

Confidential
(Translation)

MINUTES *
OF THE 236th MEETING OF THE COMMITTEE OF GOVERNORS
OF THE CENTRAL BANKS OF THE MEMBER STATES
OF THE EUROPEAN ECONOMIC COMMUNITY
HELD IN BASLE ON MONDAY, 12th JUNE 1989 AT 9.30 a.m.

Those present at the meeting were: the Governor of the Bank of Greece and Chairman of the Committee, Mr. Chalikias, accompanied by Mr. Papademos and Mr. Karamouzis; the Governor of the Banque Nationale de Belgique, Mr. Godeaux, accompanied by Mr. Rey and Mr. Michielsen; the Governor of Danmarks Nationalbank, Mr. Hoffmeyer, accompanied by Mr. Mikkelsen; the President of the Deutsche Bundesbank, Mr. Pöhl, accompanied by Mr. Schlesinger and Mr. Rieke; the Governor of the Banco de España, Mr. Rubio, accompanied by Mr. Linde and Mr. Durán; the Governor of the Banque de France, Mr. de Larosière, accompanied by Mr. Waitzenegger and Mr. Cappanera; the Governor of the Central Bank of Ireland, Mr. Doyle, accompanied by Mr. O'Grady Walshe and Mr. Reynolds; the Governor of the Banca d'Italia, Mr. Ciampi, accompanied by Mr. Dini and Mr. Santini; the President of De Nederlandsche Bank, Mr. Duisenberg, accompanied by Mr. Muller; the Governor of the Banco de Portugal, Mr. Tavares Moreira, accompanied by Mr. Pêgo Marques and Mr. Amorim; the Governor of the Bank of England, Mr. Leigh-Pemberton, accompanied by Mr. Crockett and Mr. Price; the Vice-President of the Commission of the European Communities, Mr. Christophersen, accompanied by Mr. Costa, Mr. Kolte and Mr. Boyd; the Director General of the Luxembourg Monetary Institute, Mr. Jaans. Also present at the meeting was Mr. Dalgaard, Chairman of the Group of Experts. The Secretary General of the Committee, Mr. Morelli, his Deputy, Mr. Bascoul, Mr. Scheller and Mr. Giles, and Mr. Bockelmann and Mr. Dagassan also attended.

The Chairman opened the meeting by welcoming Mr. Christophersen, Vice-President of the Commission with responsibility for economic and financial affairs, who was taking part in the Committee's work for the first time; he recalled that in May Mr. Delors had said that the Commission would in future be represented either by its President or by Mr. Christophersen, Vice-President,

* Final text, identical to the draft, approved at the meeting on 11th July 1989.

with whom the Committee would undoubtedly have the same close and constructive relations.

The Chairman added that by tradition the June meeting was confined to a few items only, principally the "monitoring" exercise, but that this time a special subject was due for discussion, namely the the Governors' opinion required for the revision of the ECU. This subject was dealt with within the framework of the Board of Governors of the EMCF (see Minutes of the 160th meeting).

I. Approval of the minutes of the 235th meeting

In view of the late distribution of the draft the Chairman proposed that approval of the minutes be held over until the July meeting.

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

- Preparation by the "Dalgaard Group";
- Statistical charts and tables

The Chairman noted that the Alternates had held only a short meeting that morning devoted entirely to finalising the opinion of the Board of Governors of the EMCF on the revision of the ECU; the "monitoring" exercise had therefore been prepared only by the experts and Mr. Dalgaard would give his customary report.

A. Statement by Mr. Dalgaard

The dollar had risen steeply in the first half of May; between late April and 20th May it had appreciated by almost 10% despite, firstly, a continued reduction in interest rate differentials (for example vis-à-vis the Deutsche Mark, with the 3-month differential narrowing from 4% in late March to 2.5% recently, the lowest level for quite some time) and, secondly, substantial intervention in particular by the Federal Reserve. However, during the last two or three weeks the dollar had fluctuated below the earlier peak. Several factors accounted for this slight easing:

- the narrowing of interest rate differentials had finally had an impact;

- the markets had expected a further decline in interest rates in the United States, especially when it had seemed clear that the Federal Reserve had eased monetary policy somewhat;
- interventions had been continued on a large scale.

Opinions differed as to the impact of these interventions. The experts from the Deutsche Bundesbank believed that in the present circumstances interventions carried out as they had been had no effect on exchange rates. On the contrary, they had been taken by the market as an opportunity to purchase dollars without putting pressure on its rate. Generally, the experts from the other central banks agreed that the interventions should and could have been conducted more effectively but considered that they had nonetheless had some impact. In particular the large sales made by the Federal Reserve had convinced the markets that the US authorities did not want a stronger dollar, whereas a few weeks ago it had been widely felt that they were unconcerned about the level of the dollar. It had also been pointed out that the central banks had now been intervening on the market for so long that a complete halt might be interpreted as a lack of interest on their part in exchange rates and would have an undesirable influence on the markets.

Intervention sales in May had reached a record total of over US\$ 19 billion. Slightly larger interventions had been made in early 1987, but in the form of purchases. The pattern of interventions was rather unusual in that the Federal Reserve had accounted for a substantial share with a record figure of US\$ 6.7 billion; the Bank of Japan had sold US\$ 5.5 billion, also a record for it, and the Bundesbank, despite its doubts as to their effectiveness, had undertaken sales of US\$ 1 billion, more than most of the other EC central banks. It was difficult to say whether the fundamental trend of the dollar had changed; market sentiment seemed to be somewhat different, but the international disturbances, for example in China, had not had any very significant influence.

