the attainment of price stability. This prohibition will take effect at the beginning of Stage Two.[5]

Compliance with Article 104 will necessitate changes in national practices and legislation (see Table 8). In this context, the Committee of Governors is examining in particular the following issues: the treatment of outstanding central bank claims on public entities; how to ensure full compliance with the prohibition of central bank credit to the public sector; the implications of the prohibition for the functioning of payment systems; and the need for clarification of such issues by secondary Community legislation in accordance with Article 104b(2). The conclusions of the Committee of Governors will be taken into account by the Commission when it presents a proposal for such legislation. The Committee also intends to follow closely the changes in national legislation which the Member States are currently preparing or implementing, and to establish a procedure whereby central banks' operations with public entities would be regularly monitored in the framework of the future EMI.

2.3 Areas of work with a long lead time

While work in the areas with a long lead time are essentially related to the foundations of Stage Three of EMU, some of the issues under study, such as payment systems questions, are also of importance in the context of Stage Two.

Conduct of a single monetary policy and harmonisation of monetary policy instruments

The manner in which the single monetary policy is to be conducted is not defined in the Statute of the ESCB. A large margin of discretion is left to the ECB, which will allow it considerable flexibility to adjust its methods to the prevailing circumstances, as the conditions under which it will operate cannot yet be fully ascertained. Significant structural changes are expected to occur following the creation of the Single Market, while Monetary Union itself may lead to further major changes. Nevertheless, given the complexity of the task of elaborating the future monetary strategy, it is necessary to start the groundwork as soon as possible.

The Committee of Governors has identified three main topics which need to be considered. Firstly, the possible concepts of the single monetary policy should be studied, focusing in particular on the choice, definition, and appropriateness of intermediate objectives

[5] In accordance with Section 11 of the Protocol relating to the United Kingdom, the government may maintain its "ways and means" facility with the Bank of England if and so long as the United Kingdom does not move to the Third Stage.

TABLE 8: CENTRAL BANK FINANCING OF THE PUBLIC SECTOR (a)

ITEM	BELGIUM	DENMARK	GERMANY	GREECE	SPAIN	FRANCE	IRELAND	ITALY	LUXEMBOURG	NETHERLANDS	PORTUGAL	U.K.
OVERDRAFT OR OTHER CREDIT FACILITIES BY CENTRAL BANK TO PUBLIC ENTITIES												
• legally possible	Yes (b)	Yes (c)	Yes	Yes	Yes	Yes (d)	Yes	Yes	Yes (e)	Yes	Yes (f)	Yes
• automatic access or on application	automatic	automatic	on application	automatic	automatic	automatic	automatic	automatic	automatic	on application	automatic	automatic
• ceiling on outstanding amount?	Yes	None	Yes	Yes	None during year	None	Yes	Yes	Yes	Yes	Yes	None
(in billions of national currency or as a % of government expenditure/revenue)	(Bfr. 20)		(ca DM 10)	(5%) (g)	(Pts. 1,200 end of year)		(Ir£0.25)	(14%)	(Bfr. 0.5) (e1)	(Fl. 0.15 + 3%)	(10%)	
• actual use (in % of GDP):												
▫ flow in 1991	-1.6	0.0	0.0	1.0	0.4	-0.2	0.0	0.1	0.0 (e2)	0.0	0.3 (f)	-0.1
▫ outstanding amount end-1991	0.0	0.0	0.0	8.4	2.1	0.4	0.0	4.8	1.0 (e2)	0.0	2.3	1.3
DIRECT PURCHASES OF PUBLIC-ENTITIES' DEBT BY CENTRAL BANKS IN PRIMARY MARKET												
• legally possible	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
• gross direct purchases in 1991 (in % of GDP)	0.0	0.0	-	2.0	2.8 (h)	0.0	0.0	0.7	0.0	0.0	7.5 (i)	1.3

(a) According to Maastricht Treaty, Article 104.
(b) The facilities will be legally abolished by June 1993 at the latest.
(c) Changes in government's current account occur due to changes in net government borrowing abroad.
(d) Changes in government's current account occur only due to exchange rate fluctuations recorded in central bank's currency reserves.
(e) 1) The Luxembourg government has an overdraft facility with the Central Bank of Belgium , subject to a ceiling.
2) In addition, the issue of notes and coins by the Institute Monétaire Luxembourgeois (IML) provides the government with -limited- liquid funds directly, against a non-callable claim of the IML on the government.
(f) The overdraft facility was eliminated at the end of 1992. The outstanding balance was consolidated into a ten-year loan. The flow figure for 1991 reflects the increase in the upper limit of the overdraft facility.
(g) Ceiling was reduced to 5% from 10% from the beginning of 1993.
(h) Purchases were sharply reduced to 0.1% of GDP in 1992.
(i) This figure reflects very large exceptional transactions related to the restructuring of monetary policy instruments and procedures. Net credit to the Public Sector actually declined during 1991.

to guide monetary policy action. The examination of this issue will involve an assessment of the relative merits of alternative target variables.

A second issue relates to the methods and organisational aspects of executing monetary policy operations. This aspect essentially concerns the division of responsibilities between the ECB and the national central banks. The Statute states that the ECB shall have recourse to the national central banks to carry out operations "to the extent deemed possible and appropriate". The practical implications of this provision must be studied in the light of the other objectives of the ESCB.

Thirdly, monetary policy instruments will have to be considered for the implementation of the single monetary policy. It is important that choices are made to promote the necessary degree of harmonisation of instruments sufficiently ahead of the start of Stage Three in order to guarantee that markets are familiar with the new procedures and practices when the ESCB takes up its full functions.

The Committee of Governors has so far given priority to the third issue. It has embarked on a comprehensive fact-finding review of the similarities and differences in monetary policy instruments currently used in Community countries. This review covers both the range of available instruments (i.e. discretionary open market operations, standing facilities offered by central banks at pre-announced rates and used on the commercial banks' initiative, and compulsory reserve requirements) and the procedures according to which they are used. In the latter respect the Committee is studying the frequency of operations, their terms and conditions and the range of market participants with which they are concluded. A short summary of the preliminary work is reported in Chapter II.

Printing and issuing a European Bank-Note

The Treaty confers upon the ECB and the national central banks the exclusive right of issuing bank notes which are legal tender within the Community. In preparation for this function, the EMI is entrusted with the task of supervising the technical planning for the introduction of ECU bank notes.

Experience at national level suggests that the development and introduction of a new bank note series normally takes several years. At the Community level, matters are expected to be even more complex. Additional elements to be taken into consideration include the much larger stock of notes which must be replaced by new ECU-denominated bank notes, and the differences between Community countries in payment habits and systems for the production, issuance and post-issue handling of bank notes. For these reasons, it was deemed wise to undertake a fact-finding exercise at an early stage to gauge the nature and likely magnitude of potential problems. A survey is consequently being undertaken covering the printing, circulation, issuing, handling, sorting and destruction of bank notes in the Community. The legal aspects of issuing bank notes are also under examination.

Furthermore, conceptual work has started in several areas. Firstly, a number of options relating to the appearance of the new bank notes are under consideration. Broadly speaking, there are three possibilities: identical bank notes in all Member States; common bank notes with national characteristics; or national bank notes with European characteristics. These options are currently being evaluated from various angles, including public acceptability and recognition, as well as the implications for the automation of note issuing and handling. A further criterion will be economies of scale in design, production and distribution costs.

