

the US Federal Reserve, the relative cyclical positions of the Europe and the US, and the perceived safety and stability of euro securities.

4.3 EMU and International Banking and Capital Markets

EMU should go a long way towards facilitating the maturation of European capital markets. It will highlight the need for more coherent EU-wide capital market regulation. There is little of direct relevance here for Canada, save to highlight the fact that although relatively efficient and well run, Canada's banking and capital markets are small in the global context and may be perceived as even more highly integrated with those of the US. Canadian borrowers and investors in Europe will need to monitor the evolution and development of the euro capital markets as part of their portfolio and debt management activities.

1. Money markets

The foundation of the euro money market has been laid with the planning for the ECB and ESCB. Its central bank discount rate will be the anchor for the term structure of interest rates in the new euro money and bond markets. This interbank market will begin operation immediately on the commencement of EMU. Governments will co-operate by issuing all new debt in euros; outstanding debt will be re-denominated. While Germany has begun to promote the development of its money market through the issuance of treasury bills, the likely UK absence from EMU will deny the euro money market the liquidity, the developed infrastructure, and the skills of the participants in the short-term sterling market.

2. Foreign Exchange Markets

The savings of 0.4% of GDP optimistically estimated by the EU from gains in efficiency from EMU means loss of jobs and revenues from exchange trading - resources which will eventually be productively employed elsewhere. It is interesting to consider where most of the job losses will be. London is the main centre of exchange trading, but most of its trading is between Europe and the US, not among the European currencies. On the continent, the situation is reversed - most trading is intra-Europe. So the job and revenue losses may be mostly in Europe.

There will be some gains from improved transparency and simplicity of transactions, mainly on the retail trade, travel, and tourism. It is not clear yet to what extent foreign trade invoicing might shift from the US dollar to the euro in Europe, which would relieve European producers of some short-term foreign exchange risks.

A rather long transition period is envisaged between the implementation date of EMU (Jan. 1, 1999) and the final issue of euro notes and discontinuance of national currencies. The question has arisen as to what type of exchange rate management might occur through this period. One would expect that for small transactions, banks would continue to quote a normal bid-offer spread around the "irrevocably fixed" exchange rates. Most large transactions