

There may be some indirect effects on Canadian trade and financial markets from EMU impacts in Europe. However, as discussed earlier, there are divergent views on the direction and magnitude of these impacts, rendering analysis of these indirect effects inconclusive. The conclusion of this paper is that such effects will not be large.

### 5.1 Implications for Day-to-Day Monetary Policy and Exchange Market Operations

The main direct implication for *domestic operations* in Canada will be in the market intelligence we do and how to interpret it. A new market replacing the national money markets of Europe will require surveillance and understanding of its features. An interesting peculiarity is that there will be no central government debt market on which to base a risk-free yield curve. The terms on which the ECB will provide financing to national governments (ie. the sharing of seigniorage) will be more arms-length than it is now with national governments. While for Canada, the US market and Fed policy will continue to be the main focus, interpreting developments in the new euro market and the ECB will be important.

A second aspect of market intelligence is in understanding how the new central bank will implement policy and how it will respond to economic developments. The key targets and indicators will be the interest rate in the overnight market for funds and the central bank's discount rate, as they are with other market-based financial systems. One aspect will be easier - the ECB has a clear independent mandate for price stability in its legislation. Yet to be determined is what time horizon it will use, what its target bands might be, and what its intermediate targets (such as monetary aggregates) might be.

*Foreign exchange operations* (exchange market intervention) and domestic monetary policy are becoming more and more integrated. Canada has no set target for the Canada/US exchange rate and would not have one for the C\$/euro. Canada's intervention policy for the most part is limited to "leaning against the wind" by buying or selling US dollars to preserve orderly market conditions in times of turmoil. Canada must evaluate whether and how to intervene in the new currency, what share of the reserve portfolio would be appropriate to dedicate to euros, and exactly what type of euro denominated securities and deposits to hold in our official reserve portfolio.

While not a matter of day-to-day operations, G-10 borrowing arrangements to support countries experiencing exchange market crises and the very occasional G-7 co-ordinated interventions in exchange markets would no doubt include the ECB as successor to European central banks in these aspects of international monetary co-operation.

At times in the past, Canadian money and exchange markets have been affected by the spillover from financial market turmoil elsewhere. Should EMU be unexpectedly postponed or discord arise among the participants, which would lead to financial market turbulence, Canadian markets could be affected again. Some commentators have suggested that the market is overly optimistic about EMU. Should turbulence occur, given the positive mood in markets