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(Translation)

MINUTES*

OF THE 234th MEETING OF THE COMMITTEE OF GOVERNORS

OF THE CENTRAL BANKS OF THE MEMBER STATES

OF THE EUROPEAN ECONOMIC COMMUNITY

HELD IN BASLE ON TUESDAY, 11th APRIL 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, Mr. Karamouzis and Mr. Brissimis; 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. Gleske 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. Szász; 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 President of the Commission of the European Communities, Mr. Delors, accompanied by Mr. Mingasson and Mr. Dixon; 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.

In addition, Mr. Gros, Head of the Banking Department of the BIS, took part in the discussion of item V of the agenda.

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* Final text approved at the meeting on 9th May 1989, which incorporates some drafting changes.

I. Approval of the minutes of the 233rd meeting

The Committee approved the draft text of the minutes of the 233rd meeting unchanged.

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

- Preparation by the "Dalgaard Group" and discussion by the Committee of Alternates;
- Statistical charts and tables.

A. Statement by Mr. Dalgaard

The "Monitoring Group" had concentrated its discussion on two topics: the US dollar and the development of the Danish krone and its effect on the EMS.

The dollar had strengthened by more than 3% in March to a level not far from the summer 1988 peak; in early April it had weakened again a little. The dollar had now remained within the DM 1.80-1.90 range for three months, while since the beginning of 1987 it had generally stood between DM 1.65 and 1.90, which represented a certain degree of stability over a period of more than two years. However, compared with its weakest position at the end of 1987, the dollar had appreciated by almost 20%, and even more in real terms. This development had undoubtedly contributed to the reversal of the adjustment process, with the current-account surpluses in Japan and Germany and the current-account deficit in the United States all increasing. The latest figures showed that in Germany, for example, the trade surplus was growing strongly and the current-account surplus even more so with the increase in German investment income.

There were a number of reasons for the continuing dollar strength:

- for domestic reasons US interest rates were kept at a high level, which resulted in sizable interest rate differentials vis-à-vis the Deutsche Mark and Japanese yen at a time when there was little expectation in the market of any serious decline in the dollar;
- this market perception was reinforced by the fact that central banks' intervention operations had been less convincing in recent months, whereas last summer there had been more impressive concerted interventions;

- the yen and the Deutsche Mark had weakened for political reasons, the former more appreciably because of the "Recruit affair" and the latter to a lesser degree on account of certain election results;
- the withholding tax and a number of other factors had made the German capital market less attractive for resident and non-resident investors.

Within the EMS the Danish krone had been subject to some pressure and had reached its lower limit shortly before Easter, giving rise to the first compulsory intervention at the margin since January 1987. The krone had, in fact, weakened gradually since last summer in connection with the decline in interest rate differentials, which vis-à-vis the Deutsche Mark had narrowed from 6 to 3 percentage points at the long end and to only 1 1/2% for short-term rates. In view of the weakness of the Danish economy, the central bank had decided not to follow the interest rate increases undertaken abroad unless this were to prove necessary for external reasons. From late February the krone had stood close to its lower intervention point, but without necessitating any interventions. The situation had changed just before Easter: although there were no expectations of a realignment, some market participants had decided to adjust their positions, perhaps because of a certain unease since the Danish market was closed on more days than other markets, but also because covering positions was not very costly. As a result, the krone had reached its lower limit vis-à-vis the Deutsche Mark, and Danmarks Nationalbank and the Deutsche Bundesbank together had had to sell Deutsche Mark and purchase Danish kroner for the equivalent of almost $1 billion within the space of three days. The experts in the "Monitoring Group" had noted that these compulsory interventions had involved sizable sales of Deutsche Mark, which the Bundesbank normally tried to avoid when the Deutsche Mark was weak internationally. Fortunately the interventions had lasted only a few days; moreover, they had not entailed use of the very short-term financing facility as Danmarks Nationalbank had made immediate settlement using its Deutsche Mark reserves. As soon as the markets had reopened after Easter the krone had moved away from its lower limit and further interventions had not been necessary. The central bank had, however, tightened its policy somewhat in the days that followed; this modest tightening had resulted in a 1/2 percentage point firming of money market rates.

The French franc had performed very well; despite a further narrowing of the interest rate differential vis-à-vis the Deutsche Mark, its exchange rate had firmed to such an extent that the Banque de France had decided to make intervention purchases. The reasons for this development were very positive fundamentals in terms of inflation, employment, etc. and the market's favourable reaction to the recent measures to liberalise capital movements.

The Italian lira had strengthened in early March as a result of the increase in interest rates. The Banca d'Italia had also made substantial intervention purchases. Subsequently, interest rate differentials had narrowed and there had been no further interventions. The situation continued to be stable, however.

The Irish pound had remained in the upper part of the EMS band, but the Central Bank of Ireland had recently carried out some intervention sales to cover net capital outflows. The fundamentals were still very favourable in Ireland: low price rises, a surplus on current account and a considerable budget improvement. Interest rate differentials vis-à-vis the Deutsche Mark were, however, very small - even narrower than those in France.

The pound sterling had been relatively stable vis-à-vis the Deutsche Mark in recent weeks. It was still hoped that economic activity would begin to cool off but there was as yet no evidence of this. The publication of rather poor foreign trade figures had led to a weakening of the pound, which the Bank of England had countered with substantial interventions.

The Spanish peseta had experienced a period of relative calm.

In Portugal, the policy of a steady devaluation of the effective exchange rate of the escudo by 1/4% a month had been pursued. The Banco de Portugal had recently raised its interest rates by one percentage point and increased reserve requirements in response to an acceleration of the rate of inflation, which amounted to more than 10% since the beginning of the year, and to a deterioration in the current account.

The Greek drachma had been subject to some pressure, chiefly of a seasonal nature.

As regards the private ECU, it was to be noted that the Banque de France had undertaken interventions for the first time, on a modest scale and with no change in its overall holdings of ECUs. Other central banks' holdings had continued to increase, by around 1 billion in March, bringing the total to ECU 13 billion. These purchases had been made principally by the Banca d'Italia, as part of a general build-up of its reserves, and to a lesser extent by the Bank of England.

B. Statement by Mr. Papademos

The Alternates had had a detailed discussion which had focused on two points: a general assessment of exchange rate developments and of the adjustment process, and developments in economic performance and policies in a number of Community countries.

Some Alternates had expressed satisfaction with the relative stability of nominal exchange rates. Although the dollar had appreciated further in March, it had fluctuated vis-à-vis the major currencies within reasonable limits for several months. This had been interpreted as demonstrating the success of international policy co-ordination. The recent interventions by the Bank of Japan and the more active role of the Federal Reserve on the exchange markets had underlined the improvement in co-ordination. Interest rate movements had also been stabilised and competitive interest rate increases had been avoided. In addition, the European Monetary System had been free of tensions, with the exception of the bout of weakness affecting the Danish krone, which had temporarily reached its lower limit within the band.

