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

GROUP OF EXPERTS UNDER THE
CHAIRMANSHIP OF MR. RAYMOND

# SPECIAL REPORT ON A COMMON FRAMEWORK FOR THE MONITORING OF MONETARY POLICIES

27TH APRIL 1990

# CONTENTS

## INTRODUCTION

In November 1989 the Committee of Governors asked the group of experts to study the questions relating to the feasibility of a system of commonly agreed targets and indicators of monetary policy, as proposed by Governor Hoffmeyer in his letter dated 28th July 1989 (see Annex I). The group should focus on the questions and issues raised in the note prepared by the Danish Alternate, Mr. Mikkelsen, dated 7th November 1989 (see Annex II).

In compliance with this mandate, the group (see attached list of participants) has prepared the present report which is divided into six chapters:

- Chapter I deals with the general features of the proposed scheme for monetary policy co-ordination;
- Chapter II considers the variables to be used for expressing final economic objectives;
- Chapter III analyses the variables to be used as intermediate objectives and indicators of monetary policies;
- Chapter IV deals with the use of monetary policy instruments;
- Chapter V develops the practical and procedural aspects of implementation;
- Chapter VI presents some conclusions and identifies areas for further study.

## CHAPTER I: THE STRATEGY IN STAGE ONE OF ECONOMIC AND MONETARY UNION

Stage One of Economic and Monetary Union (EMU) is designed to enhance monetary stability and economic convergence in the Community. This can only be the result of a protracted socio-economic process which includes close co-ordination of overall economic policies.

### 1. Aim of co-ordinating monetary policies

The primary aim of co-ordinating monetary policies in Stage One is to achieve price stability. This idea is clearly expressed in Article 3.3 of the Decision (90/142/EEC) on the co-operation between EEC central banks which stipulates that the tasks of the Committee shall be, inter alia, "to promote the co-ordination of the monetary policies of the

Member States with the aim of achieving price stability as a necessary condition for the functioning of the European Monetary System and the realisation of its objective of monetary stability". At their meetings on 12th December 1989 and 9th January 1990, the Governors unanimously agreed that "price stability should be the primary objective of monetary policy" and that "achievement of this objective by all Member States in Stage One of Economic and Monetary Union would require the reinforcing of monetary policy co-ordination".

The general idea would thus be a level of inflation close to zero throughout the Community, i.e. a maximum of 2% in the medium run. At present, the Community is far removed from this objective. Experience has shown that even under the most favourable conditions, e.g. following the decline in oil prices in 1985, the Community average annual inflation rate was still 3.4% in 1987 and thus significantly above the desired goal of price stability; in 1989, the average inflation was at a level of more than 5%.

The unsatisfactory price performance of the Community as a whole reflects the fact that only some member countries have achieved low inflation whereas others have experienced persistent inflationary pressures. Thus, intra-Community inflation differentials have remained significant; in 1989, they were within a range of more than 10 percentage points. In the EMS exchange rate mechanism, the dispersion was smaller, but still within a range of 5 percentage points. This situation mainly reflects:

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- the varying degree of acceptance by the public of stability-orientated policies, with the result that the policies required for a rapid reduction of inflation might create political problems in some Community countries;
- structural factors which in turn imply that, at least in the short-term, monetary restraint influences prices, on the one hand, and the real economy, on the other, in very different ways.

The reduction of these differences requires action in two fields. First, it will be necessary to sharpen the public's awareness that price stability is a condition for sustained economic growth. Second, the anti-inflationary stance of monetary policies needs to be supported by appropriate measures of structural policies, among which are fiscal policies.

Whilst these differences still exist, each country should adopt policies conducive to continuing improvement of its price performance and further progress towards the medium-term aim of price stability. Successful implementation of this strategy would at the same time bring about a reduction of the Community average rate.

The gradual process towards the desired long-term goal might be disturbed by exogenous factors which could cause "autonomous" increases in inflation rates and thus uneven deviations from the agreed disinflationary process. These exogenous factors may find their origins in real and financial shocks in the individual member countries or from outside the Community. In such cases, it would be essential to avoid any permanent deviation from the agreed disinflationary path and to that effect reinforce the anti-inflationary stance in the subsequent periods. Conversely, it would appear expedient that any beneficial shock causing a more rapid disinflationary process be fully used to arrive more rapidly at the desired long-term goal of price stability.

The speed of progress towards price stability throughout the Community must not be too slow. Lasting divergences in price performances might prompt speculative pressure thereby jeopardising the EMS parity grid. Conversely, if nominal exchange rates are stable, persisting inflation differentials entail changes in real effective exchange rates which might aggravate current account disequilibria and give rise to fears in low inflation countries about the inflationary impact of the real depreciation of their currencies.

The proposed strategy should also make reference to external disequilibria. Current account imbalances can be financed more easily in a monetary zone of stable exchange rates and free capital movements but significant imbalances raise the question of their sustainability at prevailing exchange rates. In some Community countries, adjustment of unsustainable current account imbalances constitutes a supplementary final objective.

## 2. Formulation of the co-ordinated anti-inflationary strategy

The implementation of the anti-inflationary strategy described in the previous section will be substantiated by a set of commonly agreed key variables, i.e.:

- variables in respect of final economic results, both nominal and real;

- variables to be used as intermediate objectives and indicators of monetary policies.

This set of variables should help to improve the dialogue among the monetary authorities of Community countries as well as between the Committee of Governors, on the one hand, and the political circles and the general public, on the other. For the latter purpose, it will be necessary to disclose some of these key variables in the form of targets, indicators or assumptions; ideally they should meet the following requirements:

- they should accurately reflect prevailing conditions and should be meaningful in respect of the envisaged goal;
- they should allow comparisons both within the Community and with the rest of the world;
- their number should be relatively limited;
- they should be easily comprehensible to the public.

These requirements are to some extent contradictory. For instance, the principle of limiting the number of key variables may contradict with the need to explain a complex reality accurately. It will, therefore, be necessary to supplement published data by additional unpublished information for internal purposes of the Committee of Governors.

All published and unpublished data would be used both ex ante and ex post.

In the framework of an ex ante exercise, they would serve to formulate:

- the desired results in respect of prices and the appropriate stance of monetary and financial conditions, both country by country and for the Community as a whole;
- assumptions on growth and exogenous factors such as international commodity prices;
- the relative position of the Community vis-à-vis the rest of the world.

Once the norms are defined, they would guide the central banks in the conduct of monetary policies.

The key variables would also be used in the context of the ex post exercise, which aims to:

- measure the degree to which the final objectives have been met, especially in respect of price performance;
- assess the causes of any deviations (e.g. failure of Community countries to comply with key variables, external shocks from outside the Community) in order to make a judgement about the necessity to take corrective measures and, if such a necessity were to be confirmed, by which country.
- assess the risks for deviations in the future and the measurement of the burden of adjustment involved for each country.

## 3. Difficulties in the implementation of the co-ordinated anti-inflationary strategy

The implementation of the co-ordinated anti-inflationary strategy relies on the formulation of a commonly agreed and mutually consistent set of key variables. It would be the first such exercise undertaken in this field and three types of heterogeneity will have to be taken into account:

- heterogeneity of available statistical material;
- heterogeneity of financial structures and transmission mechanisms;
- heterogeneity of exchange rate commitments.

### 3.1. Statistical data

Differences in the development and orientation of national statistical systems account for some technical difficulties in establishing a set of internationally comparable data. In some cases, certain data are not available; in other instances, there are methodological differences. Notable examples are the way in which consumer price indices are calculated and monetary aggregates defined. As these divergences may only be eliminated in the longer run, it will be necessary to accept that, at the outset, the co-ordinated strategy be translated into specific national norms with the result that the key variables will not be exactly the same, albeit they will be reasonably comparable. In the longer run, it would be desirable that the Committee of Governors promotes and supports any effort which might be taken in the Community with a view to greater harmonisation of statistics.

## 3.2. Economic and financial structures and transmission mechanisms

Economic and financial structures differ considerably in the Community and partly account for the heterogeneity of monetary policy objectives[1]. Differences in economic structures exist for instance, in respect of:

- the openness of the economy which, for example, matters in the context of the transmission of exchange rate changes to domestic price developments;
- the relative weight of the economy in the Community;
- the existence of wage indexation schemes in some countries.