The yen had continued to weaken not only vis-à-vis the dollar but also against the European currencies. In February the yen/Deutsche Mark rate had stood at about 68.5; now, in early June, it was about 73, which represented a large decline of over 6%. This development reflected the political scandals in Japan, which were not yet entirely overcome, and events in China, which had affected the yen more than other currencies.

The situation within the EMS had remained calm. The Deutsche Mark had still shown a weak trend up to late May, despite a widening of interest rate differentials and large intervention purchases by central banks. Nonetheless, the Deutsche Mark remained the strongest currency in the exchange rate mechanism and still had the lowest interest rates in the Community; in late May there had seemed to be signs of a change in favour of the German currency. The French franc had weakened slightly from early May, primarily owing to a contraction of interest rate differentials. These had stood at 1 3/4% in late May, compared with 5% a year ago. Though weakening a little, the French franc still held a position around the middle of the band, which was a sign of greater strength than during most of the last two years. The upward trend of the lira had continued until late May; it had then been subject to a bout of weakness but remained relatively strong. The Banca d'Italia had therefore not considered it necessary to raise interest rates to defend the exchange rate, particularly as interest rates were already fairly high so as to ensure the necessary sales of government securities. In Ireland, the position of the Irish pound had stabilised after the increase in interest rates in April. The net capital outflow had ceased. Residents were continuing to invest abroad following the measures to liberalise capital movements early this year but, attracted by high interest rates in Ireland, there had been inflows from non-residents.

Sterling had been weak, primarily as a result of high inflation, strikes and the unfavourable balance-of-payments position. When the weakening had become more pronounced the base rate had been raised by 1 percentage point to 14% on 24th May and some intervention had been undertaken. The pound had nevertheless continued to weaken and in early June had stood 5% below the January/February peak. The Spanish peseta had undergone a pronounced change. In early May it had still been subject to upward pressure; the Banco de España had countered this with large-scale intervention, which had held the rate at a ceiling of Pts. 62 to DM 1. The market had finally accepted that the exchange rate would not rise further and it had begun to soften. Some fiscal measures might also have contributed to this. Subsequently, rumours that the peseta would join the exchange rate mechanism led to a significant weakening of the Spanish currency as the market believed that it could not join at too high a level. In early June it had stood at about Pts. 65 to DM 1. The Spanish Minister of Finance had announced that the

peseta would join the exchange rate mechanism before mid-1990 with the wider margin of 6%.

III. Adoption of the Committee's report to the EC Ministers of Finance on developments on the foreign exchange markets of the nineteen countries participating in the concertation procedure during May and the first few days of June 1989

The Chairman took note of the Committee's adoption of the "concertation report", which would be sent to the EC Ministers of Finance in the usual way.

IV. Other matters falling within the competence of the Committee

There was no other business.

V. Date and place of the next meeting

The Committee's next meeting would be held in Basle on Tuesday, 11th July 1989 at 9.30 a.m.

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

MAY 1989

This report summarises developments on the exchange markets of the countries whose central banks participate in the concertation procedure¹ and briefly describes their interventions during May and the first few days of June 1989.

I. EXCHANGE RATE DEVELOPMENTS

The main features of the foreign exchange markets in May 1989 were:

- an appreciation of the US dollar, despite heavy interventions;
- a decline of sterling;
- a further weakening of the Swiss franc followed by a strengthening towards the end of the month.

The US dollar rose sharply during May amid continuing reports that corporate and investor interests were persistently bidding for dollars to increase their dollar exposure, either through investments or hedging operations. News of a smaller US trade deficit during March, as well as political uncertainty abroad, gave support to the dollar exchange rates. The dollar reached its period highs of 2.0260 against the Deutsche Mark and 144.00 against the Japanese yen. During the last ten days of the month the dollar fluctuated below this level. The US and foreign monetary authorities intervened in substantial amounts to counter the dollar's rise. The dollar

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

closed the month approximately 7.5% higher against the Japanese yen and 5.75% higher against the Deutsche Mark.

There were no tensions within the EMS. The most significant movement was the appreciation of the Italian lira which reached the upper part of the narrow band.

The Deutsche Mark strengthened vis-à-vis some currencies but lost ground against the majority, in particular the US dollar and the Swiss franc. It remained, however, the strongest EMS currency. The weighted index of the Deutsche Mark vis-à-vis the eighteen most important trading partners (1972=100) declined from 174.4 at end-April to 173.1 at end-May despite a rise in market interest rates.

The French franc remained in the middle of the narrow band but weakened somewhat during the month following a further contraction of interest rate differentials between France and Germany.

The position of the Belgian franc was virtually unchanged. In order to check an excessive narrowing of the interest differential between the franc and the Deutsche Mark, the Banque Nationale de Belgique raised its three-month Treasury certificate rate on two occasions (by a total of 0.35 percentage point).

The Dutch guilder firmed slightly against most EMS currencies and joined the Deutsche Mark at the top of the band. Short-term guilder interest rates rose less strongly than Deutsche Mark rates. As a result the interest rate differential between the two currencies narrowed considerably.

The Danish krone was stable but remained the weakest currency in the EMS band.

