

COMMITTEE OF GOVERNORS OF THE
CENTRAL BANKS OF THE MEMBER STATES
OF THE EUROPEAN ECONOMIC COMMUNITY

GROUP OF EXPERTS UNDER THE
CHAIRMANSHIP OF MR. DALGAARD

No. 58

REPORT ON ISSUES RAISED BY THE
REALIGNMENT OF 12TH JANUARY 1987

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Group of experts under the
Chairmanship of Mr. Dalgaard

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C O R R I G E N D U M

Annex II, page 2

Please note that the sentence beginning on line 5 of the
second indent should read:

"These MCAs are construed as taxes on the exports of countries
with a negative gap and as subsidies on the exports of countries with a
positive gap. (1)"

Secretariat

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INTRODUCTION

The present report has been drawn up by the group of experts (see attached list) in accordance with the mandate received from the Committee of Governors on 10th February 1987 (see Annex I). The report is preliminary, covering only the first two questions of the mandate.

The report is divided into two chapters:

- Chapter I studies the arguments and scope for procedural changes in the light of the latest realignment;
- Chapter II studies the circumstances and developments surrounding the recent realignment.

CHAPTER I REALIGNMENT PROCEDURE

1. Problems highlighted by the January 1987 realignment

There has been a widespread feeling that the recent realignment was unsatisfactory primarily because it was forced on the authorities by exceptionally large capital flows stimulated by market speculation while fundamental economic factors were, apparently, developing favourably for exchange rate stability in the EMS. A second cause of dissatisfaction was the protracted and widely reported negotiations which evolved largely because of political factors, despite the perception of the authorities of the countries concerned that this would be a small and straightforward realignment. Third, there were also problems relating to publicity during the period running up to the realignment. All these factors risk impairing the credibility of the EMS.

2. The existing realignment procedure

The existing realignment procedure is set out in the Council Decision of 21st April 1980 and the two Monetary Committee Opinions of 2nd April 1980, supplemented by the Committee of EEC Governors' note of 13th May 1982 and by the memorandum from the Chairman of the Monetary Committee of 4th October 1982. According to these rules, the country

seeking a realignment initiates the procedure and decisions are taken by Ministers after preparatory negotiations in the Monetary Committee. The procedure stresses the importance of secrecy and flexibility. It is flexible in so far as negotiations in the Monetary Committee may take place by telephone if a physical meeting is not warranted and a meeting of Ministers is not necessarily called if the Monetary Committee can reach a result which is acceptable to all governments.

Thus it was possible, for example, for the devaluation of the Irish pound in August 1986 to be conducted purely by telephone and the devaluation of the Italian lira in July 1985 to be agreed by the Monetary Committee without the need for a meeting of the Ministers and Governors.

Although, in practice, close interest by the media and, in some cases, political expediency have often led to leaks and informed commentary in the press, this seems to be primarily a problem of self-restraint in the period running up to and during the course of a realignment.

3. Arguments for and against an amendment of the realignment procedure

In connection with the recent realignment, and also with many previous realignments, there have been problems in two areas:

- realignments have tended to be predictable for the markets well ahead of the event, sometimes because decisions have had to be delayed for political reasons;
- realignment negotiations have often been prolonged and tense, giving rise to feelings in the markets of basic disagreement between authorities or a feeling of a failure of the system. Occasionally opinions about the desired size of adjustments have been leaked or even publicised early in the negotiations with the risk that smaller adjustments could result in expectations of an early new realignment.

Under these circumstances speculative capital movements have been very large, in turn triggering heavy interventions. Recently two factors have tended to increase capital movements in periods when a realignment is expected:

- the increasing sophistication of market participants;
- the liberalisation of capital movements - particularly, recently, in France and Italy.

It could be argued that an amendment of the realignment procedure might have a de-dramatising effect if it limited public comment and political posturing before and during realignments.

One possible way to amend the procedure would be to delegate the decision-making power to the Committee of Governors of EEC Central Banks.

The purpose of such a delegation of power would be to de-dramatise the decisions, that is, to make them politically uncontroversial. That might occasionally imply that decisions were taken earlier than with present rules which might limit the size of capital movements and the extent of public discussion. It should not result in bigger or more frequent changes in central rates over time.

A delegation of power would probably only be possible for small realignments. Even in such cases the delegation of responsibility to the Committee of Governors, while theoretically possible in all countries, would be likely to meet with objections. Such objections would relate, for example, to the need to debate accompanying measures and implications for agricultural policy (see the note in Annex II).

There would also be the problems of the definition and the frequency of small realignments. Although some system might be agreed, such as limiting the Governors' authority for realignments to a maximum percentage spread over a certain period, this would tend to limit the flexibility that is being sought. If a more ad hoc system were envisaged, where governments would delegate responsibility in concrete situations, this might merely have the effect of complicating the whole decision-making process.

Another problem would be the risk of trivialising small realignments, giving the market the impression that small realignments were of minor importance and could therefore be taken lightly. Such an impression would be damaging to the system - in particular now that reduced inflation-differentials may result in realignments being smaller and less frequent than in the past.

Furthermore, the creation of two classes of realignment runs the risk of creating expectations of a major adjustment in cases when a "first class" realignment seems likely.

Finally it is questionable whether a changed procedure could de-politise realignments, which under the present procedure may necessitate a ministerial meeting. It is possible that the political problems would move to the Governors' Committee, with the consequence that, inter alia, meetings of this Committee would attract much more public interest than today.

4. Conclusion

In the opinion of the group, various features of past realignments have been unsatisfactory. They have tended to be predictable and there has often been too much public debate before and during the realignment procedure. This has resulted in realignments being preceded by heavy capital movements and has created an unsatisfactory atmosphere for realignment discussions.

In the case of the last realignment the volume of destabilising capital movements was probably influenced by contradictory official statements, leaks of information and press commentary as well as by the initial lack of agreement on who should take the initiative in the activation of the realignment procedure. In this context it should be noted that, contrary to normal practice, the Chairman of the Council took this responsibility, improving in a pragmatic way existing procedural rules.

The group concluded, however, that the provisions of the existing realignment procedure are broadly satisfactory and have not been the reason for problems in connection with realignments. The provisions provide sufficient scope for flexibility while a stricter observation of existing guidelines for secrecy would contribute to the de-dramatisation of the realignment negotiations. Delegation of power to the Committee of Governors might occasionally be helpful in the sense that it would allow realignment decisions to be taken earlier, thereby limiting the size of capital movements. However, it is unlikely that such delegation of power would be acceptable and, even if it were, it does not follow that this would make it generally easier to solve the problems and, indeed, it might create new difficulties.

The main problem in the group's view is not the realignment procedure itself, but the size of the capital flows in the period preceding the realignment. In the case of the last realignment such capital flows were certainly influenced by the way member countries reacted to markets' expectations of an EMS realignment at a time of considerable volatility in the US dollar and the yen and of increased capital mobility.

The group feels that existing monitoring procedures have not been sufficiently helpful in providing adequate early warning to member countries of the building-up of tensions. It stresses the need for finding a means of running the system between realignments in such a way as to avoid speculation (see Chapter II).

CHAPTER II CIRCUMSTANCES AND DEVELOPMENTS SURROUNDING THE REALIGNMENT
OF JANUARY 1987

1. Developments in the EMS in the last few months preceding the January 1987 realignment

For the review of developments in the EMS in the last few months preceding the January 1987 realignment, the group took mid-1986 as its starting point. This date coincides with:

- renewed weakening of the US dollar, especially against the Deutsche Mark;
- the emergence of first strains in the EMS;
- far-reaching measures for liberalisation of capital flows in France and to a lesser extent in Italy.

Tensions in the EMS first appeared in July 1986 and became more pronounced in September 1986 and in particular in the period from mid-December to the realignment of January 1987. The tensions in July 1986 were rather limited; they concerned almost exclusively the Danish krone and the Irish pound. Strains eased somewhat after the downward adjustment of the Irish pound on 2nd August 1986 but re-emerged again - on a more general basis and involving especially the French franc - in September 1986 prior to the informal meeting of the Finance Ministers and Central-Bank Governors

at Gleneagles. After temporary restoration of calmer conditions in the EMS, strong expectations of an imminent realignment arose in mid-December; they resulted in continuously increasing tensions in the EMS which finally led the authorities of EMS countries to trigger the realignment procedure on the weekend 10th/11th January 1987.

The strength and the sequence of tensions in the EMS was in particular reflected in the volume and timing of interventions (see Table 1). In the period from the beginning of July 1986 to 9th January 1987 they resulted in net currency sales equivalent to almost US\$ 35 billion, of which one third was carried out at the limits.* This was the highest volume of intervention which had been carried out in defence of EMS parities within a time span of little more than six months since the start of the EMS. Roughly 60 per cent. of net currency sales took place in the second half of December 1986 and up to the realignment of 12th January 1987.

Imbalances on the exchange markets in EMS countries mainly originated from capital flows. The channels for these capital flows, however, differed from country to country, reflecting in part differences between EMS countries in respect of foreign exchange controls. By far the major part of interventions made in Denmark was a result of a deterioration of the leads and lags, commercial credits and an increase in banks' currency assets to cover commercial forward transactions. In contrast the balance of long-term capital transactions remained largely unaffected. In the case of France, leads and lags and forward cover of imports accounted for half of total interventions during the period under review. Almost one-third resulted from long-term capital exports by residents (largely due to redemptions of outstanding foreign loans) while the remainder was reflected in a reduction of French franc balances held by non-residents. In contrast, in Belgium, forward sales and withdrawal of assets denominated in Belgian francs by non-residents accounted for more than 3/4 of short-term capital outflows, the remainder being reflected in a deterioration of the leads and lags. For Italy and Ireland detailed statistics are not yet available but in the case of the former country it appears that the deterioration of the capital balance resulted from increased direct investment abroad by Italian

*Aggregated net figures.

residents, dis-investment by foreigners in Italy (including one multi-billion dollar transaction) and the repayment of outstanding debt. In Ireland these capital flows can be accounted for, almost exclusively, by the activities of Irish residents and were mainly due to leads and lags arising from the simultaneous weakening of the US dollar and sterling.

Capital flows towards Germany (whether linked to an expectation of a realignment or not) were mainly reflected in an improvement in the balance of long-term capital transactions in the non-bank sector as non-residents stepped up their holdings in DM-denominated bonds. In addition, leads and lags probably improved but no statistical data are available. At the same time there were even larger short-term capital outflows through the banking sector which in part were trade-related and in part reflected interest rate arbitrage operations. The latter were linked to the fact that Germany's partners in the EMS covered a large part of their Deutsche Mark sales by running down their Deutsche Mark balances with euro-banks. The Netherlands did not experience any capital flows directly related to the realignment.

2. Reasons for the emergence of tensions in the EMS

In the opinion of the group, there is no doubt that the tensions in the period under review were the result of expectations of an early realignment.

It is noteworthy that the first rumours of a coming realignment appeared as early as July 1986, only three months after the comprehensive realignment of April 1986. This realignment was apparently received well by the market - as witnessed by major reflows - and inflation differentials were relatively modest and narrowing after the realignment.

The group noted a number of factors which might have led the markets to re-assess the sustainability of intra-EMS exchange rate relationships in the future.

(a) Developments in the international monetary scene, in particular the weakness of the US dollar, have been influential in this context. Strains in the EMS largely coincided with a weakening of the US dollar whereas calmer conditions were restored when there was a recovery of the American currency.

This correlation between movements of the US dollar on the one hand and tensions in the EMS on the other should not be interpreted as evidence of a mechanical link between the two phenomena, i.e. that capital flows out of the US dollar necessarily also lead to a strengthening of the Deutsche Mark against the other EMS currencies. This should be true only in the very short run, given the rôle of the US dollar and the Deutsche Mark as vehicle currencies on the markets. Subsequently, if markets do not expect a realignment in the near future, other EMS currencies will more or less spontaneously keep pace with the Deutsche Mark since very small changes in exchange or interest rates will be sufficient to divert part of the capital flows which have moved into the Deutsche Mark toward other EMS currencies. The effectiveness of this mechanism was illustrated generally by the developments in the EMS during the first year of the decline of the US dollar, and even after that by the behaviour of the Dutch guilder which remained rather stable against the Deutsche Mark with only occasional interventions and with moderate movements in interest rate differentials.

In contrast, it is clear that external shocks could lead the markets to re-assess the probability that EMS central rates would remain unchanged. In the second half of 1986 the international economic environment changed significantly. Although the US dollar had fallen quite substantially since March 1985, the US current account was still deteriorating. The belief then strengthened that a pause in the dollar's depreciation could have helped to let the positive factors of the adjustment mechanism emerge by halting the negative "J-curve" effect. After the meeting in Gleneagles it appeared that the EEC countries would act to stabilise the US dollar. Failure to take effective measures to support the US dollar, together with the Baker-Miyazawa agreement, may have led market participants to expect the Deutsche Mark to become the main target of capital flows out of the dollar. This may have induced some expectation of an early realignment in the EMS.