Secondly, the Committee of Governors is considering issues relating to the general features of the new bank notes including their face values, design and size. These aspects are being examined against the background of the security technology necessary to prevent counterfeiting and the features required for automation of the post-issue handling process.

A third main area under consideration relates to the legal, institutional and organisational aspects of the issuing and post-issue handling of notes, in particular the distribution of responsibilities in this respect between the ECB and the national central banks. Several options are conceivable and their relative merits will be analysed on the basis of efficiency and cost criteria.

Finally, preliminary studies have been undertaken on transitional issues. Two options can be envisaged for the launching of new bank notes. A first option would provide for a "big bang", i.e. the new bank notes would be introduced at a given date, replacing the bank notes denominated in national currencies within a short period of time. The second option would consist of a more gradual introduction of the new bank notes which would circulate alongside the bank notes denominated in national currencies during a transitional period. These two options will need further examination from various viewpoints: their contribution to introducing the single currency within a time horizon deemed appropriate by the political authorities; the underpinning of the credibility and acceptance of the future single currency; the costs involved for economic agents; and aspects of practical feasibility. Furthermore, the introduction of new bank notes has also to be seen in the context of the transition to the ECU as the single currency of the common monetary area. The Committee of Governors, therefore, will carry out its work (as will the EMI) in close co-operation with other competent Community bodies. In particular, the Council has been given the power to take the legal measures necessary for the rapid introduction of the ECU as the single currency after the irrevocable fixing of exchange rates on the starting date of Stage Three.

Payment systems

The Committee of Governors is focusing on the implications for payment systems of both the completion of the Single Market and the realisation of a common monetary area at the beginning of Stage Three. Financial integration is expected to increase the volume of cross-border flows in the Single Market. In addition, in accordance with the Second Banking Co-ordination Directive, any bank licensed in a Member State may provide "money transmission services" anywhere in the Community and thus must be given access to interbank funds transfer systems in other Community countries on an equal footing with the respective domestic banks. Monetary unification will necessitate the connection of existing payment systems to ensure that monetary conditions are the same throughout the area. The importance of payment systems for the conduct of monetary policy is recognised in the Treaty which assigns the task of promoting "the smooth operation of payment systems" to the ESCB. In this respect, the ECB is empowered to issue regulations to ensure efficient and sound clearing and payment systems within the Community and with other countries.

The work of the Committee of Governors builds on studies made by an ad hoc group of experts which was established in 1991 to undertake an extensive survey of payment systems in the Community. The results of this review were presented in a document entitled "Payment Systems in EC Member States" (also known as the "Blue Book"). This was published by the Committee of Governors in September 1992, to meet the growing demands of interested third parties for a reference guide to payment systems in the Community.

The Committee of Governors identified several issues of common concern to central banks. These relate mainly to large value funds transfer systems and are now under further consideration.

Firstly, commonly accepted principles for the co-operative oversight of payment systems in the Community are being developed. The co-operative supervision will apply to cross-border netting and payment systems as well as to the participation of EC registered banks in domestic payment systems of countries in which they do not have either their headquarters or a branch. Under the Second Banking Co-ordination Directive, the home country supervisory authorities will have sole responsibility for the financial integrity of the banks licensed by them. This responsibility extends to branches in other EC countries. The host country authorities will thus no longer automatically receive all of the information needed to evaluate the financial condition of some participants in their domestic payment systems; home supervisors could, in turn, lack adequate information on risks taken by credit institutions through their participation in other EC domestic payment systems. As a result, central banks and other supervisors will have to co-ordinate the oversight of participants.

Secondly, possibilities for establishing and implementing minimum common standards for domestic systems are being examined. These include: setting consistent minimum conditions for access to interbank funds transfer systems; the consideration of risk reduction measures to be applied to the major interbank systems; and studying measures to reduce risks in cross-border payments resulting from differences in national legal systems. The objective is to improve the smoothness of cross-border payments in the Community while avoiding the risk of competitive pressures lowering the degree of integrity and safety of the major interbank funds transfer systems.

Thirdly, the design of an EC-wide large value funds transfer system is being studied. Such a system is indispensable for the efficient conduct of the single monetary policy in Stage Three. The time and resources required to design and implement a fully integrated system are such that this issue has to be addressed at a very early stage. Early knowledge of the design of the infrastructure will also help the EC banking community plan for the future.

Moreover, payment systems are not exclusively run by central banks but are partly organised by the banking industry itself. An effective dialogue with the banking community in the EC is, therefore, essential. Such a dialogue was initiated in November when the Committee's Working Group on EC Payment Systems met representatives of the European Banking Federations and of major commercial banks. The Committee is also liaising with the European Committee for Banking Standards created recently under the aegis of the European Banking Federations.

Finally, the ECU clearing system will continue to be monitored closely (see Section IV.1).

Statistics

Reliable and timely statistics are a vital prerequisite for the conduct of monetary policy. The Statute of the ESCB entitles the ECB, assisted by the national central banks, to collect the necessary statistics. Moreover, the ECB will contribute to the harmonisation, where necessary, of the rules and practices governing the collection, compilation and distribution of statistics in the areas within its field of competence. The EMI will promote this harmonisation in the context of its preparatory work.

The Committee of Governors has set in motion the process of improving the statistical information needed for the co-ordination of monetary policies, and has started to define the statistical base necessary for the conduct of the single monetary policy. As a first step, the statistical requirements of the EMI and the ECB need to be clarified; once identified, they will be compared with the available national data. This comparison will subsequently provide a basis for the analytical work necessary to underpin the construction of reliable statistics for the common monetary area and will facilitate the assessment of whether adjustments to current data collection systems are needed.

Three principles play an important role in the appraisal of future statistical requirements: the minimisation of the reporting burden on financial institutions; the optimal use of the infrastructure of national central banks; and the compatibility with Community and international statistical standards. At this early stage, it is also important to maintain a degree of flexibility. Room must be left for adaptations in the light of the yet to be defined concept of the single monetary policy, the harmonisation of monetary policy instruments and the likely changes in the structure and the functioning of financial markets.

The Committee of Governors co-operates closely with the competent Community institutions and international bodies in the statistical field. This co-operation takes place in the framework of the Committee on Monetary, Financial and Balance-of-Payments Statistics.

Accounting principles of national central banks

The harmonisation of accounting rules and practices of national central banks is not only an indispensable prerequisite for the conduct of a single monetary policy, but also for the application of the ESCB Statute's provision on monetary income and foreign exchange transfers. The Statute entitles the Governing Council to "establish the necessary rules for standardising the accounting and reporting of operations undertaken by the national central banks". This undertaking is expected to be very complex as the methods and practices reflect different national traditions and legal provisions.

The preliminary work undertaken by the Committee of Governors has so far been of a fact finding nature. An inventory of accounting methodologies currently applied by the central banks has been prepared. Particular attention was paid to three aspects: the institutional and legal context in which the accounts of the central banks are produced; the comparison and classification of items in the balance sheets and profit and loss accounts of the central banks; and the identification of the similarities and differences in the accounting treatment of these items, especially where they are thought to be relevant to the EMI and the ESCB. On the basis of this inventory the Committee of Governors will carry out preparatory work for the harmonisation of accounting rules and standards. It will also take into consideration, where appropriate, Community legislation in this field.

Information systems

The EMI and the ECB will need reliable information systems. These systems must communicate efficiently with those in national central banks. In Stage Two, the exchange of information will mainly concern statistical data; in Stage Three, it will extend to operational functions.