In Ireland, following the increase in official interest rates at the end of April, foreign exchange flows were somewhat more favourable in May than in earlier months. As a result, the Irish pound appreciated in the upper half of the EMS band and there were small net purchases of foreign currency by the Central Bank of Ireland.

The Italian lira appreciated significantly towards EMS currencies, reaching the upper part of the narrow band. Large capital inflows occurred during the month. In order to smooth the appreciation of the currency, the Banca d'Italia made fairly large intervention purchases in the first week of May. Purchases of Deutsche Mark against US dollars were also carried out in concerted interventions.

Sentiment towards sterling became very bearish against the background of growing industrial unrest in the United Kingdom. An unexpected jump in inflation to the 8% level and the continued weakness of the balance

of payments provoked sharp outflows from sterling. Although base rates were raised by 1 percentage point to 14% on 24th May and considerable official support was provided, the weakness persisted. With the market perceiving some divisions within the Government over economic policy, sterling's trade-weighted index fell by 3% to 92.3 (1985=100).

The Greek drachma came under some pressure during the month partly related to the forthcoming national elections. The Bank of Greece intervened several times, while domestic interest rates firmed. The drachma depreciated by 5.8% against the US dollar and it remained stable against the ECU. In effective terms the drachma weakened by 0.5%.

The Spanish peseta was under considerable upward pressure at the beginning of the month, which was met by substantial purchases of foreign exchange reserves by the Banco de España. Later on, sentiment towards the peseta changed and the Banco de España reversed its intervention with sales of foreign reserves. It ended 2.5% lower with respect to the ECU and 8.6% lower with respect to the US dollar.

The depreciation of the Portuguese escudo in effective terms was 0.25%, in line with the foreign exchange policy defined by the authorities. Against the US dollar the escudo lost 5.7%.

Up to 24th May the Swiss franc weakened against the US dollar by about 7% and vis-à-vis the EMS currencies by roughly 1%. In the last business days in May a marked interest rate increase in the domestic money market resulted in a change in trend and the value of the Swiss franc against all major currencies rose by 3% to 4%. In the domestic money market the call money rate went up by 2 percentage points to 8.5%. The euro-franc rate for investments with maturities of 1 to 12 months increased by 1 to 1.75 percentage points to reach 7.75% to 8.25%. The fact that short-term rates rose more pronouncedly than longer-term rates has led to an inverse interest rate structure. The interest rate increase is also attributable to the introduction of the flexible lombard rate, which, with effect from 26th May, is calculated on a daily basis and on the strength of market developments. Its rate lies 1 percentage point above the average call money rate of the two previous working days. The lombard rate is fixed and published every working day before 9.00 a.m.

The Austrian schilling weakened by 5.7% vis-à-vis the US dollar. Against the Deutsche Mark it fluctuated by only 0.06%.

The continued stability of the Norwegian krone, together with moderate credit demand and reduced inflation, gave room for a 0.5 percentage point reduction in Norges Bank's overnight lending rate to 10.5%, effective 9th May. The interest rate differential versus the basket currencies on

three-month placements is now slightly more than 1 percentage point, the lowest differential since 1982. On 9th May the Norwegian bond market was reopened to foreign investors. The krone strengthened somewhat after the announcements but only temporarily. Norges Bank intervened on several occasions to stabilise the market. The krone ended the month unchanged in effective terms.

The Swedish krona remained stable during the first half of the month but weakened somewhat towards the end of the period when the dollar strengthened against most currencies.

The Finnish markka remained rather stable in effective terms. Short-term interest rates fluctuated markedly but on average they were roughly at the same levels as in April.

The Japanese yen depreciated by 7.2% against the US dollar to close at 142.70. This was due mainly to the heavy buying of dollars by speculators and institutional investors worldwide, reflecting the large interest rate differentials between the United States and Japan. The yen also depreciated against the ECU. In its effort to support the yen, the Bank of Japan entered the market at various times throughout the month, selling US dollars against the Japanese yen. Effective from 31st May, the Bank of Japan raised the official discount rate by 0.75 percentage point to 3.25% in order to achieve a continuing sustained growth promoted by domestic demand while maintaining price stability.

The Canadian dollar closed the month at US\$ 0.8284, down 1.8% against the US dollar after trading quietly for most of the period. The currency weakened in the latter part of the month as the strength of the US dollar against the major overseas currencies gave rise to short-term capital outflows from Canada.

II. INTERVENTIONS

A. Interventions in US dollars

Net sales of US dollars amounted to US\$ 19.1 billion, compared with net purchases of US\$ 0.5 billion during the month of April. Some of the dollar sales were made in concerted interventions. The major net sellers were the Federal Reserve, the Bank of Japan and, to a lesser extent, the Bank of England, the Bank of Canada, the Deutsche Bundesbank, the Banco de España and the Swiss National Bank. The Banque de France, Norges Bank, the Banca d'Italia, the Nederlandsche Bank and the Banque Nationale de Belgique also made considerable sales. The Banco de Portugal was the largest purchaser.

