

speed Europe and the implications this will have for the single market. At present, opinions on balance weigh on the positive side that some form of EMU will begin on January 1, 1999.

A quantitative way to measure market sentiment about the likelihood of EMU is to track interest rate spreads against the Deutschmark over time. If EMU occurs on January 1, 1999, interest rates on "in" currency securities will be the same from that date forward (abstracting from credit differences). As the certainty about EMU has risen over the past year, interest rate spreads among potential "in" currencies have narrowed.

Financial markets are also pronouncing their opinions on the likelihood that various countries will join EMU. The local currency debt of countries expected to join EMU with certainty should exhibit similar yields after 1999 (abstracting from credit risk). Table 1 on the following page presents a notional grouping of European countries with their spreads off German interest rates in basis points (a basis point is one one-hundredth of a percent). The larger the spread, the less certainty is attached by the market to the subject country joining EMU.

The "core" countries in the table have small spreads against deutschmark securities (negative spreads in some cases are caused by liquidity premia and other institutional factors.) In spite of being well outside the Maastricht debt criterion, Belgium is expected to join EMU by virtue of its fiscal reforms, its declining debt/GDP ratio, and the key position of Brussels as the seat of the EU. Recently with Italy declaring its intention to be ready for EMU, rejoining the ERM, and taking steps on fiscal reform, the market's assessment of its chances for EMU participation have risen and lire spreads against deutschmarks have fallen from where they had been in the recent past. Relatively narrow spreads for Portugal and Spain corresponded to a period of enthusiasm about their participation.

Ironically, while the UK is one of the few countries which is close enough to the Maastricht criteria to qualify, it retains its right to opt out. The UK has not yet followed other European countries in making its central bank fully independent as required for EMU, and it remains outside the ERM.²

²With just less than 2 years until the beginning of EMU, both the UK and Sweden now have no chance of meeting a strict interpretation of the exchange rate criterion (2-year membership in the ERM prior to EMU). However given the potential for flexible interpretation of Maastricht, this may not be a problem.