History Of Bouncing Euro Essay, Research Paper

Brief History and Implementation Schedule

On January 1, 1999, eleven European countries replaced their national currencies and introduced a single European currency, the Euro. Some feel the euro is simply the ECU (European Currency Unit) renamed since the ECU’s were exchanged one-for-one for new euros. Bills and coins for the national currencies will remain in circulation as sub-denominations of the euro until January 1, 2002, (”E-day”) when they will be exchanged against new euro coins and bills. Within six months, national currencies will be completely replaced with the euro notes and coins. However, all inter-bank commerce and stock exchange trade is now denominated in the official currency.

There has been some discussion about when “E-day” should take place. Many merchants feel that January 1st is too close to the holiday season (a high cash-circulation time of the year). The merchant’s feel it will add to the confusion of the consumers and would like the date move to February or March of 2002.

On November 8th, 2000, European Union finance ministers agreed to eliminate the currencies of the 11 member nations four months ahead of schedule, leaving banks, businesses and consumers just two months to change over to Europe’s common currency.

Now, German marks, French francs and other old currencies will meet their demise

March 1, 2002 — two months after the introduction of euro cash. The changeover had been set for July 1, 2002. The move aims to minimize confusion during the transition.

Pros and Cons of a Single European Currency

There were many arguments for and against a single European currency. Some of the arguments in favor of a single European currency include:

Transaction Costs. Eliminating converting from one currency to another will benefit businesses as well as tourist.

No Exchange Rate Uncertainty. A single currency eliminates the risk of unforeseen exchange rate revaluations or devaluations.

Transparency and Competition. The direct comparability of prices and wages will increase competition across Europe, leading to lower prices for consumers and improved investment opportunities for businesses.

Strength. The new Euro will be among the strongest currencies in the world, along with the US Dollar and the Japanese Yen. It will soon become the second most important reserve currency after the US Dollar.

Capital Market. The large Euro zone will integrate the national financial markets, leading to higher efficiency in the allocation of capital in Europe.

Some of the arguments against the use of a single European currency include:

Cost of Introduction. Businesses will have to convert all prices and wages into the new currency. This will mean modifications to applications that include accounting, payroll, price list, etc.

Fiscal Policy Spillovers. Individual countries that increase their debt will raise interest rates in all other countries.

No Competitive Devaluation. In a recession, a country can no longer stimulate its economy by devaluing its currency and increasing exports.

With these and other pros and cons explained in detail, the eleven members still decided that it was in their best interest to implement a single European currency.

Participating Countries

The eleven participating countries are Belgium, Germany, Spain, France, Ireland, Italy, Luxembourg, Netherlands, Austria, Portugal, and Finland. On May 3rd, 1998, these eleven member countries irrevocably agreed to fix their exchange rates based on the ECU rate as of December 31, 1998. See Appendix A for a chart of the agreed upon exchange rates.

The European union is made up of fifteen countries. In addition to the eleven participating countries Britain, Sweden, and Denmark decided not to participate. Greece did not meet the Maastricht criteria at the time but has subsequently qualified and will be joining the Euro group as the 12th member on January 1, 2001.

The Government of Great Britain would like its citizens to consider converting to the euro. They know, however, that if they would place a referendum on the ballot at this time, they would not be successful. Some of the banks in Great Britain are supporting web sites that are trying to convince the people that the euro is bad for their country. I feel Great Britain has decided to take a wait and see attitude. If the euro turns out to be successful, then they will jump on board.

Leaders and Membership Criteria

In a compromise deal, Wim Duisenberg became the first head of the European Central Bank (ECB), but will retire after four years to make way for Jean-Claude Trichet, who is currently head of the French central bank. The regular office period for the ECB governor is eight years. The French were favoring Trichet, while the other European countries were supporting Duisenberg. Both have impeccable credentials as string central bank governors.

A country must meet the five criteria of the Maastricht Treaty to become eligible to join the euro member nations. The criteria are:

Price Stability. A country’s inflation rate must not exceed the average inflation rate of the three best performing member states by more than 1 + percent.