Against this background, it was felt necessary to embark on the definition of a technical strategy for information and communication systems for the EMI and the ESCB. Two preliminary steps have so far been taken.

Firstly, technical surveys are currently being made in order to take stock of the present information system infrastructures in the Community central banks. Secondly, the information and communication systems requirements of the EMI and of the ESCB are being evaluated in the light of the various tasks of the new institutions.

The results of the surveys as well as of the analysis of requirements, will provide the basis for preparing both the information systems infrastructure for the EMI and the ECB and for the connection of systems of the central banks.

ANNEXES

ANNEX I: Changes in monetary policy instruments and procedures since the start of Stage One

ANNEX II: Institutional status of central banks in Community countries

CHANGES IN MONETARY POLICY INSTRUMENTS AND PROCEDURES SINCE THE START OF STAGE ONE

Since the start of Stage One of EMU in July 1990, major changes in the techniques for executing monetary policy operations have been introduced in Belgium, Denmark, Germany, Greece and Portugal. This section briefly describes these changes.

Belgium

Prior to January 1991, monetary policy in Belgium relied almost entirely on the setting of the interest rate on Treasury bills. The central bank had discretion to set the rate in consultation with the Minister of Finance. The size of the Treasury bill market and the facility to issue bills "on tap" (i.e. Treasury bills were regularly available to banks upon request) allowed the central bank to exercise close control over short-term market interest rates. The system, however, had some drawbacks. In particular, monetary policy had to rely on a single instrument. The instrument also had a highly visible budgetary impact which could restrict the scope for adjusting interest rates flexibly. Finally, by reducing their portfolio in Treasury bills, banks were able to pass on liquidity shortages to the Treasury which, in turn, had to adjust its position by resorting to central bank credit facilities.

The monetary reform introduced in January 1991 had two major components. On the one hand, measures were taken to enhance competition in the primary market for short-term public securities. In particular, the issuing of Treasury bills "on tap" was replaced by a system of periodic auctions, which are open to a wide range of investors. Measures were also adopted to develop an efficient secondary market.

On the other hand, the central bank no longer sets the leading money market rate administratively, but rather conducts interest rate policy through interventions on the money market. Firstly, it uses periodic allocations of credit by tender which supply liquidity to the market on a routine basis. The interest rate applied also signals the stance of monetary policy. Secondly, between allocations, the central bank conducts open market operations on a daily basis to manage liquidity conditions. Thirdly, a deposit facility and an overdraft facility are available to meet individual end-of-day liquidity surpluses and deficits, respectively. The interest rates applied to these facilities also provide a lower limit and an upper limit to very short-term market rates. Finally, the central bank uses two official rates: the discount rate, applied to the mobilisation of a small amount of commercial bills, and the interest rate on advances above a pre-set amount. These rates are primarily of a symbolic nature and are normally used to announce a change in policy, for example when other central banks change their official interest rates.

Annex I

Denmark

Prior to April 1992, the Danmarks Nationalbank offered two standing facilities: an unlimited deposit facility to absorb excess liquidity in the money market; and a limited overdraft facility to supply liquidity. The interest rates applied on these facilities were linked to the official discount rate. In practice, this approach limited the flexibility of policy.

On 1st April 1992, the Danmarks Nationalbank consequently introduced a new system to enhance operational flexibility. Under the new procedure, two-week certificates of deposit are issued by the central bank on a regular weekly basis. To ensure that banks have sufficient surplus liquidity to purchase certificates of deposits, Danmarks Nationalbank will, if necessary, supply liquidity through repos in government paper. The interest rate on the certificates steers short-term market rates. The Bank may buy back certificates when there is a need to supply liquidity.

At the same time, the overdraft facility was suppressed and the deposit facility restricted. The amount of deposits which banks may hold at the central bank on which interest is paid has been limited to a monthly average of 5% of their own funds. Deposits in excess of this percentage are no longer remunerated. The averaging provision for the remunerated element partly helps to limit the variability of very short-term market rates.

Germany

The Deutsche Bundesbank issued liquidity paper with three-, six-, and nine-month maturities for the first time on 1st March 1993. The issue was launched in accordance with a newly introduced section 42 of the Deutsche Bundesbank Act, pursuant to which the Bundesbank may issue Treasury discount paper of the Federal Republic of Germany up to the maximum amount of DM 50 billion for its own account. Issues of this kind serve as a monetary policy instrument and do not imply a financing of any public budget. The issue of liquidity paper is directly connected both in time and substance with a substantial relaxation of the prevailing minimum reserve requirements. It implies an extension of the set of monetary policy instruments and should strengthen the competitiveness of German commercial banks. From a monetary policy point of view, this instrument enhances the flexibility in the execution of monetary policy insofar as, for instance, it permits a better response to the liquidity effects of turbulence in the foreign exchange markets and allows the central bank to influence non-banks' cash holdings directly. Following the introduction of this instrument, the central bank now has a broader range of open-market policy options at its disposal.

Greece

In December 1992, the Bank of Greece announced the introduction of two new instruments for providing liquidity to the banking system, namely a Lombard-type facility, against collateral of government paper, and a rediscount facility for commercial bills. Both facilities are subject to overall quotas which are allocated among credit institutions according to criteria relating to the size of certain balance sheet items. The interest rates on these two facilities are meant to provide a corridor within which money market rates fluctuate. The already existing overdraft facility is maintained as a means of last resort assistance at penalty rates.

In addition, in order to enhance the flexibility of liquidity management, auctions for currency swaps have been introduced since November 1992. The recent measures are intended to consolidate the use of market-oriented mechanisms in the conduct of monetary policy and thus increase its effectiveness.

Portugal

To improve the efficiency of monetary policy, open money market operations became the main instrument for regulating money market conditions in Portugal in January 1991. Under the new system, central bank intervention is centred on the reserve requirement provisions of banks. The provisions must be fulfilled on average over a period of about one week. Periodic open market operations provide a channel to supply and withdraw liquidity on a regular basis and the rates set by the Banco de Portugal indicate the orientation of monetary policy. These operations take place on the first working day of each maintenance period. The Bank may also resort to occasional open market operations during the reserve period to stabilise very short-term interest rates. Both types of operation are conducted at short-term maturities (up to one week). Initially, they were undertaken principally with repos in domestic Treasury bills. However, since mid-1991, operations to drain liquidity have mainly been carried out by issuing central bank certificates. The central bank also offers a lending facility on the last working day of the weekly maintenance period to allow banks short of funds to meet the reserve requirements. This facility is available for overnight funds and granted at a penalty rate.

The Banco de Portugal also conducts liquidity-absorbing operations at longer maturities, given the existence of a structural liquidity surplus in the money market.

At the end of March 1991, the system of remuneration of reserve requirements was changed. Reserve requirements on new liabilities (increments over and above the stock at end-1990) are now remunerated at near market rates to eliminate the implicit tax involved in holding non-remunerated reserves.

INSTITUTIONAL STATUS OF CENTRAL BANKS IN COMMUNITY COUNTRIES

1. NATIONAL BANK OF BELGIUM

1.1. Objectives and tasks

No explicit statutory objectives are laid down.

The main tasks are: monetary and exchange rate policy; management of official reserves; European and international monetary co-operation; and safeguarding the smooth functioning of payment systems. Other tasks are conferred on the Bank under specific legislative provisions. The National Bank is not responsible for banking supervision.