Several Alternates had stressed, however, that too much emphasis should not be placed on the relative stability of nominal exchange rates. Real exchange rates, which were more relevant for the international adjustment process, had been moving in the wrong direction and the adjustment process had not only come to a standstill, it had been reversed. In the first quarter of this year the Deutsche Mark and the Japanese yen had continued to depreciate in real terms vis-à-vis the dollar and Germany's current-account surplus had grown further.

There were three possible interpretations as regards the current-account imbalances. Firstly, they were sustainable in the medium term and should not therefore give cause for concern. Secondly, the markets might at some point conclude that the policies being implemented were inadequate and that the imbalances were unsustainable, thus provoking a crisis. According to a third view, the external imbalances had reached unsustainable levels and active measures were required to correct the situation. In particular, it would be necessary to change the policy mix in a number of countries, and especially in the United States. In many cases monetary policy had not been sufficiently supported by fiscal policy. As a result, the interest rate level had been higher than it would otherwise have been and had led to real currency appreciation and a worsening of the external imbalances. The situation had been more acute in the United States since, although the budget deficit was not very large as a percentage of GDP, the private savings ratio was low and had not been sufficient to finance the public deficit and investment.

The Alternates had made the following points regarding developments in economic performance and policies in certain Community countries.

In the United Kingdom, the significant increase in interest rates in 1988 should eventually dampen domestic demand. The Bank of England would resist downward pressure on sterling and would maintain its anti-inflationary policy.

The economic situation in France had continued to improve and the French authorities were determined to consolidate the results.

In Denmark the central bank had tightened monetary policy when the Danish krone had come under growing pressure around Easter and had traded at or close to its lower limit. Up to that point the authorities had been reluctant to raise interest rates because economic growth had been near zero for the third year running. The fact that the krone had been allowed to fluctuate close to its lower limit without precipitating a parity realignment had helped to dedramatise the decline of the exchange rate. The authorities had reaffirmed their intention to correct the disequilibria not by means of a realignment but by domestic policy measures, which, however, took some time to have an impact on the economy.

The Italian economy was still growing rapidly, fuelled by budget deficits and the investment boom. Capacity utilisation had reached peak levels and unemployment was declining. The economic situation was placing an excessive burden on monetary policy, although some progress had been made in reducing the budget deficits. Monetary policy had been restrictive, with rising domestic interest rates, which had induced capital inflows and a firming of the lira. However, the resultant foreign borrowing by Italian residents had undermined efforts to contain credit growth and consequently aggregate domestic demand. It had been emphasised that Italy was in a different cyclical phase from other European countries and that the Italian monetary authorities were faced with a difficult situation. The question had been raised as to whether other countries could not help in the context of closer policy co-ordination.

GDP growth in Portugal was strong, at approximately 4% in 1988, but inflation had recently moved back up to double figures and the current-account deficit had worsened despite the increase in official reserves. The monetary authorities had recently taken several measures to curb the expansion of credit and the money supply and interest rates had risen. However, the effectiveness of the monetary policy measures would be greater if fiscal policy supported the anti-inflationary efforts.

In Ireland a very strong political consensus in favour of reducing the public deficits had been reflected in a decrease in the public sector borrowing requirement from 13% of GDP two years ago to 5% this year. Moreover, inflation had been brought down to an annual rate of 2% and the current account was in surplus. Confidence in economic and exchange rate stability had led to large capital inflows. Domestic interest rates were lower than those in the United Kingdom, contrary to the view that they should be two percentage points higher.

In Spain inflation was accelerating and economic growth was rapid. The recent monetary policy measures should dampen growth and curb inflationary pressures. However, fiscal policy was unlikely to support the anti-inflationary efforts, as the estimated budget deficit for 1989 was the same in terms of GDP as the deficit in 1988.

The Alternates' discussion had led to the general conclusion that, although international monetary policy co-ordination had improved, there were still serious problems in a number of countries in the co-ordination of monetary and fiscal policies.

C. Discussion by the Committee

Mr. Moreira made few comments on the situation in Portugal and the measures taken recently; these measures were aimed at checking the acceleration of inflation, whose primary cause was the pressure of domestic demand. The consumer price index had risen at an annual rate of over 12% in January and February, compared with 9% a year earlier. As a result of the increase in the trade deficit the current account had deteriorated, closing in 1988 with a deficit of $600 million, or 1.5% of GDP; exports had risen by 7% in real terms, but imports had grown by 17%.

The measures taken consisted principally of a 1 point increase, from 13.5% to 14.5%, in the discount rate and a significant increase in compulsory reserve ratios; the new 17% rate now applied to all categories of deposit. This change in reserve requirements should absorb a large part of banks' holdings of liquidity. In addition, the Government had undertaken to reduce external indebtedness rapidly through repayments in advance of maturity expected to total $700 million in 1989. Medium and long-term capital inflows, which were continuing and which had exceeded $2 billion in 1988, made these repayments possible. They would take the form of issues of securities for subscription by the non-bank sector, and the announcement of this measure had already had an impact on market interest rates. Banks' lending rates now stood at around 20%, compared with a ceiling rate of 17% six months ago.

These monetary measures should together moderate domestic demand, but there would be no significant contribution from the budget.

Mr. Pöhl made a few remarks on the trade disequilibria. While it was true that the United States should take corrective measures, the discussion could not be limited to that country and Japan. Trade relations within the Community were also important. Here, as had just been said, the overall German trade surplus was growing, and in 1988 the surplus had narrowed only vis-à-vis two countries, the United States and Denmark. In the first case the surplus had fallen by over DM 7 billion, so that it could be said that the bilateral US/German adjustment process was well under way, which also seemed true as between the Community as a whole and the United States; the problem for the United States was primarily vis-à-vis Japan and other Asian countries. Within Europe the disequilibria were tending to worsen and it was to be noted, for example, that the German surpluses had widened particularly vis-à-vis those countries with high inflation, such as the United Kingdom, Spain, Portugal and Greece. German exports to the first three of these countries had increased by 13%, 20% and 24% respectively in 1988. Denmark was the only Community country vis-à-vis which the German surplus had contracted, and this was linked with the restrictive or stability-oriented policy followed by that country.

