
ORAL PROGRESS REPORT
BY THE CHAIRMAN OF THE COMMITTEE OF GOVERNORS
TO THE ECOFIN COUNCIL
ON THE STRENGTHENING OF THE EMS

Since the informal meeting of the ECOFIN Council of 4th April 1987 at Knokke, the Committee of Governors has continued its examination of the functioning of the EMS and of the monetary implications of the full liberalisation of capital movements within the EEC with a view to strengthening the system.

The Governors intend to present a final report on the matters falling within their competence at the next informal meeting of the ECOFIN Council in September that will take account of the two reports mandated to their experts, which have now become available.

In the meantime, I would like to give some indications on the work under way and on some guidelines for strengthening the operating mechanisms of the EMS.

Views on the management of the EMS have converged in recent years. In particular, since the January 1987 realignment, broad agreement is emerging on methods of dealing with currency flows. To this end, central banks will need to use all the monetary instruments available to defend the cohesion of the EMS without endangering the control of monetary aggregates. In particular, it is recognised that: (i) there is scope for prompter and better co-ordinated action in the use of short-term interest rates with the aim of ensuring appropriate differentials; (ii) exchange rates should be managed more flexibly within the band to maintain the perception of exchange risk among market participants; (iii) there is room for closer co-ordination of intervention policies, particularly vis-à-vis third currencies. Indeed, in recent months there has already been a tendency among the central banks concerned to operate within such a framework.

The Governors are aware that co-ordination of central bank action is all the more important both because international payments imbalances still represent a threat to EMS cohesion and because the mobility of capital has increased in the EEC. The progressive abolition of exchange controls will tend to reinforce the external constraint that the exchange rate mechanism already imposes on interest and exchange rate policies of the participating countries. Beyond ensuring that member countries do not follow conflicting monetary and exchange rate policies, co-ordinated policy action could sometimes involve differentiated operational responses so as to increase the ability of the system to resist disturbances.

The Governors agree that the first step towards implementing such a strategy would be to improve multilateral surveillance, with the aim of receiving early warning of disturbances in the markets. The reinforcement of co-ordination could be sought through a monitoring procedure that would build upon present surveillance and concertation arrangements and would focus more specifically on developments in exchange rates and money market conditions.

The Governors intend to implement such strengthened co-ordination as flexibly as possible. When tensions are clearly temporary, the measures taken should be easy to reverse when they subside. In no case should such measures of a short-term nature involve a sustained departure from a policy course consistent with monetary stability in the medium term.

However, enhanced co-ordination is not sufficient to achieve the main objective of the EMS, i.e. a zone of internal and external stability; better economic convergence, which includes close co-ordination of overall economic policies, becomes even more necessary.

The Governors are also examining proposals to strengthen the EMS through possible amendments to the mechanisms falling under their competence.

A number of proposals have been put forward concerning in particular: (i) the rules of the very short-term financing of interventions; and (ii) the reduction or abolition of the acceptance limit for the official ECU. Within this context consideration is also being given to the extension, subject to certain conditions, of very short-term financing to intramarginal interventions in EMS currencies and to holdings of Community currencies by member countries.

In addition, the Governors intend to examine proposals to establish a link between the official and the private ECU circuits as part of the broader issue of improving the features of the official ECU and increasing its usability.

On some of these proposals progress has been made. On others no consensus has yet been reached.

As I have already mentioned, the Governors will return to these issues, some of which could raise problems for domestic monetary policy, together with the whole range of questions concerning the strengthening of the EMS and the monetary implications of the liberalisation of capital movements, in the report they plan to present to the Ministers at the next informal ECOFIN meeting in September.