1.2. Governing bodies

The Bank is directed by the Governor and administered by the Board of Directors assisted by the Council of Regency. It is supervised by the Board of Censors. There is, in addition, the General Council.

The Governor is appointed by the Crown (on a nomination from the Government) for a renewable term of five years. The Governor can be suspended or dismissed by the Crown; this has never happened.

The Board of Directors includes, in addition to the Governor, three to six members appointed by the Crown on the proposal of the Council of Regency for a term of six years. The Board manages the Bank and is in charge of the orientation of policy under the control of the Council of Regency.

The Council of Regency includes the Governor, the Directors and the Regents. Regents are appointed for three years by the general meeting of shareholders (the Belgian State owns 50% of the shares). Five are appointed on the proposal of the Minister of Finance and five on the proposal of the most representative organisations of industry, commerce, agriculture and labour. It has general powers to set the rate and terms of discount, advances and loans and draws up the balance sheet.

The Board of Censors includes eight to ten Censors elected for three years by the general meeting of shareholders. Besides controlling the operations of the Bank, it votes on the budget as proposed by the Council of Regency and approves the annual accounts.

The General Council includes the Governor, the Directors, the Regents and the Censors. It has important administrative functions.

While there is no right of instruction from political authorities, there is a Government commissioner in the Bank. A power of suspension and a right to oppose can be exercised respectively by the Government commissioner and the Minister of Finance against any decision of the Bank contrary to the law, the statutes of the central bank and the interests of the State, but this power was abolished in March 1993 with respect to all the central bank's decisions and operations concerning its basic tasks.

1.3. Independence in the formulation and implementation of monetary and exchange rate policy

The Bank is responsible for the formulation and implementation of monetary policy. Monetary policy is conducted in the context of the exchange rate regime which is determined by the Government. In particular, exchange rate arrangements are adopted by the Crown (the Government) after consultation with the Bank.

The monetary policy reform of January 1991 led to a substantial change in operating procedures (see Annex I of this Report for a description). Since then, the Bank can use a wide range of monetary policy instruments: however, the introduction of reserve requirements needs the approval of the Government. The 1991 reform also included a substantial limitation of central bank financing of the Government. Due to the new legislation adopted in March 1993, "monetary financing" will be completely abolished by June 1993 at the latest.

1.4. Democratic accountability and transparency

There are no institutionalised relations between the Parliament and the Bank, and indeed the Governor has rarely appeared before Parliament. Regarding relations with the Government, the Governor has only rarely attended meetings of the Council of Ministers. In addition to the role of the Government in the appointment procedure described above, the Minister of Finance has to approve the presentation of the weekly financial statements of the Bank. Finally, the Bank publishes an Annual Report.

1.5. Prospective institutional changes

After the adoption of the new legislation in March 1993 strengthening central bank independence and prohibiting "monetary financing", no more changes are currently planned.

2. DANMARKS NATIONALBANK

2.1. Objectives and tasks

The statutory objective is to maintain a safe and secure currency system and to facilitate and regulate payment flows and the extension of credit.

The main tasks are the conduct of monetary policy and exchange rate management. The Bank also manages official reserves and serves as fiscal agent of the central government but is not the banking supervisory authority.

2.2. Governing bodies

The governing bodies are the Board of Governors, the Board of Directors, and the Committee of Directors.

The Board of Governors has three members. The Chairman is appointed by the Crown and the other two members are elected by the Board of Directors. There is no term of office. In practice, appointments are for life, with a retirement age of 70. The Board is fully responsible for the Bank's monetary policy decisions.

The Board of Directors has twenty five members of which two are appointed by the Royal Bank Commissioner, i.e. the Minister of Economic Affairs, eight by Parliament from among its members, while the remaining fifteen members are appointed by the Board to ensure a broad representation of economic life. The term is five years with a possibility of re-election. The Board is competent in administrative and organisational fields.

The Committee of Directors consists of the two members of the Board of Directors appointed by the Royal Bank Commissioner and five members elected by and from among the members of the Board of Directors. The term is one year with a possibility of re-election. The Committee also has administrative and organisational responsibilities.

The Royal Bank Commissioner monitors the Bank's observance of its legal obligations and constitutes the formal link between the Bank and the Government.

The members of the governing bodies are not subject to instructions from political authorities.

2.3. Independence in the formulation and implementation of monetary and exchange rate policy

The monetary policy authority rests with the Bank's Board of Governors, which determines the framework for monetary policy, including interest rates. By tradition, monetary policy has been formulated on the basis of concertation between the Bank and the Government. The Board of Governors has full freedom in implementing monetary policy and in setting instruments. In addition, Denmark fully abides by the "monetary financing" prohibition as laid down in the Maastricht Treaty. The central government finances budget deficits by selling government paper in the market.

The exchange rate policy is set by the Government in concertation with the Bank. Management of exchange rate developments rests with the Bank.

2.4. Democratic accountability and transparency

Accountability is provided for through the composition of the Board of Directors and the Committee of Directors and through a special provision stipulating that the Royal Bank Commissioner and the Minister of Finance are entitled to take part in deliberations on changes in the official discount rate, but without voting rights. Moreover, the Bank is statutorily obliged to publish its annual accounts, when approved by the Board of Directors and the Royal Bank Commissioner, together with an Annual Report.

2.5. Prospective institutional changes

There are no plans for institutional changes.

3. DEUTSCHE BUNDESBANK

3.1. Objectives and tasks

The Deutsche Bundesbank is the currency and note-issuing bank of the Federal Republic of Germany. Its principal objective is to safeguard the currency. The Bank is obliged to support the Government's general economic policy, but without prejudice to the principal objective. The Bank provides banks with payment system services and manages official reserves. It is not responsible for banking supervision.

3.2. Governing bodies

The governing bodies are the Central Bank Council, the Directorate and the Managing Boards of the Land Central Banks (Main Offices which have competence in the respective Länder).

The Central Bank Council (with a maximum of seventeen members) consists of the President and the Deputy President of the Bundesbank, the other members of the Directorate and the Presidents of the Land Central Banks. The Central Bank Council determines the monetary and credit policy of the Bank and is the supreme internal organ.

The Directorate comprises the President, the Deputy President and up to six (currently five) further members. All members of the Directorate are appointed by the President of the Federal Republic on the proposal of the Federal Government after consultation with the Central Bank Council. The Directorate is responsible for implementing the monetary and credit policy decisions of the Central Bank Council. The Directorate also directs and administers the Bank, except in matters falling within the competence of the Managing Boards of the Land Central Banks. Within this framework, the Directorate is responsible for transactions as fiscal agent for the Federal Government and as provider of cash advances to it and its special funds, for transactions with certain credit institutions, for foreign exchange and external transactions, for open market operations and for co-ordination tasks within the Bundesbank as a whole.

The Managing Boards of the nine Land Central Banks consist of the President, the Vice-President and in some cases one further member. The Presidents of the Land Central Banks are appointed by the President of the Federal Republic on the proposal of the Bundesrat (upper chamber of parliament), following submission of a proposal from the competent Land governments and after consultation with the Central Bank Council. The Land Central Banks carry out transactions with the public authorities and credit institutions located in their area.

Members of the governing bodies of the Bank are appointed for a period of eight years. In exceptional cases, appointments may be shorter, but with a two year minimum. Generally, appointments are renewable. The Bank and the members of its governing bodies are independent of instructions from the Federal Government in the execution of the tasks assigned to them under the Bundesbank Act.

