Mr. Duisenberg reports on the outcome of the second meeting of the Governing Council of the European Central Bank Introductory statement by the President of the European Central Bank, Dr. W. Duisenberg, at the press conference held in Frankfurt on 8/7/98.

The Governing Council first assessed current economic developments in the euro area. The general picture is one of continued economic expansion combined with broadly low inflation.

Several forecasts made during spring 1998 have even suggested slightly lower rates of inflation for 1998-99 compared with expectations in autumn 1997. As far as price developments are concerned, inflation as measured by the harmonised consumer price index (HICP) is estimated to have risen slightly in April, to 1.4%, but has not increased further in May.

Output growth has remained strong in recent quarters, with annual growth rates close to or even exceeding 3%. Economic growth has been driven increasingly by domestic demand rather than net exports, as might be expected at this stage of the cycle. Private consumption and stockbuilding have been the main factors underlying domestic demand to date.

The favourable conjunctural situation has started to feed through into the labour market, although improvements here have in some countries been too slow to appear. It is evident, however, that economic growth alone will not reduce the urgency to proceed with structural adjustments in order to tackle unacceptably high rates of unemployment.

As regards monetary and financial developments in the euro area, the annual growth rate of the broad money supply (M3H) accelerated in April to around 6% from 5.5% in March. The growth rate of M1, the narrow money supply, also picked up, to around 10%. We shall monitor these developments very carefully.

In principle, the economic performance I have just described provides a favourable environment for continued fiscal consolidation. It is with some concern that we observe that in a number of member countries the prospects for this to actually develop seem to be, to put it mildly, rather subdued.

In this respect, I should like to underline three aspects. First, any “growth dividend” resulting from the current cyclical upturn should be used to bring deficit and debt levels down, rather than relaxing control over expenditure. Second, most Member States need to go a step further, and indeed improve structural balances as they are not yet in compliance with the obligations under the Stability and Growth Pact. This implies that the benchmark for fiscal policy must now be a budget close to balance or in surplus - in surplus especially in countries with high ratios of debt to GDP. Third, further structural adjustments in fiscal policy would also help to improve the policy mix in some countries and in the euro area as a whole from the start of Stage Three.

I would not at the present time want to try to convey too strong an impression of the implications of these various economic developments for the appropriate stance of monetary policies in euro area Member States. Although the responsibility for these policies remains with national central banks until the end of this year, the Governing Council had an extensive and thorough discussion on a euro area perspective of monetary policy. We will continue to study this issue closely before we enter the regime of a single monetary policy. For the time being, it is encouraging to see the credibility of monetary policy being reflected in the exchange rates of euro countries. There is currently no sign of exchange rate tensions among euro area currencies. Forward exchange rates are expected to be virtually identical to central rates, suggesting that the pre-announced rates are considered credible. I consider this a remarkable achievement.

Following its review of economic developments, the Governing Council settled a number of organisational issues.

i. It adopted the Rules of Procedure of the European Central Bank. These will be published in the Official Journal of the European Communities;

ii. It approved, in accordance with the Rules of Procedure, the establishment of eleven ESCB committees to assist in the work of the European System of Central Banks (ESCB). The committees are as follows (listed in alphabetical order): Accounting and Monetary Income Committee, Banking Supervision Committee, Banknote Committee, External Communications Committee, Information Technology Committee, Internal Auditors Committee, Legal Committee, Market Operations Committee, Monetary Policy Committee, Payment and Settlement Systems Committee, and Statistics Committee;

iii. It formally adopted a budget for the European Central Bank for the second half of 1998 and agreed on the establishment of a Budget Committee to assist the Governing Council in ECB budget-related matters;

iv. It laid down specific rules applicable to staff transferring from the European Monetary Institute to the European Central Bank. ECB Decisions relating to the Conditions of Employment will be published in the Official Journal of the European Communities.

The Governing Council also took a number of decisions relating to various aspects of its preparatory work for Stage Three.

(a) Monetary policy issues

The Governing Council decided on the introduction of a minimum reserve system by the ESCB at the start of Stage Three. Among the three main functions that a minimum reserve system could usefully perform, the Governing Council attaches particularly high importance to its contributions to the stabilisation of money market interest rates and to the enlargement of the demand for central bank money by creating or enlarging a structural liquidity shortage in the market.

In the light of the potential burden which a minimum reserve system could impose on the private sector and the effects it might have on the financial activity of credit institutions in the euro area, the Governing Council has decided on features which fulfil the two money market management purposes outlined above, while at the same time allowing an adequate remuneration of minimum reserves.

