

MONETARY COMMITTEE
OF THE EUROPEAN COMMUNITY

Brussels, 8 October 1990.
II/368/EN

**THE MONETARY COMMITTEE'S DELIBERATIONS
LEADING TO THE INCLUSION OF THE POUND STERLING
IN THE EXCHANGE RATE MECHANISM**
(Report to ministers by the Chairman)

Following the established procedure, the Monetary Committee prepared the decision taken by the Ministers and Governors on 6 October 1990 on the entry of the pound sterling into the exchange rate mechanism of the EMS.

All members welcomed the British decision, which makes the EMS very much more representative of the Community and marks a significant advance in the economic and monetary integration of our countries at the outset of Stage 1 of economic and monetary union.

There was general regret that the British government had announced publicly on the previous day the proposed central rate and margins of fluctuation. Respect for established procedures is all the more important now that the exchange rate mechanism has been enlarged.

There was considerable debate in the Committee about the central rate which would be appropriate for the British pound. Some members argued that a relatively high rate would strengthen the disciplinary effect of the decision and would perhaps make the management of the EMS somewhat easier in the period immediately ahead. Others pointed out that considerations of competitiveness would point to a rather lower rate. On balance, and given that a proposed rate had already been announced, the Committee was led to recommend that rate.

The Monetary Committee was in favour of allowing 6% fluctuation margins for a transitional period. The reasons for this are the following

- the convergence of the UK economy on best performance in the Community is not yet satisfactory ;
- the availability of a wide margin will make it easier to follow the high interest rate policy which is needed in the UK at present ;
- sterling is a major currency in the international markets and especially susceptible to the influence of large movements of sentiment in them ;
- the UK's position as a net oil exporter may result in unusual pressures in present circumstances.

These factors suggested to the Committee that wider margins would smooth the incorporation of the pound in the mechanism. However, it must be emphasized that this arrangement must be seen as transitional and that margins of 2.25% must be adopted before long as part of the United Kingdom's efforts to converge.

The British government's statements show its awareness that ERM participation is in no sense a "soft option". The figures show that the UK still has a worryingly high rate of inflation and a large current balance-of-payments deficit. British participation in the ERM can be beneficial only if the fundamentals are put right. The government's policy stance is restrictive at the moment and monetary aggregates point in the right direction ; the Committee was of the opinion, however, that fiscal policy should make a stronger contribution to the policy mix and that the present high rate of wage increases must, by one means or another, be brought down. It is for this reason that we introduced a specific sentence about the need for an appropriate policy in the Communiqué.

There are also implications for the other participants in the ERM. Particularly if the pound sterling rises towards its upper limit in its initial period in the mechanism, the participants with relatively high inflation rates have to stand ready to tighten their policies, including monetary policies.

The incorporation of the pound sterling in the ERM has wider international implications. It increases the attractiveness of the System. The question of the association of other European currencies, notably those of Scandinavia, was referred to in our session. At your meeting at Ashford Castle, ministers discussed this problem and decided not to make any move before the calling of the Intergovernmental Conference on EMU ; undoubtedly the issue will have to be addressed with some vigour in the near future. There is information that the Norwegian government is considering the possibility of linking its currency to the Ecu.