It was, however, necessary to be precise and careful when talking about reducing the imbalances, for if this was done by wrong means there was a risk of aggravating the situation and fuelling inflation. For example, in the case of Spain, Portugal and perhaps other countries it was normal to have trade deficits for a certain time in order to promote investment and improve the basis for economic growth in the longer term. Imports of capital goods were necessary and raised no problems if they were financed by spontaneous capital flows from surplus countries as opposed to exchange market intervention. The impression should not be given that the optimal economic policy in the Community would consist in having current or trade accounts all balanced bilaterally. That would be absurd given the differences in development within the Community, and it was normal that countries with weak domestic growth and a high savings ratio should export to European regions which did not have the same conditions. The problem was obviously very different in the case of the United States, where the trade deficit was unsustainable in the long term and therefore very much a matter for concern.

The use of the exchange rate as an adjustment tool was considered less and less appropriate, which was a concrete step towards a monetary union. The markets had increasingly become aware of this but exchange rate stability carried a high price. In effect, those countries which had devalued their currencies in the past generally had to maintain large interest rate differentials vis-à-vis the Deutsche Mark because the markets thought that there could be further devaluations. It was, however, interesting to note that the interest rate differentials had narrowed, for example from 6 percentage points in the case of Denmark two years ago to 1 1/2 points now. Vis-à-vis France the differential had eased from 3 points to 2 1/2, which was perhaps still too high.

Mr. Leigh-Pemberton observed that, like Mr. Moreira, he considered that an improvement in the trade balance should come principally from a moderation of domestic demand; in 1988 domestic demand had increased by approximately 11% in the United Kingdom, compared with a 4% growth in supply. The substantial imports had perhaps lessened inflationary pressures somewhat but it was necessary to reduce them in order to restore a healthier trade-balance position. The Bank of England was itself opposed to a devaluation of sterling to correct the disequilibrium; experience had shown that this was not the right recipe and that the immediate effect was an increase in inflation. It was to be noted that much of the growth in UK imports was on account of capital goods and manufactured products. In the first case this was favourable as a basis for strengthening supply and later export performance. In the second case it was less positive to the extent that it went to meet strong domestic demand. The question arose, however, whether a correction of the situation in the deficit countries would not, perhaps soon, create problems for German economic growth and even for the Community as a whole.

Mr. Pöhl agreed that the German economy would be very much affected by a correction of the disequilibria in partner countries since it was highly export-oriented. It should, however, be pointed out that the current-account surplus was much lower than the trade surplus owing to the enormous deficit on services account connected with the net transfers to the Community and German tourist expenditure abroad. Moreover, it was normal and desirable that a country like Germany, with its demography, high standard of living and high level of savings, should be a net exporter of capital to areas which needed it not only in the Third World but also in European countries with a higher growth potential such as southern Europe. However, while it was natural that Germany should have a current surplus, it was at present too high. The proposition that it could be reduced through stronger domestic demand was problematic, indeed hardly desirable for Europe. In fact, if Germany used its large savings to expand investment, consumption and economic growth, the disparity between countries or regions in the Community would widen. The ideal would be to have real capital flows from the wealthy regions to the less wealthy ones so as to level out degrees of development. Europe should not end up in the absurd position of the United States, the richest country in the world, which for years had been a net importer of capital even from developing countries.

Mr. Hoffmeyer added that when the Deutsche Bundesbank had raised its discount rate in January he had tried, without much success, to contact his colleagues and had hoped that the members of the exchange rate mechanism would not automatically follow the German initiative. Denmark had finally found itself alone in not raising interest rates. This experience showed that it was possible to exercise some degree of autonomy in interest rate policy when domestic economic factors militated against raising interest rates; it had also shown, on the one hand, that even though the Danish krone had touched its lower intervention point speculation had not run wild and, on the other, that the interest rate differential had had to be restored soon afterwards, demonstrating the limits of autonomy and implying that the next time, if there was a next time, Denmark would probably have to follow the measures taken by Germany and the other members and not remain isolated.

Mr. de Larosière made a few comments. The exchange rate was now no longer seen as the optimal adjustment mechanism, not least because all countries were in a situation characterised by a high degree of capacity utilisation and some risks of inflationary pressures. By allowing its currency to depreciate, a country with a trade deficit would induce a rise in inflation but not an increase in exports owing to constraints on the supply side. Adjustment therefore had to be viewed in terms of the economic fundamentals. This was true for surplus countries, which had to examine the imperfections or structural problems in their economies. It was also true for the deficit countries, which should deal with the causes of excessive rates of absorption. One should not be too mechanistic and demand that all trade or current balances should be in perfect equilibrium, but it was necessary to try to co-ordinate the fundamentals within the international economy with the aim of supporting growth without yielding to inflationary pressures. A difficult task had to be accomplished and the old idea abandoned that in the case of current-account disequilibria one only had to adjust exchange rates.

It would, of course, be desirable for the United States to be a net capital exporter, in particular to countries of the Third World. However, these countries did not, today, have the financial capacity to absorb this capital. On the other hand, other OECD countries had a higher savings rate than the United States, which led to two conclusions:

- either one had an international system in greater equilibrium with lower capital imports by the United States, but, to the extent that the developing countries could not increase their absorption capacity and Japan and other rich countries were generators of savings, the equilibrium could only be established at a lower level of activity;
- or the large US deficit was financed because major investment opportunities existed in the United States which motivated foreign investors to place their capital in that market.

The Chairman, closing the Committee's discussion, noted that very interesting observations had been made on a number of key aspects of the current situation.

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 March and the first few days of April 1989

The Chairman noted that the Committee approved the "concertation report", which would be sent to the EC Ministers of Finance in the usual way.

IV. Longer-term perspective of changes in the exchange rate structure on on the basis of a short presentation by Dr. Bockelmann

The Chairman informed the Committee that, for lack of time, the Alternates had not dealt with this item on the agenda; he suggested taking it up at the next meeting and moving on to the following item, which the Alternates had discussed.

V. Organisation of the ECU clearing: Criteria for extension

A. Statement by Mr. Papademos

Following a comprehensive résumé by Mr. Gros, the Alternates had held a thorough discussion on the enlargement of the private ECU clearing system; they were convinced that the clearing system should evolve according to both commercial and prudential criteria and not be deadlocked by a number of institutions wishing to preserve their seemingly privileged positions. However, the Alternates had not been able to complete their discussion of a number of points and had felt that it would be better to come back to the subject at the May meeting and report to the Committee then.

B. Discussion by the Committee

Mr. de Larosière said that views had to be absolutely clear in this connection. The ECU clearing system must evolve and expand along the lines mentioned by Mr. Papademos. There was often an inclination in professional groups to practise anti-competitive corporatism and to protect themselves. It was precisely the Governors' duty not to protect groups that wished to establish preserves but, on the contrary, to allow the system to evolve and to be opened up. In France, for example, there were large international banks such as Crédit Commercial de France, Banque Indosuez and the Caisse Centrale des banques populaires which were unquestionably well-established and which did not obtain their admission as clearing banks. This situation is not acceptable. The central banks and the BIS had to resist a movement which would block the evolution and opening-up of the clearing system.