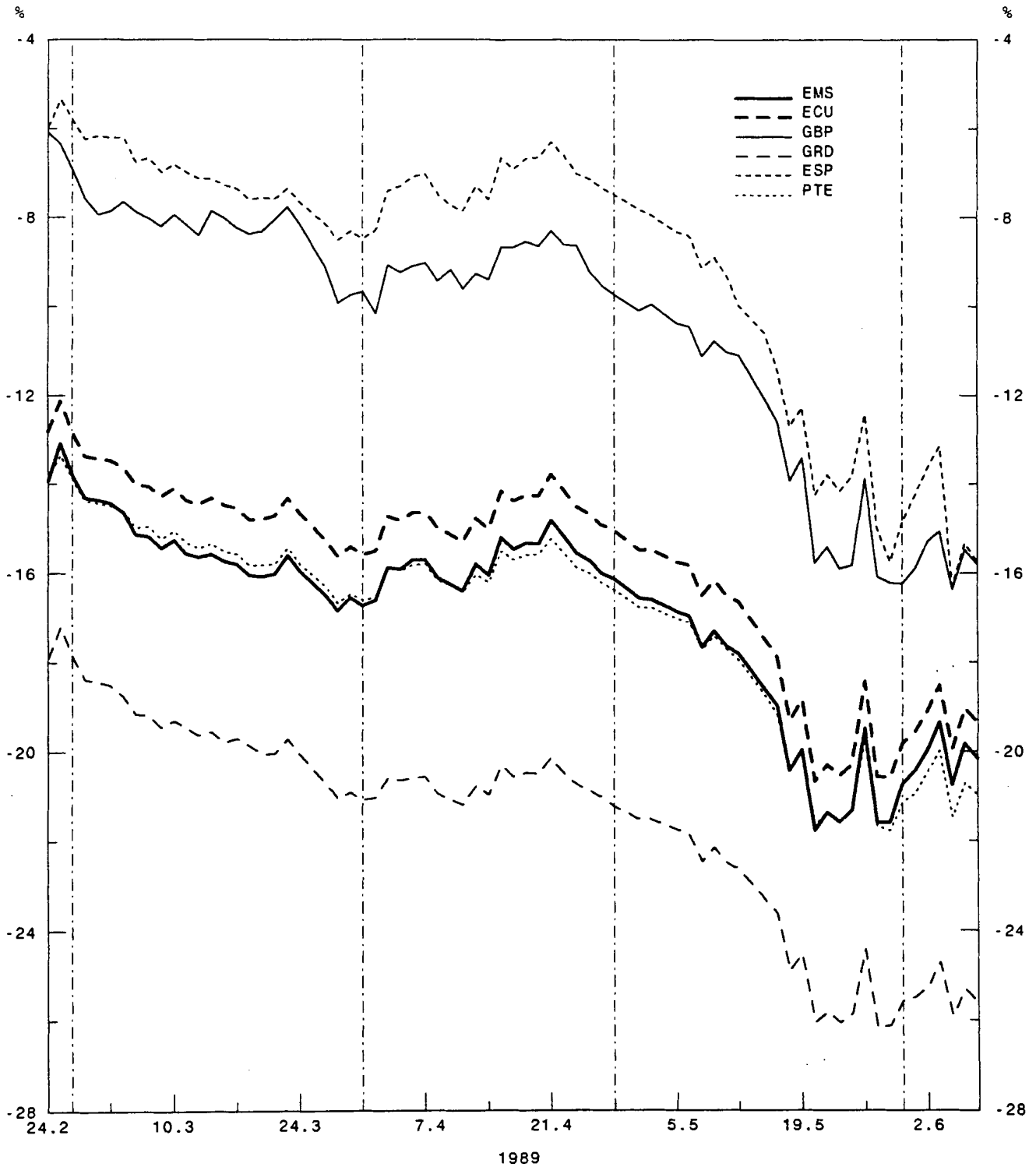
B. Interventions in Community currencies and in private ECUs

Interventions in EMS currencies and private ECUs by Community central banks amounted to the equivalent of US\$ 3.7 billion, compared with US\$ 2.3 billion in April. The interventions consisted almost entirely of purchases of Deutsche Mark by the Banco de España, the Banca d'Italia, the Banque de France, the Banque Nationale de Belgique and the Central Bank of Ireland. Norges Bank also made substantial purchases.