Fiscal Prudence. A country must not exceed either of the following two reference values relative to its gross domestic product at market prices:

A – 3 percent for the ratio of the planned or actual government deficit to GDP.

B – 60 percent for the ratio of government debt to GDP.

Successful EMS Membership. A country must have stayed within the normal fluctuation margins provided by the Exchange Rate Mechanism of the European Monetary System for at least two years without devaluing against the currency of any other member state.

Interest Rate Convergence. A country must have had an average nominal long-term interest rate that does not exceed by more than two percentage points that of the three best-performing member states in terms of price stability.

Symbol & Forms of Currency

The dollar, the pound and the yen all have symbols to represent their currency. is the new symbol that has been created for the euro. Microsoft and Adobe already have the symbol available for download from their websites.

One euro corresponds to 100 euro-cents. The coins will consist of: 1 Euro Cent, 2 Euro Cent, 5 Euro Cent, 10 Euro Cent, 20 Euro Cent, 50 Euro Cent, 1 Euro, and 2 Euro. The paper bills will consist of: 5 Euro, 10 Euro, 20 Euro, 50 Euro, 100 Euro, 200 Euro, and 500 Euro.

Current Status

Europe’s single currency is now 22 months old. In almost every one of those months its value has fallen on the foreign-exchange markets. It hit another new low against the Dollar on October 25th, of just below 83 cents, 30% below the rate at which it started life. Occasionally, it has managed a tentative step upwards – but this has invariably been a prelude to a further two steps down.

Lately, however, there have been a few more solid signs of improvement. The euro was helped away from its latest nadir by evidence that the American economy may be slowing, and by hints from officials in both America and Europe that they might repeat September’s foreign-exchange market intervention, which bought the currency a couple of weeks’ respite.

The Euro in a Global Market

Saddam Hussein, of all people, is doing his bit by insisting that Iraq be paid for its oil exports in euros instead of the “devil’s gold” (US dollars).

The principal force pushing the Euro down against the Dollar has been the belief of investors everywhere, including in the euro-area countries, that fast growing America is a better place in which to stick their money than tired old Europe. Foreign firms still regard America as the place to be, not only for its economy but for its laws, taxes and institutions make corporate purchase much more attractive and simpler to do than in the euro area.

There remains a great deal of euro-pessimism in the markets. “The Euro turned out to be a failed initial public offering,” says Rudi Dornbusch (an economist at the Massachusetts Institute of Technology), accusing it of the ultimate crime in today’s market.

The sinking euro has been particularly hard on small companies that do business with countries in the ‘euro zone.’ Many U.S. companies are feeling the impact of the euro’s decline. “It absolutely prohibits us from having any business in Germany,” Thomey (a logging/sawmill entrepreneur) said of the exchange rate. In addition to Germany, their company’s revenues in five other European countries have also seen a downturn.

Two Minnesota firms — Automatic Products International in St. Paul and Partridge River in Hoyt Lakes — are examples of other small businesses that have seen their European sales decline significantly since the euro’s introduction.

Losing market share has been the most significant impact of the exchange rate for these companies. Because European revenues did not comprise a major portion of their total sales, the firms used emerging markets elsewhere and domestic growth to offset declines.

The euro’s downturn has affected smaller firms more dramatically than larger corporations, which have more options for absorbing losses in European markets. For example, larger firms can trade in euros or use hedging — attempting to offset a currency’s decline by buying up other currencies — to help them handle a volatile exchange rate. Many small companies do not have that ability. Unable to reduce prices by much, they often find themselves left out of the potentially profitable European economy.

The Euro and the United Kingdom

Although the UK was not one of the 11 European countries that adopted a single currency on January 1ST 1999, many businesses (small as well as large) are now beginning to feel the impact of the euro on how they do business. Not all businesses will experience that impact at the same time or to the same degree. Businesses directly exporting to, or importing from, euro zone countries are likely to have the most urgent need to consider what action to take.