Mr. Duisenberg fully shared the opinion expressed by Mr. de Larosière.

Mr. Leigh-Pemberton said that the Governors must indeed support the principles of evolution and opening-up of the clearing system and that it would be desirable to make this support known. The present composition of the banks in the system was not good. It was important, for developing the use of the ECU, that the clearing system should function and evolve satisfactorily and that the geographical distribution should be better.

Mr. Pöhl expressed agreement with what Mr. de Larosière and his other colleagues had said. The central banks had originally given their support to the BIS and to the system and they must continue to do so. However, it should be remembered that neither the BIS nor the central banks would accept any responsibility as lender of last resort. This was a fundamental principle which had been laid down in 1983 when the Governors had first broached the subject of the ECU clearing system and it must remain a basis of the system.

Mr. Rubio also expressed complete agreement with Mr. de Larosière's remarks.

The Chairman concluded the exchange of views by noting that this important question of the ECU clearing system would be taken up again at the May meeting after further examination by the Alternates.

VI. Other matters falling within the competence of the Committee

There was no other business.

VII. Date and place of the next meeting

The Chairman suggested that the next meeting of the Committee should take place on Tuesday, 9th May at 9.30 a.m.; he noted that the BIS Board of Directors had decided to hold its meetings at 9 a.m. rather than at 9.30 as in the past. The Committee could therefore meet each month at 9.30 instead of 10 a.m., which would give more time for discussions.

The Chairman took note of the Committee's approval of the new time.

Committee of Governors of the
Central Banks of the Member States
of the European Economic Community

Annex

11th April 1989

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

MARCH 1989

This report summarises developments on the exchange markets of the countries whose central banks participate in the concertation procedure[1] and briefly describes their interventions during March and the first few days of April 1989.

I. EXCHANGE RATE DEVELOPMENTS

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

- a sharp appreciation of the US dollar against most other currencies, despite several rounds of concerted central bank intervention;
- in the EMS the French franc appreciating significantly and the Danish krone exhibiting continued weakness;
- a substantial weakening of the Swiss franc.

The US dollar came under upward pressure, closing the month over 4.5% higher against the Japanese yen and 4% higher against the Deutsche Mark. Upward pressure picked up during the month as market participants came to the view that, given continued price pressures in the US economy, interest rate differentials would remain favourable to dollar investments. Other factors, including rising oil prices and quarter-end demand for

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

dollars, also gave support to the dollar. The US monetary authorities, at times in concertation with some European central banks, intervened during the month to counter the rise of the dollar which closed the month near its highs for the year at 132.80 against the yen and 1.8975 against the Deutsche Mark.

In the EMS, the narrow band was temporarily expanded to the full width when the Danish krone touched its lower limit against the Deutsche Mark, and for the first time since January 1987 there were interventions at the limits. The French franc strengthened markedly throughout the month.

The Deutsche Mark weakened against almost all the currencies officially quoted in Frankfurt, as short and long-term capital outflows, largely interest-rate related, still tended to exceed the high, and even rising, current-account surpluses. The weighted index of the Deutsche Mark vis-à-vis Germany's fourteen most important trading partners (1972=100) declined from 169.1 at end-February to 168.0 at end-March.

The French franc strengthened significantly and regained its levels of the middle of 1988. At the beginning of the period, the official announcement of an easing of exchange controls was very well received by the markets. Subsequently, the publication of favourable economic indicators further strengthened the position of the French franc, which benefited from substantial switching into francs, notably from Deutsche Mark.

The Belgian franc demonstrated considerable stability, which made it possible to lower short-term interest rates slightly and to effect modest purchases of foreign currencies.

The Dutch guilder remained in the upper part of the EMS band, strengthening slightly against the Deutsche Mark.

The Danish krone weakened further, and shortly before the Easter holidays it temporarily touched the bottom of the EMS band despite sizable intervention in support of the krone. The Nationalbank tightened the borrowing facilities for the private banks on 30th March, leading to an increase in money-market rates of around 0.5%. The krone subsequently strengthened somewhat.

Following some downward pressure in early March, the Irish pound appreciated in the upper half of the EMS band for most of the remainder of the month. Towards the end of March the Central Bank responded to commercial outflows by sales of foreign currency and by permitting an easing of the Irish pound in the EMS band.

The Italian lira strengthened to a level in the narrow EMS band after the discount rate was raised by 1 percentage point to 13.5% on 6th March. Short-term capital inflows continued during the period and sizable purchases of Deutsche Mark by the Banca d'Italia were made in order to smooth the appreciation of the lira.

Sterling came under downward pressure at the beginning of March following the publication of worse-than-expected trade figures for January and amid fears of increases in interest rates in other European centres. Some official support was provided at the time and sterling recovered, particularly following the Chancellor's Budget speech. After Easter, however, sentiment turned against sterling and, despite official support, it fell sharply following publication (on 29th March) of February's trade figures. Sterling's trade-weighted index fell by 0.3% to 95.5 (1985=100).

The Greek drachma came under some pressure, possibly reflecting the narrowing of interest rate differentials. The drachma depreciated by 3.9% and 0.8% against the US dollar and the ECU respectively, and by 0.9% in effective terms.

The Spanish peseta rose slightly against most currencies at the beginning of the month, driven by increases in the intervention rate for overnight funds to 13.75% on 3rd March and in the three-month repurchase agreement rate to 13.25% on 6th March. For the rest of the period it showed remarkable stability, in spite of a further increase in the three-month repurchase agreement rate to 13.35% on 14th March. In all, the peseta ended the month 0.3% higher against the ECU and 2.8% lower against the US dollar.

In line with official objectives, the Portuguese escudo depreciated by 0.25% in effective terms, while vis-à-vis the US dollar, it decreased by 3.1%. On 20th March, to counter inflationary pressures and moderate excessive growth of domestic demand, the Banco de Portugal's discount rate was raised by 1 percentage point to 14.5% and the reserve requirements were increased.

The Swiss franc experienced increased downward pressure depreciating by 6.0% against the US dollar and by just under 3% vis-à-vis most remaining currencies. The export weighted index at month end was 3.2% below the level reached a month earlier. Interest rates in the domestic money market remained stable at a relatively high level.

The Austrian schilling weakened by 3.5% vis-à-vis the US dollar. Against the Deutsche Mark it fluctuated by only 0.03%. With effect from 2nd March the rate for short-term open market operations was raised from 5.25% to 5.75%.

The Norwegian krone moved within a fairly narrow range around the central value of the currency index and ended the month unchanged in effective terms.