In the financial field, there are notable differences with regard to:

- the relative shares in total financing of the economy of credit by financial intermediaries, on the one hand, and market financing, on the other;
- the strategy and behaviour of financial intermediaries and respective legislation and administrative practices;
- the structure of firms' and private households' assets and liabilities;
- the relative size of the public sector in the economy, the tax burden and public debt ratios.

The integration of financial markets will continue to reduce differences in financial structures. However, this change will be uneven and may affect the informative value of the key variables of monetary policy in individual countries. Under these conditions, the definition of the financial key variables and their interpretation will have to take account of differences in financial structures and their evolution.

## 3.3. Exchange rate regimes

The Community countries are not all subject to the same exchange rate regime. Whereas eight countries respect a narrow fluctuation margin of ±2.25% between their currencies, Spain applies a margin of ±6%. The other

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[1] See for instance the Report No. 2 of the Harmonisation group, dated December 1978 and the group's Special Report on current practice with quantitative intermediate monetary objectives in EEC countries, dated February 1983.

countries follow a floating regime. Portugal announces an annual target for the depreciation of its currency; the exchange rate policies of the United Kingdom and Greece are not pre-defined in quantitative terms.

The anti-inflationary strategy should apply to all Community countries but it will be necessary to make a distinction between the countries participating in the EMS exchange rate mechanism, on the one hand, and those that do not, on the other.

## CHAPTER II: FINAL OBJECTIVES AND INDICATORS[2]

### 1. Price performance

Price performance is in general measured in terms of the rate of increase in consumer prices. This indicator is well known to the public and used in the formulation of domestic economic policies. Publication of consumer price increases also has an impact on exchange markets. Accordingly, it is recommended to announce publicly the normative price increases in terms of changes in the consumer price index.

The exclusive use of the consumer price index, however, would not be sufficient in the framework of the co-ordination exercise, since this index does not always enable underlying inflation to be assessed accurately, for instance in the case of changes in consumer taxes of public tariffs. In addition, mortgage interest rates are included in the CPI in some countries. Accordingly, the anti-inflationary strategy should also be monitored internally in terms of the following measures:

- deflator of GDP at factor cost: it would reflect value added in the economy, excluding indirect taxes and subsidies. However, its main shortcoming is the time lag in which it is available. This limits its usability in the current monitoring of the anti-inflationary strategy;
- unit labour costs in manufacturing: this indicator is already used by the group as a supplementary indicator of price performance. It is available in all countries and has a certain

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[2] Part of these issues have already been addressed by the group in Report No. 29 dated December 1986.

prognostic value in respect of future price developments. In contrast, it only reflects one cost element in one sector of domestic production (in general this sector enjoys a much stronger productivity growth than others) and data have to be carefully assessed in the light of cyclical developments and structural changes in productive sectors;

- import prices: this indicator allows the measurement of influences from abroad which can be split into exchange rate and price changes.

## 2. Indicators of economic developments

### 2.1. Economic growth and domestic demand

Real GDP growth is not a target in its own right in the framework of the exercise under review, but it has to be taken into consideration in the formulation of quantitative intermediate objectives (see Chapter III below). In addition, the sustainability of economic growth should be assessed; the difference between the actual and potential growth rates or the degree of capacity utilisation might give some guidance in this context, as well as the difference between domestic demand and GDP growth which is an important element in order to assess the convergence of current account positions.

### 2.2. External imbalances

The implications of national current account positions for the sustainability of the anti-inflationary strategy will be judged in the light of cyclical and structural factors, the way in which balances are financed[3] and competitive positions. A commonly agreed set of measures of intra-EMS and overall competitiveness is already used in the framework of the Committee of Governors. Nominal effective exchange rates are deflated by consumer prices, producer prices and unit labour costs. An alternative deflator would be total expenditure prices which is only used in one country.

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[3] See the group's Report No. 33 dated December 1988.

Apart from national positions, the Governors will also need to consider the aggregate balance and exchange rate relationships vis-à-vis the US dollar and the Japanese yen.

### 2.3. Fiscal stance

The fiscal stance may exert a significant impact on monetary and financial conditions and is thus also relevant for monetary policy co-ordination in the context of the envisaged exercise. The Committee may also wish to formulate its views in the framework of multilateral surveillance of economic policies at the Council level. The most significant indicators to be analysed would be the general government deficit and the way in which it is financed.

## 3. Conclusions

Public announcement of final economic variables, for the Community and the EMS as a whole as well as the individual countries, should cover:

- the normative price increases in terms of changes in the consumer price index;
- compatible projections relating to feasible economic growth.

Since the announcement of normative price increases is intended to influence economic agents' expectations, it will be important that the targets be realistic, albeit reflecting ambitious policies. In this respect it should be made explicit that they are part of a medium-term strategy designed to achieve price stability.

The other indicators would be for internal use by the Committee of Governors in the framework of multilateral surveillance (see Chapter V below).

# CHAPTER III: TARGETS AND INDICATORS OF MONETARY POLICIES

## 1. Quantitative targets and indicators of monetary policy

In the framework of its mandate, the group has studied the feasibility of establishing a mutually consistent set of co-ordinated quantitative targets and indicators of monetary policy which would help the authorities pursue their strategy of achieving greater convergence towards the aim of price stability. Analysis of methodological differences in the definition of national aggregates has shown that full harmonisation will take time. However, this will not prevent most countries from finding "conceptually comparable" aggregates[4] for co-ordinated targeting and surveillance. The group has also studied targeting practices in Community countries; while some countries set quantitative intermediate objectives, others formulate monetary policy primarily in terms of exchange rate targets.

Taking into account these factors, the group proposes the scheme described below for ex ante co-ordination and ex post surveillance of monetary policies.

### 1.1. Methodological issues

The concept of M1 (cash and chequable sight deposits) exists everywhere in the Community but the volatile behaviour of this aggregate does not in general qualify it to be used in the envisaged exercise. In addition, the distinction between transaction balances and portfolio balances has been blurred in some Community countries.

Broad money aggregates are also used everywhere. Their definition reveals some methodological differences which in part reflect the heterogeneity of financial structures (see Annex III). Nevertheless, most countries will be able to refer to conceptually comparable broad aggregates comprising liquid bank liabilities (in principle, sight accounts, short-term deposits and certificates of deposits), but excluding liquid assets issued by non-banks, e.g. Treasury bills. In these countries, such aggregates have shown a reasonably stable relationship with nominal spending and are deemed to be controllable. Thus they qualify for use as intermediate objectives of monetary policy (see section 1.2.).

The possibility of adopting fully harmonised aggregates in all Community countries will require further studies designed to eliminate the methodological differences in the definition of monetary aggregates (see Annex III), in particular with regard to:

- the liquidity of assets counted as money;
- the institutional framework;
- the treatment of cross-border holdings of monetary assets.

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[4] See Governor Hoffmeyer's letter dated 28th July 1989 in Annex I.

The studies should especially deal with the international consistency of monetary aggregates, which is a pre-condition for constructing a global Community (or EMS) monetary aggregate. Present national definitions do not comply with this requirement since cross-border deposits are in general not included. Thus a certain amount of liquid assets which are relevant for monetary policy is excluded. This amount is not yet very significant but it is expected to gain in importance in line with the liberalisation of capital flows and the integration of financial markets. In the near future, the solution to the problem will require a constant exchange of information among central banks as well as full harmonisation of criteria for the definition of monetary aggregates.

### 1.2. Targeting

In the EMS exchange rate mechanism, monetary policies are formulated in terms of quantitative intermediate objectives in the four largest economies. Germany targets M3; this aggregate closely corresponds to that proposed in section 1.1. above, except that it does not include short-term bank bonds. France, at present, uses M2 (defined on the basis of a transaction balances concept) as a target variable but would be ready to monitor M3. Italy uses M2, which roughly corresponds to the lines above and further adjustments could be made to enhance comparability. Spain's current target variable (ALP) is more comprehensive than M3 but the latter measure already serves as a supplementary indicator of monetary policy and might, with some changes, become a target variable in the future.

In these four countries targeting follows a relatively uniform method according to which targets are based on normative price increases. This method is also an essential feature of the proposed anti-inflationary strategy. Targeting also takes account of either the increase in potential output or a rate of GDP growth which is consistent with the normative price increase. Non-cyclical changes in velocity are also taken into consideration.

