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

Secretariat

28th June 1991

DISCUSSION OF THE ECONOMIC UNIT'S PAPER ENTITLED "THE USEFULNESS OF THE MONEY SUPPLY AND ITS COUNTERPARTS IN THE ASSESSMENT OF MONETARY POLICY" AT THE MEETING OF THE MONETARY POLICY SUB-COMMITTEE ON 21ST JUNE 1991

A revised version of the paper by the Economic Unit on money supply counterparts was presented at the meeting, taking account of written comments on an earlier version received from central banks.

The starting point of the paper by the Economic Unit is that in an environment of free capital movements and exchange rate constraints imposed by the ERM, there is limited room for national monetary autonomy. For this reason the assessment of national monetary policy cannot rely solely on monetary aggregates and more information is needed to ascertain the appropriateness of monetary policy regarding price and exchange rate stability.

As requested by the Committee of Alternates, the Economic Unit has examined whether the counterparts of the money supply could provide such useful information. Their paper concluded that in assessing the monetary policy stance in ERM countries special attention should be paid to the evolution of official reserves. In particular, the absence of persistent official reserve flows (i.e. changes in the net foreign asset position of the central bank) would signal that national monetary policies are appropriately set provided the overall monetary stance in the Community is in line with price stability. Nevertheless, care should be taken not to interpret any observed persistent official reserve flows as an indication that domestic monetary policy is inappropriate. For instance, reserve inflows may result from attempts by the monetary authorities not to accommodate the inflationary consequences of non-monetary shocks (i.e. an inadequate fiscal stance or wage behaviour). In such situations, monetary policy would be overburdened in its task of preserving price and exchange rate stability and there would be a dilemma between conflicting internal and external objectives.

The analysis by the Economic Unit and the conclusions in the paper met with the approval of the Sub-Committee. There were, however, two points raised by the Dutch experts which led to a subsequent discussion.

The first was that a drop in the net foreign asset position of banks, in the absence of changes in the net foreign asset position of the central bank, would indicate that the monetary policy of the country is "too loose". The Economic Unit, in contrast, argued that changes in the net foreign asset position of banks should not be interpreted as indicating that monetary policy is inappropriate. The Sub-Committee tended to support the views of the Economic Unit.

The second point raised by the Dutch delegates was that, at times, the monetary policies of Member countries designed to fight inflationary pressures may not be as tight as it would be appropriate as a result of the constraints imposed by ERM obligations. Thus, when a country could not unilaterally raise its interest rates by enough to offset inflationary pressures, it should bring this point to the attention of the Committee of Governors which would then decide whether an overall increase in Community interest rates is desirable. This point was accepted as a valid one by the Sub-Committee and the Economic Unit and has been incorporated in the final version of the counterparts paper.