The Swedish krona has been stable on the upper side of the index benchmark due to higher domestic interest rates. The Riksbank absorbed small inflows, mainly in early March, but also on the last day of the month when revaluation rumours resulted in a large inflow of foreign currency.

The Finnish markka appreciated in effective terms by 3.3% after the fluctuation limits of the currency index were lowered by 4% on 17th March. This made it possible to increase short-term interest rates by more than 2 percentage points.

The Japanese yen declined by 4.0% against the US dollar, mainly as a result of higher oil prices and large interest rate differentials between Japan and the United States. The yen also weakened slightly against the ECU.

The Canadian dollar firmed rising by 0.5% against the US dollar to close the month at US$ 0.8386. Over the period, the currency was supported by firming domestic interest rates, expectations of a continued tightening in monetary policy to combat growing inflationary pressures, and by news of a widening in the trade surplus in January. Further gains have been forestalled, however, by caution ahead of the Federal Budget expected in late April.

II. INTERVENTIONS

A. Interventions in US dollars

Net sales of US dollars amounted to US$ 4.4 billion, compared with US$ 3.3 billion during the month of February. A significant proportion of sales, about one half of which were effected against Deutsche Mark, took the form of concerted interventions. The Federal Reserve, the Bank of England, Finlands Bank and the Central Bank of Ireland were the major sellers while Banco de Portugal and Sveriges Riksbank were the largest purchasers.

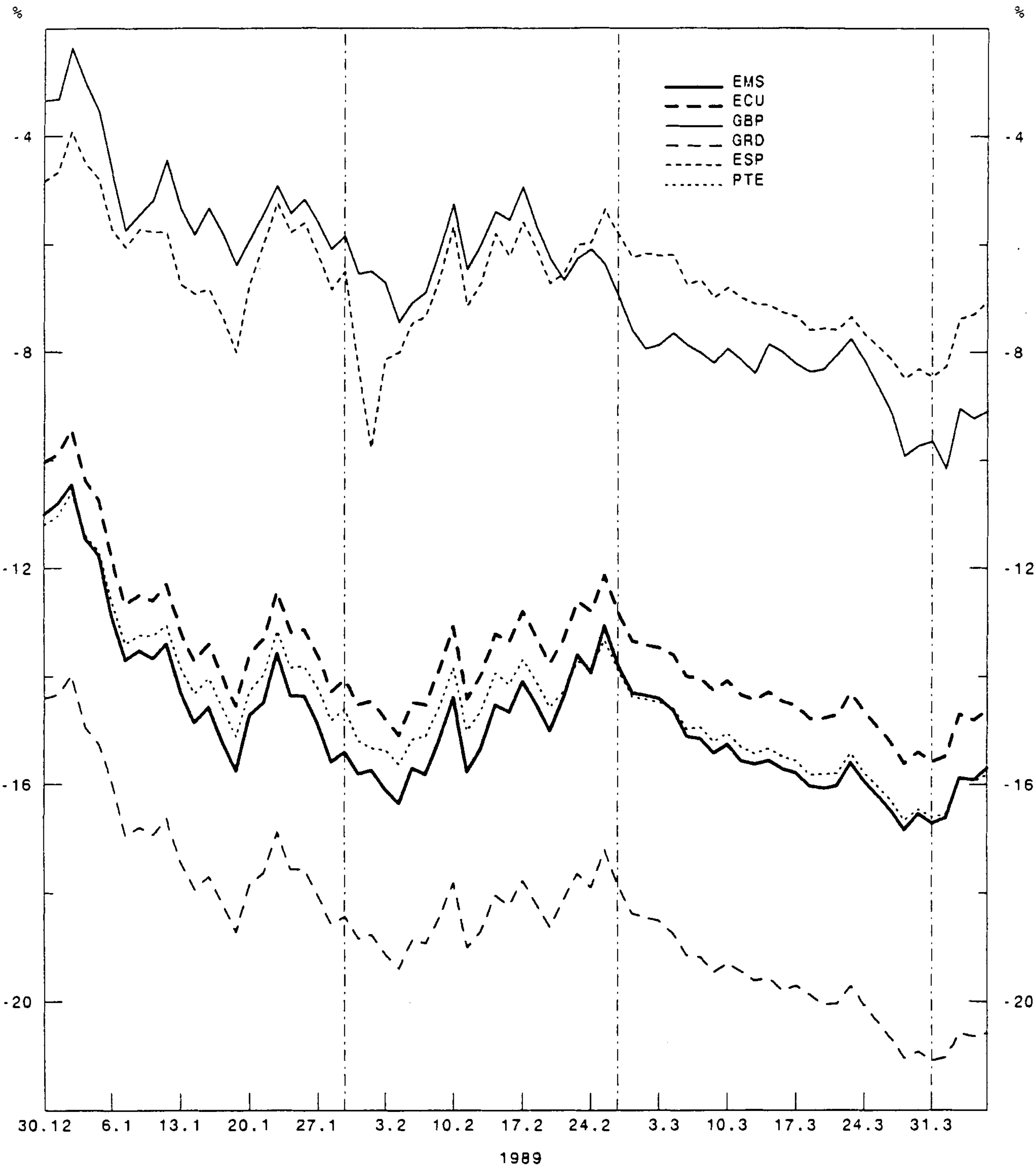
B. Interventions in Community currencies and in private ECUs

Interventions in EMS currencies by Community central banks amounted to the equivalent of US$ 2.9 billion, compared with US$ 1.9 billion in February 1989. While the bulk of the interventions consisted of intramarginal purchases of Deutsche Mark, with the Banca d'Italia and the Banque de France being the main buyers, there were also substantial sales of Deutsche Mark at the limits by Danmarks Nationalbank. Sveriges Riksbank also made some intervention purchases of Deutsche Mark.

III. DEVELOPMENTS IN THE CURRENT MONTH, UP TO 7TH APRIL

The US dollar eased in early April following the G7 meeting and subsequent Bank of Japan intervention. The publication on 7th April of March employment data had little impact on the currency.

