

'The reallignment of the EMS exchange rates: necessary and opportune' from Europe (5-6 October 1981)

Caption: In his editorial of 5 and 6 October 1981, Emanuele Gazzo, Director-General of Agence Europe, welcomes the latest readjustment of parities within the European monetary system (EMS) and attempts to determine its impact.

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The realignment of EMS exchange rates: necessary and opportune

The setting is traditional: a tense situation, discreet meetings, calculated and contradictory leaks, categorical denials; the members of the European Monetary system have initiated a “realignment” of the exchange rates, the most important since the creation of the EMS.

The agreement was not easy to reach since not only important economic factors had to be taken into account, but also a series of demands that were often contradictory in themselves. It was necessary to restore a “new balance” between different political and economic interests. These latter should often be “balanced” with care, for each country should appreciate the consequences of realignments, not only in relation to a given economic factor, but also to the changes they entail in the trading patterns with its partners and with the rest of the world. Thus, some are concerned mostly with the dollar rate, others, with the German mark or the French franc. Moreover, realignments can both encourage and discourage certain trends. This is why Bonn does not want to neglect the present strong trend in the expansion of its exports, and why Rome — which is also registering a real “boom” in its exports (+45% in July and +50% in August) — was hostile to a devaluation of the lira that, it considered, was unnecessary, especially since it introduces a new “variable” into the economic recovery plan that the government has just adopted. Furthermore, each country should assess the inflationary or deflationary effects of a change in exchange rates as against more classical measures (the raising or lowering of interest rates, for example). Important psychological factors were also in play: one understands why France did not want to “remain alone” in “devaluing” and why Belgium has “victoriously resisted.”

The present timing for the implementation of this event seems impeccable. It is evident that one of the factors which have stimulated the decision was the confirmation, at the IMF meetings in Washington, that no immediate changes in the American policy were expected. The Americans do not intend to intervene on the market unless there are “abnormal” changes, and they believe that the present fluctuations are due solely to market forces. In his final address to the IMF, Mr. De la Rosière “reacted favourably” to the request from several countries for a “strengthening of the surveillance on rates of exchange”; but, one may ask, what are the means for implementing this? We recall, moreover, that the Jamaica agreement of January 1976, in dismantling the organisation of the international monetary system that then existed, urged the IMF to exercise such a surveillance, above all, in order to prevent countries from manipulating exchange rates for commercial ends: from this point of view, the present dollar policy would be perfectly orthodox (especially since the increase in the dollar is detrimental to American foreign trade — and trade figures prove this).

The need to proceed with this realignment was recognised as a result of the increasing divergences in economic policies and performances, notably, concerning the rates of inflation. The “timing” of the event is the best possible given the circumstances and the situation of the markets. Now, in addition to the statements of the authorities involved, a market evaluation will show its effectiveness. It is a question of knowing whether the market finds the new exchange rates credible or not. But this is not only of value for the short- or medium-term; for the long-term, the cohesion of the system will be assured by the change in the policies which have brought about a realignment of the exchange rates.

In any case, what has occurred proves that the EMS is viable and adaptable to changes without major crises resulting. It thus reaches its first objective: to assure a relative stability of exchange relations among Community currencies. We note, once again, that it is not a system of fixed exchange rates, even if it is tending to become one. We also note that the use of the “divergence indicator” (75% at its maximum) has been corrected by allowing the series of interventions planned in Article 3.6 of the Resolution of December 1978 to begin; this plans, in paragraph c) the “modification of the central rate,” and in paragraph d), “other economic policy measures.” These are the measures that Mr. Delors is about to adopt and upon which the Italian government had already decided.

The fact that the EMS is now functioning makes it still more necessary to give it the specific features designed for it at its creation.

Emanuele Gazzo