III. DEVELOPMENTS IN THE CURRENT MONTH, UP TO 9TH JUNE

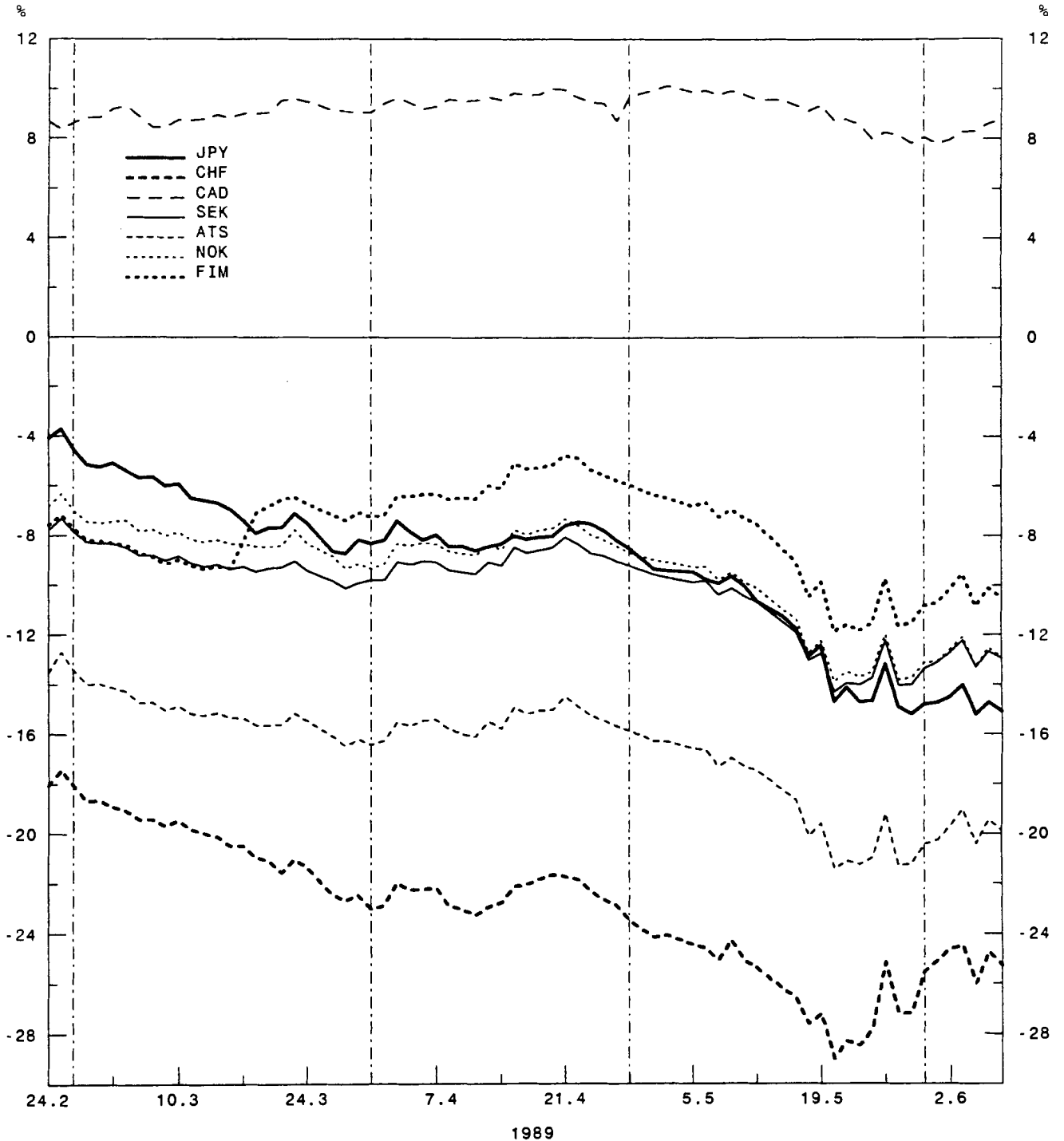
The dollar eased during the first days of June. Weaker-than-expected US employment data that pointed towards a slowing economy led to expectations of lower US interest rates and major US banks lowered their prime rates on 5th June from 11.5% to 11%. However, markets remain volatile due to the political situation in China and, at the end of the week, the dollar firmed again as a result of the publication of a higher-than-expected producer price index.

EVOLUTION OF THE ECU, THE MIDDLE RATE OF THE CURRENCIES PARTICIPATING IN THE EXCHANGE RATE MECHANISM OF THE EMS, AND THE CURRENCIES OF THE EEC CENTRAL BANKS WHICH DO NOT PARTICIPATE IN THAT MECHANISM, ON THE BASIS OF THE EXCHANGE RATES PREVAILING ON 31ST DECEMBER 1987 AGAINST THE USD*



* See next page.