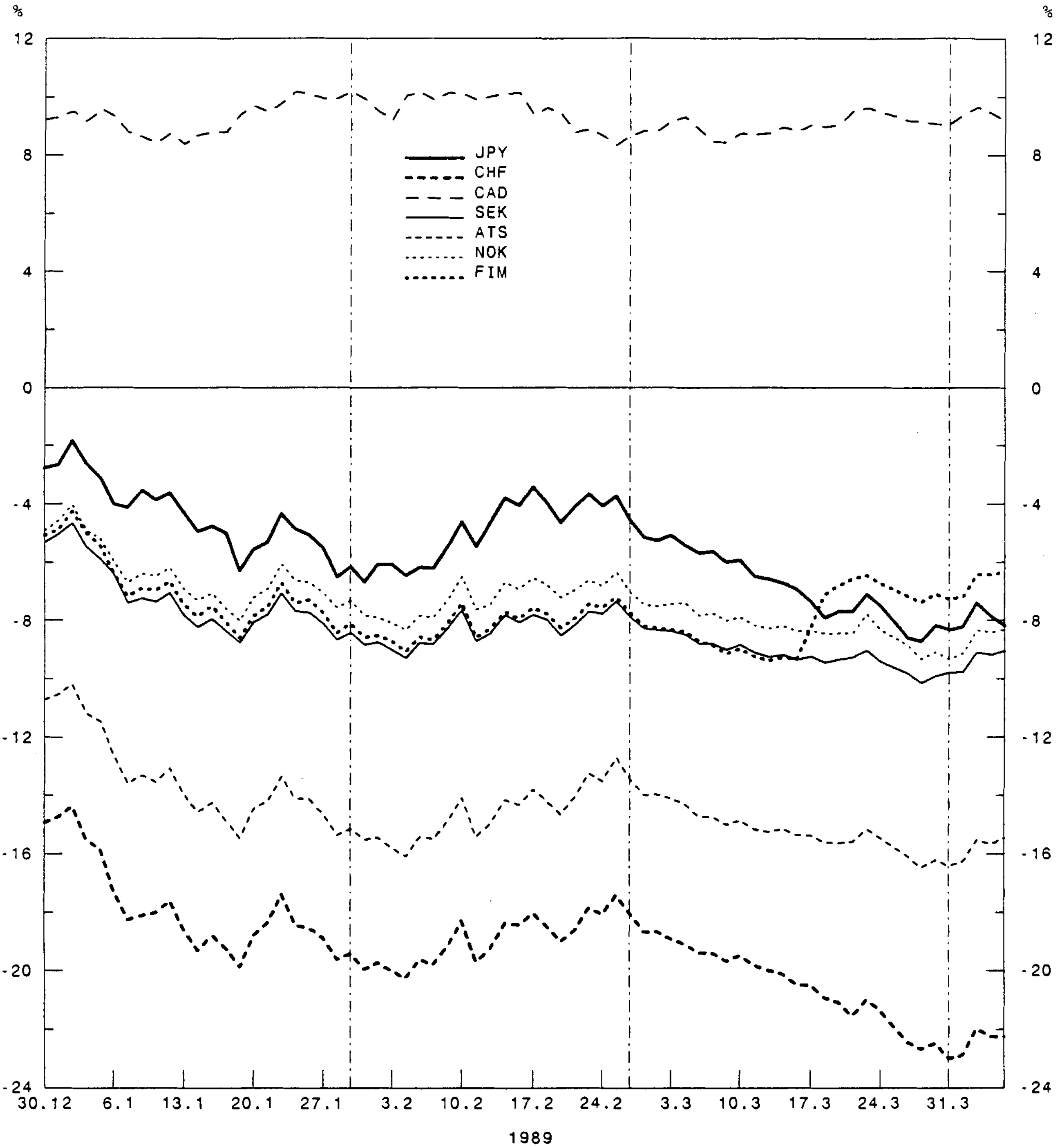
EVOLUTION OF THE ECU, THE MIDDLE RATE OF THE CURRENCIES PARTICIPATING IN THE EXCHANGE RATE MECHANISM OF THE EMS, AND THE CURRENCIES OF THE EEC CENTRAL BANKS WHICH DO NOT PARTICIPATE IN THAT MECHANISM, ON THE BASIS OF THE EXCHANGE RATES PREVAILING ON 31ST DECEMBER 1987 AGAINST THE USD*



* See next page.

7.4.1989

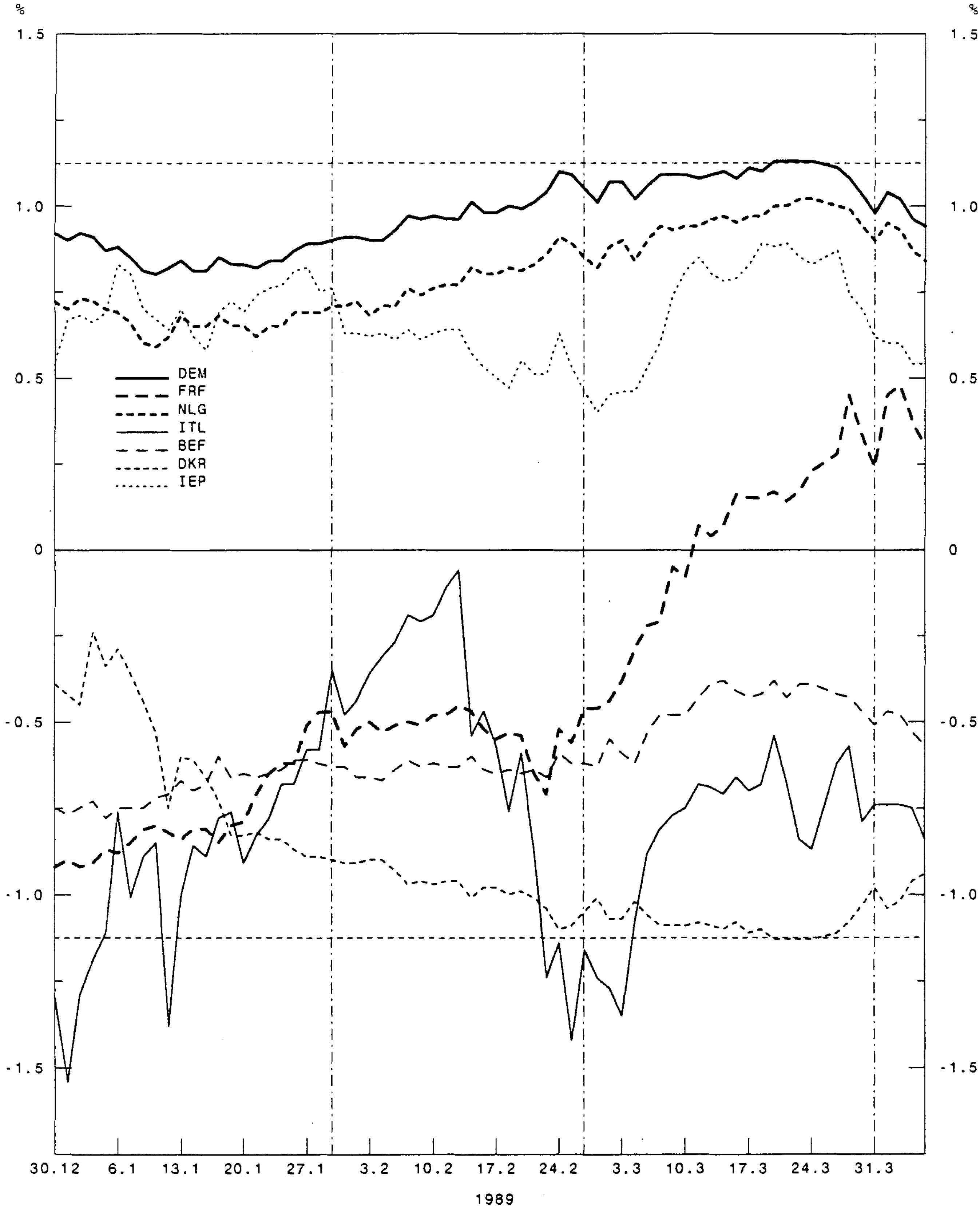
EVOLUTION OF THE CURRENCIES OF THE NON-EEC CENTRAL BANKS PARTICIPATING IN THE CONCERTATION, ON THE BASIS OF THE EXCHANGE RATES PREVAILING ON 31ST DECEMBER 1987 AGAINST THE USD*