3.3. Independence in the formulation and implementation of monetary and exchange rate policy

Monetary and credit policy is determined by the Central Bank Council on its own authority. A provision specifies that the adoption of monetary policy decisions by the Central Bank Council may be deferred for up to two weeks on the request of the Federal Government. Hitherto, the Federal Government has not exercised this power. In any event, the final decision rests with the Central Bank Council.

The instruments of monetary policy are determined by the Bundesbank Act. Within this statutory framework the Bank may employ, develop and refine the monetary policy instruments at its discretion. There is no binding obligation to grant credit to the public sector. The Bank "is permitted" to grant credits to the Federal and Land governments and to certain other public authorities, but only at short term and subject to statutory ceilings. Interest is currently levied at the respective Lombard rate, which is quite close to the market interest rate level.

The Bank operates in the foreign exchange market on its own authority. However, it is the Federal Government that sets central rates, albeit in consultation with the Bank.

3.4. Democratic accountability and transparency

The independence of the Bundesbank as stipulated in the Bundesbank Act rests on a social consensus in favour of a policy geared to price stability. The Bank has no obligation to report to Parliament and the Federal Government, but it regularly informs the public through publications and speeches. The annual accounts are verified by auditors and by the Federal Audit Office.

3.5. Prospective institutional changes

There are currently no plans for institutional changes.

4. BANK OF GREECE

4.1. Objectives and tasks

The statutory objective is to control the currency in circulation and credit. This is considered to imply that monetary stability is the ultimate objective of the Bank.

The main tasks are the implementation of monetary and exchange rate policies in accordance with the general guidelines set by the Government. The Bank has the exclusive right to issue bank notes and manages official reserves. In addition, the Bank is the banking supervisory authority and plays a key role in the country's payment systems.

4.2. Governing bodies

The General Council consists of the Governor, the Deputy Governors and nine non-executive Counsellors. The Governor and the Deputy Governors are appointed for a renewable four-year term by the Government following a proposal of the General Council, while the nine Counsellors are elected by the General Meeting of Shareholders for a renewable three-year term. The Council is entrusted with the general conduct of the affairs of the Bank.

The Governor is the chief executive of the Bank. He or, in his absence, a Deputy Governor presides over the General Council, legally represents the Bank and, on behalf of the Council, decides upon all matters not specifically reserved to the General Council.

A non-voting Government Commissioner can be nominated by the Minister of Finance. He attends the General Meeting of the Shareholders and the meetings of the General Council and can veto decisions if he considers them to be contrary to the Statutes of the Bank or the laws of the State.

4.3. Independence in the formulation and implementation of monetary and exchange rate policy

The Bank formulates monetary policy on the basis of the Government's macroeconomic objectives. The Bank enjoys considerable freedom in adopting monetary targets and in implementing monetary policy. However, the setting of policy instruments is constrained by the fact that the interest rate on government paper is administratively set by the Government, although in consultation with the Bank. Finally, although the Bank is currently obliged to provide overdraft facilities to the Government, the amount is in practice limited.

Exchange rate policy is formulated by the Government in consultation with the Bank, which in turn is responsible for its implementation.

4.4. Democratic accountability and transparency

There is a competent parliamentary committee which expresses an opinion regarding the suitability of candidates proposed for appointment as Governor. Transparency is ensured by the publication of an Annual Report and certain financial statements.

4.5. Prospective institutional changes

The Bank of Greece has proposed to the Government legislative changes concerning its objectives and main tasks, independence, organisational structure, and monetary functions and operations. The proposed legislation aims at increasing the degree of independence of the Bank in the near future and making its Statute compatible with the Maastricht Treaty.

5. BANCO DE ESPAÑA

5.1. Objectives and tasks

The Bank is entrusted with the implementation of monetary policy with a view, in particular, to safeguarding the value of the currency.

The main tasks of the Bank are: the implementation of internal and external monetary policy; the issuing of bank notes and the regulation of their circulation; the ownership and management of official reserves; and the supervision of banking institutions and of certain financial markets. The Bank also acts as fiscal agent of the Government and advisor to the Government on financial and economic matters.

5.2. Governing bodies

The governing bodies comprise the Governor, the Deputy Governor, the General Council and the Executive Council.

The Governor is appointed by the Crown on a proposal of the President of the Government for a renewable four-year term. The Governor represents the Bank externally, chairs both the General Council and the Executive Council with a casting vote, and acts as Chief Executive Officer in the management of the Bank.

The Deputy Governor is appointed by the Government on a proposal of the Minister of Economy and Finance for a renewable four-year term. The Deputy Governor substitutes for the Governor in the case of vacancy, absence or illness, and may exercise all powers delegated to him by the Governor.

The members of the General Council are: the Governor; the Deputy Governor; six members appointed by the Government; two ex-officio members who are the Director-General of the Budget and the Director-General of the Treasury and Financial Policy; the Director-Generals of the Bank (up to four); and a representative of the staff of the Bank. The six members of the General Council are appointed by the Government for a renewable three-year term; the Director-Generals of the Bank are appointed by the Minister of Economy and Finance on a proposal of the Executive Council of the Bank for an unspecified term. The General Council takes the decisions and adopts the guidelines necessary to ensure the performance of the tasks entrusted to the Bank. It also acts as advisor to the Government and approves the Bank's reports and regulations, submitting the former to the Government.

The Executive Council comprises the Governor, the Deputy Governor, three members elected by the General Council from the six members appointed by the Government, and one Director-General of the Bank. The Executive Council implements the policy guidelines issued by the General Council. It drafts and proposes the Bank's reports which are submitted for approval to the General Council, and decides upon any authorisation required under banking and financial legislation as well as on the sanctions envisaged under this legislation.

There is no provision in Spanish legislation for the issuance of instructions by the Government to the governing bodies of the Bank. Moreover, according to the Bank's Law, "the Banco de España shall act with independence of the Government, within the limits established under this Law". These limits, however, do not consist of precise instructions, but refer rather to the general division of responsibilities for monetary policy as indicated below.

5.3. Independence in the formulation and implementation of monetary and exchange rate policy

The current Banco de España Law states that "the Bank shall conduct monetary policy both domestically and externally in accordance with the general objectives set by the Government, implementing it as it deems most appropriate for attaining the stated ends". Accordingly, the general objectives of monetary policy are formulated by the Government, while the implementation, both domestically and externally, is the responsibility of the Banco de España. In that capacity, the Bank may exercise freedom of choice in the instruments it wishes to employ.

In practice, the general objectives of domestic monetary policy are set in terms of annual targets for monetary aggregates which are established by the Bank and adopted by the Government.

Exchange rate policy is conducted in the framework of the EMS. Thus, central rates are set by the Government in close consultation with the Bank; thereafter, exchange rate policy is determined by the Bank. In this regard, it must be noted that the Bank has full freedom with regard to interventions in the foreign exchange market.

5.4. Democratic accountability and transparency

The Parliament is entitled to call on the Governor to report on monetary policy and other areas related to the tasks and functions of the Bank. In addition, the Bank publishes an Annual Report and monthly Economic Bulletins which examine economic and financial developments and explain monetary policy.

The Bank publishes Annual Accounts. The management and operations of the Bank are audited by the Spanish Court of Auditors.