This new international scenario was certainly not the only cause of an irresistible pressure for a realignment. However, the combination of this international environment with internal factors in the EMS, which will be discussed below, created a situation which resulted in heavy intervention and finally led to the realignment.

There are other ways in which the fall of the US dollar may have created adverse effects on intra-EMS exchange rate stability in the second half of 1986.

- In 1985 some loss in competitiveness was considered acceptable by all EMS countries, given the sharp improvement since 1980. In 1986, the continued fall of the US dollar, resulting in a further loss of competitiveness, led to the expectation that some EMS countries with underlying current account positions which were less favourable than those in Germany and the Netherlands might be compelled to seek some offsetting exchange rate movements in the EMS.
- In 1985 markets may have seen some exchange rate appreciation of EMS currencies as being compatible with the aim of further reducing inflation differentials between EMS countries. In the second half of 1986 they might have been of the opinion that a further appreciation would be less welcome to the authorities since it would have an adverse impact on economic growth whereas the achievement of inflation targets did not need additional support from the external side.

The falling dollar also had a direct effect on the relative competitive positions of the individual EMS countries to the extent that the share of trade with the dollar-area varies from one country to another. These differences seem, however, to be of minor importance, except for Ireland, where dollar trade is relatively big, and this effect was strongly increased by a similar influence from sterling which broadly followed the US dollar. The resulting increase in the effective exchange rate was reversed by the downward adjustment of the Irish pound on 2nd August 1986. Subsequently, pressure on the Irish pound revived when both the US dollar and sterling weakened further at the same time. These specific factors meant that the pattern of developments with regard to the Irish pound was somewhat different from other EMS currencies.

(b) The impact of external factors has been reinforced by developments in the political and economic field in individual EMS countries. First,

current account developments have played a rôle in a number of countries, in particular in Denmark where high deficits persisted and in Germany where the current account surplus continued to widen (in nominal terms).

Second, interest rate differentials in the EMS may have moved more than was tenable in the long run. After the April 1986 realignment, the particularly favourable situation on the inflation front, following the oil price drop, led the countries whose currencies depreciated to reduce interest rates quite substantially albeit from rather high pre-realignment levels. Therefore the adjustment of interest rates was simply aimed at restoring the level of real rates prevailing before the tensions in the EMS emerged at the beginning of 1986. Other EMS countries gave more attention to the "underlying inflation rate", i.e. the rate calculated by excluding the oil price drop. These countries kept their rates stable while their domestic inflation was falling rapidly; as a consequence their short-term real rates increased quite substantially.

The interest rate differentials were maintained despite heavy and persistent interventions in a number of countries. Some experts felt that, to the extent that the volume of these interventions were known to the market, they might have contributed in themselves to expectations of a realignment. When in December short-term interest rates in Germany rose for seasonal reasons, this phenomenon was taken by the market as a further indication of a lack of co-ordination between EMS countries' monetary policies.

Third, the students' demonstration and the industrial dispute in France were certainly factors which, in combination with the others, reinforced marginally market expectations of an imminent realignment.

3. The rôle of the liberalisation of capital movements

It is difficult to quantify to what extent tensions in the EMS were increased by the liberalisation of capital movements in France and Italy (see Annex III) as the currently available statistics are not sufficient for detailed analysis. The liberalisation measures not only increase the possibilities for speculative capital flows but they also have a once-and-for-all effect on the structure of the capital balance when residents use the new forms of transactions which were formerly prohibited.

It appears that the liberalisation of capital movements played a major rôle in France. The greater freedom of exporters to manage their foreign exchange receipts and the unlimited possibilities for forward cover of imports of goods and services seem to have been used widely. The abolition of restrictions on portfolio investment abroad by French residents (i.e. the suppression of the so-called "devises-titres") also resulted in a considerable outflow. However, it is possible that at least part of these outflows would have taken place even without tensions in the EMS. It is noteworthy that a sizable part of portfolio investment abroad by French residents was offset by the acquisition of French securities by non-residents.

In Denmark portfolio investments had been liberalised some time ago, and the structural portfolio adjustment, therefore, had already taken place. Nevertheless it is interesting that the tensions from mid-1986 until the realignment did not result in increased interest from residents in buying foreign securities, nor in any major resale of Danish krone-bonds owned by non-residents.

4. Response by the authorities to tensions in the EMS

In periods of tensions in the EMS, the first-line-of-defence instruments available to authorities are interventions, a change in the position of the exchange rate within the band and a change in interest rates.

During most of the period under review, monetary authorities reacted to exchange rate pressure mainly by means of interventions. The larger part of these interventions were intramarginal and carried out by the central banks whose currencies were under downward pressure. The Deutsche Bundesbank intervened with some dollar purchases in the framework of concerted actions designed to stabilise the dollar exchange rate. The remainder were interventions at the limits which involved creation of Deutsche Mark by the Deutsche Bundesbank for sizable amounts. The bulk of these latter interventions occurred within the last three days before the realignment.

The width of the narrow exchange rate fluctuation band was extensively used only by Denmark, where the krone was allowed to fall to the lower limit as early as the spring of 1986. This policy was decided on against the background of a steady capital outflow over several months. The

intention was to limit the outflow by making sure that positions against the Danish krone would result in a loss (because of interest rate differentials) except maybe in the case of a realignment. In contrast, the Belgian, French and Irish authorities defended their currencies within the limits. The Belgian authorities maintained this approach during the whole period until the realignment. The French franc and the Irish pound were allowed to drop to the floor only some days before the realignment when market pressure had become too strong to be resisted. Coming at this late stage, this may have reinforced expectations of an imminent realignment. In the case of France it should be noted that two-thirds of its total margin against the Deutsche Mark had already been used. Furthermore, interventions made after the French franc had reached its lower limit represented 40 per cent. of net intra-marginal interventions made between 1st July 1986 and 6th January 1987. In the case of the Italian lira, the wider band allowed more scope for exchange rate adjustment and this was in part used by the Italian authorities. In particular, the lira was allowed to fall by about 2 per cent. on the Thursday before the realignment and the following day exchange rate pressure subsided.

The reluctance to exploit the full width of the exchange rate fluctuation band was motivated by the belief that maintenance of a position well within the EMS band could in certain circumstances keep confidence in the currency concerned and thus limit the volume of intervention in defence of the currency, or, in other words, that a fall to the floor would reinforce expectations of an imminent realignment and thus necessitate an even higher volume of interventions.

Adjustment of monetary policies in response to exchange rate pressure was very limited both in countries whose currencies were under downward pressure and in those whose currencies were at the top of the EMS band. All countries concerned tended to neutralise the expansionary or contractionary effects of interventions on money-market conditions. Interest differentials between the Deutsche Mark and the Dutch guilder on the one hand and the other EMS currencies on the other therefore widened only slightly during most of the period, despite the fact that differentials were relatively narrow as a result of the reflow after the realignment in April 1986. Exceptions were Ireland and Italy where interest rates rose in the

fourth quarter. In France the money market intervention rate was increased in early December. In December the differentials even narrowed as Deutsche Mark interest rates firmed. Only in the last few days before the realignment was there a more decisive increase in differentials but this may have been too late to impress markets.

The weak use of monetary policy measures resulted from various factors. Germany found it difficult to lower interest rates and to prevent the seasonal rise in December as the authorities' domestic monetary objective had already been largely overshot at prevailing interest rates. Countries whose currencies were under downward pressure hesitated to increase interest rates while inflation rates continued to fall and inflation-adjusted interest rates already stood at relatively high levels with adverse repercussions on public debt servicing. Although there is no unanimous approach to these measures of "real" rates, they nevertheless play an important rôle in public discussions on monetary policy in some EMS countries.

5. Recent developments after the realignment

The situation after the realignment was characterised by a very hesitant start of capital reflows. So far only Italy has recorded a reflow which more than offset the outflows experienced in the pre-realignment period. Capital flows towards France started around the end of January and since then have continuously increased in size; they mainly stem from non-residents restoring their French franc balances with banks. Nevertheless, repurchases of foreign exchange by the Banque de France have constituted only a fraction of sales carried out before the realignment. In the case of other currencies, the reversal of flows has been very moderate.

The group felt that the slow and hesitant unwinding of speculative positions in Deutsche Mark does not mean that the realignment was a failure, i.e. that markets expect a further realignment in the near future. An explanation might be rather that the market expects a weakening of some EMS currencies within the band in relation to the Deutsche Mark. This may be for special reasons (for instance, continued balance of payments problems in Denmark, weak dollar and sterling rates in combination with a general election in Ireland) or for general reasons, especially the generally favourable sentiment towards the Deutsche Mark and the expectation that the

desire of EMS central banks to replenish their foreign exchange reserves or to reduce their indebtedness vis-à-vis the EMCF through repurchases of Deutsche Mark makes unlikely any sizable depreciation of the Deutsche Mark from its present exchange rate level. There is probably also some reluctance to part with Deutsche Mark positions in the cases where this would result in a loss (i.e. against Belgian francs and Danish krone). There could also be a technical reason because part of the transactions carried out before the realignment may mature only in some weeks' time as the realignment occurred earlier than some market operators had actually expected.

6. Conclusions

In the realignment of 12th January 1987 there were some undesirable features. First, the realignment took place under the pressure of the markets and - contrary to prior realignments - without any country really wanting it for correcting differences in inflation rates. This may have given the market the impression that it is possible to force a realignment upon the authorities if pressure is strong enough. Second, the January 1987 realignment was the fourth EMS central rate adjustment within eighteen months which might suggest to the markets that realignments are becoming rather more frequent.

Market perception of these factors might complicate intra-EMS exchange rate stabilisation which in any case has become more difficult as the influence of market speculation has grown with the progressive liberalisation of capital movements and the increasing sophistication of market participants - developments which are likely to continue. Recent experience has shown that speculation can arise despite increased convergence of final economic results.

On the basis of the experience of the last realignment the group felt that the following preliminary conclusions could be drawn. It is necessary to achieve continued progress towards convergence of economic fundamentals - an area where there fortunately has been considerable progress recently. It is also necessary to strengthen co-ordination of monetary (and budgetary) policies in the countries participating in the EMS exchange rate mechanism. At the same time it is important to develop strategies in order

to combat speculation more effectively. Recent developments suggest that interventions alone cannot counter exchange rate pressures. To be effective in cases of prolonged pressure, interventions should be accompanied by measures which make speculation less rewarding (if a realignment actually takes place) and more costly. This might be achieved by combined use of a number of measures aimed at:

- making realignments less likely in the eyes of the market - by taking decisive steps at an early stage to convince markets that realignments will only be made if necessary for real economic reasons and never as a result of market speculation;
- making realignments less predictable - inter alia by trying to avoid realignments in connection with general elections in major countries and by making realignments more timely;
- making position-taking more expensive in the case of major, prolonged pressures by a combination of greater use of the band (introducing a two-way risk for speculators) and increasing interest rate differentials;
- making gains in connection with realignments less likely - by ensuring that market rates will not move much in connection with realignments: this will lead to small realignments with a maximum spread of 4 1/2 per cent. making it possible to neutralise central rate changes by shifts within the band, thus preventing or at least limiting changes in market rates;
- taking steps towards greater co-ordination of exchange rate policies with the United States and Japan.

The group would like to underline the preliminary nature of the findings of the present report. It intends to study further the problems raised in the report as well as the other questions outlined in the mandate.

MANDATE
FOR THE GROUP OF EXPERTS
UNDER THE CHAIRMANSHIP OF MR. DALGAARD

The group has been invited to examine:

- the realignment procedure, in particular procedures to be followed in the case of small realignments;
- circumstances and developments surrounding the recent realignment, in particular as regards
 - . the evolution of interventions and their linkage with the utilisation of the exchange rate fluctuation band and with short-term interest rate differentials,
 - . the part played by recent liberalisation measures in the tensions within the EMS;
- the extension of EMS exchange rate commitments to all EEC countries;
- problems arising with regard to intervention currencies and the sharing of the burden of interventions; in this context the rôle of the ECU could be re-examined;
- the consequences for the system and its mechanisms of dollar (and yen) exchange rate fluctuations;
- the short-term credit facilities, with particular regard to the following problems: the adequacy of the amounts available, the degree to which the provisions governing access correspond to the needs of the system and, as regards the short-term support mechanism the means of financing; taking into account in all these areas the impact of the liberalisation of capital movements.

Since the Chairman of the Committee of Governors will present a preliminary report to the informal ECOFIN meeting at the beginning of next April, the group should aim at reaching some preliminary conclusions on the questions mentioned in the two first indents in time for the next meeting of the Committee of Governors on 10th March 1987.