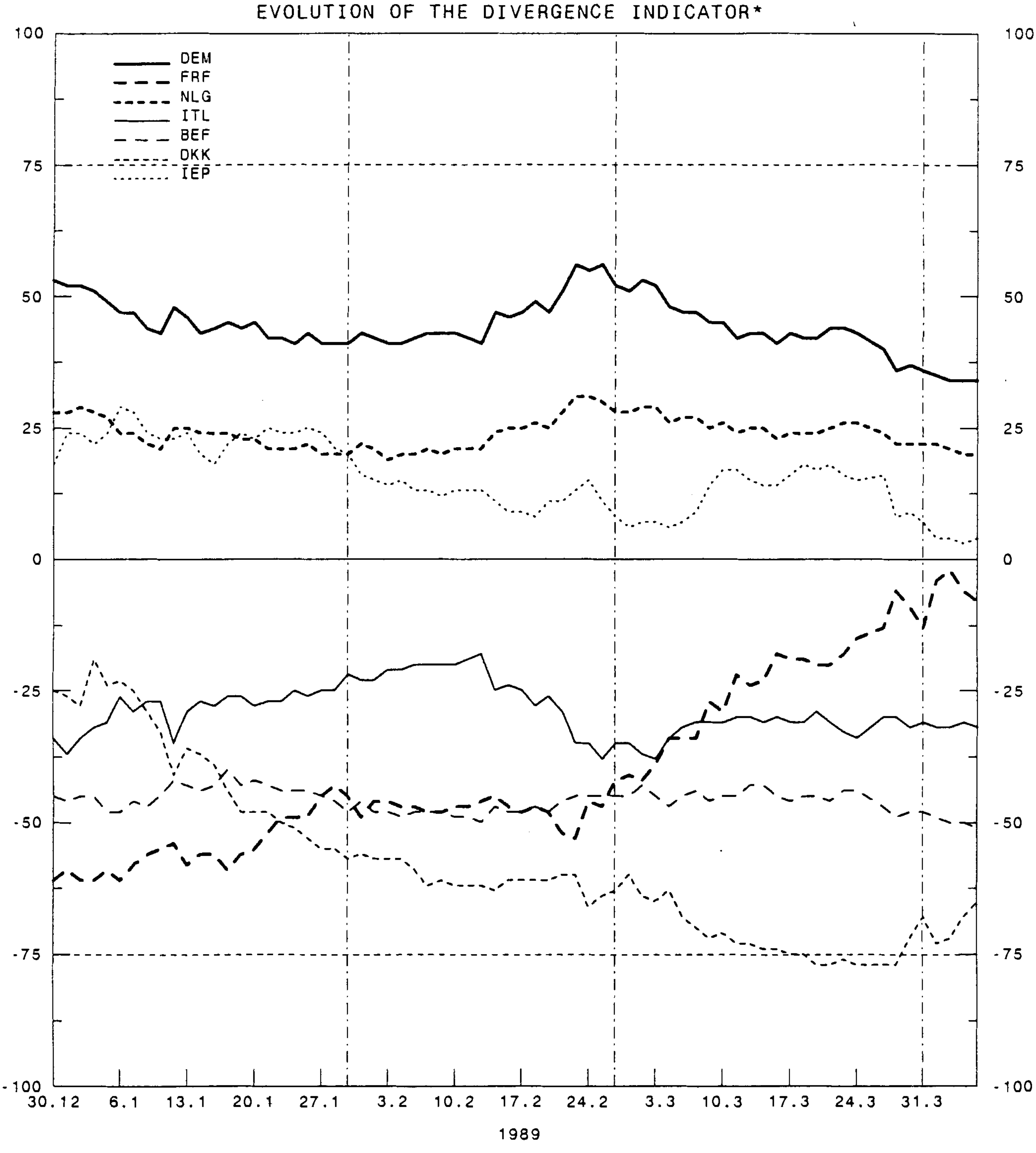
* ECU 0,767254; GBP 0,5346; GRD 126,2002; ESP 107,8498; PTE 130,0242; FIM 3,945; CAD 1,302; CHF 1,2775; JPY 121,4501; SEK 5,795; NOK 6,233; ATS 11,129; middle rate of the currencies participating in the EMS 0,77324. The middle rate of the currencies participating in the EMS represents the daily average 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%.

