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

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OUTLINE OF SEPTEMBER REPORT TO INFORMAL ECOFIN

I. INTRODUCTION

II. ANALYSIS

1. New features of the economic environment

- (a) increased convergence, notably of inflation rates; however, full convergence has not been achieved in a number of areas;
- (b) weak dollar: how it affects EMS;
- (c) increased capital mobility and integration of financial markets;
 - less room for independent course of monetary policy,
 - increased dangers for EMS cohesion of inconsistent/divergent monetary policy courses.

2. Functioning of EMS arrangements

- (a) working of the System on the whole satisfactory, but: excessive emphasis on interventions under pressure; insufficient use of interest rate differentials, sometimes rigid defense of exchange rates; lack of co-ordination in responses to external shocks;
- (b) interventions;
- (c) financing mechanisms;
- (d) monetary policy co-ordination.

3. Main conclusions of analysis

- (a) increased likelihood of financial shocks, of a short-term nature, owing (i) to developments in the dollar; (ii) to the continuing need for some time for central rates realignments;

- (b) increased costs/risks of unco-ordinated policies/policy responses for EMS cohesion;
- (c) need for further reduction of inflation differentials and convergence of fundamentals as a way of progressively eliminating the recourse to realignments.

III. POLICY RECOMMENDATIONS

1. Economic convergence; medium-term monetary targets geared to reducing inflation differentials; supportive policies in other areas.
2. Need for fuller use by each country of available monetary instruments to maintain EMS cohesion, also because of possible external shocks; more co-ordinated use of these instruments.
3. Appropriate policy response should be assessed within a strengthened joint monitoring procedure
 - of internal EMS developments;
 - of third currencies' developments and effects on the EMS.
4. Adaptation of EMS procedures and operational mechanisms.
 - (a) realignment procedures: realignments small and less predictable; less frequent;
 - (b) co-ordination of interventions; greater willingness to accept in the very short-run the domestic monetary consequences of interventions;
 - (c) financing of interventions: access to VSTF for intramarginal interventions; use of the ECU (acceptability); holdings of Community currencies.
5. Implications of liberalisation of capital movements for credit mechanisms: duration and quotas for renewal of VSTF, size of STMS and debtor quotas; other (?).

6. Recognition of foreign currency status for the ECU. Issues raised by a possible link between the official and the private ECU.

7. Full participation in EMS exchange arrangements by all members(?).