Under these conditions, these four countries will be able to implement co-ordinated targeting of broad monetary aggregates.

Along the same lines, Denmark and the Netherlands are prepared to set a target for domestic money creation based on a normative price increase and a compatible rate of GDP growth.

In the small countries participating in the EMS exchange rate mechanism, the openness of the economy and the EMS exchange rate commitment do not permit control over broad monetary aggregates in the short run through interest rate changes since this instrument is exclusively assigned to exchange rate stabilisation. Nevertheless in these countries, such monetary aggregates are useful as an indicator of monetary policy, and monetary growth should be estimated in order to permit definition of the overall stance of monetary policy in the Community. The EMS exchange rate would remain the main target.

Outside the EMS exchange rate mechanism, Greece and Portugal are ready to participate in the exercise by targeting broad monetary aggregates, following the method outlined above. Greece will also look at the domestic counterpart. The United Kingdom currently targets a narrow aggregate M0. It uses M4 (comparable to M3 in other countries) only as a supplementary indicator because the relationship between M4 and inflation has proved to be complex and variable.

### 1.3. Conclusions

The group recommends that, in the short run, the Community-wide anti-inflationary strategy be enhanced by setting national monetary targets according to similar procedures. In the EMS exchange rate mechanism, four countries would set co-ordinated quantitative intermediate objectives in terms of conceptually comparable monetary aggregates. Denmark and the Netherlands would target domestic money creation along the same lines. These two countries, together with Belgium, Ireland and Luxembourg, would continue to explain that their monetary policy primarily aims at maintaining stable exchange rates in the EMS, thus "importing" the monetary stance prevailing in the EMS area. Outside the EMS exchange rate mechanism, Greece and Portugal would associate themselves with the targeting of broad money. The United Kingdom hesitates to participate in this part of the exercise because it doubts whether monetary aggregates form a suitable basis for the co-ordination of monetary policies.

To check the cross-country coherence of monetary targets, it will be necessary to supplement the targets by separate forecasts on cross-border deposits and to improve the collection of statistical information in this field. It should also be agreed that henceforth any change in the definition of monetary aggregates which might be envisaged by the national authorities should be discussed in advance in the framework of the Committee of Governors with a view to enhancing the harmonisation and consistency of national concepts.

At the same time it will be necessary to work out a more sophisticated concept of monetary policy co-ordination in the future. The need for such an advanced concept will become greater as, in a financially integrated area with fixed exchange rates, monetary policy will be in a position to control inflation only at the EMS level. According to this concept, the central banks of the Community would decide jointly on an ex ante basis on the overall stance of monetary policy in the system. For this purpose studies should be undertaken to determine how to:

- harmonise fully the aggregates;
- find a Community aggregate which has a stable relationship with nominal spending and might be used as a target;
- develop a rule for the distribution of money creation.

## 2. Other indicators of monetary policy

The counterparts of the money stock, interest rate and exchange rate measures, as well as interventions in the foreign exchange markets, should be used as supplementary indicators of monetary policy.

### 2.1. Counterparts

Especially for the purpose of ex post exercises, it will be necessary to analyse the evolution of the respective domestic and external counterparts of the money stock.

### 2.2. Interest rate differentials

Nominal short-term interest rate differentials should be analysed in the light of possible tensions in the exchange markets, the stance of fiscal policies and the desired differentiation of monetary policies in Community countries.

### 2.3. Yield curve

The slope of the yield curve may give insight into market expectations of future interest rate developments and it may provide some information on the stance of monetary policies.

### 2.4. Exchange rates

The following measures should be taken into consideration:

- the position of EMS currencies in the narrow band;
- the position of other Community currencies;
- the position of the EMS vis-à-vis the rest of the world.

### 2.5. Interventions

Not only may interventions on the foreign exchange markets have an important impact on money creation (see section 2.1.), but they may also reveal tensions in the EMS exchange rate mechanism originating from insufficient co-ordination of monetary policies.

## CHAPTER IV: INSTRUMENTS OF MONETARY POLICIES

Co-ordination of monetary policies in Stage One will not require harmonisation of monetary policy instruments. Nevertheless, the progressive integration of capital markets increases the constraints on the use of the instruments. In addition, Stage One should be used to examine the working of the different instruments with a view to harmonisation which would be effective before the start of Stage Two of EMU.

### 1. Official key interest rates and refinancing facilities

At present, Community countries apply official key rates which differ significantly in nature. Although open market operations have generally gained in importance in recent years, increasingly substituting for refinancing facilities, the development has been uneven and, in some cases, the refinancing facilities continue to play a major role.

Harmonisation would be justified by three considerations:

- changes in official key rates signal the authorities' policy intentions;
- differences in the modalities of refinancing facilities have an impact on the national banking systems' competitive positions;
- it would be useful to prepare banks for European monetary unification which will imply a uniform method of providing liquidity.

### 2. Other instruments

2.1. <u>Compulsory reserve requirements</u> exist in most Community countries, but differences exist in respect of:

- the aggregates to which they apply (banks' outstanding liabilities or changes in their liabilities, increase in net money creating activity, etc.);
- remuneration of compulsory reserves: non-interest bearing or remunerated reserves;
- the reference period (contemporaneous or lagged schemes);
- the use made by the authorities: relatively frequent tactical changes in order to vary the spread between bank lending rate and money market rate or as a strategic "lever" of monetary policy.

Compulsory reserve schemes which are non-interest bearing or carry a remuneration below market levels represent a "tax" for the respective national banking systems. Differences in "tax rates", which are to be assessed in connection with other specific cost elements of bank activity, have a bearing on banks' competitive positions and stimulate shifts of bank activity to the xeno-markets with the result of reducing the effectiveness of domestic monetary policies. On the other hand, some central banks consider this instrument as relatively important. Accordingly, Stage One of EMU should be used to review the working of these schemes and to define their role in the framework of a more "centralised" pursuit of monetary policies in Stage Two of EMU.

2.2. A review should also be undertaken in respect of <u>credit ceilings</u> which are still in use. The effectiveness of this instrument is limited to the extent that economic agents have free access to alternative sources of financing, i.e. recourse to foreign financial markets and domestic credit other than bank lending[5]. In Stage One, the possibilities of circumventing the effects of credit ceilings will increase following the liberalisation of capital flows and enhanced substitutability of EMS currencies.

Under these circumstances, the use of credit ceilings should be reserved for emergency situations subject to a common assessment in the framework of the Committee of Governors.

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[5] See the group's Special Report on the consequences of the progressive decline in the use of direct control schemes in favour of indirect instruments of monetary policy dated November 1986.

## CHAPTER V: IMPLEMENTATION

The implementation of the scheme under review would consist of two elements:

- the formulation of objectives in the framework of an ex ante exercise based on Article 3, paragraph 2 of Decision EEC/142/90;
- the surveillance and assessment of actual developments in comparison with the desired objectives.

### 1. Ex ante exercise

In the framework of the ex ante exercise, Community central banks would commonly assess:

- annual normative price increases set by respective national authorities in the framework of a medium-term strategy;
- the corresponding quantitative intermediate objectives of monetary policy where they exist (see Chapter III, section 1).

The ex ante exercise should take place once a year, at a time before the beginning of the next calendar year. The result of this ex ante exercise would be published, for instance, in the form of a communiqué, a skeleton of which is attached in Annex IV.

### 2. Ex post exercise

The ex post exercise would consist of a multilateral surveillance which should lead to a judgement of the necessity to take corrective action. It would use the full range of published and unpublished key variables proposed in Chapters II and III. Failure to achieve intermediate objectives of monetary policy would help to determine which country, or countries, would be presumed to take corrective action. The analysis will, of course, have to take into account other developments. Conversely, achievement of intermediate objectives need not necessarily ensure that final objectives are reached.

The procedure for the preparation of this exercise and the intervals will have to be fixed by the Committee of Governors. With regard to the latter aspect, the group considered that too short an interval would not be appropriate since:

- the complexity and labour-consuming nature of preparatory work may set practical limitations;

- short-term developments may reflect random movements;
- too frequent public statements may quickly reduce their effectiveness on public opinion.

