Box 5

CONVENTIONS AND PROCEDURES FOR THE EXCHANGE RATE MECHANISM II (ERM II)

The exchange rate mechanism II (ERM II) was introduced at the start of Stage Three of EMU, on 1 January 1999. This mechanism links the currencies of non-euro area Member States to the euro. By helping to ensure that the non-euro area Member States participating in the mechanism orient their policies towards stability, ERM II fosters convergence and thereby helps them in their efforts to adopt the euro. Participation in the exchange rate mechanism is voluntary for all non-euro area Member States. However, as ERM II membership is one of the convergence criteria for the eventual adoption of the euro, new Member States are expected to join the mechanism at some stage. The operating procedures for ERM II have been laid down in an agreement between the ECB and the non-euro area NCBs.

For the currency of each Member State participating in the mechanism, a central rate against the euro and a standard fluctuation band of ±15% are defined, in principle supported by automatic unlimited intervention at the margins, with very short-term financing available. However, the ECB and the participating non-euro area NCBs could suspend automatic intervention if this were to conflict with their primary objective of maintaining price stability. Exchange rate policy cooperation may be further strengthened, for example by allowing closer exchange rate links between the euro and other currencies in ERM II where, and to the extent that, these are appropriate in the light of progress towards convergence.

The following operating features of the mechanism are applied:

- For all the currencies of the non-euro area Member States participating in ERM II, the exchange rate for the bilateral central rate against the euro is quoted using the euro as the base currency. This means that for all currencies the exchange rate is expressed as the value of one euro using six significant digits. The same convention is applied for quoting the upper and lower intervention rates against the euro of the currencies of the non-euro area Member States participating in ERM II. The intervention rates are determined by adding or subtracting the agreed bandwidth, expressed as a percentage, to or from the bilateral central rates. The resulting rates are rounded to six significant digits;

- In order to reduce the settlement risk inherent in unlimited intervention at the margins, a payment after payment procedure is applied by both the ECB and the euro area NCBs involved in the intervention and may be applied by the non-euro area NCBs participating in ERM II;

- Under normal circumstances, both the ECB and the euro area NCBs will only conduct ERM II interventions between 9 a.m. and 5 p.m. Central European Time. Also, both the ECB and the euro area NCBs will not, under normal circumstances, intervene on the so-called TARGET holidays (i.e. 1 January, Good Friday, Easter Monday, 1 May, 25 and 26 December). Euro area NCBs may, in addition, observe other national holidays, while non-euro area NCBs may follow their own separate national holiday calendars.