

The new Euro and Economic effects on non-Euro countries such as Israel
Aharon Shapiro, Ph. D. Professor of Economics, St. John's U., N.Y. City.
Academy of Business Conference, Barcelona, Spain, 7/13/99

Introduction

On January 1, 1999, Eleven European countries, Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal and Spain, adopted a single currency called the *Euro*. The eleven have been dubbed *Euroland*. No Euros will actually be minted or printed until Jan 1, 2002 at which time they will replace the local currencies. Until then present currencies will be used but also translated into fixed Euros for bookkeeping purposes. Most important, monetary policy is now concentrated in one European Central Bank.

The birth of the Euro has generated great hopes for a unified economic Europe. Optimism prevails despite the reluctance for the moment of 4 other European Monetary and Economic Union (EMU) countries, Britain, Sweden, Greece and Denmark to join the currency conversion.

This optimism arises from the potential power of an EMU that exceeds the USA in population and economic output. However, the events of the last 6 months are mildly discouraging. Two major countries, Germany and Italy are struggling to grow at an annual rate of about 1.5-%. France is growing at only about 2-%. By comparison, the USA at practically full employment grew in the last quarter of 1998 at an astounding 6.1%.and a boisterous 4.3% for the first quarter of 1999 (1)

This of course may explain the sharp drop of the euro/dollar exchange rate from \$1.18 at its inception on January 1, to its low of about \$1.03 on June 5, a drop of more than 12%.. Some analysts believe this could lead to Euroland inflation as dollar denominated imports to Europe (such as oil) could become more expensive. A resulting decline in imports from the USA could further upset the Americans who criticized European governments in the past for deliberately discouraging the buying of American goods. (2)

The following is an analysis of both beneficial and detrimental effects of the new Euro on Israel with probably similar consequences for other emerging nations.

Beneficial Effects

1) Growth of the Euroland economy will provide a larger market for Israeli. Europe is Israel's number one trading partner

2) Euroland will become a centralized capital market where Israeli companies and its government will be able to raise capital. This might also force down interest rates locally in Israel and stimulate local business investment...(3).

- 3) Israel will enjoy some savings in transaction costs and more simplified bookkeeping.
- 4) Israel despite its tiny population of 6 million, is remarkable in that it is the third in line after Canada and England among foreign countries raising money on Wall Street. Israel is a leader in new hi-tech products. The Euroland securities markets may now become an excellent alternative for new Israeli offerings.
- 5) European investors may find that interest rates are kept low by the European Central bank. Investors might seek out Israel's higher real rate of interest compared to Euroland as a target for placing investment funds. (4). Note that Israel is a member of GATT and sells duty free to both the USA and Europe. Investors in Israel can produce products that can enter duty free a market of 630 million consumers. (5)
- 6) Israeli hi-tech firms may capitalize on the opportunity to provide software and communications systems necessary for the currency change over
- 7) The Euro may become a de facto currency in Israel since enlarged Euro banks and larger securities fund managers may compete with Israeli banks and managers for financial services. Israeli hotels and tourist centers will be dealing more and more with Euro accounts. Euro prices are more transparent than the national currencies and will force Israel tourism to become more competitive.

Detrimental Effects

- 1) The euro will remove trade barriers between the Euroland nations, making for lower prices and greater transparency within Europe. Trade barriers, including currency differentials are now totally removed. This could make it more difficult for Israel and other non-Euroland to take advantage of former price differentials between the 11 countries to market their exports.
- 2) A stable euro will discourage former attacks on individual currencies within Euroland. This might encourage speculators to attack the more exposed non-European countries such as Israel. The Israeli shekel could become less stable.
- 3) The Treaty of Maastricht in 1991 laid down strict budgetary, monetary fiscal conditions for its membership in the EMU. Euro countries must keep a debt to GDP ratio not higher than 60% Israel's debt ratio stands at a high 111%. Israel would have great difficulty meeting requirements if it ever aspired to convert to the Euro.
- 4) Lower interest rates in the EMU will reduce the earnings of the Israeli government on its foreign currency reserves held in European banks...
- 5) With economic borders eliminated, Euro countries will engage in a wave of mergers to enable firms to produce on enlarged and more efficient scale of operation. This could make small scale Israeli firms less competitive.

What has happened since Jan 1, 1999

Over the last six months, the advent of the euro has produced somewhat less than a major revolution. The sharp drop in Euro/dollar rate of 12% has dampened some enthusiasm. It does seem that the less favorable euro/dollar rates have made sales to Europe by Israel and other non-European countries less rewarding in terms of dollars. Israel shekel values are very much geared to earning dollars.

On the other hand European investors may now be finding greater investment opportunities in fairly stable countries such as Israel which offers higher interest rates than Europe.

Some examples: Less than a month ago on June 10, 1999, The Israel government raised 400 million in Euro denominated bonds offer (about \$420 million). This was 100 million over its original plan. In fact there were bids for 600 million.

This is Israel's first Euro float and proved extremely successful. The 7-year bonds sold for a yield of only 4.91%. This was only 97 basis points over the benchmark French bond.. Standard and Poor, Moody's and Fitch have rated Israel as A3. The underwriters included, Deutsche Bank, Morgan and Stanley, Merrill Lynch, Goldman and Sachs, Warburg Dillon-Read, Daiwa and Paribas.