The group therefore recommended organisation of ex post exercises on a quarterly basis. An assessment would be made public twice a year; one preferably in the middle of the year, and the second in connection with the Committee's Annual Report[6].

The conduct of the exercise will be a learning process and the Governors might wish to review from time to time the methods used, in the light of experience.

## CHAPTER VI: CONCLUSIONS AND FOLLOW-UP

### 1. Conclusions

In the short run it is not possible to set and publish a target for the Community's global money stock with sub-targets for all Community countries. The scheme elaborated by the group (see page 12) comprises setting national monetary targets in terms of conceptually comparable monetary aggregates or domestic money creation by the majority of Community countries. Monetary policy in Denmark and the Netherlands (two countries which will target domestic money creation) as well as Belgium, Ireland and Luxembourg would primarily aim at stable exchange rates in the EMS. The United Kingdom feels unable to associate itself with this exercise and will continue to target M0.

The proposed scheme has the following merits:

- the unequivocal and public commitment to the aim of price stability;
- the substantiation of the anti-inflationary strategy by way of annual normative price increases which are compatible both with the aim of reducing inflation differentials and the gradual realisation of the objective of price stability throughout the Community in the medium run;

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[6] Article 3 of Decision EEC/142/90.

- reinforcing the elements of co-ordination but leaving the responsibility for monetary policy with national authorities;
- a common procedure for ex ante formulation of monetary policies and for periodic ex post assessments;
- a joint publication by the Committee of Governors of Community central banks' policy intentions on the basis of a limited number of easily comprehensible key variables;
- a pragmatic and flexible approach in respect of the co-ordination of monetary policies at the level of intermediate objectives, taking into account existing differences in economic and financial structures;
- an evolutionary aspect through learning-by-doing.

The credibility of the proposed strategy crucially depends on the achievement of visible and prompt results with regard to better control over inflation and the reduction of inflation differentials. In the absence of such achievements, the public relation effect of the proposed scheme would quickly be reduced. It is also important to be cautious in public statements to avoid raising undue expectations.

## 2. Follow-up

If the Governors agreed to set the proposed scheme into force by the end of the current year, two types of work would need to be undertaken. The first would relate to the implementation of the short-term approach. The central banks which are participating in the exercise should define the aggregates to be used as intermediate objectives in the co-ordination exercise. In addition, the procedure for the preparation of ex ante and ex post exercises will have to be elaborated, including the method of calculating the statistics, e.g. in terms of year-on-year or annual average changes. This work should be carried out by the forthcoming Monetary Policy Sub-Committee in co-operation with the Economic Unit and the Secretariat.

The second would relate to the elaboration of a more advanced concept of co-ordination of monetary policies. In this context the following topics could be studied:

- demand for money functions in Community countries;
- Phillips-curves - models of transmission mechanisms;
- concept of potential output;
- sectorial and regional disparities in prices in a monetary zone;

- criteria for harmonisation of monetary aggregates;
- establishing and testing demand for money functions at an aggregate Community/EMS level;
- instruments of monetary policy and their adaptation to the requirements of a more advanced approach of monetary policy co-ordination.

The Economic Unit should carry out this work in co-operation with the Monetary Policy Sub-Committee.

Annex I

## LETTER, DATED 28th JULY, 1989, FROM GOVERNOR HOFFMEYER TO THE OTHER MEMBERS OF THE COMMITTEE OF GOVERNORS

Dear

At the September meeting of the Committee of Central Bank Governors we will probably have to discuss a reenforcement and extension of the Committee's tasks and powers, including enhanced collaboration between the central banks.

In the Delors Report it was suggested that the Committee be consulted in advance of national decisions on the course of monetary policy. Moreover, when at our last meeting at July 11 we discussed the follow-up to the European Council, ideas were put forward, that stressed the importance to find ways of expressing publicly and in an appropriate manner the views of the Governors. The essence of these ideas was, inter alia, to obtain the support of public opinion in formulating prudent monetary policies, that could not be ignored by governments.

Against this background, I think we should establish a scheme of common targets that are clearly visible and well understood by politicians and the general public. More specifically, we should contemplate to launch a mutually agreed system of monetary policy monitoring, based on one or more monetary aggregates - $M_x$ and/or DCE. The aggregates should be conceptually comparable across countries and applied as indicators of the monetary policy stance. The mutually agreed growth paths of the aggregates should be published, and they should be surveyed every three months and opinions formulated on the overall orientation of monetary developments in each participating country.

For reasons of practical implementation, we could start out with a rather homogeneous group, i.e. members of the ERM or - perhaps preferably - the narrow band countries.

Obviously, there are important technicalities and procedures to be agreed on. Nevertheless, I think it is crucial that we come out as soon as possible with an operational surveillance mechanism, and I suggest that our alternates and experts be instructed to look into the problems as a matter of priority.

In my opinion, if we soon could put in place a system along the lines suggested, such an agreement would have an important demonstration effect and signal a firm determination to go forward in strengthening monetary policy coordination.

Sincerely yours,

Signed: E Hoffmeyer

DANMARKS NATIONALBANK

Richard Mikkelsen

Copenhagen, November 7, 1989.

## Note on Governor Hoffmeyer's proposal to launch a mutually agreed system of monetary policy monitoring.

With a view to the forthcoming discussion in the Committee of Alternates on the above-mentioned proposal I should like to make the following comments in addition to those contained in Governor Hoffmeyer's letter of July 28, 1989.

1. Needless to say, there are many problems involved in the establishment of such a mechanism, and especially in making it operational in a satisfactory way.

Inter alia could be mentioned differences in the environment for the conduct of monetary policy, different structures in money and capital markets, instability of the demand for money function, a weak relationship between domestic credit expansion and internal demand, and so on and so forth.

In addition, because of the opening of the borders between financial markets it is becoming more and more widespread that residents keep assets, abroad and domestically, in other currencies than their own, and that banks extend credits, likewise abroad and at home, in other currencies than the national currency. This development poses a number of special problems.

Deregulation and liberalization of capital movements have made monetary aggregates less reliable as indicators, at least while this process is an on-going one.

On the other hand, it would seem wrong to draw the conclusion that money does no longer matter. Furthermore, the linkage between European money and capital markets makes it even more important to improve monetary policy coordination.

The problem is how to formulate and execute our endeavours in this field.

2. There are, of course, other possibilities including a closer cooperation on interest rates.

But interest rates are - presumably - mostly treated as an instrumental variable and not as an intermediate objective. Furthermore, should such closer cooperation involve progress compared with present procedures it should entail some kind of ex-ante consultation, and this could meet with serious difficulties of both a political and practical nature.

This does not mean that interest rate policy should be relegated to a second-tier position. On the contrary, interest rate policy should be the principal instrument for influencing monetary conditions, but the scope for ex-ante coordination will remain limited in the present phase of integration. Our cooperation in this field should primarily rest on discretion.

3. The idea behind a closer cooperation based on monetary aggregates is, as mentioned in Governor Hoffmeyer's letter, to create a mechanism that would give the monetary policies of member states a Community dimension and thereby, at the same time, make monetary policy more visible at a European level.

If this approach is accepted, a number of questions have to be discussed.

4. Perhaps the most important of these will be the ultimate objective. Here we think that price stability should be given top priority. There may be other preferences, for instance stable exchange rates and even non-inflationary growth. But for sake of clarity and in conformity with the mainstream thinking amongst central banks we would prefer a simple and hopefully well understood final objective.

As well as the important signal effect implied by a policy orientation with this aim, a concensus on this question would probably make it easier to agree on the many operational elements.

5. Four questions are briefly touched upon in the following:

- what should be the common intermediate objective(s)
- should the objective be observed by all countries on an equal footing or would an average fulfilment be enough
- choice of instruments to achieve the objective
- reaction in case of non-compliance.

6. On the first question it would probably be necessary, for operational reasons and for the sake of clarity, to limit the choice of intermediate objective to one or two aggregates, e.g. broad money and some measure of credit extended by banks.

It would hardly be sufficient to work solely on the basis of the money stock in its broad concept. Compliance with a money target of e.g. 5 per cent is not necessarily tantamount to a satisfactory development if it is a result of a domestic credit expansion of say 8 per cent and capital outflows corresponding to 3 per cent.

