would be increasingly denominated in euro, as would bank clearing and the money market. It is not clear exactly how banks in Europe and abroad would regard long and short positions on their balance sheets in the national currencies during the transition: if they regard them all as euro, then there is no concern. But if one or more EMU participants were rumoured to be rethinking their participation, national European currencies might assume a separate identity again in markets. Exchange rates can remain "irrevocably fixed" only if major market participants regard them as so.

3. Bond Markets

A key feature in European bond markets at present is the convergence of national interest rates for the "in" currencies. Rates will converge to one level (abstracting from creditworthiness premia) on the implementation date - likely January 1, 1999. Eurobond market participants are fostering this process by arbitraging among markets based on "in" and "out" scenarios and among various currencies and the ecu, which will be exchanged 1-for-1 with euros.

A peculiar feature of the new "Euro-bond" market is that it will not have a benchmark issuer in the sense of a central fiscal authority issuing "risk free" securities across the yield curve. Instead it will have a spectrum of issuers of varying creditworthiness, none of which will have control over central bank finance - similar in appearance to the Canadian provincial bond market. London-based securities houses are hiring credit specialists to enhance their analytic capabilities in this area. There will be a ready supply of euro denominated securities as all outstanding bonds denominated in participating currencies will effectively be converted to euros[9] and "in" governments will be committed to issuing new securities in euro. As a result, the euro-bond market will be liquid and deep almost from the first days of operation.

After EMU, the London eurobond and money market will no doubt adapt quickly to the new currency, and euro denominated issues will be sold to the same groups of investors who had been buying securities denominated in the predecessor currencies. EMU will highlight the fact that much of the continent's financial intermediation will be taking place "offshore" in London, under a different regulatory regime. This might lead the continent to deregulate, hoping to repatriate this activity and attract international finance, or the UK might feel pressure to bring its regulation in line with the rest of Europe. This could become a pressure point within the EU over the next decade.

4. Stock Markets

Unlike bonds, which are traded over the counter, stocks are listed and traded on regulated national exchanges. Stock exchanges compete for company listings and trading

[9]There is a remote possibility of legal challenge to this on the part of bondholders who may argue that they contracted to be paid in a national currency. This challenge may be more important for derivatives; see below.