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EMU: What It Is & How It May Affect You

On January 1, 1999, markets held their collective breath for a walk into the unknown—EMU and the changeover to the new "Euro" unit of currency. Never before have multiple nations vountarily surrendered their own currencies and sovereign powers over monetary policy. For those with an investment or business interest in Europe, following is a Q&A on the significance of this historic event.

What is EMU?

Whether you call it European Monetary Union or Economic and Monetary Union, EMU could be described as a 40-year political process now in its fiscal phase—the launch of a common currency within the European Union (EU). The goal of EMU has always been to create an integrated economic zone that would ensure the region's stability and prosperity for generations to come. Born out of war-torn Europe of the late 1940s and 1950s, those interests are alive and well today amid the ravages of globalization. EMU ushers in nothing short of a new economic and monetary order for European nations involved.

Who's In EMU & Who's Not?

Eleven countries are in the first wave of EMU: Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal and Spain. The second round of EMU admissions will probably occur in 2001. Greece is committed to gaining entry at that time. The United Kingdom and Sweden may conduct public referendums on joining by 2002. To qualify for EMU, countries must be a member of the EU and meet the financial terms set by the Masstricht Treaty of 1991.

Why is EMU Significant?

EMU's start could mark the biggest economic event in post-war history. The 11 countries, accounting for $6.8 trillion in aggregate size as measured by annual GDP, could make this the single biggest merger of all time.

The "Eurozone" has an economy virtually equal in size to the U.S., and larger population at 291 million. Although the equity markets of the Eurozone will be just 32 percent of the U.S. in aggregate value, its formation produces the world's second-largest equity market priced in the same currency, and the largest government bond market (20 percent bigger than the U.S. Treasury market).[1] This may set up a new asset class rival to the dollar and dollar-dominated assets that competes more successfully for global capital flows and central bank holdings. *This could have important implications for the dollar as a reserve currency of choice.*

How Does the Euro Affect Financial & Cash Transactions?

Effective January 1, 1999, stocks, bonds and all large financial transactions are quoted and transacted in the Euro. Physical cash transactions continue in the old national currencies until 2002 at an irrevocable locked rate of exchange to the Euro. Within the Eurozone, therefore, exchange risks no longer exist for businesses, consumers and investors.

Actual Euro notes and coins will not be introduced until January 1, 2002. All cash and consumer transactions will continue to be handled in the local currency (deutschmarks, francs, etc.) until then. By July 1, 2002, local currency will cease to be legal tender, being fully replaced by Euro notes and coins.

Will the Euro Be a Strong Currency?

In its first full year, the Euro could become the strongest major currency in the world, reflecting relatively supportive growth, interest rate and current account prospects for the EMU-11 bloc. The value of the Euro

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