There are many important problems involved here but it would be going too far to deal with them in this short note.

Two points ought to be emphasized.

First, it would not be fruitful to aim at fully harmonized concepts. That would be a thing for the future. The aggregate chosen should be reasonably comparable across EC-countries, but it would be up to each central bank to choose, within the agreed spectrum, the aggregate that it would find the most suitable.

Secondly, the common intermediate objective should not in any way reduce the effectiveness of the monetary policy that is being pursued by individual countries. This means that each country should be able to maintain its existing monetary policy arrangements.

Community monetary cooperation would only focus on the aggregate or aggregates chosen for this purpose.

7. In so far as the second question is concerned, it is evident from the idea behind the proposal that the common

intermediate objective should be observed by each individual country.

But as economic and financial conditions differ from country to country it would presumably be necessary to express the target for the intermediate objective as a zone or range.

For the same reason it has been suggested that the participation in the system should, from the outset, be limited to a homogeneous group of countries, e.g. members of the ERM or - perhaps preferably - the narrow band countries.

8. As to the third question, it would probably be reasonable to leave it to each individual country to specify which instruments it finds appropriate to use in order to reach the target, provided that the instruments are market-oriented.

9. Finally, on the fourth question, it would hardly be feasible to make the objective normative in the sense that a deviation from the agreed growth path would be supposed automatically to lead to policy action to restore the objective.

It should rather, as an important element in monetary policy monitoring, be used as a reference point for discussion, if necessary followed by subsequent policy adjustments.

10. Some of the above-mentioned questions are of a technical nature but they are at the same time crucial in the sense that the operational value of the system will depend very much on the solutions that can be found. It would presumably be useful, at some time, to ask the Raymond-group to have a look at the technical aspects.

The introduction of such a scheme would initially need to be experimental. It is therefore important to adopt a flexible approach. Furthermore, when the nature of this form of cooperation is made public it would be advisable to use cautious language in order to avoid undue expectations.

As central bankers we are aware of the fact that there can be valid reasons to accept deviations from a previously agreed target. It is important to avoid situations where such justified deviations could give rise to disillusion and thereby impair the credibility of the Community central banks.

Annex III
27th April 1990

# DEFINITION OF MONETARY AGGREGATES IN COMMUNITY COUNTRIES

## - A comparative analysis -

The present note focuses on the differences between Community countries with regard to the definition of monetary aggregates. It has been prepared on the basis of contributions made by the various Community central banks.

## 1. Compilation of monetary aggregates

At the present juncture, the Community countries compile the following aggregates:

- Belgium: M1, M2 harmonised, M2 national;
- Denmark: M1, M2 harmonised;
- Germany: M1, M2, M3, M3 extended;
- Greece: M0, M1, M2, M3, M4;
- Spain: M1, M2, M3, ALP;
- France: M1, M2, M3, L;
- Ireland: M1, M3, an aggregate called "M3 and other liquid assets";
- Italy: M1, M2, M3;
- Luxembourg: M1, M2;
- Netherlands: M1, M2;
- Portugal: M1, $L^-$;
- United Kingdom: M0, M1, M2, M4, M4c, M5.

Part of these aggregates are not monetary measures in the strict sense but rather constitute means of broad liquidity (L in France, ALP in Spain, M5 in the United Kingdom).

As is shown below, the "semantics" need qualification. Except for M1, which is defined in a relatively homogenous way throughout the

Community, broader aggregates are more differentiated (see the attached table and charts). Thus, although bearing the same name, the elements of such aggregates may vary considerably. For instance, M2 in France and the United Kingdom are based on a "transaction balances concept", whereas in other Community countries M2 reflects a broader money concept which in turn may sometimes be defined more widely than M3.

The definition of monetary aggregates in Community countries takes into account, to varying degrees, the following criteria:

- the sector and location of the issuer;
- the sector and residence of the holder;
- the characteristics (liquidity, maturity, currency denomination, etc) of the asset.

Differences in the use of these criteria reflect three factors. First, differences in financial structures: a given type of asset may be very important in one country, whereas its role can be insignificant in another. Second, each country has developed its own methods for assessing the degree of "moneyness" of financial assets. While there is little doubt about "moneyness" of those assets which can directly be used as a medium of exchange, the classification as money of other assets, which are not themselves usable as a media of exchange but nevertheless are close substitutes, is much more difficult since the borderline between them and other assets is fluent. The difficulties are all the greater since in a modern economy with an advanced financial system there is a large spectrum of hybrid assets which are neither transaction balances nor illiquid assets. Conversely, in less advanced economies, a part of liquid assets is genuine savings. Third, practical aspects relating to the collection of data also influence to some extent the definition of monetary aggregates.

## 2. Liquidity and maturity of assets

The main differences exist in respect of three issues:

- the maturity of assets;
- the criteria of whether the liquidity is ensured by the issuer and/or by the market;
- the currency of the asset.

Time deposits are considered - regardless of their maturity - as quasi-money in Denmark, Greece, Spain, France, Ireland, Italy and the

United Kingdom. In contrast, the other Community countries only include time deposits up to a certain maximum maturity: Belgium and Luxembourg up to one year, the Netherlands up to two years and Germany up to four years. In the latter two countries, however, the bulk of these time deposits is relatively short-term.

In most Community countries, balances on savings accounts can be converted into media of exchange without any significant interest loss or penalty. They are therefore fully counted as quasi-money, and in France even as part of transaction balances (M2-M1). In contrast, in Germany, sight savings accounts do not exist. All savings accounts are either at statutory or agreed notice. Savings accounts at statutory notice allow immediate withdrawals of up to DM 2,000 per month and are considered as quasi-money (M3-M2), whereas savings deposits with agreed notice are not included in M3. In the Netherlands only "liquid savings" are included; the distinction between "liquid" and "genuine" savings is based on stability criteria. If the rate of turnover is less than 0.5, the deposits are counted fully as "genuine" savings. As the rate of turnover rises, an increasing part is counted as "liquid" savings, the assumption being that if the rate of turnover is 2.0 or more, the savings are fully liquid.

Belgium, Greece, Ireland and Luxembourg only include in money assets whose liquidity is ensured by the issuer alone. This is also true for the traditional monetary aggregates in Germany, whereas the broader aggregate "M3 extended" also comprises short-term bank bonds. The other Community countries systematically include short-term negotiable instruments but apply different maturity criteria. Denmark and the Netherlands: up to two years; Greece: up to three years; Portugal: up to five years. Spain includes all kinds of deposits and certificates of deposit regardless of their maturity in M3 and other negotiable instruments issued by banks and the Treasury with maturities up to six years in ALP-M3. In France money market paper issued by credit institutions with maturities of up to seven years are counted as M3-M2, whereas instruments issued by the State and other non-financial entities with the same maturities are included in L-M3. The United Kingdom includes Treasury bills of up to one year in M5.

Approaches also differ with regard to the classification of foreign currency deposits as money. Foreign currency holdings do not form part of national monetary aggregates in Greece, where they are not intimately related to domestic spending, in Spain, where such deposits are supposed to be small, and in Luxembourg, for statistical reasons. In the United Kingdom non-sterling items are excluded from the main monetary aggregates but included in M4c. France, Belgium and the Netherlands consider foreign currency holdings as quasi-money (M3-M2 and M2-M1 respectively). The remaining countries classify foreign currency assets along with domestic currency assets according to their maturity.

## 3. Financial institutions other than banks

Financial institutions other than banks are treated in different ways. In Belgium, Germany, France and the Netherlands, the financial system, whose liquid liabilities are counted as money, in principle comprises all domestic financial intermediaries. Other countries apply a less broad concept. In Spain, some types of financial institution, for instance, building societies, finance entities, leasing and factoring companies are excluded; the same applies to specialised credit institutions in Italy. In Ireland, the generally used monetary variables (M1 and M3) relate only to the liabilities of the Central Bank and licensed banks. In contrast, the wider concept of money and other liquid assets is based on the whole financial sector of the economy (excluding credit unions).

Conversely, monetary aggregates sometimes also include deposits held by financial institutions which are not counted as issuers of money. This is the case in Spain. In the United Kingdom M2 (but not M4) includes building societies' holdings of cash and non-interest bearing deposits. The reason for this practice (which means that M2 is not nested within M4) is historical; at the time M2 was created, separate data for these holdings were not available.

