Ⅳ. Korea Economic Focus

The Birth of the Euro

On January 1, 1999, the world will witness the birth of the euro in the third and final stage of Europe's monetary integration. Initially, eleven of the 15 European Union (EU) members are to be part of the newly emerged European Monetary Union (EMU), with the others possibly joining sometime in the future.

The emergence of the euro will have a profound impact on the global economy. To begin with, the combined economy of the EMU members or "Euroland" will rank as the world's second biggest in terms of GDP, and if the remaining four EU members are added, the new entity will even surpass the U.S. Furthermore, the members will account for 31.9% of the world's total trade, thus making Euroland the world's greatest economy.

The birth of the EMU will provide a strong boost to European stock markets, with the accelerated integration of the European stock markets, lower interest rates, more active portfolio investment in the other member markets, and substantial investment by pension funds. Euroland will account for 63% or the world's dollar-denominated bond market or 6 trillion dollars and will also rank second in terms of yen-denominated bonds.

The successful adoption of the euro should serve as a catalyst for the European economy thanks to the lower interest rates, price stability, and elimination of currency barriers and should ultimately boost the economic growth rate and increase employment among the EU members. In addition, the birth of the euro will enhance price transparency across the region.

The Implications for Korea

One important issue for Korea is how much of its public assets (foreign currency reserves) should be converted over to the euro. Beside the Eastern European nations, most nations do seem like they will convert a substantial part of their assets. China, for instance, has said that it will exchange about 20% of its reserves for euros.

While the euro should be stable in the long run, its short-term direction is unclear. At the end of this year, the dollar/euro exchange rate should be finalized at around 1.15~1.17. Forecasts for the first half of 1999 range from 1.10 to 1.23. Assuming that Korea converted 20~30% of its reserves (currently $46.47 billion) into euros, this possible currency exchange outcomes could vary from a gain of $500~700 million to a loss of $300~600 million. Given Korea's precarious financial status, it would seem appropriate to wait and see before committing a substantial portion of reserves.

What should Korean firms do? First, they should be aware that the European market will become even more important in the global market, both as a financial market and also as an export market, and make the necessary adjustments. With the common utilization of a single currency, the European goods market will expand and competition among firms will become even more fierce, and so Korean firms should reconsider their trade and investment plans for Europe.

Local subsidiaries and branch offices should be prepared to deal with how the new currency will affect many aspects of their business operations, such as employment and supply. Firms will have to reexamine their overall financial operations, particularly in terms of trade financing, raising capital, and project financing. Marketing strategies will also need to be altered given the changing market, along with distribution plans. And last but not least, firms and financial institutions will also need to work out the technical details in dealing with their European partners.

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