THE AGRI-MONETARY PROCEDURES AND THE EMS

A. GENERAL PRINCIPLES

1. Each year, around March-April, the Agricultural Council fixes the "intervention" price levels for a wide range of products. These are the prices at which the Community guarantees to buy any excess supply, thus putting effectively a floor under the market prices.
2. The intervention prices are denominated in ECUs but, since in the Common Agricultural Policy (CAP) the ECU is only used as a unit of account, these prices are converted into national currencies for all operational purposes. According to the initial rules, this conversion is to be done, for the currencies that participate in the 2 1/4 per cent. fluctuating band, at their respective ECU parity rate.⁽¹⁾
3. Under these conditions a realignment, which normally⁽²⁾ results in the appreciation of some EMS currencies against the ECU while others depreciate, will automatically lead to lower guaranteed price levels in the revaluing countries while these prices will increase in the countries that devalue against the ECU.

B. THE PRINCIPLES AS APPLIED

4. Already in an early stage the need was acknowledged to spread over time the automatic, and at times sizable, price and production consequences that can result from realignments. Indeed, the supply curve of this sector (revaluing countries) is, by nature, not very elastic in the short run while large, sudden price increases (devaluing countries) may be considered inappropriate because of their inflationary impact.

(1) For the Italian lira and the non-ERM currencies (sterling, Greek drachma, Spanish peseta and Portuguese escudo) see footnote 2 on page 2.

(2) The dividing line between revaluing and devaluing EMS currencies in terms of the ECU may be influenced by the adjustments of the theoretical ECU parity of sterling (and of the Greek drachma since September 1984) that are undertaken on the occasion of a realignment.

Consequently, a phasing-out system was set up whereby, temporarily:

- the national price levels were to remain unchanged. This was done by keeping the old parity rate as the conversion rate for the common ECU prices instead of applying the new one. The "green rate" was born as well as the so-called "Monetary Gap", i.e. the difference (in per cent.) between the actual ECU parity and the "green rate". For the revaluing countries, whose green rate stays undervalued vis-à-vis their ECU parity, this gap is labelled "positive"; it is "negative" for the devaluing countries whose green rate is overvalued vis-à-vis their ECU parity;
- in order to avoid the trade distortion that could result from the divorce between (unchanged) guaranteed price levels in national currencies and a (changed) exchange rate relationship, a system of border levies and subsidies, call Monetary Compensatory Amounts (MCA) was introduced to fill the "Monetary Gap". These MCAs are construed as taxes on the exports of countries with a positive gap.⁽¹⁾ Indeed the "green rate" system temporarily maintains the guaranteed prices artificially low in the devaluing countries and artificially high in the revaluing countries, when compared to the prevailing exchange rate relationship.⁽²⁾

5. Experience has shown that in a period characterised by several realignments and moderate annual CAP price increases, it is more difficult to eliminate the positive MCAs than the negative ones. This should come as no surprise since the phasing-out of negative MCAs,⁽³⁾ while in line with the basic aim of the system, also leads to additional price increases at the national level; in contrast, the elimination of positive MCAs leads

(1) In order to give some flexibility to the management of the system, *inter alia* by avoiding the need for imposing MCAs for minor monetary gaps, a "franchise" is deducted. It is fixed at 1 point in the case of a positive gap and 1.5 points for a negative one.

(2) The MCA system also applies to the non-ERM currencies and the Italian lira. However given the relatively high degree of their potential for exchange rate fluctuation, the MCA's for each of these currencies are based on the difference between its green rate and the weekly average of its market exchange rate against the narrow band currencies. Whenever the difference from one week to another is 1 point or more, its MCAs are adjusted accordingly.

(3) This is done by devaluing the "green rate" so as to bring it in line with the actual ECU parity of the currency involved.

to price decreases at the national level. In the past some elimination has taken place on the occasion of the annual CAP price rise and resulted in a national price rise which was less than the common price rise. Since realignments were seen as the source of the problem, agri-monetary questions have tended to become an issue at the realignment proceedings, i.e. in respect of the size of the envisaged parity change and the search for possibilities to shift the "dividing line" between positive and negative MCAs (cf. the agri-monetary realignment of sterling in May 1983).

6. In 1984, as part of an agreement to phase out part of the existing "stock" of positive MCAs, a new set of agri-monetary rules was temporarily (3 years) introduced that would eliminate the creation of positive MCAs at future realignments. This was achieved in the following way: at a realignment and for the CAP's purposes only, a "corrective factor" is applied to all the new ECU parities which is equal to the revaluation percentage of the currency that revalues most against the ECU. This effectively keeps the existing gap between this currency's "green rate" and its "corrected" ECU parity unaltered. Since for consistency reasons the correction has to be applied to the new ECU parities of the other currencies as well, any negative gap between their green rates and their new ECU parity is "pro tanto" increased. In fact, MCAs that would have been positive under the previous method now turn up as additional negative MCAs for the currencies that devalue against the ECU.

7. Notwithstanding this change, agri-monetary questions have continued to be part of the realignment proceedings i.e. in January 1987. This has to do with the changed policy stance taken by the Council of Agricultural Ministers. Indeed, in order to avoid surplus production and to contain budgetary expenses, the Council, on proposal of the Commission, now severely limits common price increases and in some cases imposes a price freeze. As a result, price increases in national currency terms remain possible only in those countries that, following past or new realignments, are in a position to phase out negative MCAs. Moreover, by creating solely negative MCAs, the present system increases the scope for price increases in the countries concerned, thus eroding joint pressure for increases at the yearly common price fixing. This explains also why, when a realignment takes place before March-April, revaluing countries strive to obtain a commitment for deferral of the elimination of the newly created negative MCAs until after the annual price fixing.

8. Earlier this year, the Commission, worried about the prospect of continued overproduction as a consequence of MCA-induced national price increases, has proposed to the Council to change the existing proceedings in the following way:

- in the two years following a realignment, a two-stage decrease of the common price level is implemented equal to the increase in the "corrective factor". At the same dates, the "artificial" negative MCAs resulting from the corrective factor are phased out. The net result of this proposal represents an indirect return to the old positive/negative MCA system but is now associated with a phasing out - in a context of an unchanged common price level - of the positive MCAs created after a realignment;
- the "franchise" can be raised up to 10 points depending on market conditions. Indeed it has become apparent over time that the monetary gap has to be relatively wide in some sectors, mainly those of derived agricultural products where the non-agricultural input is relatively high, before trade distortion effects tend to arise. This allows for larger franchises.

9. The proposed new procedures, if accepted, are not, for obvious reasons, likely to free the realignment procedures from agri-monetary interferences.

RECENT MEASURES DESIGNED TO LIBERALISE CAPITAL MOVEMENTS

France

In April 1986 the French authorities implemented an initial part of a relaxation of foreign exchange controls announced on 6th April. In particular:

- the ceiling above which authorisation was required for corporate borrowing abroad was lifted and advance redemptions on such borrowing became free if made at least one year after the initiation of the loan;
- the obligation for exporters to redeem foreign exchange receipts two weeks after the dispatch of goods was removed;
- residents were allowed to buy foreign currency three months forward (up to six months in the case of bills in ECUs) to cover import payments and trade-related foreign currency costs;
- outward direct investment no longer required prior authorisation provided that certain requirements are fulfilled;
- the ceiling on transfers which do not have to be justified was raised to Fr.fr. 3,000 for each transfer.

In May 1986 the second phase of foreign exchange liberalisation measures was implemented. It included:

- the abolition of the "devises-titre" régime impeding portfolio investments abroad;
- freedom for residents to purchase residences abroad;
- extension of the forward cover requirement for imports to six months (up to three months previously) and to include imports of services and - for the first time since 1968 - foreign debt servicing, and permission for exporters to hold currency earnings for up to one month (eight days previously);
- the possibility for dealers in currencies and commodity futures to purchase currencies up to six months forward and the extension of futures trading to include professional arbitrage operations between the Paris Commodity Exchange and foreign centres.

In July 1986 the French authorities further dismantled foreign exchange controls. The measures included:

- complete lifting of the limit on forward buying of foreign currency to hedge purchases of goods and services and foreign currency loans;
- extension from one to three months of the period in which exporters can hold currency earnings. This delay applies to any receipt from abroad;
- freeing of down payments up to 30 per cent. of the value for all types of imported goods;

In November 1986 it was decided that:

- no prior authorisation was required for selling or purchasing unlisted securities between residents and non-residents;
- credit cards could be used abroad by residents without any limitation for expenses relating to their stay or travel abroad or to purchase goods for their own use.

In December 1986 banks were authorised to extend French franc loans to non-residents within the limit of their non-resident French franc resources.

It should be noted that all payments - even liberalised - between residents and non-residents must be executed through banks which have been accorded the status of "intermédiaires agréés".

Italy

In April 1986 the Italian authorities removed the restrictive measures introduced in early January, namely the requirement to finance in foreign currency 75 per cent. of export credits and the prohibition to repay in advance foreign debts. At the same time, the ceiling on forward operations by banks was raised by 25 per cent.; forward cover was liberalised for all current transactions, including services; dealing in foreign currency options was authorised; the surrender requirement on foreign currency receipts was extended from fifteen to ninety days.

In August 1986 the non-interest bearing deposit on portfolio investment abroad by residents was reduced to 15 per cent. This deposit does not apply to direct investment abroad and unit trusts remain free to purchase foreign bonds and stocks in exemption of the deposit up to 10 per cent. of their total assets.

Moreover non-residents are free to invest in Italy in any form and there are no limitations on the repatriation of the invested capital, profits and dividends. Commercial banks are free to engage in foreign currency dealings, as well as borrowing and lending, the only limitation being the requirement to balance daily their lira position.

Period	July 1986	Aug. 1986	Sept. 1986	Oct. 1986	Nov. 1986	Dec. 1986	01.01-09.01 1987	1.07.86-09.01.87	12.01-31.01 1987	Feb. 1987	12.01-27.02 1987
BEC											
-EMS Currencies	57	-347	-123	-176	-446	-691	-1,234	-2,960	-19	348	329
of which: at the limits	(0)	(-26)	(0)	(0)	(0)	(0)	(0)	(-26)	(0)	(0)	(0)
-USD	0	17	0	0	-28	-17	0	-28	0	0	0
-Other Currencies	6	4	4	6	7	6	0	33	4	9	13
-Total net	63	-326	-119	-170	-467	-702	-1,234	-2,955	-15	357	342
DKK											
-EMS Currencies	-1,333	-192	-1,212	0	22	-968	-2,422	-6,105	-36	115	79
of which: at the limits	(-1,159)	(-109)	(-1,212)	(0)	(0)	(-693)	(-2,422)	(-5,595)	(0)	(0)	(0)
-USD	-150	-39	5	-16	-7	-45	0	-252	130	0	130
-Other Currencies	0	0	0	0	0	0	0	0	0	0	0
-Total net	-1,483	-231	-1,207	-16	15	-1,013	-2,422	-6,357	94	115	209
DEM											
-EMS Currencies	2,245	1,799	6,012	1,761	1,581	6,066	13,915	33,379	-1,288	-4,174	-5,462
of which: at the limits	(0)	(0)	(1,212)	(0)	(0)	(693)	(8,440)	(10,345)	(0)	(0)	(0)
-USD	0	0	40	1,128	0	0	248	1,416	318	0	318
-Other Currencies	0	0	0	0	0	0	0	0	0	0	0
-Total net	2,245	1,799	6,052	2,889	1,581	6,066	14,163	34,795	-970	-4,174	-5,144
FRF											
-EMS Currencies	-1,128	-625	-4,158	-1,470	-716	-2,852	-8,131	-19,080	77	2,067	2,144
of which: at the limits	(1,159)	(0)	(0)	(0)	(0)	(0)	(-5,805)	(-4,646)	(0)	(0)	(0)
-USD	450	0	0	115	0	-101	0	464	191	751	942
-Other Currencies	0	0	0	0	0	0	0	0	0	0	0
-Total net	-678	-625	-4,158	-1,355	-716	-2,953	-8,131	-18,616	268	2,818	3,086
IEP											
-EMS Currencies	-35	182	-127	-733	-89	-251	-335	-1,388	-49	-327	-376
of which: at the limits	(0)	(135)	(0)	(0)	(0)	(0)	(-213)	(-78)	(0)	(0)	(0)
-USD	-366	45	-142	189	385	129	-114	106	33	73	106
-Other Currencies	-18	0	0	0	0	0	0	-18	0	0	0
-Total net	-419	227	-269	-564	296	-122	-449	-1,300	-16	-254	-270
ITL											
-EMS Currencies	226	-817	-382	662	-309	-710	-1,793	-3,123	1,315	1,977	3,292
of which: at the limits	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)
-USD	512	445	-94	695	83	-193	-51	1,397	398	513	912
-Other Currencies	0	10	0	0	0	0	-13	-3	0	0	0
-Total net	738	-362	-476	1,357	-226	-903	-1,857	-1,729	1,714	2,490	4,204
NLG											
-EMS Currencies	-32	0	-10	-44	-43	-594	0	-723	0	-6	-6
of which: at the limits	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)
-USD	1,567	598	0	38	0	100	35	2,338	212	-219	-7
-Other Currencies	0	0	0	0	0	0	0	0	0	-7	-7
-Total net	1,535	598	-10	-6	-43	-494	35	1,615	212	-232	-20
EMS											
-EMS Currencies (2)	2,528	1,981	6,012	2,423	1,603	6,066	13,915	34,528	1,392	4,507	5,899
of which: at the limits	(1,159)	(135)	(1,212)	(0)	(0)	(693)	(8,440)	(11,639)	(0)	(0)	(0)
-USD and other currencies	2,535	1,109	49	2,151	468	229	283	6,824	1,287	1,346	2,633
net purchases	534	39	236	16	7	350	178	1,360	0	-226	-226
-Total gross (3)	5,597	3,129	6,297	4,590	2,078	6,645	14,376	42,712	2,679	6,079	8,758
-Net bal. vis-à-vis non-EMS	2,001	1,070	-287	2,135	461	-121	105	5,464	1,287	1,120	2,407
-Total net positions (4)	4,633	2,187	6,279	3,934	1,741	6,187	14,376	33,988	1,897	5,933	7,376

(1) Prepared by the Secretariat of the Committee of Governors on the basis of data provided by EEC central banks in the framework of the concertation procedure. Figures comprise all net purchases (-) or sales (+) of a given currency both by the issuing central bank and its EMS partners. (2) Sum of net purchases and net sales respectively. (3) Interventions in EMS currencies plus the sum of the absolute amounts of each EMS central bank's net interventions in non-EMS currencies. Cumulative figures for the period from 1st July 1986 to 9th January 1987 and 12th January 1987 to 16th February 1987 respectively differ from the sum of each central bank's net position; the difference is due to reversals in net positions over the periods under review. (4) Sum of the absolute amounts of each EMS central bank's net interventions in EMS and non-EMS currencies after adjustment for double accounting of interventions in EMS currencies. Reading horizontally, monthly figures do not add up to cumulative figures; the difference is due to reversals in net positions over the periods under review.