But, increasingly, others (for example, those in the retail and tourism sectors or those who are in supply chains which have “euro users”) will also need to assess the implications of the euro for their business.

With the insistence of waves beating on the shore, European economic technicians have been reassuring the world with the message that, in the context of fundamentals, there is nothing wrong with the euro at all.

The Last Two Months of Propping Up the Euro

On September 22nd, 2000, the ECB, the U.S. Federal Reserve and the central bank of Japan all joined forces in a coordinated bout of intervention that spent as much as $10 billion to bolster the euro. This move briefly drove the currency above 90 cents before it resumed a downward spiral.

On October 5th, 2000, The European Central Bank unexpectedly raised interest rates for the seventh time in a year, striving to boost the euro and prevent its slide from fanning inflation in the eleven nations sharing the currency.

By making U.S. products cheaper for European buyers, a stronger euro could also create jobs in U.S. export industries whose sale in Europe have sagged. Likewise, it might boost the profits of U.S. companies whose European business has suffered under the cheap euro: a report by chipmaker Intel Corporation that euro problems would crimp its profits triggered a sell-off of technology stocks today.

October 25th, 2000, the euro reaches a record low of 82.86 cents. At this time, with the election less than two weeks away, the U.S. decided to refrain from joining the rescue efforts.

On November 2nd, when the European Central Bank left interest rates unchanged at 4.75%, as expected, it had blipped up, but only to around 86 cents.

On November 3rd, the euro ended the day almost unchanged at about 86 cents despite two efforts by the ECB to propel its ascent by buying euros with American dollars. The moves were undermined by the fact that the bank acted alone. The U.S. Federal Reserve and the central banks of Japan and Britain stayed out, limiting the amount of funds available and the psychological effect on currency traders.

On November 9th, the ECB acted alone for the fourth time is less than a week in another attempt to support the euro. The ECB, together with the central banks from its member countries, stepped in and bought common currency.

On November 17th, 2000, The European Central Bank walked a thin line between rising inflation and fragile economic recovery, deciding to keep its main interest rate steady and gamble that the euro will cling to its recent level of stability. Most economists had expected the ECB to stay its hand. Another rate hike could bolster the euro and dampen an inflation rate that has already burst predictions. But, economists warn, raising the cost of borrowing also might unnecessarily burden the region’s businesses as they struggle to match U.S. levels of economic growth.

It remains too early to make predictions about the outcome of the euro. The last two months have proven that we live in a world where capital cannot be forced to revalue against its will, and the marketplace cannot be artificially dictated to by politicians.

Summary

The future of the euro is still very uncertain, even though many economists feel it is undervalued by 20-30%. There is no surefire method for calculating a currency’s fundamental value. There are many factors that upset the euro further. Two very obvious United States factors come to mind. A win for George W. Bush might be bad for the euro, because Lawrence Lindsey, Mr. Bush’s main economic advisor, recently decried intervention. Also, fourth-quarter bounce in American growth would not be seen as favorable to the euro.

Conclusion

In the end, though, the euro’s fate rests with the American economy, and weather it is really slowing. Even if the currency has now hit bottom, that is not exactly a triumph for what was suppose to be the symbol of Europe’s arrival as an equal to the superpower across the pond.

Fixed Conversion Rate of the 11 Euro Members

Country Conversion Rate

Belgium 1 euro = 40.3399 Belgian francs (BEF)

Germany 1 euro = 1.95583 German marks (DEM)

Spain 1 euro = 166.386 Spanish pesetas (ESP)

France 1 euro = 6.55957 French francs (FRF)

Ireland 1 euro = .787564 Irish pounds (IEP)

Italy 1 euro = 1936.27 Italian lire (ITL)

Luxembourg 1 euro = 40.3399 Luxembourg francs (LUV)

Netherlands 1 euro = 2.20371 Dutch guilders (NLG)

Austria 1 euro = 13.7603 Austrian shillings (ATS)

Portugal 1 euro = 200.482 Portuguese escudos (PTE)

Finland 1 euro = 5.94573 Finnish marks (FIM)