

In practice, day-to-day monetary co-ordination occurs through the markets. Interest rates and exchange rates respond to economic data and the markets' perceptions and judgements of policy domestically and abroad. Policy makers adjust based on their objectives, knowledge about other central banks' policy regimes, their own economic projection scenarios, and the estimated response of the economy to various policy alternatives. A large new policy maker and a new set of financial and economic data will change the details but not the process of these arrangements. The euro is unlikely to challenge the US dollar as the benchmark currency until it demonstrates its stability, depth and liquidity, the ECB demonstrates its competence, and Europe itself demonstrates that its economy can adapt and adjust to a single currency and monetary policy.

An emerging issue in monetary policy is that of prudential supervision (eg. ensuring solvency of banks) and systemic risk. The single currency will highlight the question of EU-wide regulation of the financial sector, and the likely clash between the UK and the continental approach.

5. Implications for Canada

EMU will be a major landmark event for Europe and for world financial markets. Given the amount of publicity and the years of planning and official deliberations on the implementation of EMU, one looks for important implications for Canada. However, it is difficult to point to major specific direct implications for Canadian policy or economic performance. Before particular implications are discussed in this concluding section, some general reasons why EMU may pass without major direct implications for Canada are offered.

- Europeans have been trying to implement a more or less fixed exchange rate regime for many years, which is, broadly speaking, equivalent to a single currency zone. In policy approach, the ECB is likely to operate in similar fashion to the Bundesbank. EMU will just formalize more clearly the regime which the Europeans (sans the UK) have been moving towards.
- After a slow start, European banks and businesses are gearing up for EMU. Banks are most advanced in this, and are educating their business clients. The short run objective for a successful EMU will be to make it "transparent to the user".
- Financial markets are very innovative and flexible. One of the reasons Canada has an open and market-oriented financial system, including a floating exchange rate, is that it is able to accommodate and adapt to shocks such as EMU. The biggest EMU event in financial markets (more important than the formal implementation date of 1999) will probably be the designation of EMU participants in early 1998.