	BE	DK	DE	FR	IE	IT	LX	NL	average unweighted	dispersion unweighted
CONSUMER PRICE INCREASES (% changes over one year)										
annual averages										
1980	6.6	12.3	5.5	13.6	18.2	21.2	6.3	6.5	11.2	5.6
1981	7.6	11.7	5.9	13.4	20.4	17.8	8.1	6.7	11.8	5.8
1982	8.7	10.1	4.8	11.8	17.1	16.5	9.4	5.9	10.4	4.5
1983	7.7	6.9	3.3	9.6	10.5	14.7	8.7	2.8	7.7	3.9
1984	6.3	6.3	2.5	7.4	8.6	10.8	5.6	3.3	6.3	2.9
1985	4.9	4.7	2.2	5.8	5.4	8.6	4.1	2.2	4.7	2.2
1986	1.3	3.7	-0.4	2.5	3.9	6.4	0.3	0.0	2.2	2.3
1987 f)	1.5	3.8	..	..	3.2	..	1.4	-1.5	..	..
quarterly averages										
1986 Q2	1.3	4.0	-0.2	2.4	4.4	6.5	..	-0.4	2.4	2.4
1986 Q3	0.8	4.2	-0.4	2.1	3.1	5.8	..	-0.6	1.9	2.3
1986 Q4	0.7	4.4	-1.0	2.1	3.2	4.7	..	-0.2	1.8	2.2
monthly data										
1986 Oct.	0.8	4.5	-0.9	2.2	..	5.1	..	-0.2	1.9	2.2
1986 Nov.	0.5	4.3	-1.2	2.1	..	4.8	..	-0.2	1.7	2.2
1986 Dec.	0.6	4.3	-1.1	2.1	..	4.3	..	-0.1	1.7	2.1
UNIT LABOUR COST (% change over over one year)										
1980	5.0	10.0	6.6	13.6	19.6	18.9	8.4	5.3	10.9	5.8
1981	5.9	8.7	4.3	13.1	13.4	22.3	10.6	2.7	10.1	6.3
1982	5.1	9.1	3.1	11.9	13.9	17.7	6.0	4.6	8.9	5.2
1983	5.4	6.2	1.1	9.4	8.4	17.1	4.6	0.2	6.5	5.3
1984	5.4	4.2	0.7	5.4	3.9	9.6	1.9	-1.4	3.7	3.4
1985	3.4	4.2	1.1	5.1	2.6	8.0	3.7	0.8	3.5	2.3
1986 pe	0.6	3.3	2.3	2.5	4.1	5.3	2.3	1.7	2.7	1.5
1987 f	1.3	6.9	2.2	2.0	3.7	4.8	4.4	0.7	3.3	2.0
CURRENT ACCOUNT (1)										
Annual data in % of GDP										
1980	-4.5	-3.6	-1.9	-0.6	-11.3	-2.5	17.8	-1.5	-3.9	3.7
1981	-4.6	-3.0	-1.0	-0.8	-14.4	-2.3	21.6	2.2	-3.5	5.4
1982	-3.4	-4.1	0.5	-2.2	-10.1	-1.6	23.0	3.2	-2.8	4.2
1983	-0.8	-2.5	0.6	-1.1	-6.0	0.2	23.7	3.1	-1.1	3.1
1984	-0.7	-3.3	1.0	-0.2	-4.8	-0.8	26.0	4.1	-0.8	3.0
1985	0.1	-4.6	2.1	0.0	-2.8	-1.2	28.1	4.2	-0.4	3.0
1986 pe	2.1	-4.9	4.0	0.6	-1.0	1.0	29.0	3.1	0.7	3.0
1987 f	2.9	-3.2	3.0	..	1.2	0.7	30.0	1.8	..	..
quarterly data (in US dollar billion)										
1986 Q1	0.3	-1.0	6.9	-0.4	..	-3.4	..	1.4	X	X
1986 Q2	0.6	-1.3	8.3	1.0	..	1.2	..	2.4	X	X
1986 Q3	1.1	-0.9	8.0	0.9	..	5.0	..	1.6	X	X
1986 Q4	..	..	13.2	2.4	..	..	..	..	X	X
REAL GDP GROWTH										
(% change on preceding year)										
1980	3.9	-0.4	1.8	1.4	1.5	3.9	2.7	1.0	1.9	X
1981	-1.4	-0.9	0.1	0.5	1.9	0.2	-0.4	-0.7	-0.1	X
1982	1.8	3.0	-0.6	1.8	1.2	-0.5	1.5	-1.5	0.7	X
1983	-0.3	2.5	1.2	0.7	0.6	-0.2	2.8	1.7	0.9	X
1984	1.6	3.4	2.8	1.5	3.8	2.8	4.9	2.1	2.8	X
1985	1.5	3.9	2.5	1.4	2.3	2.3	2.3	2.0	2.2	X
1986 pe	2.1	3.3	2.5	2.3	1.0	2.8	2.5	1.6	2.3	X
1987 f	0.9	0.7	2.5	..	2.0	3.5	2.0	1.9	..	X
UNEMPLOYMENT										
(% of active labour force, annual average levels)										
1980	8.9	7.0	3.3	6.3	8.7	7.6	0.7	6.0	6.0	X
1981	10.9	9.2	4.8	7.3	11.1	8.7	1.0	8.6	7.6	X
1982	12.8	9.8	6.7	8.1	13.7	9.2	1.2	11.5	9.1	X
1983	14.0	10.6	8.1	8.3	14.8	10.1	1.6	13.8	10.4	X
1984	14.1	10.3	8.1	9.7	16.2	10.4	1.8	13.9	10.9	X
1985	14.0	9.0	8.2	10.5	17.8	10.1	1.7	12.8	10.8	X
1986	13.2	7.8	7.9	10.8	18.2	11.0	1.4	11.8	10.5	X
1987 f	12.3	8.3	7.5	..	18.5	..	1.8	11.0	..	X

(1) On a transaction basis.

Source: EMS central banks; for unit labour cost, Commission services

Table 3

NOMINAL EFFECTIVE EXCHANGE RATES

(Index figures, April 1983 = 100)

PERIOD	BEC	DKK	DEM	FRF	IEP	ITL	NLG
Against 20 trading partners (1)							
86 Jan	98.5	98.2	101.7	99.6	98.3	88.0	101.4
86 Feb	99.7	99.0	103.2	101.0	99.5	89.5	102.5
86 Mar	100.5	99.8	104.3	101.8	100.3	90.4	103.5
86 Apr	100.8	99.4	103.9	98.1	100.0	89.5	103.2
86 May	100.8	99.5	104.3	97.9	100.7	89.7	103.7
86 Jun	100.9	99.6	104.5	98.0	100.5	89.9	103.9
86 Jul	101.6	100.1	106.1	98.5	101.0	91.2	105.4
86 Aug	103.2	101.9	108.7	99.5	96.5	93.0	107.6
86 Sep	104.1	102.2	109.7	99.9	96.3	93.5	108.3
86 Oct	105.1	104.1	111.3	101.4	97.4	94.6	109.7
86 Nov	105.1	104.1	111.5	101.5	97.4	94.6	109.7
86 Dec	105.8	104.8	112.5	101.9	98.1	95.3	110.6
87 Jan	108.9	107.4	116.1	103.4	99.3	96.0	113.9
Intra-EMS (2)							
86 Jan	99.9	99.7	105.0	102.0	99.3	88.5	103.1
86 Feb	99.8	99.1	105.1	102.0	98.8	88.7	102.9
86 Mar	99.8	98.9	105.1	101.8	98.7	88.7	103.0
86 Apr	101.2	99.7	106.3	98.8	99.8	88.9	103.8
86 May	101.2	99.5	106.5	98.4	100.1	88.9	104.1
86 Jun	101.2	99.4	106.6	98.3	99.7	88.9	104.2
86 Jul	100.7	98.7	107.2	97.6	98.9	89.3	104.5
86 Aug	100.6	98.6	108.1	96.7	92.0	89.5	105.0
86 Sep	100.8	98.3	108.4	96.3	91.2	89.4	105.0
86 Oct	100.6	98.8	108.5	96.4	90.6	89.3	105.0
86 Nov	100.5	98.6	108.5	96.5	90.6	89.2	105.0
86 Dec	100.5	98.6	108.8	96.3	90.6	89.2	105.1
87 Jan	101.5	98.8	109.9	95.4	89.5	87.7	106.0

(1) Mixed weights: 1/3 bilateral trade; 1/3 multilateral trade;
1/3 nominal GNP. Source : BIS.

(2) Double export weights variable from year to year until 1984.
Source: Commission Departments.

REAL EXCHANGE RATES

(Index figures, April 1983 = 100)

	BE	DK	DE	FR	IE	IT	NL
1986	Against 20 trading partners (1)						
Jan.	95.6	98.9	97.2	105.9	102.4	101.5	97.9
Feb.	96.9	96.7	98.6	107.9	104.2	103.0	98.7
Mar.	97.5	97.3	99.5	108.9	105.3	104.8	99.6
Apr.	97.7	95.0	98.9	104.7	105.1	104.2	99.9
May	96.5	94.5	99.0	103.8	106.0	104.7	100.7
June	96.8	92.5	98.9	103.6	105.6	105.1	100.5
July	97.2	91.9	100.1	104.4	105.7	106.4	101.6
Aug.	98.5	94.2	102.5	105.1	101.6	109.0	104.1
Sept.	99.6	94.5	103.6	105.2	101.2	110.0	104.7
Oct.	100.2	95.4	104.6	106.3	101.7	111.7	105.6
Nov.	100.5	96.1	104.5	105.6	101.6	112.0	105.2
Dec.	101.0	96.7	105.5	105.4	102.5	113.4	105.8
1986	Intra-EMS (2)						
Jan.	96.6	103.2	97.2	109.1	103.3	100.4	92.5
Feb.	97.1	102.0	98.0	109.3	103.8	100.1	90.6
Mar.	97.2	102.7	98.0	110.0	104.2	100.4	88.6
Apr.	98.5	102.8	98.7	107.9	105.7	100.8	88.6
May	97.5	103.1	98.9	107.9	106.8	101.1	88.4
June	97.7	102.3	98.7	108.6	106.2	101.4	87.6
July	97.4	101.6	99.2	108.4	105.2	101.8	86.8
Aug.	97.0	101.3	99.6	108.1	98.6	102.2	87.0
Sept.	97.1	100.8	99.8	108.0	97.2	102.3	86.9
Oct.	96.8	101.2	99.3	108.8	96.5	102.3	86.9
Nov.	97.0	100.5	98.8	109.2	96.7	102.6	86.9
Dec.	97.0	100.2	99.1	108.8	96.5	102.7	86.8

(1) Calculated by BIS services. Mixed weights: 1/3 bilateral trade; 1/3 multilateral trade in manufactured goods; 1/3 nominal GNP. Deflated on the basis of wholesale prices of manufactured goods (see attached list).

(2) Calculated by Banca d'Italia using the weighting scheme of the EC Commission (double export weights). Deflated on the basis of wholesale prices of manufactured goods (see attached list).