A number of details of the minimum reserve system that will be applied were already specified in previous documents published by the European Monetary Institute. Additional features agreed upon yesterday include the liability base, the lump-sum allowance and the rate of remuneration. With regard to the latter, the ECB will remunerate minimum reserve holdings at a level corresponding to the rate of its main refinancing operations. The Governing Council intends to decide on the exact specification of the minimum reserve system in November

1998 at the latest. This decision, in particular as regards the reserve ratio (which is currently defined within a range of 1.5% - 2.5%), will be based on the early data from the new system for money and banking statistics.

Further details are provided in the separate press release that is being issued to you this morning.

It is intended that the precise features of the minimum reserve system will be published in the form of an EU Council Regulation. For this purpose, the Governing Council adopted an ECB Recommendation for an EU Council Regulation on the application of minimum reserves by the European Central Bank. In accordance with the provisions of the Statute of the ESCB, the EU Council, acting by a qualified majority and after consulting the European Parliament and the Commission, is expected to adopt this Regulation.

The Governing Council also adopted ECB Recommendations for EU Council Regulations concerning the collection of statistical information by the ECB and concerning the powers of the ECB to impose sanctions. All three ECB Recommendations will be published in the Official Journal of the European Communities for general notice.

(b) Foreign exchange issues

The Governing Council decided on the size and form of the initial transfer of foreign reserve assets to the European Central Bank from the national central banks participating in the euro area. This transfer is to take place on the first day of 1999. It has been decided that the initial transfer will be to the maximum allowed amount of EUR 50 billion, adjusted downwards by deducting the shares in the ECB’s capital subscription key of the EU central banks which will not participate in the euro area at the outset. The transfer will thus be equal to 78.9153% of EUR 50 billion, i.e. approximately EUR 39.46 billion.

The Governing Council furthermore agreed that this initial transfer should be in gold in an amount equivalent to 15% of the sum I have just mentioned, with the remaining 85% being transferred in foreign currency assets. I should stress that the decision on the percentage of gold to be transferred to the ECB will have no implications for the consolidated gold holdings of the ESCB.

The precise modalities of the initial transfer will be finalised before the end of the year.

Before the end of the current year the Governing Council will also have to adopt an ECB Guideline pursuant to Article 31.3 of the Statute of the ESCB, which will subject all operations in foreign reserve assets remaining with the national central banks - including gold - to approval by the ECB.

In connection with the setting-up of common market standards, the Governing Council also reached agreement on a number of issues related to the quotation and publication of reference exchange rates for the euro. Specifically, it was agreed to recommend to market participants the “certain” method for quoting the exchange rates for the euro (i.e. 1 euro = X foreign currency units) and to have daily reference exchange rates for the euro computed and published by the ECB.

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(c) Payment systems issues

The Governing Council decided on the conditions for the participation of the non-euro area EU central banks and credit institutions in the TARGET (Trans-European Automated Real-time Gross settlement Express Transfer) system. In TARGET the ESCB will provide central bank liquidity in the course of the day (i.e. intraday liquidity) to the extent necessary to avoid delays in the execution of payment orders. If intraday liquidity is not reimbursed at the end of the day it becomes overnight credit granted by the ESCB, which, for evident monetary policy reasons, cannot be offered to institutions outside the euro area. Nonetheless, non-euro area EU central banks and institutions in those countries will be connected to TARGET.

The Governing Council considered that giving such institutions outside the euro area unlimited access to intraday credit would have created risks for the conduct of monetary policy that it was not ready to take. A facility will therefore be put in place to enable the non-euro area EU central banks to provide collateralised intraday credit in euro to their credit institutions, subject to a ceiling both at the level of the non-euro area EU central banks and at that of non-euro area credit institutions. There will also be a liquidity deadline, set at 5 p.m., for non-euro area credit institutions so that they do not incur an overnight overdraft in euro.

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The Governing Council also agreed that a report on recent developments in the field of electronic money - and their monetary policy implications - would be published in September 1998.

(d) Legal protection of euro banknotes

Finally, the Governing Council agreed on a number of legal instruments aimed at enhancing the protection of euro banknotes. In particular, an ECB Decision on the denominations, specifications, reproduction, exchange and withdrawal of banknotes has been adopted, as well as an ECB Recommendation regarding the adoption of certain measures to enhance the legal protection of euro banknotes and coins. Both documents will be published for general information in the Official Journal of the European Communities.