Alain Naef (Banque de France) & Barry Eichengreen (UC Berkeley)
'Imported or home grown? The 1992-3 EMS Crisis'

Using newly assembled data on foreign exchange market intervention, we construct a daily index of exchange market pressure during the 1992-3 crisis in the European Monetary System. Using this index, we pinpoint when and where the crisis was most severe. Our analysis focuses on a neglected factor in the crisis: the role of the weak dollar in intra-EMS tensions. We provide new evidence of the contribution of a falling dollar-Deutschmark exchange rate to pressure on EMS currencies.

The 1992-3 crisis in the European Monetary System was a decisive event in Europe's monetary history. It underscored the fragility of pegged exchange rates between national currencies and, in so doing, reinforced the commitment of members of the European Union to complete the transition to monetary union.

One long-standing motivation for creating a single European currency was to free Europe from the thrall of the dollar. The 1992-3 EMS crisis, to the extent that it was attributable to dollar weakness, reinforced the perceived urgency of completing the task. This is not the entire explanation for the advent of the euro. But it is an important aspect.

We develop this argument about the role of the dollar in the EMS crisis with two types of evidence. First, we draw on primary and secondary sources to document that contemporaries were aware and concerned about dollar weakness and dollar-Deutschmark polarization. Second, we show that movements in the dollar-Deutschmark exchange rate explain a significant fraction of the pressure on EMS currencies in this period.

Our statistical analysis is based on new data on foreign-exchange market intervention by EMS central banks between 1986 and 1995, years spanning the crisis. We use them to construct daily measures of exchange-market pressure. This allows for greater precision in distinguishing sources of pressure on ERM exchange rates, compared to previous studies that used monthly or even lower frequency data and/or were forced to neglect foreign-exchange market intervention. Our data were assembled by European central banks on a confidential basis; we are able to access them because of a change in policy governing the delay in making available to researchers material in the British official archives, including those of the Bank of England, which shortened the period of delay from 30 to 20 years.