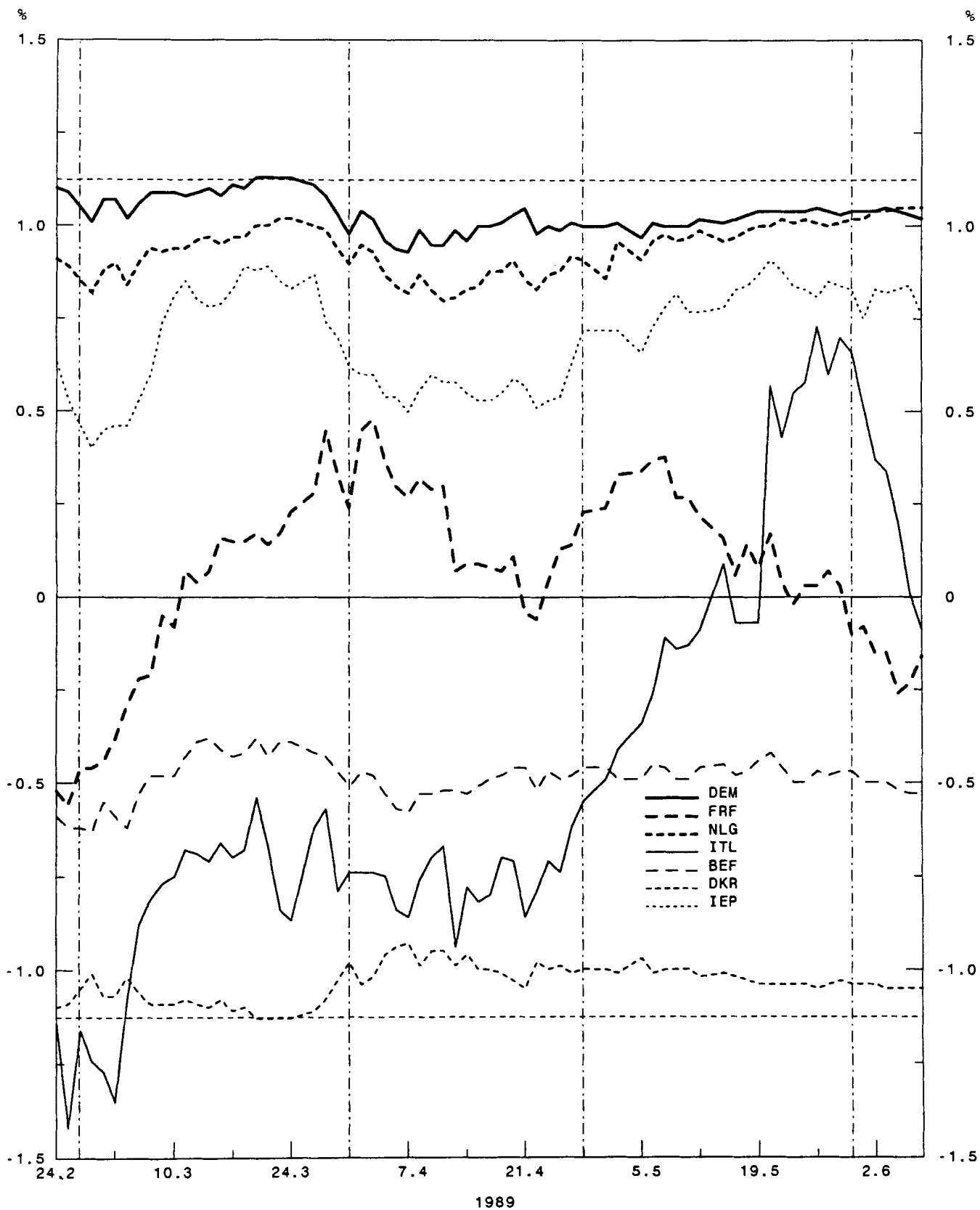
EVOLUTION OF THE CURRENCIES OF THE NON-EEC CENTRAL BANKS
PARTICIPATING IN THE CONCERTATION, ON THE BASIS OF THE EXCHANGE
RATES PREVAILING ON 31ST DECEMBER 1987 AGAINST THE USD*



* ECU 0,767254; GBP 0,5346; GRD 126,2002; ESP 107,8498; PTE 130,0242; FIM 3,945; CAD 1,302; CHF 1,2775; JPY 121,4501; SEK 5,795; NOK 6,233; ATS 11,129; middle rate of the currencies participating in the EMS 0,77324. The middle rate of the currencies participating in the EMS represents the daily average of the exchange rates of those two currencies which have the largest divergence from their current bilateral central rates, with a maximum fluctuation of 2.25%.

