

'Foreign exchange markets welcome the start of the EMS' from Le Monde (14 March 1979)

Caption: On 14 March 1979, the day after the implementation of the European Monetary System (EMS), the French daily newspaper Le Monde describes the operation of the EMS and highlights its impact on the European currency exchange market.

Source: Le Monde. dir. de publ. Fauvet, Jacques. 14.03.1979, n° 10 612; 36e année. Paris: Le Monde. "Le marché des changes a bien accueilli l'entrée en vigueur du S.M.E.", auteur:Fabra, Paul , p. 37.

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Foreign exchange markets welcome the start of the EMS

With a little more than three months' delay, the European Monetary System (EMS) came into force on Tuesday 13 March. The only definite decision taken by the European Council, it was announced in an official communiqué published separately at the end of Monday afternoon. In the official text, the European Council stated that 'all the conditions had now been met for the implementation of the exchange mechanism of the European Monetary System.'

As a result, the eight full members of the exchange rate mechanism, i.e. all the EEC Member States except for the United Kingdom, which signed the agreement but whose currency will continue to float, have released their official exchange rates. The participating currencies are the German mark, the Belgo-Luxembourg franc, the Dutch guilder, the Danish crown, the French franc, the Irish pound, also known as the punt, and the Italian lira. The first four currencies were already in the *mini currency snake* and will undergo no significant changes, as the EMS intervention mechanism is closely based on that of the snake. The system sets a minimum and maximum rate for each currency in relation to all the others; the daily rate for each currency may fluctuate between these two rates.

A minor 'drift'

This means that the Banque de France will be required to ensure that the rate for the German mark does not fall below 2.2581 francs or rise — generally considered the more realistic threat — above 2.3621 francs. Very roughly, this means that the French franc can fluctuate by plus or minus 2.25 % above or below the central rate, which has been set as 2.3095 francs, the rate recorded at 11 a.m. on Monday. Only the lira enjoys a more lenient regime (although, in fact, this deprives its participation of much of its content) in that the currency may float by a margin of plus or minus 6 %.

The Banque de France will be required to maintain the rate for the French franc against the Deutschmark between 2.2581, the floor rate, and 2.3621, the ceiling rate.

The following are the intervention limits, expressed in French francs, for the currencies participating in the European Monetary System:

	Buy	Sell
100 marks	225.81	236.21
100 guilders	208.38	217.96
1 000 lira	4.7560	5.3620
100 Belgian francs	14.3689	15.0290
100 Danish crowns	80.01	83.69
1 Irish pound	3.5555	3.9495

The central rate, which can be regarded as the official rate, comes more or less at mid-point between the floor and ceiling rates, but it is calculated using a different method.

On 12 March, the value of the ecu in French francs was 5.79831; in other words, one franc was worth ECU 0.172464. These rates, recorded on foreign exchange markets, were chosen as the 'central rates' for the ecu and the French franc. The ecu is the new name given to the European unit of account that is calculated daily on the basis of a 'basket' of EEC currencies, each of which is assigned a weighted average of the whole. The French franc accounts for 20 % of the basket.

Based on the parities in ecu of the other currencies participating in the mechanism, the central rates for the French franc are as follows:

1 German mark	2.30950 F
1 Belgian franc	0.146948 F
1 Dutch guilder	2.13113 F

1 Danish crown 0.818286 F
1 Italian lira 0.00505013 F
1 Irish pound 8.75034 F

The first observation concerning the French franc is that, compared to the rates that would have been fixed at the start of January had the EMS been launched then as originally planned, the central and intervention rates represent a slight drift of the French franc in relation to the German mark. At the beginning of January, the central rate would have been approximately 2.30, but it is now close to 2.31. The French authorities were, then, a little optimistic when they predicted, late last year, that for at least a few months the franc would tend to move towards the upper levels of the enlarged snake. For the time being, the market has reacted favourably to the start of the EMS. On Monday, the day the meter was reset, the German mark was quoted at the central rate of 2.3095 French francs and then, on Tuesday morning, it fell back to 2.3016. But, on 12 March 1976, the day before the French franc left the snake, the mark was quoted in Paris at 1.7642 francs, a 30.5 % rise over three years.

Unlimited credit for intervention

If, in future, one of the EEC central banks — the Banque de France, for example — has to intervene on the market in Paris to prevent the German mark (1) from ‘bursting through the ceiling’, it would borrow German marks from the Bundesbank in order to buy French francs. (If the opposite were to occur and the German mark weakened, the Bundesbank would borrow French francs and use them to sell against marks.) In practice, however, this type of intervention would no doubt continue to be in US dollars, except in periods when the dollar is relatively stable, as it has been since 1 November 1978.

For day-to-day intervention, the EEC’s central banks can offer each other unlimited credit, repayable at 45 days following the end of the month during which the intervention takes place. If a country is unable or unwilling to repay its loan, it can request short or medium-term support so as not to deplete its foreign exchange reserves. An aid mechanism already exists for this purpose, but it will be expanded.

The birth of the ecu

In the next few days, the participating Member States will be depositing 20 % of their exchange reserves with the European Monetary Cooperation Fund (EMCF), whose sole task it is to record intra-EEC payments. The noteworthy aspect of this exercise, apart from its sheer scale, is that the deposited gold reserves will be registered at a market-based price, i.e. the average London rate over the past six months. This price will be recalculated every three months, as will the dollar rate for accounting purposes, in other words the rate quoted on the market the day before the deposit. In exchange for their gold and dollars, the participating Member States will be credited in ecus, the amount of which is then entered in the central banks’ balance sheet as a unit of account constituting a share of their reserves.

These increased resources will be used to fund short-term (a maximum of nine months) and medium-term support. Parliamentary ratification is required in each country for the extension of medium-term credit. The participating countries have decided to table the draft legislation before their parliaments by 30 June next. ‘There should be no problems’ with parliamentary approval, it is affirmed in Paris. The Nine have agreed to come to a decision within two years on whether to create a fully-fledged European monetary fund, which would convert the ecu into a reserve instrument similar to the IMF’s Special Drawing Rights. If that decision is reached within the planned period, it will then have to be submitted for ratification to the national parliaments.

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(1) Or any other EMS currency.