Methodological problems also exist in those countries where assets issued by undertakings for collective investment in transferable securities are close substitutes to monetary holdings. Either these assets are included in monetary assets held by non-bank residents or the entities are treated as "transparent" organisms with the result that these entities' assets are dealt with as if they were directly held by the subscribers. The second method has been followed by Belgium and France. In Luxembourg, these assets are not included in either way in monetary statistics.

Savings banks' insurance products are considered as part of broad liquidity only in Spain (ALP-M3); however, following a new regulation in 1989, their outstanding amount has been decreasing sharply.

## 4. Treatment of public sector entities

Methodological problems exist in respect of public sector entities both as holder and issuer of monetary assets.

Public authorities' deposits with financial intermediaries are excluded by some countries, i.e. Belgium, Spain, Italy, Luxembourg and the United Kingdom as well as Ireland which does not include central government deposits. Germany excludes deposits held by central and regional authorities with the Deutsche Bundesbank in accordance with Article 17 of the Bundesbank Act in order to facilitate management of the money market; these deposits are thus not deemed to be fully comparable with bank deposits.

The exclusion of public authorities' monetary holdings is explained by the following considerations: the role of the public sector as an issuer of monetary assets (see below) as well as the fact that there is no relationship between the public sector's monetary holding and spending. An increase in such deposits may indeed signal a surplus of the public sector and thus a contractionary influence.

Conversely, the public sector is also an issuer of money in some countries. In addition to coins which are part of monetary aggregates everywhere, Treasury bills are included by the following countries: Belgium, Denmark and the Netherlands (in M2-M1), France (in L-M3), Spain (ALP-M3), Italy (in M3-M2), Portugal (L-M1), the United Kingdom (in M5-M4). In the Netherlands, claims on local authorities (comprising money at call, temporary loans, advances and commercial paper) are also counted as money (M2-M1).

## 5. Fiscal aspects

Yields on financial assets held by non-financial residents are taxed according to schemes which differ from country to country. Current yields on financial assets are part of income and thus are taxed at the income tax rate in Denmark, Germany, Luxembourg and the Netherlands. There is no withholding tax in these countries and no tax privileges except for savings schemes in Denmark.

More complicated tax schemes are applied in other countries with tax treatments varying according to the issuer and holders of financial assets and their characteristics. For instance, yields on government paper is tax-exempted in Ireland and Portugal as well as in Greece where, in addition, interest on bank deposits is tax-free. In Italy, the withholding tax rate on government issues is about half that on bank deposits and other financial assets. In Spain, interest income from short-term government paper is not subject to the withholding tax while this tax applies to the rest of financial assets. In the United Kingdom, a fixed rate of tax - known as composite tax rate - is charged on interest paid to individuals by building societies, banks and certain other deposit takers. It is not repayable in any circumstances, even to depositors who are not liable to tax. Yields on other assets are subject to a basic rate tax with some national savings schemes being exempted from tax. However, the composite rate tax will be abolished from 6th April 1991 and the basic tax rate will be deducted from interest on deposits.

In France, residents may choose between taxation at personal income tax rates or a withholding tax in full discharge of income tax liability. In the latter case, the withholding tax rates on interest income vary according to three criteria: negotiable assets, other liquid assets and anonymous subscriptions to notes. In Belgium, a withholding tax of 10% which fully discharges individuals of their income tax liability applies to interest income from financial assets issued since 1990, with some exoneration of interest on saving books; the withholding tax on dividends and interest income from assets issued before 1990 is 25%.

## 6. International consistency of monetary aggregates

In an environment of full capital liberalisation and increasingly integrated financial markets residents are free to hold liquid assets in domestic currency or foreign currencies with domestic or foreign banks. At the same time non-residents may hold liquid assets in the currency of a given country either with that country's banks or abroad and domestic banks may receive deposits from non-residents in foreign currencies. Thus liquid assets can be classified according to the following criteria:

- the currency of the liquid assets (domestic or foreign currency);
- the residence of the holder (resident or non-resident);

- the location of the issuer of the liquid asset (home or foreign banks).

Monetary aggregates would be internationally consistent if they complied comprehensively and uniformly with one of these three criteria above. However, this is not the case. Although monetary aggregates are based on the criteria of residence of the holder of liquid assets, cross-border holdings are in general excluded. Monetary assets held by residents with foreign financial intermediaries are taken into consideration only in two countries: in Germany where they are included in M3 extended and in Belgium where balances held with banks abroad form part of M2 national. Conversely, monetary aggregates also include cash held by non-residents as these statistics do not permit the identification of holdings. Apart from this special feature (which is of limited significance except for the Deutsche Mark) non-residents' holdings of domestic currency are part of the domestic money stock in Greece where, for the time being, it is not possible to distinguish between residents and non-residents, given a lack of appropriate statistics.

Accordingly, Community countries' national monetary aggregates would not add up to a Community aggregate money stock as it excludes a certain amount of liquid assets.

Available statistics show that the outstanding amount which is excluded is not substantial compared with the total. Cross-border holdings of other Community residents are mainly denominated in foreign currency and are deemed to be unrelated to domestic spending. However, sizeable amounts in national currencies are held abroad by Belgian and German residents and the example of Germany shows that the monetary growth rate can differ significantly according to whether cross border holdings are included or not.

If a European Community aggregate were desired, this could be achieved by adding up national data aggregated uniformly according to one of the following three criteria:

- residents' holdings of liquid assets worldwide and in any currency;
- holdings in national currency by residents and non-residents;
- liquid assets held with each country's financial intermediaries.

The three methods would not lead to the same overall aggregate. The first method would result in global Community money stock held by

Community residents. In the second case, the Community aggregate would also comprise holdings by non-Community residents in Community currencies. In the third case, the overall aggregate would exclude holdings by Community residents with non-Community financial intermediaries but include holdings by non-Community residents.

## (PROVISIONAL)

⁘ M1
▥ M2-M1
▨ M3-M2
▤ Broader aggregates (M4, L, ALP, "M3 extended")

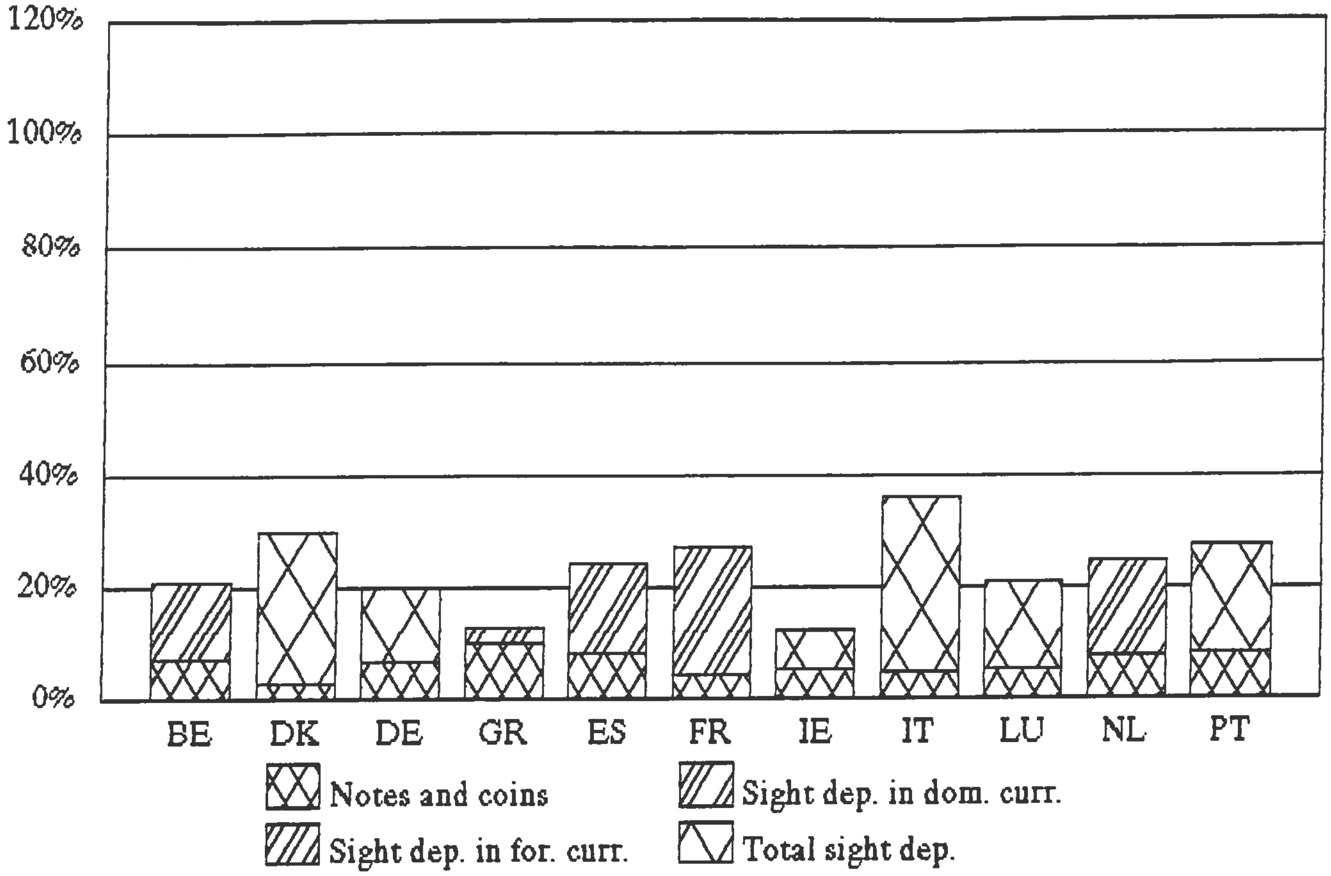
# RELATIVE SHARES OF THE VARIOUS FINANCIAL ASSETS HELD BY RESIDENT NON-FINANCIAL AGENTS (DECEMBER 1988)(AS A PERCENTAGE OF GDP - DOMESTIC OR FOREIGN CURRENCY DENOMINATED)