Table 4

TITLE AND SOURCE OF PRICE SERIES USED IN CALCULATING
REAL EXCHANGE RATES AGAINST REST OF 20 TRADING PARTNERS

<u>Country</u>	<u>Title of Series</u>	<u>Source</u>
Belgium	Prix de gros - produits finis	Institut National de Statistique: Bulletin de Statistique
Denmark	Producers' material prices (Engrosprisindex)	Danmarks Statistik
Germany	Erzeugerpreise gewerblicher Produkte	Statistisches Bundesamt: Wirtschaft und Statistik
Greece	Wholesale prices of finished goods	Bank of Greece
France	Indice des prix de vente à la production hors TVA Biens intermédiaires	INSEE: Bulletin Mensuel Statistique, Tab. 11
Ireland	Output prices of manufactured goods	Central Statistics Office Irish Statistical Bulletin and Economic Series
Italy	Pressi all ingrosso beni finali di consumo	ISTAT: Bollettino mensile di statistica Notiziario INSTAT, Tav. 13-1
Netherlands	Afzet binnenland, producentenprijzen van finale production (consumptie en investeringsgoederen)	Centraal Bureau voor de Statistiek: Maandstatistiek van de prijzen, T3.1 L.8
United Kingdom	Producer prices index - manufactured goods (other than food, drink and tobacco industries)	Central Statistical Office, Monthly Bulletin of Statistics
Norway	Engrosprisindeksen Industri	Statistisk Sentralbyrå: Statistik Ukehefte
Sweden	Producer prices Producentenprisindex	Statistiska Centralbyran: Statistiska Middelanden Sev. P
Austria	Grosshandelspreisindex	Oesterreichische Institut für Wirtschaftsforschung
Switzerland	Grosshandelspreisindex Konsumgüter	Volkswirtschaftsdepartement Die Volkswirtschaft
Japan	Wholesale prices of industrial goods	Bank of Japan, Economic Statistics, Monthly, Tab. 120

<u>Country</u>	<u>Title of Series</u>	<u>Source</u>
Canada	Industry selling prices of industrial goods	Bank of Canada, Review Tab. H13
U.S.A.	Producer prices of finished goods	US Department of Labour
Australia	Prices manufacturing output	ABS, Monthly Summary of Statistics, Australia
Spain	Producer prices consumer goods	Banco de España Boletín Estadístico, Tab XIX-4, col. 6
Portugal	Wholesale prices manufactured goods	Banco de Portugal Bolletín Trimestrial, Tab. 4.2.6
Saudi Arabia	Constant prices assumed	

TITLE AND SOURCE OF PRICE SERIES USED IN CALCULATING
INTRA-EMS REAL EXCHANGE RATES

<u>Country</u>	<u>Title of Series</u>	<u>Source</u>
Belgium	Prix de gros - produits finis	Institut National de Statistique: Bulletin de Statistique
Denmark	Prices - home goods	IMF: International Financial Statistics
Germany	Erzeugerpreise gewerblicher Produkte	Statistisches Bundesamt: Wirtschaft und Statistik
France	Prix à la consommation produits manufacturés	INSEE: Bulletin Mensuel Statistique
Ireland	Wholesale prices of manufactured Goods	OECD: Main Economic Indicators
Italy	Pressi all ingrosso prodotto non agricoli	ISTAT: Bollettino mensile di statistica Notiziario INSTAT
Netherlands	Prijsindexcijfers - afgezetta finale goederan	Centraal Bureau voor de Statistiek: Maandstatistiek van de prijzen

NOTES ON CHARTS

Domestic interest rates

Daily observations of representative money market rates and official rates.

Short-term interest rate differentials

Daily observations of the difference between the representative domestic money market rate, on the one hand, and the three-month interbank rate in Germany and the three-month yield on the US dollar, on the other hand.

Exchange rate indices

Bilateral exchange rates are expressed in units of foreign currency per one unit of domestic currency.

Effective exchange rates are the trade-weighted average against twenty trading partners. Figures have been calculated by the BIS using mixed weights: 1/3 bilateral trade, 1/3 multilateral trade and 1/3 nominal GNP.

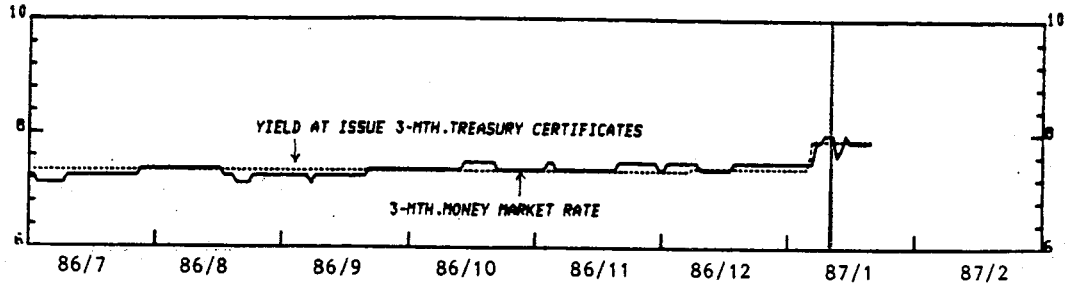
An increase in the exchange rate indices reflects an appreciation of the domestic currency and vice versa.

Net interventions

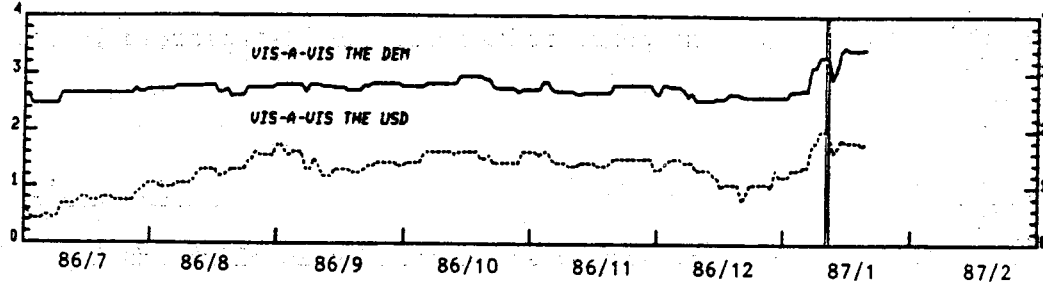
They are defined as all purchases (-) and sales (+) of the currency of the country concerned against foreign exchange, irrespective of whether the central bank of the country concerned or its EMS partners intervenes. Non-dollar flows are converted into US dollars at end-month exchange rates. The data used are monthly net figures, except for the month of January 1987, where data have been detailed according to intervention carried out before and after the realignment of 12th January 1987.

BELGIUM

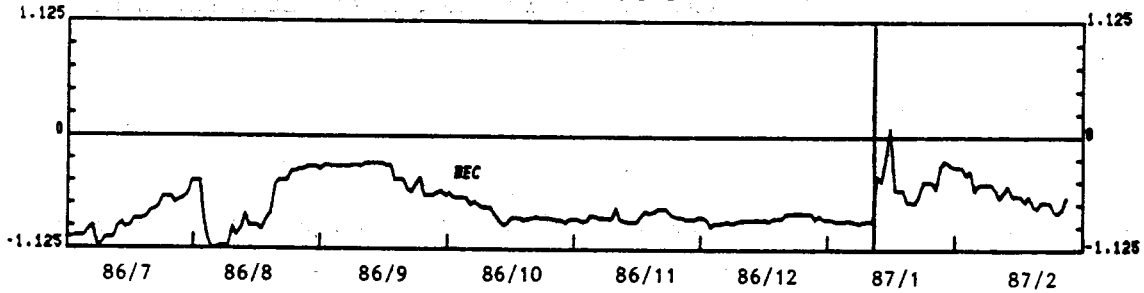
DOMESTIC INTEREST RATES



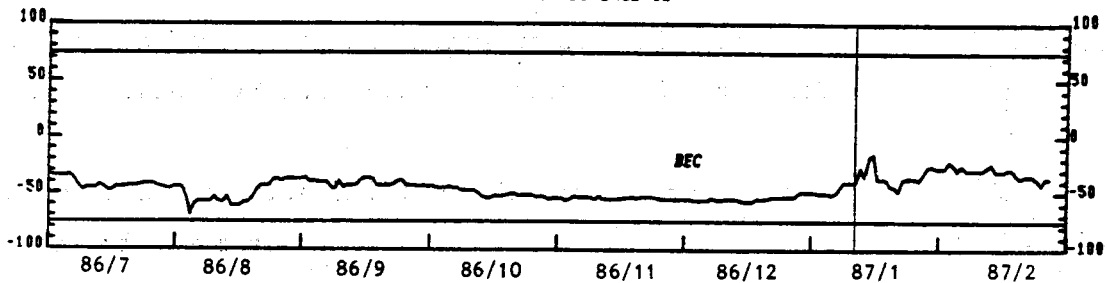
SHORT-TERM INTEREST RATE DIFFERENTIALS



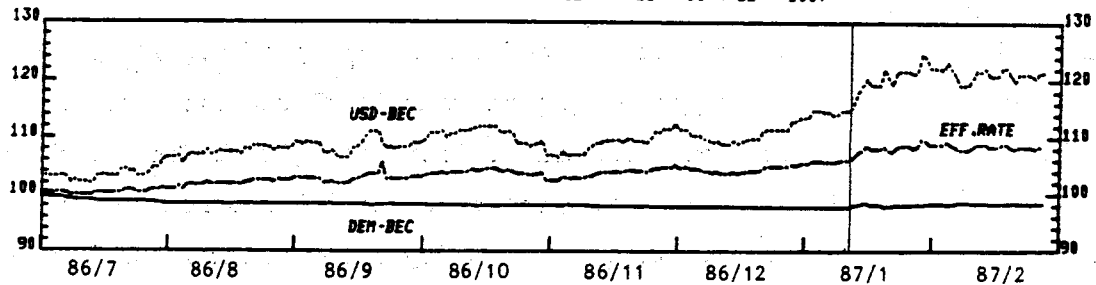
POSITION IN THE BAND



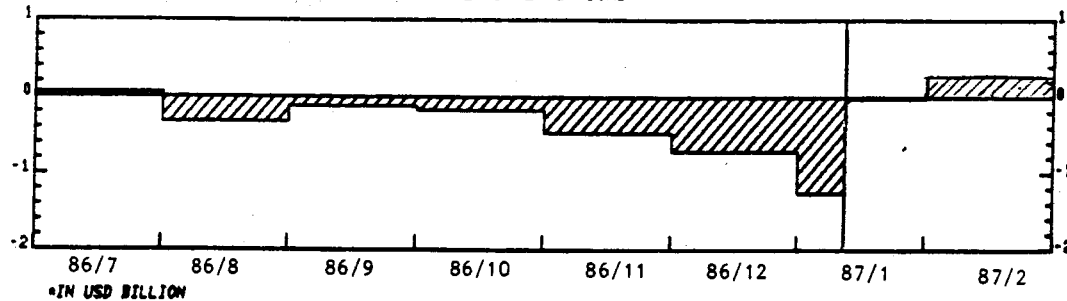
INDICATOR OF DIVERGENCE



EXCHANGE RATES (INDICES AVERAGE 7/4/86 - 30/4/86 = 100)

