

PROCEDURE FOR DETERMINING THE IRREVOCABLE CONVERSION RATES FOR THE EURO

The determination of irrevocable conversion rates is one of the cornerstones of a monetary union. In accordance with the Treaty on European Union, the conversion rates for the euro were irrevocably fixed on the first day of Monetary Union **on 1 January 1999**. However, the Ministers for Economic and Financial Affairs and the Governors of Central Banks had already announced on 2 May 1998 the bilateral conversion rates of the currencies participating in the euro area (1.). The bilateral rates between participating currencies and the euro conversion rates were irrevocably fixed on 1 January 1999 (2.).

1. On 2 May 1998, the monetary authorities announced the bilateral rates to be used in determining the irrevocable conversion rates on 1 January 1999

Meeting in Mondorf (Luxemburg) on 12 and 13 September 1997, the Finance Ministers and Governors of Central Banks of the 15 EU Member States decided that:

- the authorities **would first announce** the bilateral rates, which would then be irrevocably fixed on 1 January 1999,
- this announcement would be made in spring 1998, in parallel with the drawing up of the list of countries participating in Monetary Union on 1 January 1999.

1.1. Institutional provisions

According to the Treaty on European Union, the irrevocable conversion rates for the euro cannot be fixed at a date other than 1 January 1999. The monetary authorities are not, however, prohibited from providing economic agents with early information on the functioning of Monetary Union, by means of a formal declaration constituting a political commitment.

It appeared logical to make this announcement in parallel with the one concerning the list of countries participating in the single currency, at the European Council meeting of **1-2 May 1998**.

It is worth pointing out that the announcement referred only to **the bilateral rates of the currencies participating in Monetary Union**. The euro conversion rates could only be calculated, and therefore published, at the end of 1998. Indeed:

- the final conversion rates for the euro would depend on the fluctuations of the ECU basket throughout 1998 (on 1 January 1999, the ECU was replaced by the euro at the rate of 1 to 1),
- the ECU basket included currencies that were not participating in Monetary Union as from 1 January 1999, i.e. the Danish krone, the Greek drachma and the pound sterling.

1.2. Objectives of the pre-announcement of bilateral rates

This pre-announcement of the bilateral rates **contributed to reducing uncertainties**.

- it stabilised expectations by providing market operators and all other economic agents with early information on the functioning of Monetary Union;
- it also served as a reference for conducting monetary and exchange rate policies until 1 January 1999.

This pre-announcement was therefore an additional stabilisation factor.

1.2.1. Foreign exchange markets continued to operate during the “interim period”

During the “interim period”, i.e. between the announcement of the list of countries participating in the single currency and bilateral central rates on 2 May 1998 and the start of Monetary Union on 1 January 1999:

- foreign exchange markets for euro area participating currencies continued to operate (this is no longer the case since 1 January 1999): exchange rates between these currencies were not fixed; the euro did not yet exist;
- Interest rates were not necessarily identical (since 1 January 1999, however, key rates and short-term rates have been harmonised);
- monetary and exchange rate policies remained within the remit of national authorities (the ESCB and the ECB only became in charge of monetary policy on 1 January 1999).

1.2.2. Stabilisation of exchange rates between euro area participating currencies during the “interim period”

Several factors played a major role in stabilising exchange rates between euro area participating currencies and speeding-up the **convergence of exchange rates towards announced rates**.

- the list of countries participating in Monetary Union was agreed upon; most exchange rates were already stable, even before this **major decision** was taken;
- these countries were selected on the basis of their sustainable compliance with the **convergence criteria**;
- these countries continued to meet the exchange rate stability criterion: according to the Treaty, this stability is a means of testing a country’s capacity to relinquish its foreign exchange policy; **the stability requirement does not come to an end** once the decision on the participating countries has been taken;
- The **European Exchange Rate Mechanism** continued to operate;
- the **bilateral central rates** were decided on unanimously by all of the countries concerned and were announced: it was in none of the market participants’ interest to take a position different to the announced rate on 1 January 1999;
- the **coordination** of monetary and foreign exchange policies was strengthened: the ESCB and the ECB were set up shortly after the bilateral rates had been announced. The ECB immediately took over the tasks of the EMI, in particular monetary policy coordination. The strong interest rate convergence, which had started two years earlier, continued.

1.2.3. Stabilisation of exchange rates between euro area participating currencies and non-participating currencies

The fact that most non-participating countries have expressed their wish to join Monetary Union within a relatively short time horizon, and therefore meet **the exchange rate stability criteria, has contributed to stabilising the exchange rates with currencies participating in Monetary Union**.

It is worth pointing out that the currencies participating in Monetary Union account for the lion’s share of the ECU basket (83.7% at end-April 1998): during the interim period, this factor mechanically limited the amplitude of the potential variations in the ECU against the currencies participating in Monetary Union.