| CATEGORY | BELGIUM | DENMARK | F.R.G. | GREECE | SPAIN | FRANCE | IRELAND (Déc.89) | ITALY | LUXEMBOURG | NETHERLANDS | PORTUGAL |
|---|---|---|---|---|---|---|---|---|---|---|---|
| NOTES AND COIN | 7.4 | 3.0 | 6.7 | 9.9 | 8.1 | 4.2 | 5.5 | 5.1 | 5.5 | 7.7 | 8.4 |
| SIGHT DEPOSITS | | | | | | | | | | | |
| .Denominated in dom.cur. | 13.7 | 27.0 | 13.4 | 3.2 | 16.2 | 22.8 | 6.9 | 30.9 | 15.4 | 17.1 | 19.1 |
| .Denominated in foreign currencies | 1.1 | | | 2.5 | | 0.4 | | | | 1.2 | |
| SIGHT SAVINGS ACCOUNTS | 38.0 | | - | 49.8 (in domestic currency)<br>1.4 in f.c | 18.1 | 22.8 | 36.0<br>(of which 23.6 in M3-M1) | 17.5 | 24.5 | 35.4 in total (in the aggregates: liquid deposits only : 1.0) | |
| DEPOSITS AT NOTICE | 17.6 (of which 15.0 at 1 year or less) | 7.0 | 34.3 agreed (11.0)<br>legal(23.3) | 0.4 | | - | | | | 19.7 in total (in the aggregates: liquid deposits only: 16.6) | 0 |
| FIXED TIME DEPOSITS | | 13.0 | 34.0<br>< 4 years (12.7)<br>> 4 years (21.3) | 21.4 (ordinary)<br>14.6 (other) | 24.1 | 4.3 (of which 0.3 denominated in foreign currencies) | 13.0 (of which 9.6 in M3 - M1) | | 59.8 | | 40.7 |
| NON-NEGOTIABLE CERTIFICATES | 3.8 (at one year or less only) | | 10.6 | 0.6 (certificates of deposits) | 0.6 | 6.6 | | 8.0 (Post Office bills) | | 0.9 (of which 0.1 in M2-M1) | 0 |
| REPURCHASE AGREEMENTS | | | | | 13.9 | 2.5 | | 0.4 | | | |
| SHORT-TERM SECURITIES | | | | | | | | | | | |
| .Certificates of deposit | | | 0.2 (short term Bank bonds) | 5.2 (Bank bonds) | 1.9 (incl.short T.Bank bonds) | 7.7 | | 5.2 | | 1.2 (0.3inM2-M1) | 0.9 |
| .Treasury bills | 0 | 2.0 | | 5.5 | 2.4 | 1.8 | 2.5 | 19.1 | | 2.1 | 9.5 (incl.other asset) |
| .Commercial paper | | | | | 0.7 | 1.0 | 4.3 | - | | 0.2 | |
| .Others (short term) | | | | | 2.3 | | | 0 | | | 2.7 |
| SAVINGS SCHEMES | - | 12.0 | 5.4 | 5.4 (of which 1.5 in dom.cur.) | | 7.2 | 12.5 | | | | 11.5 |
| SIGHT OR TIME DEPOSITS HELD ABROAD BY RESIDENT NON-FINANCIAL AGENTS (data compiled by the BIS) | 12.2 (for the B.L.E.U.) | 2.0 | 3.9 (of which 3.0 in "M3 extended") | 9.4 | 1.6 | 2.0 | 9.8 | 0.8 | (see Belgium) | 14.3 | 7.5 |
| MEMORANDUM ITEMS | | | | | | | | | | | |
| BONDS | 80.7 (incl.notes at more at than 1 year) | | 21.1 | 4.6 | 9.7 (of which 4.8 in ALP-M3) | 9.2 | 24.5 | 41.1 | | 34.0(1987) | 12.8 |
| SHARES | 4.8 (histor.cost) (listed secur.) | | 24.9 | 7.9 | 20.7 | 21.0 (listed securities only) | 27.5 | 7.5 | | 28.9(1987) | 6.5 |
| UCITS* UNITS | 10.2 | | | 0.8 | 1.6 | 20.0 | | 4.8 | | | 1.0 |
| INSURANCE PRODUCTS | 12.2 | | | | 9.4 (of which 3.4 in ALP-M3) | 13.9 | 32.4 | 4.5 | | | |

