MH CHEONG & ASSOCIATES
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THE EURO

Introduction

The European Economic Community, now known as the European Union ("EU") has always wanted to work towards the formation of a more closely integrated Europe. The European Economic Monetary Union ("EMU") is essentially an integration of monetary policies of the 15-member EU countries. A single currency will be adopted for the EMU member countries to create a more efficient single European market in Europe. The **Euro** is the name of the single currency that will replace the currencies of the EMU member countries.

At this stage, the eleven EU countries in the EMU are Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal and Spain.

Denmark, Sweden and the United Kingdom opted not to be in the EMU while Greece has failed to qualify for EMU membership.

The EMU has announced bilateral exchange rates locking the Deutsche Mark to the other ten national currencies. These conversion rates are announced to minimize speculation in the eleven EMU currencies before the launch of the Euro on 1 January 1999. EMU member countries will review these bilateral rates and irrevocably fix their exchange rates to the Euro on 1 January 1999. It is to note that the conversion rates between the Euro and the eleven EMU currencies are not known as yet.

There will be a 3-year transition period from 1 January 1999 to 31 December 2001 to prepare the EMU member countries for the complete integration. During the transition, the Euro will exist as means of payment between banks.

Physical Euro notes and coins will only come into circulation on 1 January 2002 and by 1 July 2002, the Euro will completely replace the eleven EMU currencies. Until then, 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" will apply during this transition period. Under this rule, payment obligations in any of the EMU currencies can still be discharged in the EMU currency, unless both paying and receiving parties agree to use Euro. In other words, no one is obliged to use the Euro during the transition period.

Impact Of The Euro On Business

The introduction of a single currency and a common monetary policy is expected to lead to the removal of trade barriers among the EMU member countries.

Since the conversion rates of the eleven EMU currencies to the Euro will be irrevocably fixed on 1 January 1999, there will be significant savings in foreign exchange for individuals and corporations in the EMU countries as foreign exchange risks and transaction costs are eliminated.

Effects Of Implementing The Euro On The Following:-

- ***Stocks/Bonds***

All stock exchanges in the eleven EMU member countries will quote prices in Euro from 1 January 1999. Trade settlements will also be in Euro.

Outstanding government bonds in the eleven EMU currencies will be converted to Euro on 1 January 1999 with new government bonds issued in Euro only.

Corporate bonds issued in the eleven EMU currencies may be converted to Euro during the three-year transition period at the pace of the issuing party.

- ***Spot And Forward Contracts***

During the three-year transition period, foreign exchange (both spot and forward) can be transacted in any of the eleven EMU currencies or in Euro.

Forward contracts entered into before 1 January 1999 will be settled in the respective EMU currencies indicated in the contracts unless there is bilateral agreement to settle in Euro. Outstanding contracts with extensions granted will be executed in the original EMU currency until 31 December 2001. However, this is subject to approval by the bank. Thereafter, all such transactions will be denominated in Euro.

. ***Existing Foreign Currency Current Account Denominated In The Eleven EMU Currencies***

During the three-year transition period, there is a choice to:
(a) Maintain the existing balances in the Foreign Currency Current Account in any of the EMU currencies*
(b) Open a new Euro Foreign Currency Current Account to facilitate payments in Euro, while continue to maintain the existing Foreign Currency Current Account in the EMU currency.*
(c) Convert the EMU currency balances to Euro.

* As the transition period for the eleven EMU currencies ends on 31 December 2001, any outstanding EMU currency balances maintained in the Foreign Currency Current Account will be converted to Euro on 31 December 2001.

. ***Existing Foreign Currency Fixed Deposit ("FCFD) Denominated In The Eleven EMU Currencies***

During the three-year transition period, the existing FCFD may be maintained in any of the eleven EMU currencies.

Upon maturity of the fixed deposits during the three-year transition period, there is a choice to:
(a) Renew them in the EMU currency.
(b) Convert the EMU currency fixed deposits to Euro.

Until the conversion of EMU currency FCFD to Euro, interest will continue to be earned on the FCFD in the respective currencies. If the maturity date of the FCFD falls after 31 December 2001, the contracted interest rate will apply until the deposit matures.

On and after 1 January 1999, the interest rates for the eleven EMU currencies are expected to converge and be replaced by a single new interest rate set by the European Central Bank.

. ***Existing European Currency Unit ("ECU") Currency And FCFD Denominated In ECU***

The existing ECU is a basket of currencies of twelve countries, namely, Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain and the United Kingdom. In the European Monetary System ("EMS"), the ECU is used as a basis for setting central rates in the exchange rate mechanism and means of settlement among EMS central banks.

On 1 January 1999, the ECU will cease to exist and will be replaced by the Euro on a one-to-one basis.

Summary of EMU Development

Here is a brief summary of the EMU development:-

<u>1 January 1999</u>
. The Euro becomes a currency.
. Existing ECU convert to the Euro on a 1:1 basis.
. Conversion rates between the EMU currencies and the Euro are irrevocably fixed.

<u>1 January 1999 – 31 December 2001</u>
. No compulsion and no prohibition over the use of the Euro.
. Banknotes and coins of the EMU currencies remain legal tender.

<u>1 January 2002</u>
. Latest date by which Euro notes and coins are issued.
. All transactions in the EMU currencies in the EMU member countries are converted to the Euro.

<u>30 June 2002</u>
. Change over to a single currency completed.
. Latest date for withdrawal of legal tender status of the EMU currency banknotes and coins.