5.5. Prospective institutional changes

The Government has recently approved a Draft Law on the Autonomy of the Bank which has been submitted to Parliament for enactment. This Draft Law introduces all the provisions of the Treaty of European Union relating to central banks and will come into force on 1st January 1994. The tasks and functions of the Bank are modified to encompass both the definition and implementation of monetary policy. The main objective assigned to monetary policy is price stability. "Monetary financing" of the public sector is prohibited. The term of office of the Governor and the Deputy Governor is set at six years, non-renewable.

6. BANQUE DE FRANCE

6.1. Objectives and tasks

The Bank has the objectives of overseeing money and credit; in this connection it oversees that the banking system functions smoothly.

The main tasks are: to issue bank notes; to participate in the preparation and implementation of monetary policy; to implement foreign exchange policy and to manage official reserves; to hold the Treasury bank account; to participate in the management of the payment system; to participate in banking and financial regulation and to supervise credit institutions on behalf of the Banking Commission.

6.2. Governing bodies

The governing bodies of the Bank are: the Governor, the two Deputy Governors and the General Council.

The Governor and Deputy Governors are appointed by the Government without a fixed term of office. The Governor manages and administers the Bank and exercises all the powers not vested in the General Council, which he chairs.

The General Council includes the Governor and Deputy Governors and the Councillors. Nine of the Councillors are appointed by the Government on a proposal from the Minister of Economic Affairs and Finance while one Councillor is elected by the personnel of the Bank. All the Councillors are appointed for six years. The Council deals with operational, administrative and financial matters.

A Censor appointed by the Minister of Economic Affairs and Finance attends meetings of the General Council and may raise objections to decisions of the Council. If he does object, the Governor asks the General Council to reconsider the matter.

6.3. Independence in the formulation and implementation of monetary and exchange rate policy

The Bank contributes to the definition of the monetary policy adopted by the Government. The implementation of monetary policy is the subject of joint decisions by the Minister of Economic Affairs and Finance and the Governor. This covers both the choice of instruments and the changes affecting them.

Government deficits are not financed by the central bank. Since the agreement on the operation of the Foreign Exchange Stabilisation Fund in 1973, central bank assistance to the Government only involves neutralising the impact on the Treasury's liquidity position of the Fund's operating results. There is therefore no central bank financing of the public authorities through this channel. Moreover, the Bank does not purchase securities, either government or private sector, in the primary market.

Operations in the foreign exchange market are conducted by the Bank in close consultation with the Minister of Economic Affairs and Finance, who may give the Bank general directions in this area.

6.4. Democratic accountability and transparency

The Governor takes an oath before the President of the Republic that he will duly and faithfully manage the Bank in conformity with the laws and regulations. He also presents the report on the Bank's operations to the President of the Republic in the name of the General Council as often as he deems it necessary, and at least once a year. Reports are regularly published describing monetary and economic developments and the policy actions of the Bank.

6.5. Prospective institutional changes

The statutes of the Bank will have to be amended in order to be brought into line with the provisions of the Maastricht Treaty. The Government has, in a number of recent statements, confirmed its commitment to implement such a reform but has not to date officially presented any draft amendments. A parliamentary group recently announced the tabling of a bill to make the Bank independent.

7. CENTRAL BANK OF IRELAND

7.1. Objectives and tasks

The statutory objective is to safeguard the integrity of the currency.

The main tasks include: issuing currency; formulating and implementing monetary policy; managing official reserves; overseeing financial markets; and acting as fiscal agent of the Government and as registrar of government securities. The Bank is also responsible for banking and financial regulation.

7.2. Governing bodies

The Bank is governed by the Board of Directors which consists of the Governor and up to nine Directors. The Governor is appointed by the President of the Republic on the advice of the Government for a renewable term of seven years. Other members of the Board are appointed by the Minister of Finance for a period of five years.

7.3. Independence in the formulation and implementation of monetary and exchange rate policy

The Bank is responsible for the formulation and implementation of monetary policy. Decisions on monetary policy are taken in the context of the exchange rate policy set by the Government but without ongoing reference to the Finance Ministry. The Government's input to monetary policy is via the Secretary of the Department of Finance in his capacity as a member of the Board of the Central Bank. The Minister can require the Governor (and/or the Board) to consult with him in regard to the execution and performance by the Bank of its general function and duty. This power has never been used.

The Bank exercises full freedom in its choice and use of instruments. There are no obligations on the Bank to finance the Government or public sector and, in practice, such financing has been extremely limited.

While the determination of exchange rate policy is ultimately a matter for Government, the Minister of Finance is statutorily obliged to consult with the Bank on matters relating to exchange rate policy.

7.4. Democratic accountability and transparency

The Bank is required to prepare an Annual Report and send it to the Minister of Finance, who has the duty to present it to both Houses of Parliament. Similarly, a Statement of the Bank's annual financial accounts is provided to the Comptroller and Auditor General; he, in turn, after audit and certification, sends it to the Minister, who circulates it to the Members of Parliament.

7.5. Prospective institutional changes

A bill incorporating changes in the Bank legislation to make it consistent with the Treaty on European Union is intended to be sent to Parliament before the end of this year. Proposed changes include provisions for modifying the current right of the Minister of Finance to request that the Governor consults him; clarifying the role of the Bank in regard to payment systems; permitting the disclosure of information to the ECB; and enabling the Bank to comply with Treaty requirements relating to the collection of statistics and the application of special deposits and reserve ratios on behalf of the ECB.

8. BANCA D'ITALIA

8.1. Objectives and tasks

Although no statutory objective is set, the Italian Constitution states that the Republic has a duty to protect savings, which implies that the Bank should pursue the goal of monetary stability.

Main tasks are: issue of bank notes; implementation of monetary policy; supervision of banks and other financial institutions; fiscal agent of the Government; and management of official reserves jointly with the Italian Foreign Exchange Office.

8.2. Governing bodies

The governing bodies are: the Governor, the Director General and two Deputy Director-Generals, forming the Directorate; and the Board of Directors.

The Directorate is not a collegiate body, since the Governor has a pre-eminent position. The members are appointed for life by the Board of Directors on the approval of the Government; a dismissal should follow the same procedure. The Directorate has the responsibility for carrying out the tasks of the Banca d'Italia and it is not subject to instructions from political authorities in the monetary field.

The Board of Directors is composed of the Governor, acting as Chairman, and thirteen members appointed by the local General Assembly of Shareholders for a three-year term. None of the members can hold a political office. The Board is in charge of the administration of the Bank but is not empowered to deal with monetary or exchange rate policy nor with matters relating to banking supervision.

8.3. Independence in the formulation and implementation of monetary and exchange rate policy

Annual monetary policy objectives are set by the Governor and are formally approved by the Government. In no case have the objectives presented by the Governor been rejected.

The Bank has full freedom in setting instruments for the implementation of monetary policy. An important step in this direction was the acquisition of the right to set the discount rate autonomously, which was granted in February 1992.

The main credit facility to the Treasury is an unconditional overdraft on a direct credit line, up to the limit of 14% of total expenditures planned in the Budget Law. Above this limit, in case of financing needs that conflict with monetary policy targets, the Treasury may only obtain an "extraordinary advance" following an authorisation by the Parliament with a specific law (this has happened only once in January 1983).

The Bank operates within the exchange rate regime set by the Government, but has full discretion regarding the conduct of foreign exchange market operations.