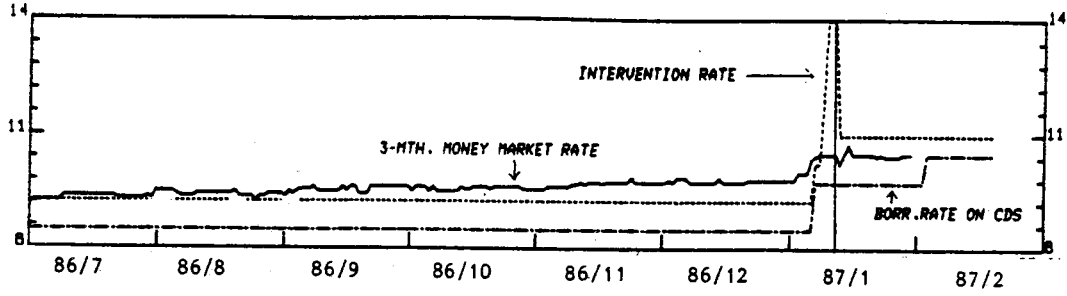


NET INTERVENTIONS*

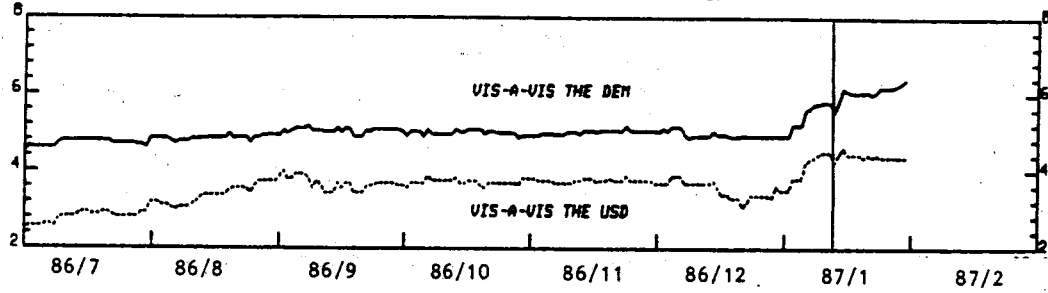


DENMARK

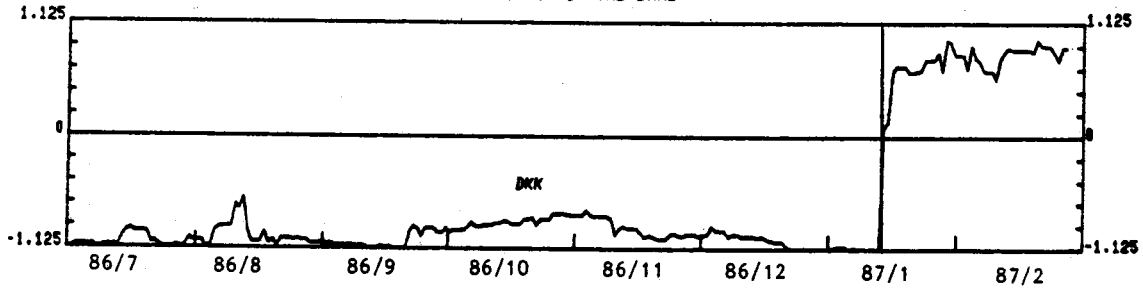
DOMESTIC INTEREST RATES



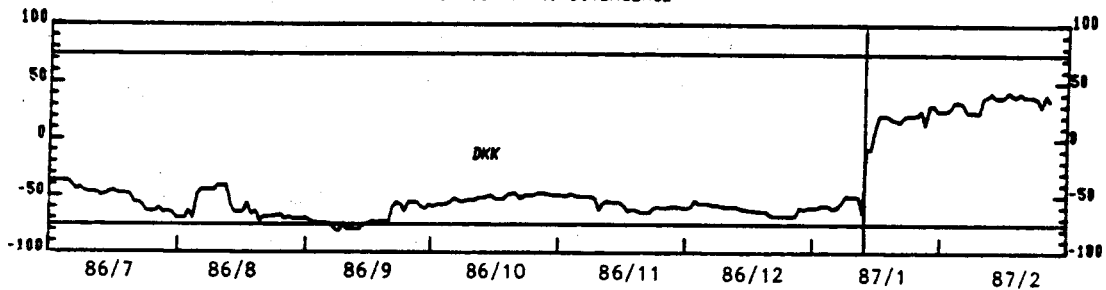
SHORT TERM INTEREST RATE DIFFERENTIALS



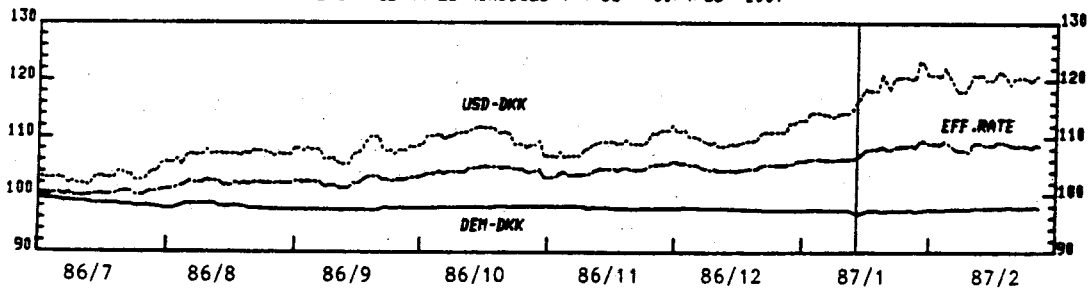
POSITION IN THE BAND



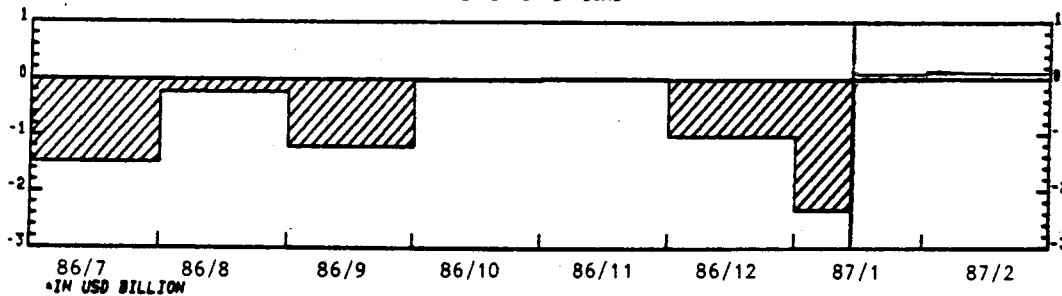
INDICATOR OF DIVERGENCE



EXCHANGE RATES (INDICES 7/4/86 - 30/4/86 = 100)

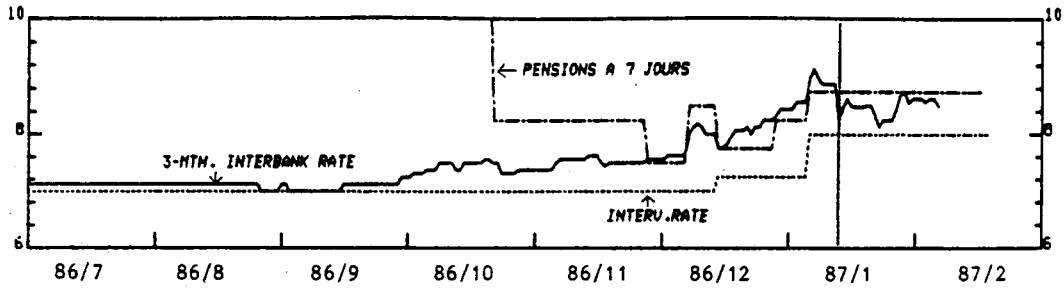


NET INTERVENTIONS

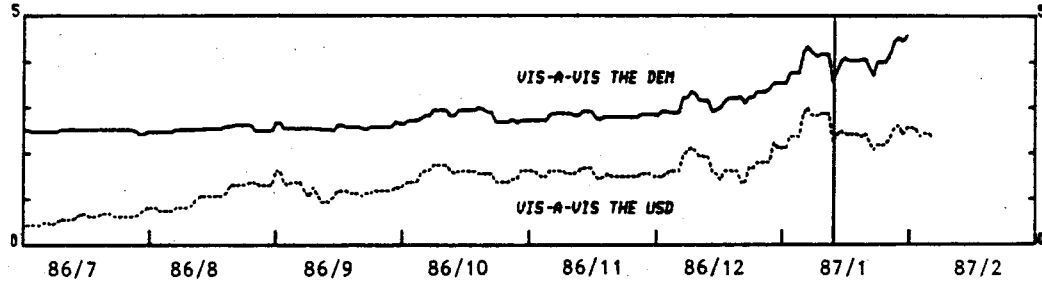


FRANCE

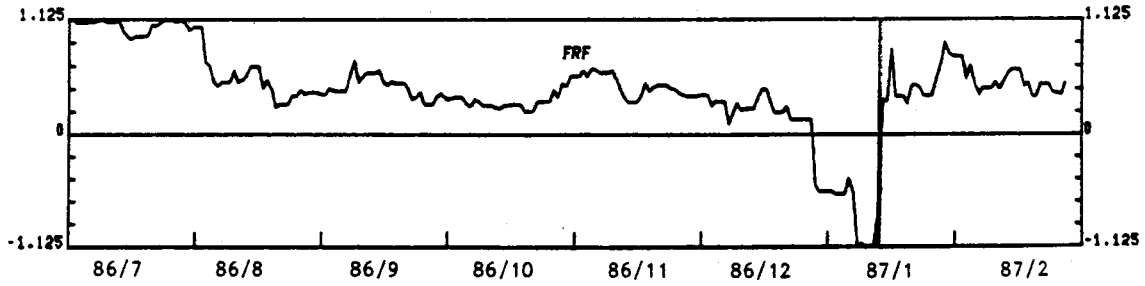
DOMESTIC INTEREST RATES



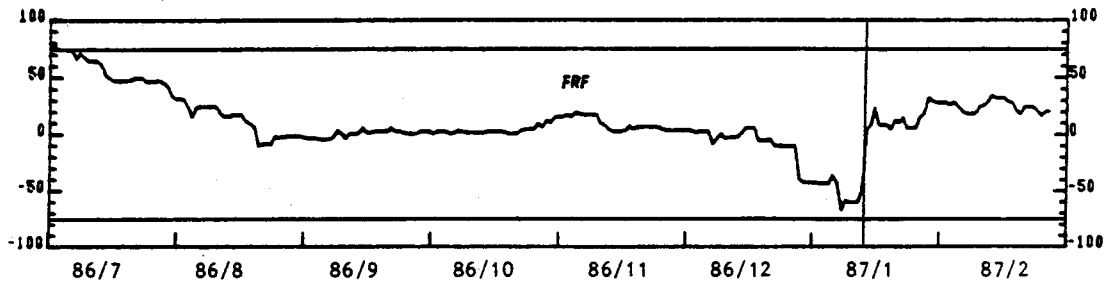
SHORT TERM INTEREST RATE DIFFERENTIALS



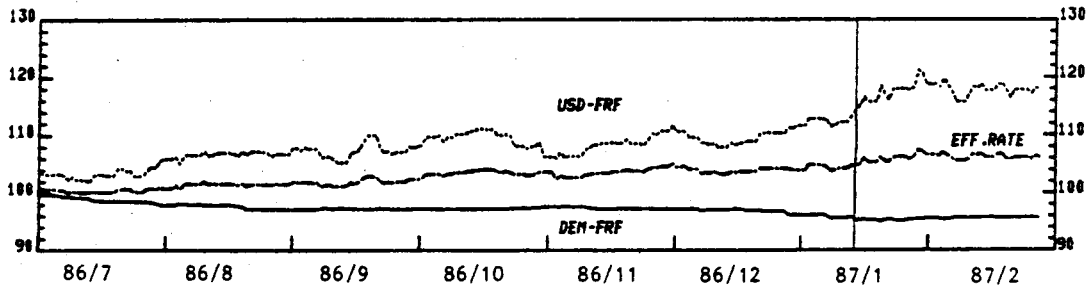
POSITION IN THE BAND



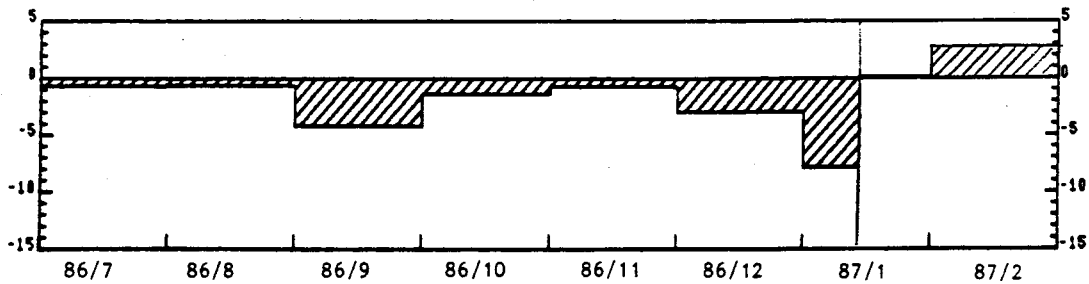
INDICATOR OF DIVERGENCE



EXCHANGE RATES (INDICES 7/4/86 - 30/4/86 = 100)