7.4.1989

MOVEMENTS IN THE EMS PARITY GRID



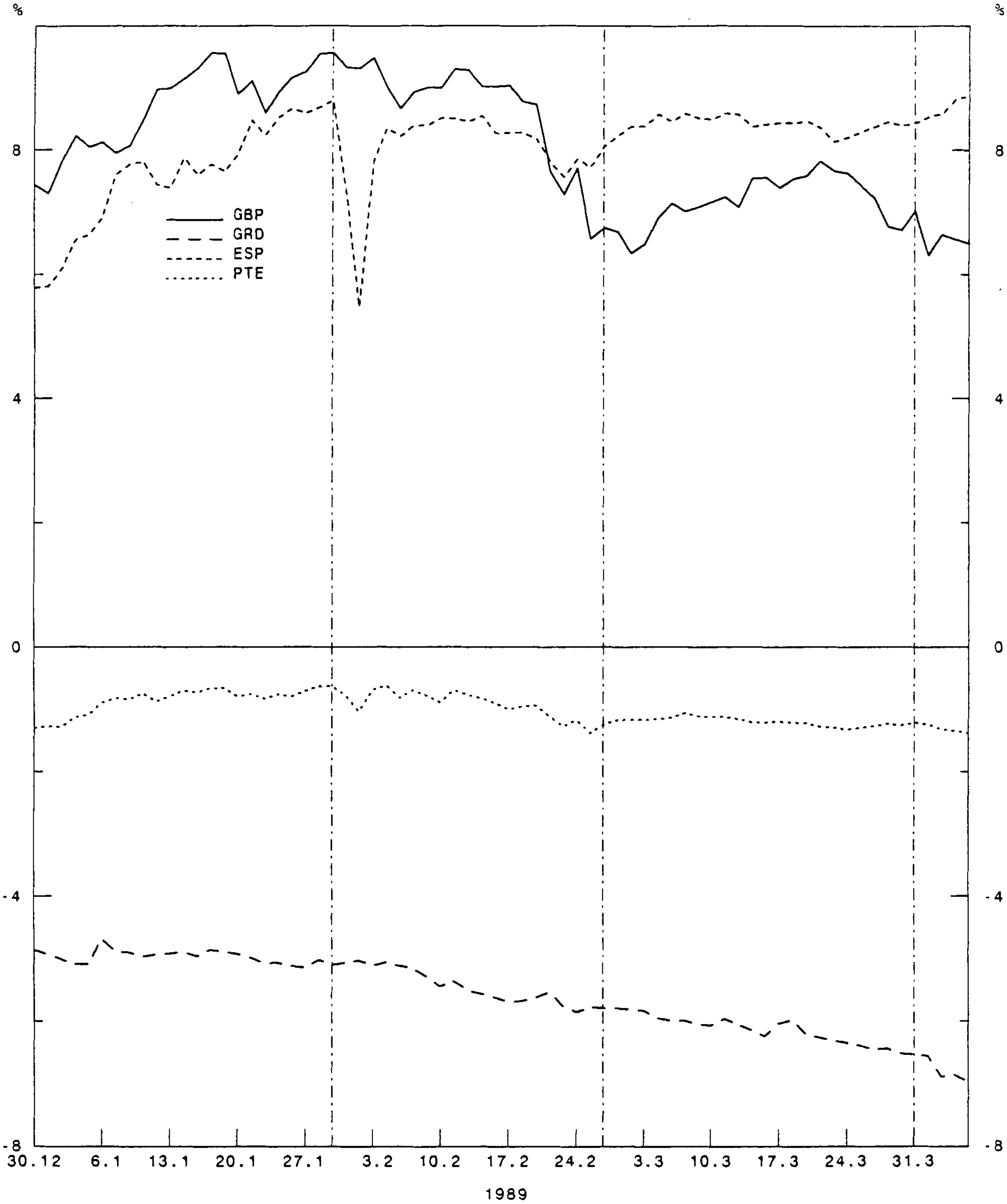
7.4.1989



* 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.

7.4.1989

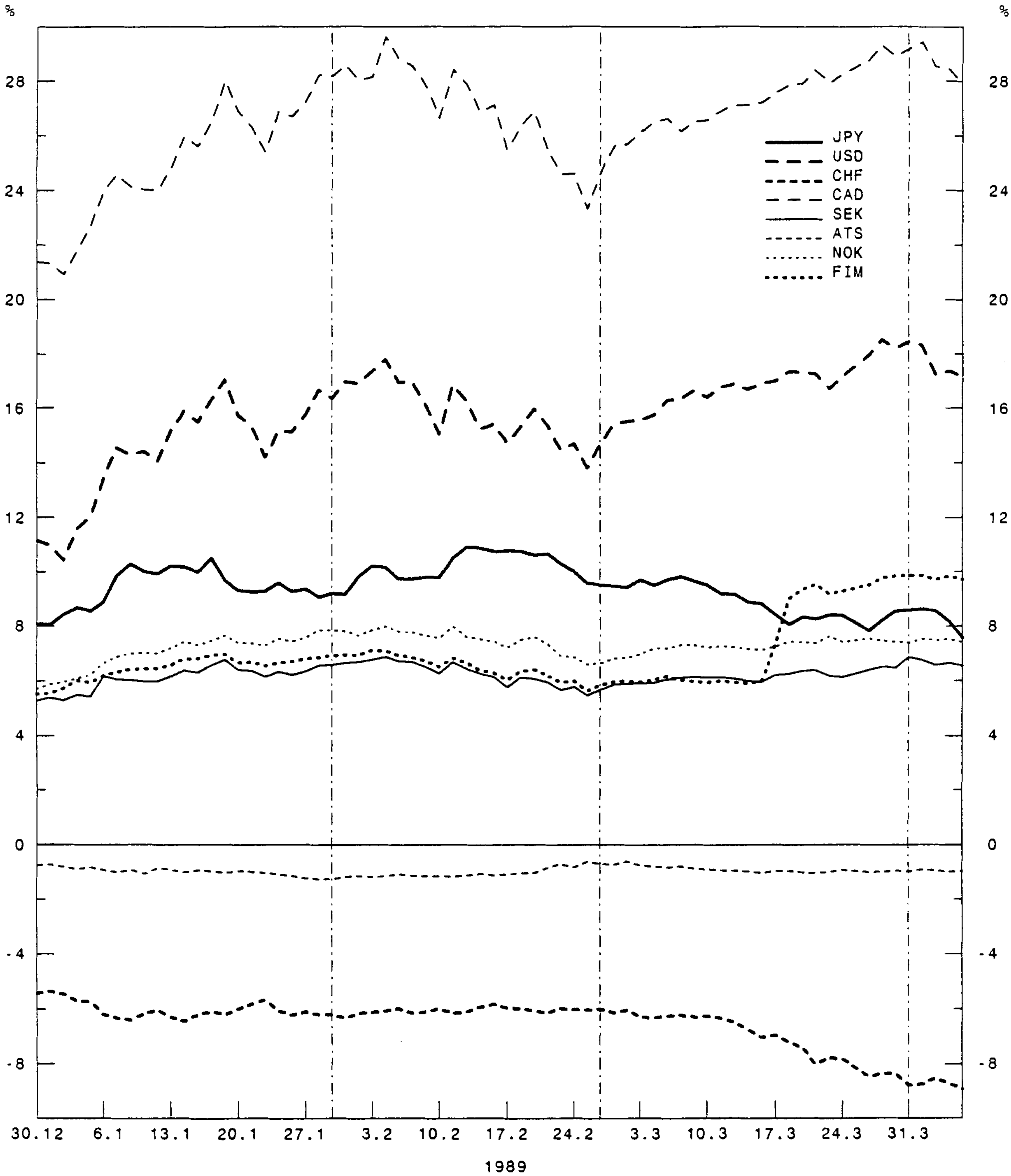
EVOLUTION OF THE POUND STERLING, THE GREEK DRACHMA, THE SPANISH PESETA AND THE PORTUGUESE ESCUDO, ON THE BASIS OF THE MARKET RATES PREVAILING ON 31ST DECEMBER 1987 AGAINST THE ECU*



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

7.4.1989

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.

7.4.1989