8.4. Democratic accountability and transparency

The Treasury has supervisory powers over the issue of bank notes, the administration and the accounting of the Banca d'Italia. A representative of the Treasury attends the meetings of the Board and the Board conclusions take effect if the Treasury does not oppose them within five days. The Governor may be invited to appear before Parliamentary Commissions and to give an account of the conduct of monetary policy. An Annual Report and other documents are published.

8.5. Prospective institutional changes

In 1993, the Government submitted to Parliament a bill to reform the overdraft facility which provides for: abolition of any form of advances to the Treasury; conversion of the existing debt on the overdraft facility into government securities with a specified term to maturity; and creation of an interest bearing account at the Bank which must have a permanent positive balance. The same bill transfers to the Banca d'Italia the power to modify the compulsory reserve ratio. In addition, a first reform of the required reserve regime has been decided, which reduces the required reserve ratio. Finally, other institutional changes required to fulfil the criteria of the Maastricht Treaty are under joint examination by the Banca d'Italia and the Treasury.

9. INSTITUT MONÉTAIRE LUXEMBOURGEOIS

9.1. Objectives and tasks

Luxembourg is linked to Belgium in an economic union comprising a monetary association, dating back to 1922. The Institut Monétaire Luxembourgeois (IML), created in 1983, does not exercise at this stage all the attributions of a fully-fledged central bank, as the National Bank of Belgium currently fulfils a series of tasks for both Member States of the association.

The tasks of the IML are: to issue notes and coins; to promote the stability of the currency and to that effect to oversee the proper functioning of financial markets; to execute obligations and to exercise rights resulting from international agreements in the monetary and financial field; and to exercise the prudential supervision of the financial sector.

9.2. Governing bodies

The governing bodies of the IML are the Management and the Council.

The Management is a collegiate body, comprising the Director General and two Directors. They are appointed by the Grand-Duke on a proposal from the Council of Ministers for a renewable six-year term. The Management is the executive organ of the IML, responsible for the fulfilment of the IML's objectives. If there is a fundamental disagreement between the Government and the Management on the IML's policy and the execution of its tasks, the Government with the consent of the Council of the IML may propose to the Grand-Duke the collective, and only the collective, dismissal of the Management. Without prejudice to this provision, members of the Management are not subject to instructions from political authorities.

The Council has seven members appointed by the Council of Ministers for a renewable four-year term. The Council provides guidelines and gives opinions on specified activities of the IML, approves the annual accounts and the yearly budget of the IML but has no competence in the field of prudential supervision. The members of the Council are not subject to instructions from political authorities.

9.3. Independence in the formulation and implementation of monetary and exchange rate policy

The "last word" in monetary and exchange rate policy decisions belongs to the Government and the IML avails itself only of a limited number of monetary policy instruments. Although the IML has the authority to regulate the use of banks' franc-denominated liabilities, it has never used this facility.

9.4. Democratic accountability and transparency

The Management of the IML has statutory obligations to submit an annual report, financial accounts and a budget for the approval of the Government. These documents are forwarded to Parliament. The Government-appointed auditor of the IML also draws up an annual report which is transmitted to the council of the IML, the Government and Parliament. In addition, the Director General of the IML traditionally meets for a twice-yearly exchange of views with the Parliamentary Committee for Budgetary and Financial Matters.

9.5. Prospective institutional changes

The passage to the final stage of EMU will entail substantial amendments to the monetary association with Belgium, with the IML taking over the full functions of the central bank of Luxembourg. A draft bill to that effect is in preparation at the IML.

10. DE NEDERLANDSCHE BANK

10.1. Objectives and tasks

The statutory objective of the Bank is to safeguard the value of the currency. Thus price stability is clearly a policy objective.

The Bank's main tasks include: to issue bank notes; to facilitate domestic and external money transfers; to manage official reserves; and to supervise banks and other financial institutions.

10.2. Governing bodies

The Governing Board and the Supervisory Board are the governing bodies of the Bank and the Bank Council is an advisory body.

The Governing Board consists of the President, the Secretary, as well as not less than three (the present number) and not more than five Executive Directors. They are nominated by a joint meeting of the Governing Board and the Supervisory Board, and appointed by the Crown on a proposal by the Cabinet for a renewable seven-year term. All policy decisions of the Bank are made by the Governing Board, which is also fully responsible for the management of the Bank. Except in cases of a major policy conflict between the Bank and the Government, the Governing Board is not subject to instructions from the Government regarding the conduct of monetary policy.

The Supervisory Board consists of twelve members, appointed by the Minister of Finance for a renewable term of four years. It supervises the Bank's business affairs and adopts the annual balance sheet and profit and loss account. A Royal Commissioner supervises the affairs of the Bank on behalf of the Government.

The Bank Council consists of sixteen members and the Royal Commissioner. Its role is to offer advice to the Bank and the Minister of Finance on matters of the Bank's policy. Four members are appointed by and from the members of the Supervisory Board. The other twelve are appointed by the Crown, and include financial experts and representatives of industry and labour.

10.3. Independence in the formulation and implementation of monetary and exchange rate policy

The Bank has full freedom regarding the formulation and implementation of domestic monetary policy. As the Minister of Finance is responsible to Parliament for the conduct of monetary policy, regular consultation between the Bank and the Minister is required.

In the event of a major conflict, the Minister of Finance has the authority to give such directions to the Governing Board as he thinks necessary for the Bank's policy to be properly co-ordinated with the Government's monetary and financial policies. The Governing Board, however, can state its objections to these directions and appeal to the Crown. The Crown's decision can only be taken by the Council of Ministers meeting in plenary session. If it is decided that the Governing Board has to comply with the directions, the reasoned decision of the Crown, as well as the Bank's objections, would be published in the official gazette; in such an event, a dispute would most likely cause a major political crisis. However, until now the Minister of Finance has never exercised his statutory right to give directions; this was intended by the legislator, and has continued to be considered by policy makers, as only an ultimate remedy. In practice, therefore, the Bank has a high degree of independence and has complete freedom to enact measures of monetary control such as cash reserves, providing the banking system has been consulted.

The Bank has an obligation to grant secured and interest-free credit to the Treasury, on request of the Minister of Finance, to a maximum of only Fl. 150 million. A further, limited and collateralised credit facility is agreed yearly on which the Minister of Finance can draw to bridge temporary cash needs.

Participation in exchange rate arrangements as well as the acceptance of changes in central rates is determined by the Government, after consultation with the Bank. Within the constraints posed by the EMS arrangement, the Bank has full freedom in the formulation of the strategy with respect to exchange rate policy and in the use of instruments (interest rates, intervention, the fluctuation margin).

10.4. Democratic accountability and transparency

The Minister of Finance is accountable to Parliament for the conduct of monetary policy. As required by the Bank Act, the Governing Board publishes weekly a summary balance sheet of the Bank. Furthermore, the Bank publishes an Annual Report (including the annual accounts) on its activities.

10.5. Prospective institutional changes

It is envisaged that an explicit clause will be added to the Bank Act that all operations of the Bank by the start of Stage Two shall be in accordance with Article 104 of the Treaty referring to the prohibition of "monetary financing". Necessary amendments to legislation will probably be laid before Parliament before the summer of 1993. In accordance with the Treaty, the statutory right of the Minister of Finance to give instructions to the Bank will be abolished before the establishment of the ESCB. Furthermore, the appointment procedures, the composition and the structure of the governing bodies of the Bank will be reconsidered. Additionally, the Government considers it advisable to give Parliament the opportunity to hear the President of the Nederlandsche Bank on the activities of the ESCB, in a manner comparable to provisions in the Treaty.