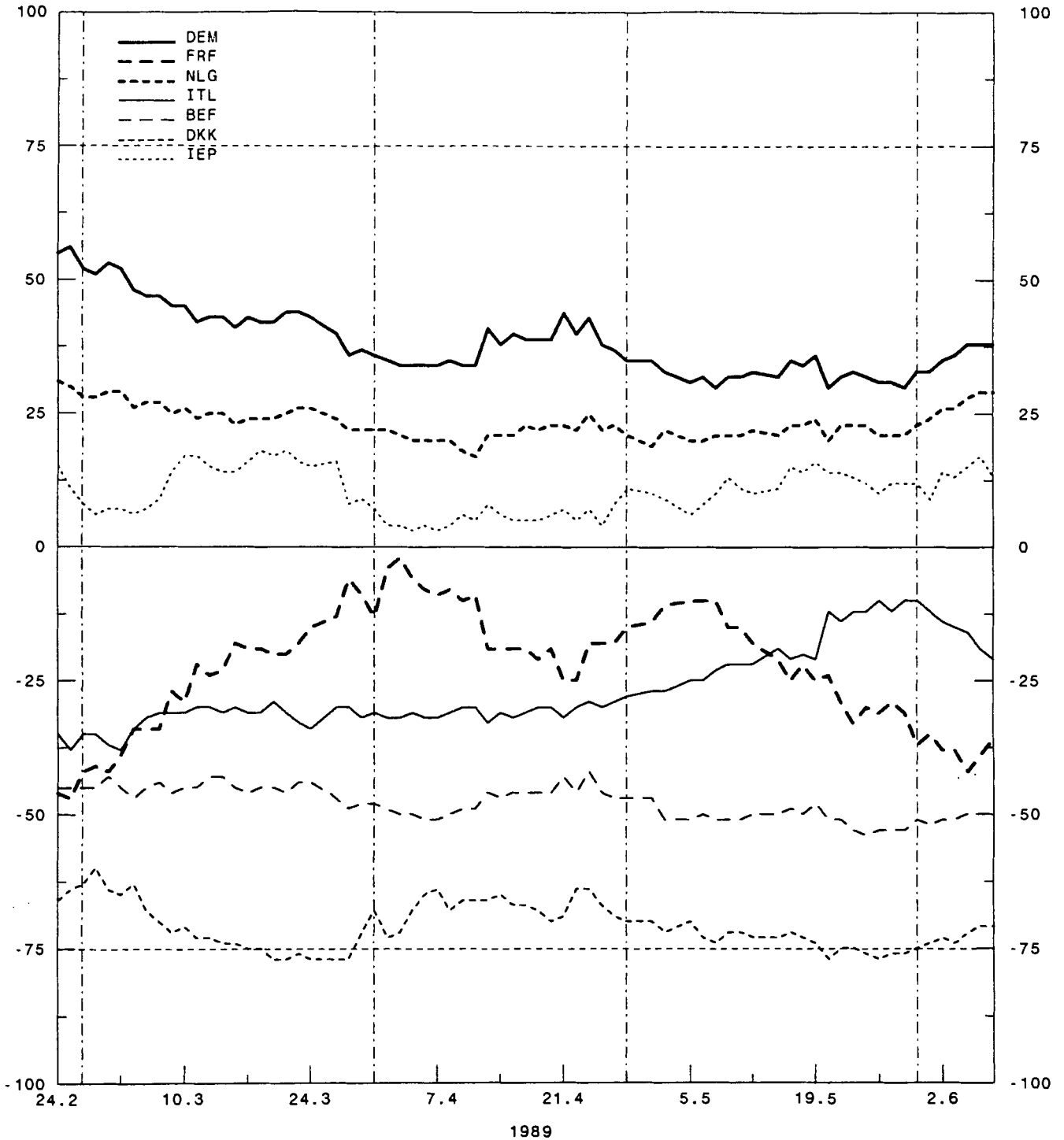
9.6.1989

MOVEMENTS IN THE EMS PARITY GRID



9.6.1989

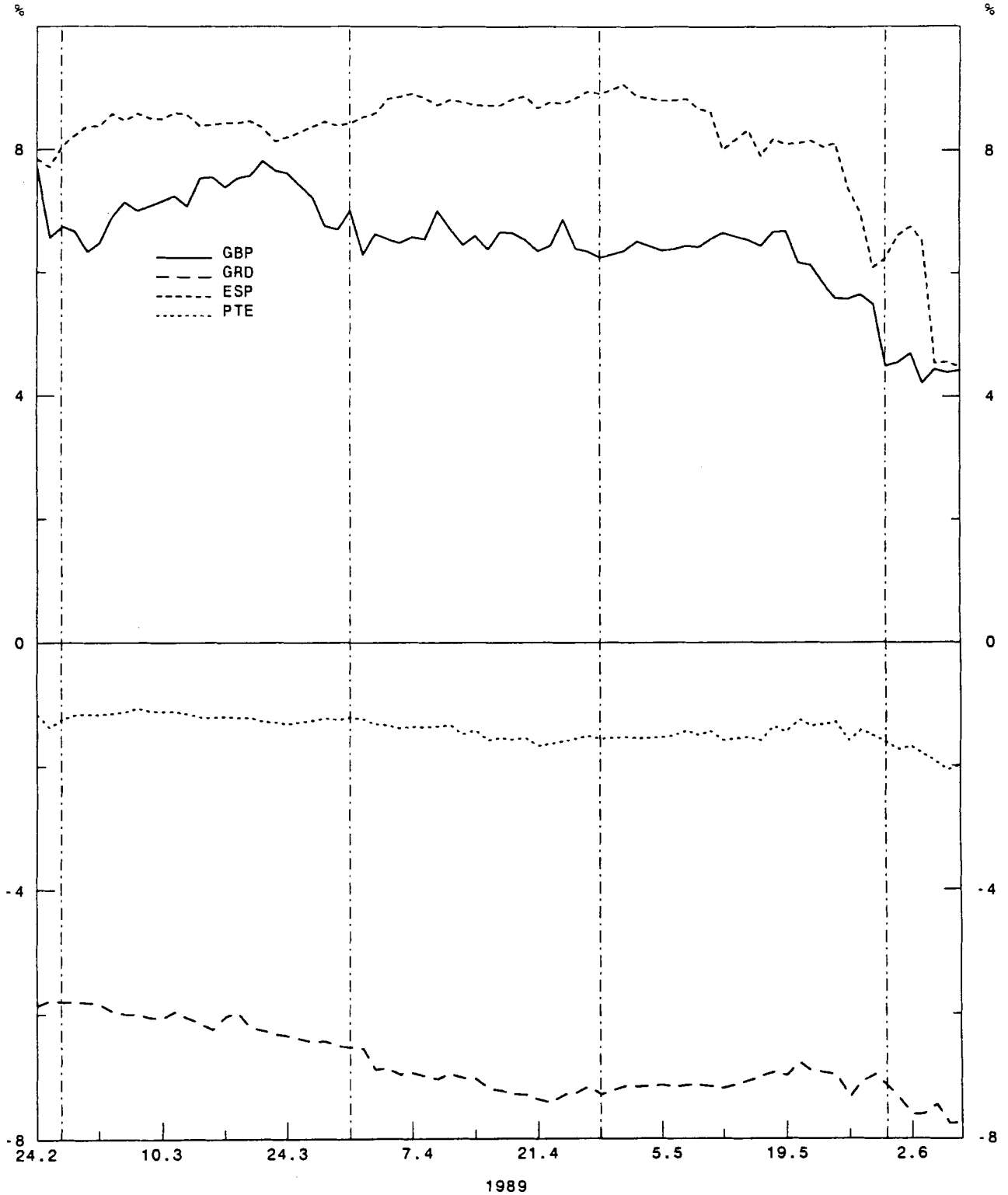
EVOLUTION OF THE DIVERGENCE INDICATOR*



* The divergence indicator provides a uniform measure of a currency's position in relation to its ECU central rate. The maximum divergence spread is the maximum percentage by which a currency's market rate against the ECU may appreciate or depreciate in relation to its ECU central rate; it is expressed as +/-100, the divergence threshold being +/-75. The data which has been used to draw this graph are the ECU rates against the different currencies, adjusted to eliminate the effect of the fluctuation of the Italian lira, the pound sterling and the Greek drachma outside the 2.5% margin against the other currencies participating in the EMS.

