

File
E.M.

HARD ECU

You mentioned the other day the mechanism which would ensure that the issue of hard ecus would not add to the money supply. Could I clarify the position. You need to distinguish:

- i. the liabilities of the European Monetary Fund (EMF), which can be thought of as the central bank of the non-existent Eculand;
- ii. ecu deposits with commercial banks around the Community.

The liabilities of the EMF will be of three kinds:

- a. Commercial banks will be required to deposit with the EMF a small proportion of the ecus deposited with them, perhaps half a per cent. These are equivalent to the operational deposits which banks in this country keep with the Bank of England. Their purpose is to provide a float for clearing deficits and shortages between the banks. The fact that banks need to keep these deposits up to a certain minimum level gives the central bank leverage in operating in the money markets.
- b. Ecus deposited directly with the EMF by customers. There is no equivalent of this with the Bank of England as it now operates almost entirely in a wholesale way, dealing only with other banks. As the ecu market develops, the EMF might withdraw to a wholesale role.
- c. National currencies deposited with the EMF by banks who buy ecu notes and coin to be supplied to their customers.

The sum of a + b + c is in effect the monetary base or MO of Eculand. The provision that ecus cannot be issued unless national currencies are withdrawn applies only to (c) as this is the only point at which there is a direct exchange between ecu and national currencies.

Ecu deposits with commercial banks will grow at the rate at which the market determines. Such deposits will be many times larger than the liabilities of the EMF in the same way that M4 is many times larger than M0. There is no requirement that ecu deposits can be created only if an equivalent amount of deposits in national currency is cancelled. The safeguarding of the non-inflationary ecu is provided by the EMF's duty to ensure that the ecu cannot depreciate against other Community currencies. If ecu deposits are expanded too fast, the ecu will begin to sag against other currencies and the EMF will be required to raise the ecu interest rate. This will increase the demand for ecu assets and reduce the supply of ecu liabilities and ecu credit as fewer people will want to borrow in ecus.

Pages 3 and 4 of the article the Treasury published recently on the hard ecu explain these points further. You may like to look at the whole piece which explains:

- what the hard ecu is;
- how it helps to ensure low inflation conditions;
- how the hard ecu might develop from a common currency towards a single currency.

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