11. BANCO DE PORTUGAL

11.1 Objectives and tasks

The objectives of the Bank are the maintenance of internal monetary stability and the external solvency of the currency.

The main tasks are: to define, jointly with the government, and to implement monetary and exchange-rate policy; to hold and manage the official reserves; to act as intermediary in the state's international monetary relations; and to oversee the stability of the national financial system. In the latter respect the Bank has responsibility for banking supervision.

11.2 Governing bodies

The governing bodies of the Banco de Portugal are the Governor and the Board of Directors. The Governor and the members of the Board are appointed for five-year renewable terms by the Council of Ministers on a proposal from the Minister of Finance. The members of the Board are not subject to instructions; however, there are frequent consultations with the Minister of Finance. Furthermore, the law explicitly states that the Bank take into account the Government's guidelines. In addition, there is a Board of Auditors and an Advisory Board.

11.3 Independence in the formulation and implementation of monetary and exchange rate policy

The formulation of both monetary and exchange rate policy is decided jointly with the Government. The Bank has the responsibility for the implementation of monetary policy and has full freedom in setting policy instruments. One important qualification, however, concerns the policy measures that, by law, have to be published in the form of Notices (Avisos) of the Banco de Portugal before coming into effect. The Avisos have to be signed by the Minister of Finance.

Within the Exchange Rate Mechanism the choice of the central rate is the responsibility of the Government after consulting the Bank. The Bank is responsible for the implementation of exchange rate policy and for the management of the exchange rate within the fluctuation bands.

There are no provisions for resolving conflicts. The most important tasks that might conceivably conflict with monetary policy are prudential supervision and lender of last resort functions. Additionally, the central bank statutes do not preclude the underwriting of Treasury bills, under terms agreed between the Finance Ministry and the Bank.

11.4 Democratic accountability and transparency

The Board of Auditors and the Advisory Board perform important functions to ensure transparency. Furthermore the Annual Report and Financial Statements have to be approved by the Minister of Finance taking into account the advice of the Board of Auditors. In addition, the Governor is invited to appear before the relevant Committees of Parliament.

11.5 Prospective institutional changes

The only immediate change envisaged in the central bank statute is an amendment to prohibit the underwriting of Treasury bills. Independence will be further reinforced within the prescribed schedule in the Treaty in line with the recent revision of the Portuguese Constitution.

12. BANK OF ENGLAND

12.1. Objectives and tasks

Although there are no explicit statutory objectives in the monetary policy field, the 1987 Banking Act gives the Bank, in its role as banking supervisor, the objective of protecting the interests of depositors. In practice, the main objectives are: to maintain the integrity and value of the currency; to safeguard the integrity of the financial system, including payment and settlement arrangements; and to promote the efficiency and effectiveness of the financial sector.

When the appointment of the next Governor, Mr. E.A.J. George, was announced on 22nd January 1993, the Chancellor said that the new Governor's central responsibility should be "to support the Government in its determination to bring a lasting reduction in the rate of inflation, the only sound basis on which sustainable growth and secure jobs can be built".

The main tasks of the Bank are: the implementation of monetary policy, the issue of currency, management of official reserves and supervision of banks.

12.2. Governing bodies

The governing body is the Court of Directors. It consists of the Governor, the Deputy Governor and sixteen Directors, up to four of whom may have executive responsibilities in the Bank. Governors and Directors are appointed by the Crown on the advice of the Prime Minister. The Governor and Deputy Governor are appointed for renewable five-year terms, and Directors for renewable four-year terms. The Court is responsible for the affairs of the Bank.

Members of the Court are not individually subject to instructions from political authorities. However, the Treasury has the legal power to issue "directions" to the Bank "in the public interest" after consultations with the Governor, though this power has never formally been invoked.

12.3. Independence in the formulation and implementation of monetary and exchange rate policy

The Bank's responsibility is to advise on monetary policy and to carry out the policy that has been agreed with the Government. Final decisions on monetary policy matters are for the Government. When a conflict arises between the views of the Bank and the Government, the Government's opinion will ultimately prevail. It is open to the Bank to make its views public.

The main instrument of monetary policy is the short-term interest rate, which the Bank influences through its operations in the money markets. The Bank has considerable discretion in the conduct of these operations, although the interest rate objective is determined by the Government.

The Bank acts as fiscal agent for the Government and at times provides short-term finance in the form of "Ways and Means Advances" although at others the Government has a deposit at the Bank. Neither of these activities, nor the Bank's role as supervisor of banks and certain market participants, conflict in any way with its monetary policy functions.

Foreign exchange market activities are conducted by the Bank as agent for the Government, which owns the foreign exchange reserves. As agent, the Bank operates within guidelines set by the Treasury.

12.4. Democratic accountability and transparency

The Bank makes an Annual Report to Parliament presenting the accounts, and a further Annual Report describing its conduct of supervision. In addition, the Bank regularly publishes reports commenting on economic and financial developments, and the Governor appears frequently before Committees of Parliament. Formally, however, the Chancellor of the Exchequer or another Treasury Minister answers for the Bank in Parliament.

The Chancellor recently announced new measures to increase the transparency of the monetary policy process. These include the announcement of a Government target for inflation; publication of monetary reports on data relevant to monetary policy by the Treasury; and publication of a quarterly report from the Bank on the progress being made in achieving the Government's inflation target.

12.5. Prospective institutional changes

There are no plans for institutional changes other than the moves described above towards greater openness of monetary policy. If the United Kingdom were to participate in Stage Three of EMU, institutional change would be required.

ABBREVIATIONS AND SYMBOLS

COUNTRIES[6]

BE	Belgium
DK	Denmark
DE	Germany
GR	Greece
ES	Spain
FR	France
IE	Ireland
IT	Italy
LU	Luxembourg
NL	Netherlands
PT	Portugal
UK	United Kingdom
US	United States of America
JP	Japan

CURRENCIES

ECU	European Currency Unit
BEF	Belgian/Luxembourg franc
DKK	Danish krone
DEM	Deutsche Mark
GRD	Greek drachma
ESP	Spanish peseta
FRF	French franc
IEP	Irish pound
ITL	Italian lira
NLG	Dutch guilder
PTE	Portuguese escudo
GBP	Pound sterling
USD	US dollar
JPY	Japanese yen

[6] In accordance with Community practice, countries are listed in the Report using the alphabetical order of the national languages.

OTHER ABBREVIATIONS

BIS	Bank for International Settlements
CBHs	Cross-Border Holdings
ECB	European Central Bank
ECOFIN Council	Council of the European Communities (Economic and Financial Affairs)
EEA	European Economic Area
EEC	European Economic Community
EFTA	European Free Trade Association
EMCF	European Monetary Co-operation Fund
EMI	European Monetary Institute
EMS	European Monetary System
EMU	Economic and Monetary Union
ERM	Exchange Rate Mechanism of the European Monetary System
ERM Original Narrow Band Countries	EEC Member States that participated in the narrow band of the ERM in 1979 (BE, DK, DE, FR, IE, LU, NL)
ESCB	European System of Central Banks
GDP	Gross Domestic Product
GNP	Gross National Product
IML	Institut Monétaire Luxembourgeois
OECD	Organisation for Economic Co-operation and Development
PPP	Purchasing Power Parity