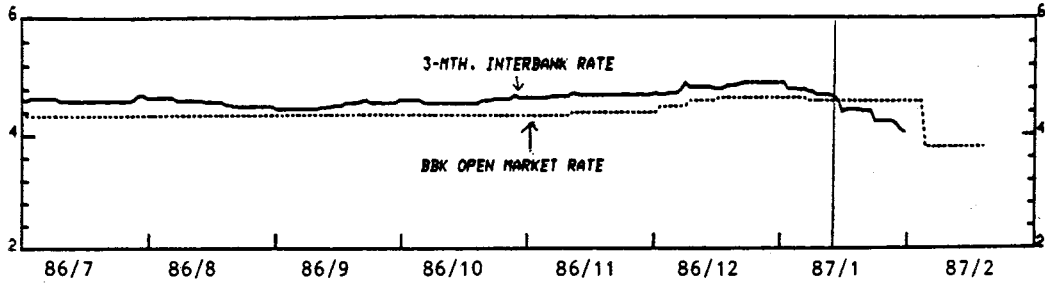


NET INTERVENTIONS*

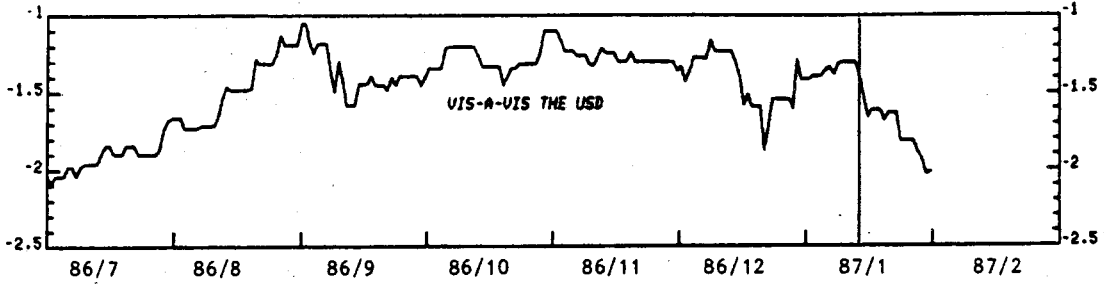


GERMANY

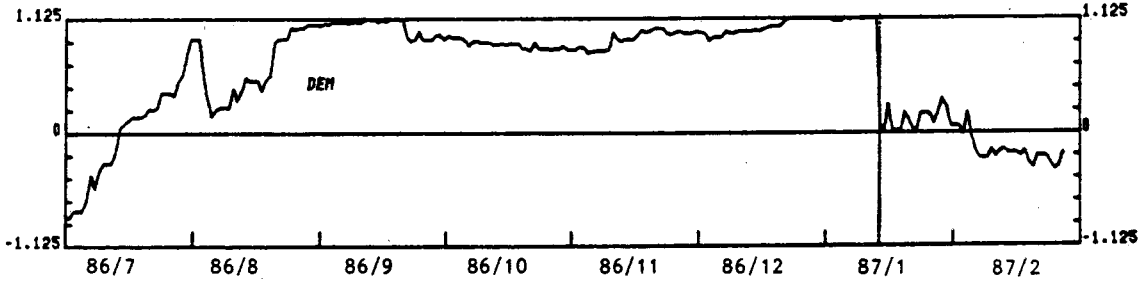
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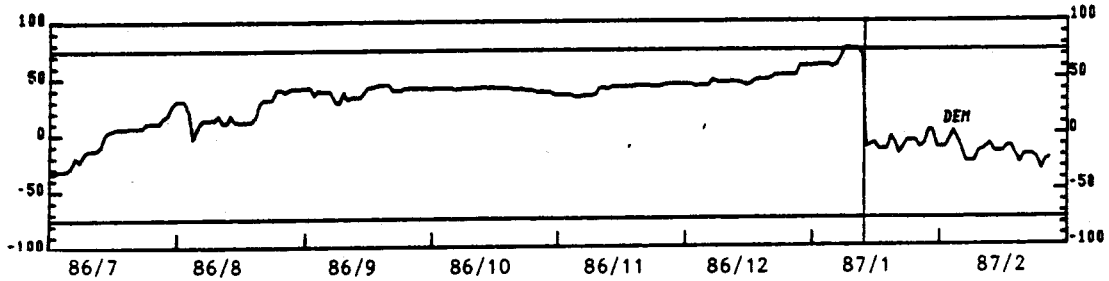
SHORT TERM INTEREST RATE DIFFERENTIALS



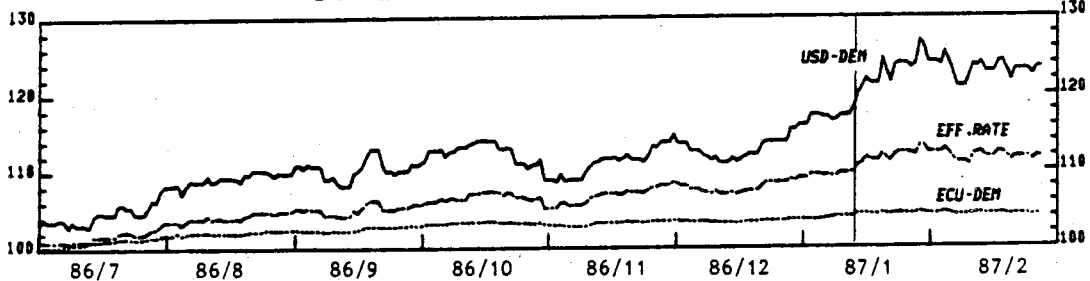
POSITION IN THE BAND



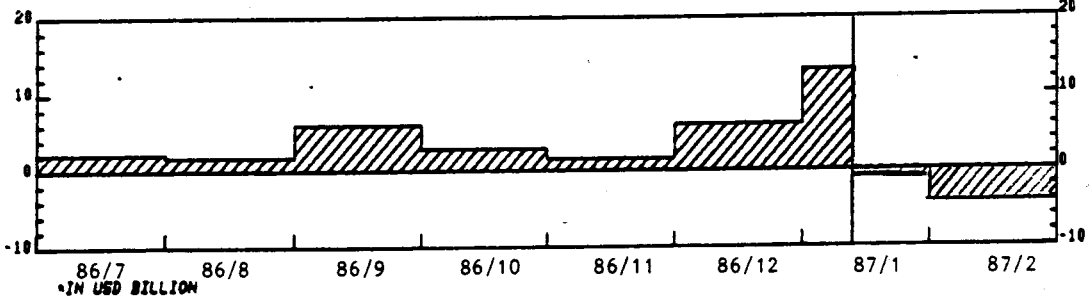
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EXCHANGE RATES (INDICES 7/4/86 - 30/4/86 = 100)

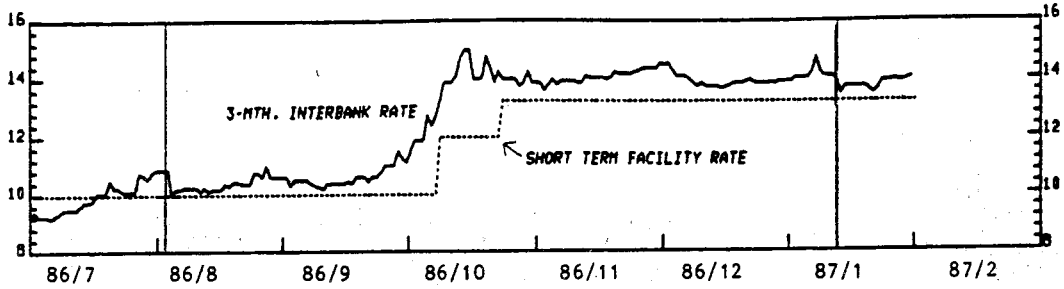


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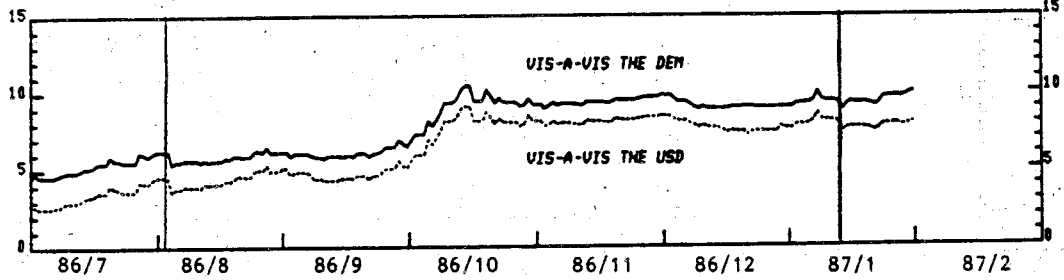


IRELAND

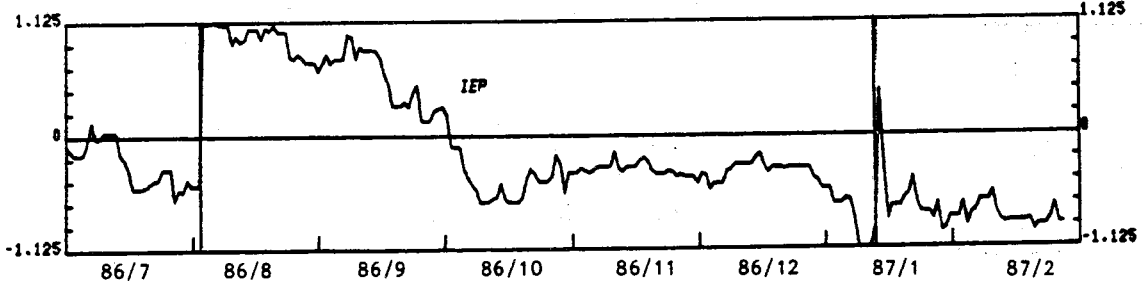
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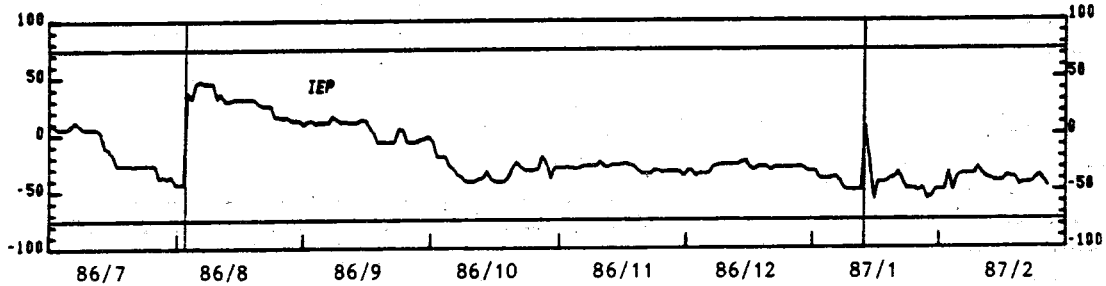
SHORT TERM INTEREST RATE DIFFERENTIALS



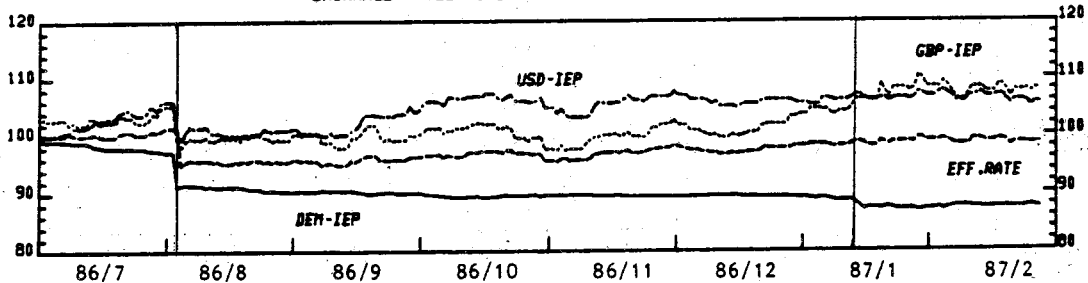
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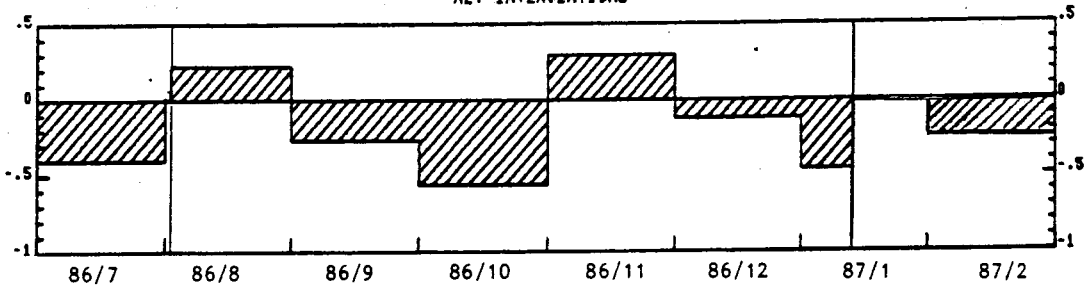
INDICATOR OF DIVERGENCE



EXCHANGE RATES (INDICES 7/4/86 = 30/4/86 = 100)

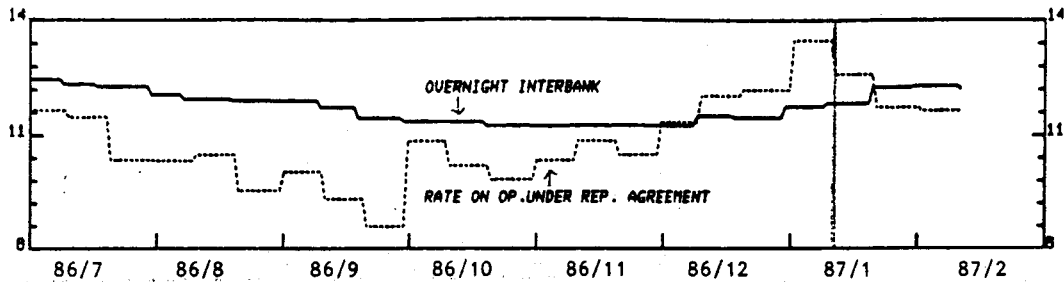


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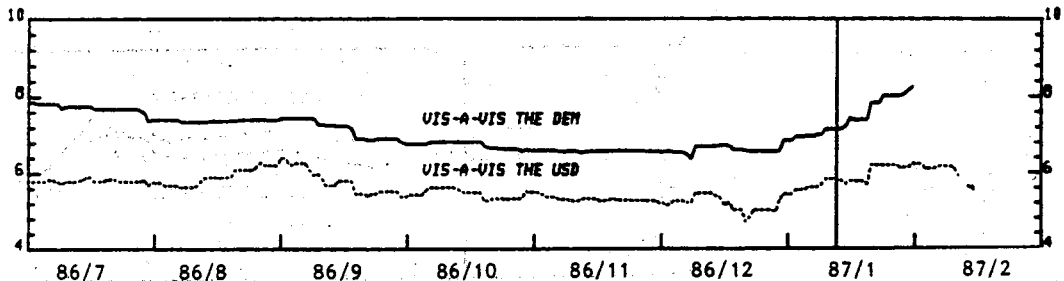