Israel is one of the first non-European governments to raise money in the new Europe. The bond sale was the fifth Israeli issue in Europe. Although, Israel had previously issued eurobonds in December 1996, these were dollar denominated and geared to be sold to eurodollar investors. This latest issue was focused on local European investors who invested with local European currency denominated debt in the past. Interestingly, the bonds were paid for in euros although sold in non-euro London. They were offered to 100 of Europe's largest institutional investors , including insurance companies and pension funds mainly in Frankfurt, Paris and London (6)

In June, Israeli based Sapiens International, a software firm, won a \$3 million euro-conversion project with Berlinische Levin, a German insurance company. This is in addition to a previous contract with the same German firm. Sapiens vice president stressed that Euroland has a high demand for his firm's products. (7)

Forsoft Inc. in Israel has developed a bugless Y2k program for bank conversions that it is marketing in Europe (8)

Conclusion

I admit that much of this essay involves considerable speculation about the impact of the euro on emerging nations. But I am no more conjectural than some doomsayers who believe that EMU itself can not survive given all the political, cultural and economic disparities. Six months of the Euro is much too short to conclude how the infant will grow. But at least this article may suggest some of the reactions for which we should watch in the future.

Endnotes

- 1) *N.Y. Times*, 3/3/99
- 2) *Wall St. Journal* 6/7/99
- 3) *Ha'aretz* (Israel Hebrew daily) 12/28/98
- 4) D. Gerstenfeld, *Jerusalem Post* (Israel English Daily) 1/8/99
- 5) <http://www.israel.org/mfa/go>
- 6) D. Gerstenfeld and E. Groner, *Jerusalem Post* 6/11/99, p. A-9
- 7) *Jerusalem Post* 6/9/99
- 8) *Israel's Business Arena* (Monthly) 4/22/99

Valued CustomerBC:\My Documents\AutoRecovery save of Euro and Economic effects.asd

Valued Customer A:\Euro and Economic effects.doc

Times New Roman

Times New Roman

Symbol

Symbol

Valued Customer

Valued Customer

Valued Customer

Valued Customer

dollar ratio has particularly

of the eleven nations carefully .

dollar ratio has particularly

of the eleven nations carefully .

Normal

Normal

Default Paragraph Font

Default Paragraph Font

Valued CustomerBC:\My Documents\AutoRecovery save of Euro and Economic effects.asd

Valued CustomerBC:\My Documents\AutoRecovery save of Euro and Economic effects.asd

Valued Customer A:\Euro and Economic effects.doc

Valued Customer A:\Euro and Economic effects.doc

Valued Customer A:\Euro and Economic effects.doc

Valued Customer A:\Euro and Economic effects.doc

Valued Customer A:\Euro and Economic effects.doc

Times New Roman

Times New Roman

Symbol

Symbol

Valued Customer

Valued Customer

Valued Customer

Valued Customer

Root Entry

Root Entry

ro and Economic effects on non-Euro countr

Table

ed Customer\par Valued Customer\par }er-C:\My Doc Economic effects.do

WordDocument

mic effects.doc\par Valued Customer-C:

Euro and Economic effects.doc\par Va4
t □ □ SummaryInformation
SummaryInformation
fects.doc\par Valued Cus(
uments\\Euro and Economic effects.do

DocumentSummaryInformation
DocumentSummaryInformation

CompObj
CompObj

slation

slation

OTable

OTable

Microsoft Word Document

MSWordDoc

Word.Document.8

_PID_GUID

{B2390F65-257D-11D3-A357-18DA05C10627}

{B2390F65-257D-11D3-A357-18DA05C10627}

Valued Customer

Normal

Valued Customer

Microsoft Word 8.0

Valued Customer

Normal

Valued Customer

Microsoft Word 8.0

_PID_GUID

{B2390F65-257D-11D3-A357-18DA05C10627}

{B2390F65-257D-11D3-A357-18DA05C10627}

Normal

Normal

Default Paragraph Font

Default Paragraph Font

Valued CustomerBC:\My Documents\AutoRecovery save of Euro and Economic effects.asd

Valued CustomerBC:\My Documents\AutoRecovery save of Euro and Economic effects.asd

Valued Customer A:\Euro and Economic effects.doc

Valued Customer A:\Euro and Economic effects.doc

Valued Customer A:\Euro and Economic effects.docÿ □ □ _

Times New Roman

Times New Roman

Symbol

Symbol

Valued Customer
Valued Customer
Valued Customer
Valued Customer
Root Entry
Root Entry
ro and Economic effects on non-Euro countr
1Table
ed Customer\par Valued Customer\par }er-C:\\My Doc
Economic effects.doc\par Valued Cus
WordDocument
mic effects.doc\par Valued Customer-C:
Euro and Economic effects.doc\par VaG
% □t□□SummaryInformation
SummaryInformation
fects.doc\par Valued Cus(
uments\\Euro and Economic effects.do

DocumentSummaryInformation
DocumentSummaryInformation
CompObj
CompObj
slation
slation
0Table
0Table