1.3. Contents of the pre-announcement

On 2 May 1998, the Finance Ministers and the Governors of the Central Banks of the Member States adopting the euro announced in a joint communiqué that the **ERM bilateral central rates**

would be used in determining the irrevocable conversion rates for the euro on 1 January 1999.

The ERM bilateral central rates fully met the requirements laid down in the Treaty for the determination of the irrevocable conversion rates.

- as the Finance Ministers and Governors pointed out, they were in line with the fundamentals of the economies concerned; this was an essential condition as the conversion rates would influence the economic relationships between the Member States participating in Monetary Union.
- they were very close to market rates, over a long time horizon. This was required by:
 - legal considerations (Article 123 of the Treaty ensures the “continuity of the external value of the ECU” during the changeover from the ECU to the euro. This provision implies the continuity of the value of the ECU basket – which is based on market rates – on 31 December 1998 and the value of the euro on the first day of Monetary Union. It is viewed as the continuity of this value against all other currencies, including the currencies in the ECU basket);
 - economic considerations (need to prevent any speculation concerning a possible “last-minute realignment” of exchange rates; there is a crucial difference between Monetary Union and monetary reform: the creation of Monetary Union does not generate any wealth effect – whether positive or negative – for the different economic agents or between countries).

Central Bank Governors also expressed their intention to ensure, if necessary through appropriate market techniques, the convergence between the pre-announced rates and the market rates on 31 December 1998, recorded according to the regular concertation procedure between central banks. The official ECU exchange rates calculated following the concertation on 31 December 1998 were used as the irrevocable euro conversion rates for the participating currencies. As required by Article 123 of the Treaty, the external value of the ECU, replaced on a 1:1 basis by the euro on 1 January 1999, was not affected.

This joint communiqué includes two appendices:

- a **parity grid** setting forth the irrevocable conversion rate for each pair of currencies participating in Monetary Union. **It only includes one bilateral rate (out of the two possible ones) for each pair of currencies** in order to avoid arithmetical inconsistencies stemming from inverse calculations, which could have increased the uncertainty as to the exact rate used for the determination of the irrevocable conversion rates. For each pair, the most widely used market rate was chosen.
- a **technical appendix** describes the procedure for calculating the irrevocable conversion rates (see 2.2).

2. Exchange rates were irrevocably fixed on 1 January 1999

Irrevocability means that exchange rates cannot vary as from 1 January 1999. On this date, the foreign exchange market between the national currencies of the Member States participating in Monetary Union disappeared and the ECU ceased to exist.

2.1. Institutional provisions

Article 123 of the Treaty provided for the decision to be taken:

- by the Council of the European Union (i.e. the ECOFIN Council) upon a proposal from the Commission and after consultation of the European Central Bank;

- **unanimously** by the Member States participating in Monetary Union on 1 January 1999.

The following rates were hence formally and irrevocably adopted on 1 January 1999:

- the conversion rates between the euro and the participating currencies (i.e. the rates at which the euro shall be substituted for the participating currencies);
- the conversion rates between participating currencies (i.e. the bilateral central rates pre-announced on 2 May 1998).

According to Council Regulation No. 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, conversion rates are expressed with six significant digits.

2.2. Procedure

The procedure for determining the irrevocable conversion rates for the euro on 1 January 1999 is described in the technical appendix attached to the joint communiqué of 2 May 1998.

The irrevocable conversion rates were determined according to the **usual daily concertation procedure between central banks**. On 31 December 1998 at 11:30 am, each central bank communicated the exchange rate of its currency against the US dollar to the other central banks. Each exchange rate was within the market bid-ask spread.

The bilateral rates obtained by crossing the respective USD rates recorded by the central banks of Member States participating in Monetary Union were equal, up to the sixth significant figure, to the ERM bilateral central rates announced on 2 May 1998.

The irrevocable conversion rates for the euro calculated on 31 December 1998 are as follows:

Austrian schilling	1 euro =	13.7603	ATS
Belgian franc	1 euro =	40.3399	BEF
Deutsche mark	1 euro =	1.95583	DEM
Spanish peseta	1 euro =	166.386	ESP
Finnish markka	1 euro =	5.94573	FIM
French franc	1 euro =	6.55957	FRF
Irish pound	1 euro =	0.787564	IEP
Italian lira	1 euro =	1936.27	ITL
Luxembourg franc	1 euro =	40.3399	LUF
Dutch guilder	1 euro =	2.20371	NLG
Portuguese escudo	1 euro =	200.482	PTE
Greek drachma *	1 euro =	340.75	GRD

* Rate determined on 31/12/2000 upon Greece's participation in Monetary Union.

In compliance with the legal framework for the use of the euro, the irrevocable euro conversion rate for each participating currency is the only rate to be used for conversions either way between the euro and the national currency unit.

The complete text of the joint communiqué of 2 May 1998 (including the parity grid and the technical appendix) is appended.