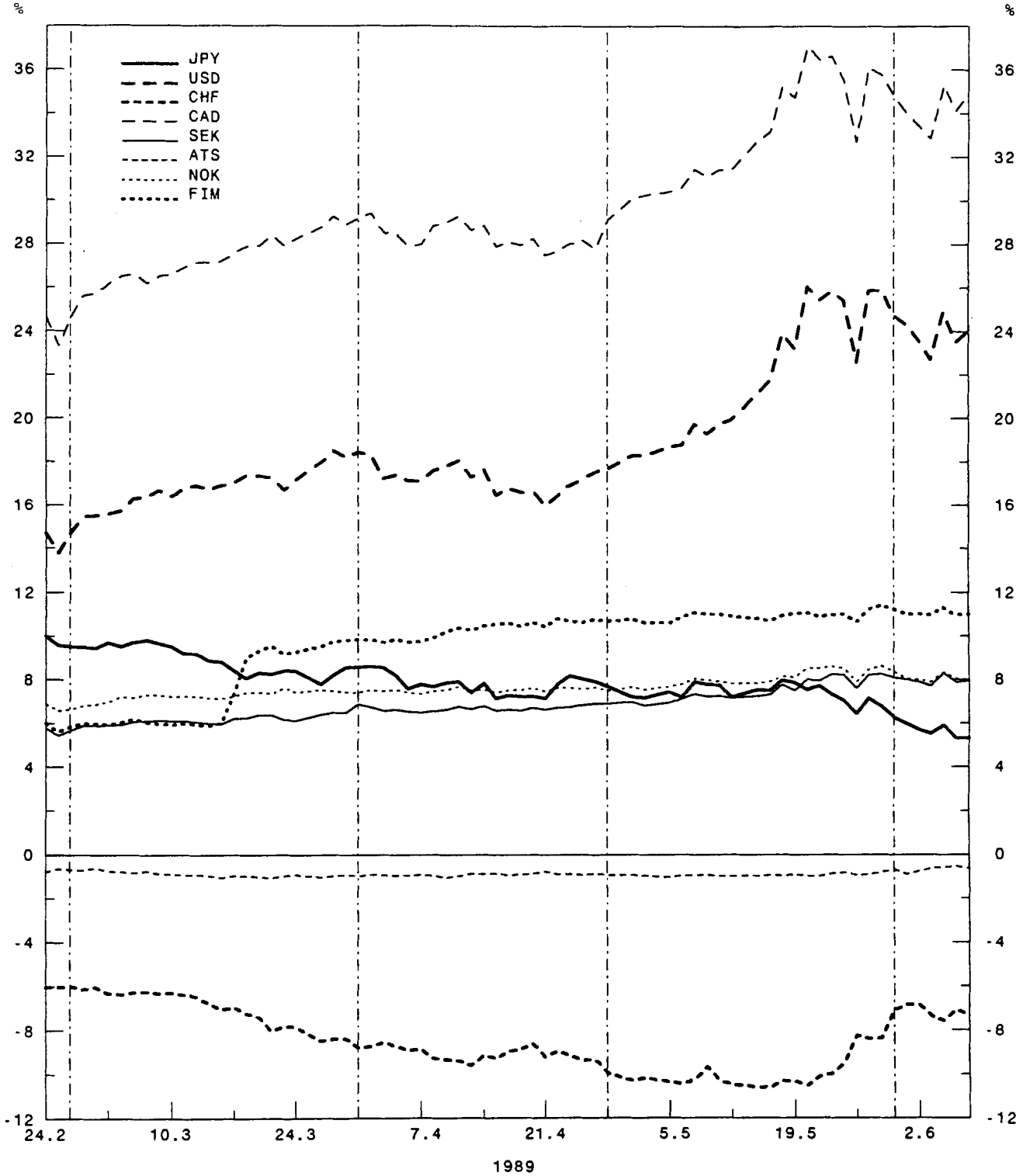
9.6.1989

EVOLUTION OF THE POUND STERLING, THE GREEK DRACHMA, THE SPANISH PESETA AND THE PORTUGUESE ESCUDO, ON THE BASIS OF THE MARKET RATES PREVAILING ON 31ST DECEMBER 1987 AGAINST THE ECU*



* GBP 0,696793; GRD 164,483; ESP 140,566; PTE 169,467.

EVOLUTION OF THE CURRENCIES OF THE NON-EEC CENTRAL BANKS PARTICIPATING IN THE CONCERTATION, ON THE BASIS OF THE EXCHANGE RATES PREVAILING ON 31ST DECEMBER 1987 AGAINST THE ECU*



* USD 1,30335; CAD 1,69696; CHF 1,66503; JPY 158,292; SEK 7,55292; NOK 8,12378; ATS 14,5050; FIM 5,14172.