ITALY

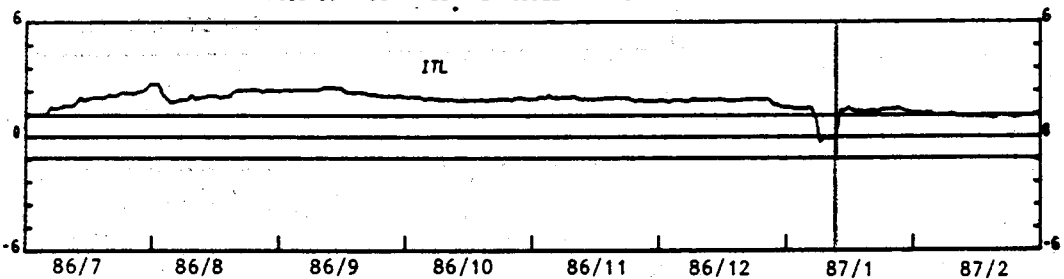
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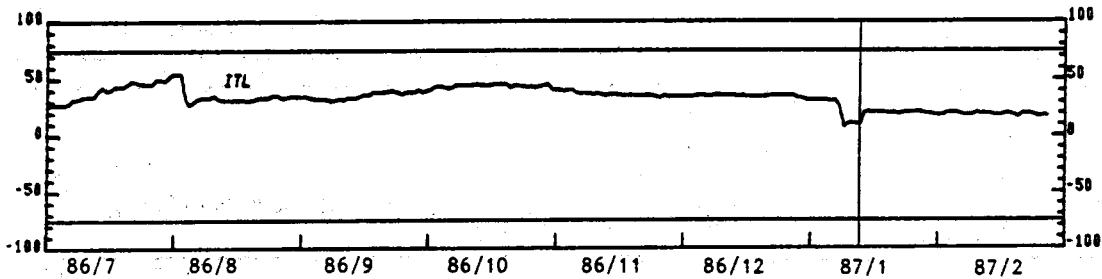
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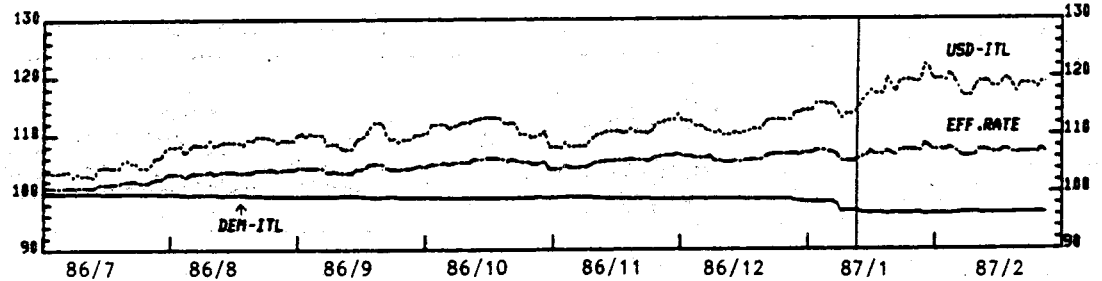
POSITION VIS-A-VIS THE MIDDLE OF THE NARROW EMS BAND



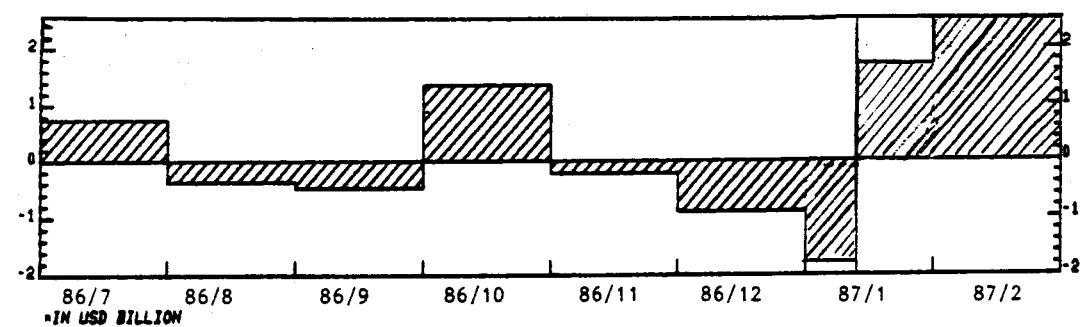
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EXCHANGE RATES (INDICES 7/4/86 - 30/4/86 = 100)

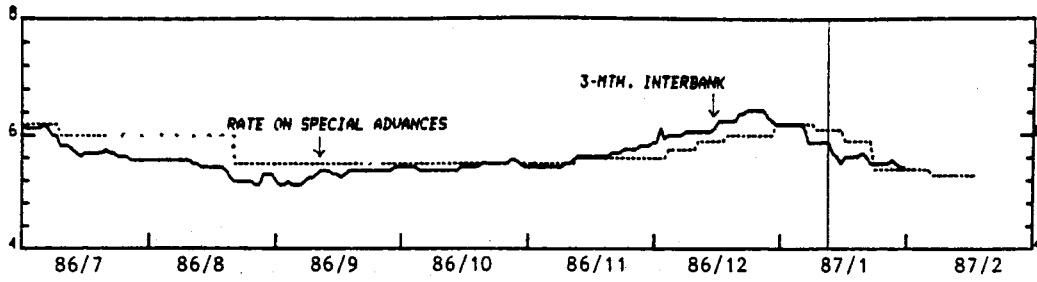


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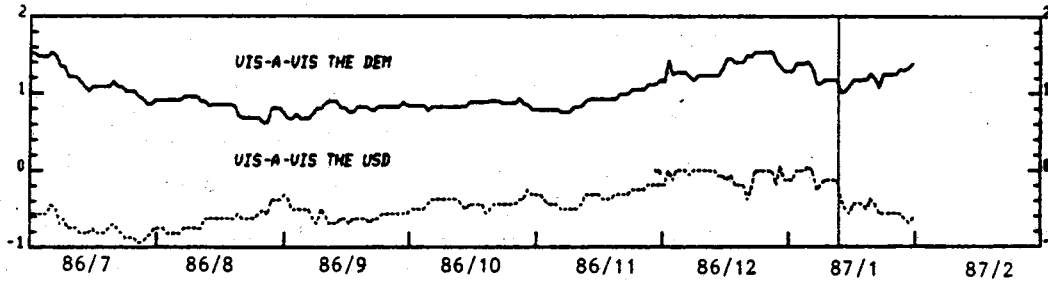


NETHERLANDS

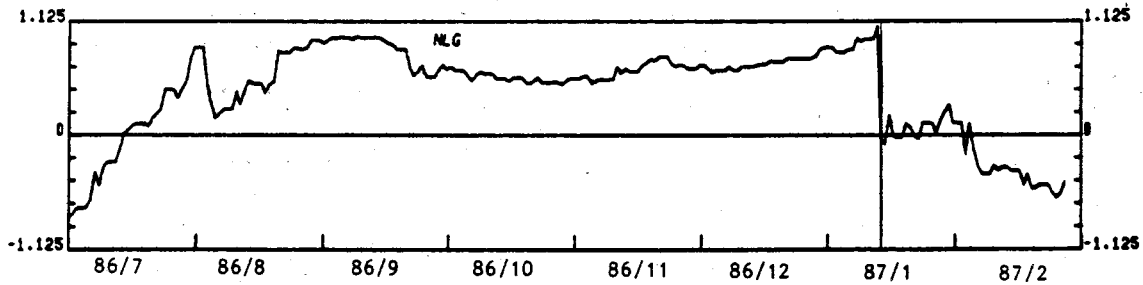
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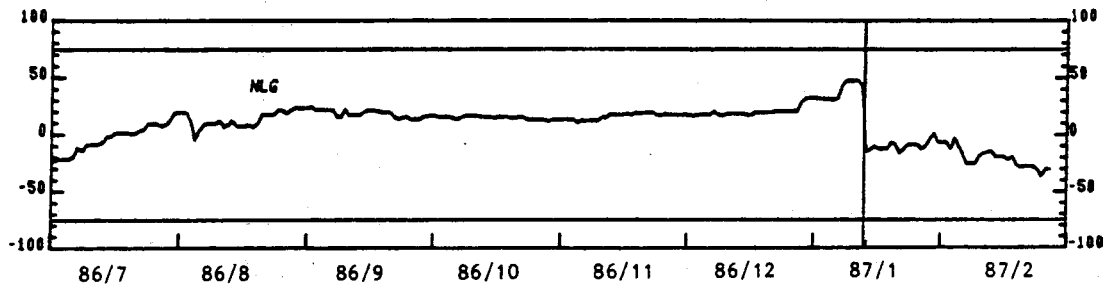
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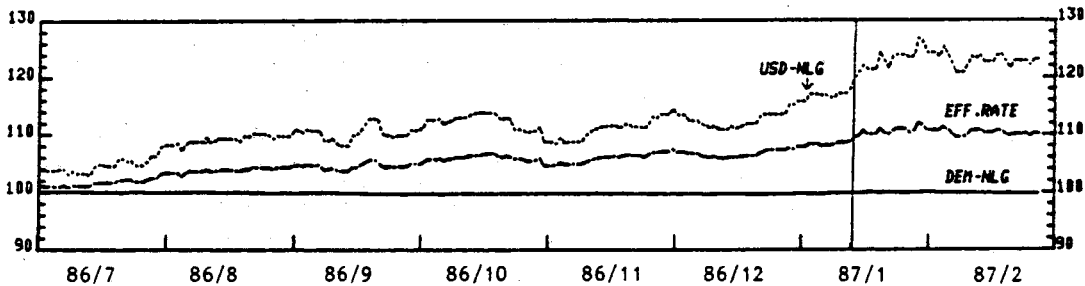
POSITION IN THE BAND



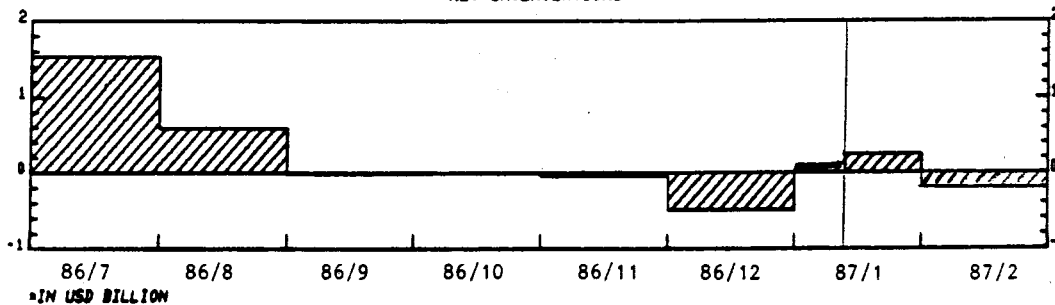
INDICATOR OF DIVERGENCE



EXCHANGE RATES (INDICES 7/4/86 - 30/4/86 = 100)



NET INTERVENTIONS*



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

GROUP OF EXPERTS UNDER THE CHAIRMANSHIP OF Mr. DALGAARD

List of Participants

Chairman	H. Dalgaard
Banque Nationale de Belgique	H. Bussers J. Michielsens
Danmarks Nationalbank	H. Fosgaard O. Jensen
Deutsche Bundesbank	P.-E. Fischer-Erlach K. Weber A. Müller
Bank of Greece	P. Pliatsikas N. Karamouzis
Banco de España	L. Linde G. Gil
Banque de France	B. Marillia J.P. Redouin
Central Bank of Ireland	B. Daly T. Grimes
Banca d'Italia	F. Saccomanni S. Vona
Nederlandsche Bank	J.W. Brockmeijer A.F.P. Bakker
Banco de Portugal	J. da Costa Pinto A. Domingues
Bank of England	T. Smeeton I.M. Erskine
Institut monétaire luxembourgeois	J. Guill
Commission of the European Communities	A. Louw J. Bozzi
Secretariat of the Monetary Committee	R. Barthélémy
Agent for the EMCF	J.C. Dagassan
Secretariat of the Committee of Governors	A. Bascoul H.K. Scheller N.K. Cook

The group held two meetings: on 16th and 17th February 1987, and
on 2nd and 3rd March 1987.