MH CHEONG & ASSOCIATES
CERTIFIED PUBLIC ACCOUNTANTS

AROUND US

VOL.2
ISSUE 3
December 2000

THE EURO (AN UPDATE)

Introduction

The European Union ("EU") has been working towards the formation of a more closely integrated Europe. A single currency ("The Euro") was adopted since 1 January 1999 to create a more efficient single European market. The Euro will replace the currencies of the following eleven countries in the EU, namely Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal and Spain.

The Economic Monetary Union ("EMU") is essentially an integration of the monetary policies of the 15-member EU countries. The other three countries in the EU i.e. Denmark, Sweden and The United Kingdom opted not to be in the EMU while Greece had failed to qualify for the EMU membership.

Brief summary of EMU Development

Before 1 January 1999

Before 1 January 1999, the existing European Currency Unit ("ECU") was a basket of currencies of twelve countries, namely, Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain and the United Kingdom. On 1 January 1999, the ECU ceased to exist and was replaced by the Euro on a one-to-one basis; and the conversion rates between the EMU currencies and the Euro were irrevocably fixed.

1 January 1999 to 31 December 2001

To prepare the EMU member countries for the complete integration, there is a 3-year transition period from 1 January 1999 to 31 December 2001. During the transition, the Euro exists as means of payment between banks. The eleven EMU currencies will continue to co-exist with the Euro and in denominations of the Euro. The rule of "No Compulsion, No Prohibition" applies during the transition period. Under this rule, payment obligations in any of the EMU currencies can still be discharged in the EMU currency. In other words, no one is obliged to use the Euro during the transition period.

Banknotes and coins of the EMU currencies remain legal tender.

1 January 2002 and beyond

1 January 2002 is the latest date by which Euro notes and coins are issued. All transactions in the EMU currencies in the EMU countries are converted to the Euro.

By 30 June 2002, the legal tender status of the EMU currency banknotes and coins must be withdrawn. The change over to the Euro will then be completed.

Brief summary of exchange rate movement of the Euro

The Euro came into being as the official currency on 1 January 1999. However, the financial markets only opened on 4 January 1999 after the New Year holidays and the spot rate of the Euro against the US dollar actually hit a high of 1.22 on the day but closed at around 1.16. From that day on, the Euro never saw those levels again but went onward a downward spiral to reach a low of 0.82 against the US dollar.

In 1998, many analysts expected the Euro to play a major role in the financial markets, like the US dollar and the Japanese Yen. Many had predicted that investment opportunities in the newly created Euro economy would generate a large capital inflow – a scenario leading to a strong currency and calling for a tighter monetary policy. During that time, however, internal demand in Europe was quite low, doing little to confirm expectations of a coming boom. As it was, towards the end of 1998, monetary conditions in Europe were quite relaxed – and became even more so with the large interest rate cut in April. The expected large capital inflows never materialized. If anything, the flow of European foreign direct investment and portfolio investment abroad by Europeans – already sizeable in 1998 – continued to increase in 1999 and 2000. A combination of strong growth in the US and a relaxed monetary stance in Europe gave good reasons for investors to believe that, at least in the short-run, the Euro would not appreciate considerably vis-à-vis the US dollar.

With the stock markets booming in the US and the bullish hope of reforms in Japan, the Euro lost about 30% of its value to the greenback, reaching a low of around US$0.82 and 89 Yen in October 2000. However, a combination of factors helped turn the Euro just as analysts thought the downtrend would continue. A slew of softer economic data coming out of the US and Japan lately point to a strong possibility of economic stalling.

In the US, the growth was underscored by a downward revision of the gross domestic product data for the third quarter from the prior 2.4 percent to 2.2 percent. The signs of economy slow down had given the Euro a boost to above US$0.90 in December 2000, i.e. by more than 10% from its lowest point.

Over in Japan, the yen remained vulnerable, hamstrung by the weak economy data and steep losses in the Tokyo stocks. The Euro had soared to a ten-month peak above 105 Yen in December 2000.

Conclusion

The introduction of a single currency and a common monetary policy was expected to lead to the removal of trade barriers among the EMU member countries. Being the single European currency, the Euro may significantly reduce the foreign exchange risks and transaction costs. The creation of the Euro was expected to lead to greater economic integration and co-operation among the EMU member countries.

Some view that that Europe's economy would be best placed to withstand a slowdown in global economic growth. This view was reinforced after the European Central Bank said on 21 December 2000 that growth in the Euro zone would moderate but the "underlying dynamism of growth" prevailed.