

Frankfurt, September 8, 1978

Draft of a letter of transmittal to submit the Heyvaert Report No. 39 to the Council of Ministers.

Hans Matthöfer  
Chairman  
Council of Ministers  
Brussels



RE: EMS

Dear Mr. Chairman,

In the course of its meeting on September 12, 1978 the Committee of Governors of EEC Central Banks conducted its first thorough discussion of the envisaged new EMS.

In their discussion, the Governors took note of the results of technical studies that a group of experts had undertaken at the Governors' request. These results are incorporated in a report which is transmitted to the Council as an annex.

The discussion in the Committee concentrated on a number of topics which are of particular interest to EEC Central Banks.

1. Preconditions for increased exchange rate stability in the EEC

It is in principle welcome that a new effort should be undertaken to re-establish more stable exchange rates among Community currencies. Exchange rates, however, are a reflection of underlying economic conditions which continue to diverge considerable among member countries (inflation rates, trade patterns etc.)

The new system can only provide a genuine contribution to overcoming those disparities if policies in the various countries are oriented towards stability in underlying conditions. The governors also point to the fact that developments in the dollar tend to affect the stability of exchange rates of EEC member countries. It is not clear to all Governors how the new EMS would contribute decisively towards an improvement of this situation given the different effects of the movements of the dollar on various partner currencies, e.g. those in the "snake" as against those outside.

## 2. Numéraire

The Governors agree that the new European Currency Unit (ECU) is to serve to denominate claims and liabilities deriving from interventions and that settlement is to take place in the new unit after the new system has entered into operation.

The Governors agree that the new system should be centered on the ECU as a numeraire. They have different inclinations, moreover, how to determine points of interventions in the EMS. Some of them think that the intervention points should be established directly vis-à-vis the ECU (basket system) while others contend that such an approach would raise serious problems of an economic and technical character that argue strongly against such a system. They therefore suggest that the ECU value of EEC currencies on a given date be used to calculate cross-parities in EEC currencies and to establish bilateral intervention points around those cross-parities (parity grid system). A third formula put forward by one member tries to combine features of the two systems described above but would require further study.

## 3. Changes in central rates

In view of the remaining divergencies in basic economic conditions among member countries changes in central rates cannot be ruled out. Procedural provisions which would hamper these adjustments from being executed in a timely manner should be avoided. In this respect the choice of numéraire may have repercussions. This holds particularly true in the case of non-participation of individual member countries from the start of temporary opting out.

## 4. Interventions

The choice of numéraire has far-reaching effects on the intervention system.

In a basket system currencies will normally reach the intervention limit individually without any other participating currency being at the opposite margin at the same time. If the bank of issue of the currency being at the margin uses another EEC-currency not itself in an intervention situation the bank of issue of the latter is either rendered involuntary debtor or creditor.

Governors who favour a basket solution think that settlement obligations for the involuntary debtor might be eased. The development of the ECU value in the various EEC currencies allows to identify which currency deviates most from the average among all EEC currencies. The Central Bank issuing the deviating currency would have to undertake special obligations to bring its currency back into line and/or allow other EEC Central Banks to use the deviating currency for intervention purposes on easier terms. Alternatively, the Central Bank issuing the deviating currency would have to intervene in dollars.

A parity grid system by contrast always identifies the currency to be used for intervention. The system does not always as clearly indicate the deviating currency but Governors favouring the parity grid system point out that deviation from the average value of the ECU, given the above-mentioned divergencies, only has limited significance and its automatic or presumptive use as an indicator should therefore not be considered.

##### 5. The Fund

The Governors agree that adequate financing should be available to render the EMS credible and to assist the process of balance of payments adjustment.

It is generally assumed that in the transitional period the existing credit mechanisms could serve that purpose after the competent bodies have reexamined the mechanisms both as to their volume and/or the period for which credit is made available.

The transitional period should be used to study the many unresolved aspects of the European Monetary Fund.

The question will have to be dealt with in what way the existing European Fund for Monetary Co-operation could be made instrumental in putting the system into effect without undue delay.