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August 26, 1994

WP/94/72
Correction 1

Subject: Determining the Value of a Financial Unit of Account Based
on Composite Currencies - The Case of the Private ECU

The attached title page of WP/94/72 (June 1994) is reissued to include the last two lines of footnote 1/, which were inadvertently omitted.

Att: (1)

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WP/94/72

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Research Department

Determining the Value of a Financial Unit of Account Based on
Composite Currencies: The Case of the Private ECU 1/

Prepared by David Folkerts-Landau and Peter M. Garber

June 1994

Abstract

Evidence from the past three years indicates that the exchange rate between the private ECU and the official ECU Basket can deviate substantially from par. The value of the private ECU is driven by expectations that a future European Central Bank will enforce par convertibility between the private ECU and the official ECU basket of currencies. Meanwhile, no existing institutional arrangement limits the private ECU's value in terms of the Basket. This paper addresses the question of what determines the values of the private ECU and of private ECU interest rates. We show that an anticipation of a future fixing of the private ECU's value, together with the interest rate setting mechanism of the large-value ECU payment and clearing system, are sufficient to determine its value. The determination of the private ECU exchange rate provides the template for how to determine the value of any private composite currency, such as, for example, a private SDR.

JEL Classification Numbers:

E42, E43, E58, F31

1/ This paper has benefitted from comments of participants at seminars held at the Research Department of International Monetary Fund, the Federal Reserve Board, Princeton University, University of Pennsylvania, Harvard University, the University of Chicago, the OECD, and the European Commission. We are particularly in debt to Bennett T. McCallum, whose comments helped us correct several errors in an earlier draft. The authors are grateful for information and data received from the Kredietbank N.V., the Bank for International Settlements, Eurostat, and the Bank of England. The views expressed are the authors' alone and do not necessarily represent the views of the International Monetary Fund. An early draft of this paper appeared as "The Private ECU: A Currency Floating on Gossamer Wings," NBER Working Paper No. 4017, March 1992.

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