* Undertakings for collective investment in transferable securities

## Graph 1. M1 as a percentage of GDP (*)

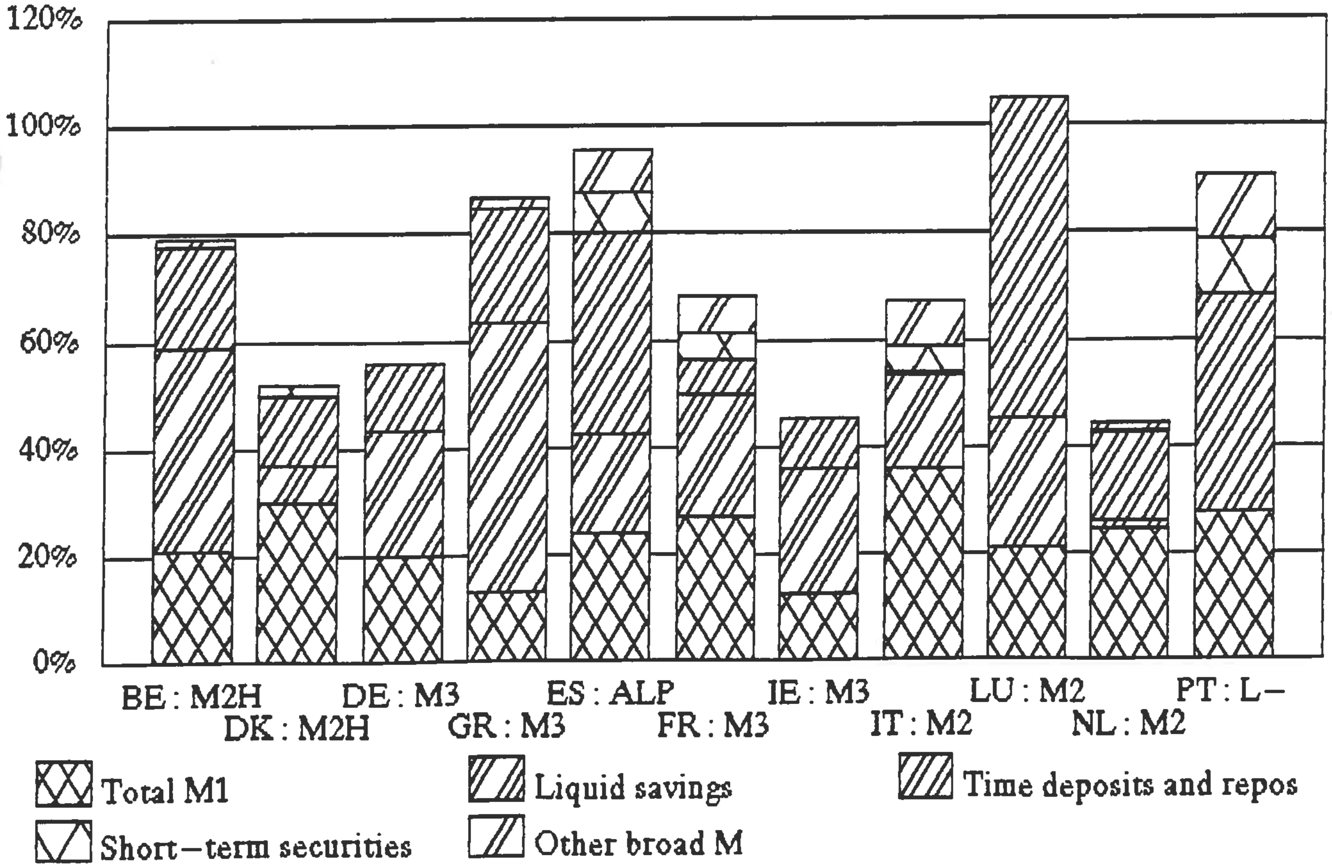
Amounts outstanding in December 1988



(*) PROVISIONAL. For explanations see notes

## Graph 2. BROAD M as a percentage of GDP (*)

Amounts outstanding in December 1988



(*) PROVISIONAL. For explanations, see notes

## EXPLANATORY NOTES

### Graph 1. M1 as a percentage of GDP

For Italy, sight deposits include post office sight deposits and deposits at notice.

### Graph 2. BROAD M as a percentage of GDP

For Portugal: $L^-$, for Spain: ALP.

### Liquid savings

Belgium: sight savings accounts in domestic currency.
Denmark: deposits at notice.
Germany: savings deposits at statutory notice.
Greece: sight savings accounts in domestic currency and deposits at notice.
Spain: sight savings accounts and deposits at notice.
France: sight savings accounts in domestic currency.
Ireland: sight savings accounts and deposits at notice.
Italy: sight savings accounts and fixed time deposits.
Luxembourg: sight savings accounts.
Netherlands: all accounts and deposits treated as savings amount to 35.4% of GDP, of which 1.0% of GDP are liquid savings.
Portugal: deposits at notice (0.02% of GDP).

### Time deposits and repurchase agreements

Belgium: in domestic and foreign currency, including bank bills up to one year.
Germany: at less than four years.
Greece: ordinary time deposits in domestic currency.
Italy: fixed time deposits included in liquid savings (see above).
Netherlands: deposits at notice and fixed time deposits. All accounts and deposits not treated as savings amount to 19.7% of GDP, of which 16.6% of GDP have an original maturity of less than two years and are included in M2.

## Short-term securities

| | |
|---|---|
| Denmark: | Treasury bills. |
| Spain: | certificates of deposits and short-term bank bonds. |
| France: | certificates of deposits. |
| Italy: | certificates of deposits. |
| Netherlands: | certificates of deposits and claims on central and local government with an original maturity of less than two years. |
| Portugal: | certificates of deposits, Treasury bills and Auctioned Credit for Public Investment. |

## Other broad M

| | |
|---|---|
| Belgium: | domestic sight deposits in foreign currencies. |
| Greece: | certificates of deposits and housing saving schemes in domestic currency. |
| France: | remunerated sight deposits in foreign currencies and non-negotiable certificates. |
| Italy: | post office savings accounts and post office bills. |
| Netherlands: | domestic sight deposits in foreign currency and non-negotiable certificates with an original maturity of less than two years. |
| Portugal: | savings schemes, cash bonds. |

Annex IV

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

27th April 1990

**Following from the conclusions of the Report, the experts have prepared a draft communiqué which is only an example of what could be published. The text below is regarded by the experts as a most extensive version.**

## SKELETON DRAFT COMMUNIQUÉ

1. On .......... 1990, the Governors of the central banks of the Member States of the European Economic Community decided to implement a system of monitoring based on a commonly agreed framework of targets and indicators of monetary policies. This new system is part of Community central banks' common anti-inflation strategy designed to bring about price stability in the medium run throughout the Community.

2. In 1991 the Community central banks will pursue policies conducive to increased convergence towards a low level of inflation. The normative price increases (as measured by the [year-on-year] [annual average] rate of growth of the consumer price index) for the forthcoming year are as follows :

EMS Exchange Rate Mechanism

| | Maximum price increase (in %) | Change compared with 1990 |
|---|---|---|
| BE ) | | |
| DK ) | | |
| DE ) | | |
| ES ) | | |
| FR ) In ascending order of inflation rates | | |
| IE ) | | |
| IT ) | | |
| LU ) | | |
| NL ) | | |

On the basis of these targets, the average inflation rate in the EMS exchange rate mechanism would be ..%, a reduction of .. percentage points compared with 1990.

Non-ERM Countries

| | Maximum price increase (in %) | Change compared with 1990 |
|---|---|---|
| GR ) | | |
| PT ) | In ascending order of inflation rates | |
| GB ) | | |

3. With a view to achieving these price objectives and taking into account a compatible rate of economic growth (e.g. potential output growth in Germany), the following targets have been set for the central banks mentioned below:

| | Rate of increase in broad money stock | Assumed real growth |
|---|---|---|
| DE | | |
| ES | | |
| FR | | |
| IT | | |

| | Domestic money creation | Assumed real growth |
|---|---|---|
| DK | | |
| NL | | |

The compatibility of the targets above with the final aims as set out in section 2 and their mutual consistency were commonly assessed by the Governors.

The central banks of Belgium, Ireland and Luxembourg will participate in the agreed strategy by conducting policies conducive to exchange rate stability in the EMS.

The intermediate objectives of the countries which do not participate in the EMS exchange rate mechanism are as follows:

| | Target Variable | Rate of increase in the target variable | Assumed real growth |
|---|---|---|---|
| GR | | | |
| PT | | | |
| GB | | | |

4. The success of the anti-inflationary strategy will also depend on support from other policies, in particular budgetary and structural policies.

5. The Committee of Governors will monitor closely developments in final and intermediate variables in order to identify timely any deviations and to commonly evaluate possible co-ordinated policy responses.

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

## GROUP OF EXPERTS ON MONETARY POLICY

### List of Participants

| | |
|---|---|
| Chairman | R. Raymond |
| Banque Nationale de Belgique | E. Jacobs<br>V. Périlleux |
| Danmarks Nationalbank | O.I. Nielsen<br>H.F. Jensen |
| Deutsche Bundesbank | H. Herrmann<br>Mme D. Voigt |
| Bank of Greece | E. Gyparakis<br>T. Gagalis |
| Banco de España | J. Malo de Molina<br>Mme B. Sanz |
| Banque de France | Mme M. Alleron<br>P. Berger |
| Central Bank of Ireland | P. Charleton<br>T. Grimes |
| Banca d'Italia | G. Gomel<br>I. Angeloni |
| Nederlandsche Bank* | Mme H.C.J. van der Wielen<br>G. Korteweg<br>E. de Vryer |
| Banco de Portugal | Mme T. Cardoso<br>J. de Matos |
| Bank of England | R.D. Clews<br>N.H. Jenkinson |
| Luxembourg Monetary Institute | S. Kolb |
| Commission of the European Communities | B. Conolly<br>M. Sanchis |
| Secretariat of the Committee of Governors* | A. Bascoul<br>H.K. Scheller<br>A.J.V. Giles<br>M. Stubbe |

The group held two meetings: on 22nd and 23rd March 1990
on 19th and 20th April 1990

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* The composition of this delegation was not the same at each meeting.