THE EURO AND FINANCIAL MARKETS

Huludeţ Simona Mihaela (cas. Popovici)
University: "Alexandru Ioan Cuza", Iaşi Faculty of Economics and Business Administration Adress: Carol I , No 11, 700506 Iaşi, Romania Phone: +40 0232.201.000, mobile: +40 0740.430.217 Email : simonahuludet@yahoo.com

Adopting the euro eliminate the currency risk within the Euro Area. In principle, therefore, the ones that save should not worry about the place where the securities were issued, so long as they are issued in euro and those who lend can explore the whole euro area making debts contracts in euro. A single financial market means, first, greater competition, as long as national currencies that were used as non-tariff barriers are eliminated. The need to maintain and attract new customers will push financial institutions to improve their performance. A unified market will also enable a better exploitation of scale economies with the development of expanded financial institutions and markets.
Keywords: financial markets, the single market, bonds, shares, Euro Zone

JEL Classification: G15

1.Introduction

Adopting the single currency is intended to radically alter the landscape, providing equally for those who save and those who borrow more and better opportunities. Therefore, it is expected to improve overall productivity of the European economy, and possibly to affect the operation of monetary policy.
An important aspect of this experiment is the one that the institutions and financial markets were designed by centuries in the national traditions. The single market has already profoundly changed the financial markets, but there are still important differences. The single currency could announce a new era of transformation, bringing light to many limits of the single market and requiring future actions, which will be examined here.
Finally, monetary policy works through financial markets. Central banks act on very short term interest rates, but the effect of monetary policy on the economy came from, mostly long-term rates and exchange rates, and availability of credit. Each national central bank has developed its own strategy to deal with local conditions, but now the Euro system operates simultaneously through the various national financial markets, with possible effects different from country to country. The possible asymmetric effects of the monetary policy are an additional challenge.
If these aimed benefits are valued is another problem. It may be too early to evaluate the effects of the single currency, but some changes are already observable, sometimes but not always, as well. Preliminary evidence is rare, but absolutely encouraging.

2. Results and discussion

Financial services industry is also dedicated to making the granting of loans. What makes this industry special is that the loaning process is risky. A loan involves give up of money in exchange to the promise for recovery in future. Meanwhile, the borrower can face difficulties leading to impossibility of payment of credit, partially or totally, and some borrowers may simply be dishonest.
The most well known financial institutions are banks: they receive deposits; actually they lend from customers, offer credit and often provide assistance for managing portfolios. In context with these universal banks, investment banks specialize in managing portfolios, they may even not accept deposits and sometimes deal only with wealthy clients. Many fund management companies are not working with individuals; they provide services "wholesale" to banks and insurance companies. Insurance companies and also considered financial institutions. Part of their work is to provide insurance, which, strictly speaking, is not a financial service. In addition, to

face situations of massive payments, they accumulate large reserves, which, obviously, want to manage in order to achieve higher benefits. In fact, they take "deposits" - insurance paid by customers - which they use to "lend" since investing in financial assets. In addition, many insurance companies offer pension schemes and life insurance which can be viewed as deposits with a very long maturity. In fact, in recent years has been noticed the development of financial conglomerates that combines classical universal bank with investment bank and insurance company.

Bonds and shares markets are the other component of the financial system.

Bonds are debt issued by companies and governments on a fixed term at an explicit interest rate, which can be indexed and therefore variable. Stock shares are evidence of ownership of the company: they have no maturity whereas lasts how long the company itself and the yield is determined by company performance. Lender (also named, investors) usually operate through intermediaries - brokers, investment banks - whom it delegates to buy or sell assets in their behalf on markets. Most small investors, as many large ones, actually buy funds that are ready-made packages of shares and bonds managed by financial intermediaries. Each has its characteristics: the relative importance of shares and bonds, industry or country in which they invest the degree of risk and associated security, as will be explained in the next section.

Financial institutions are all forms and sizes. Several huge international banks coexist with some small and local ones. Some financial markets attract lenders and borrowers around the world (New York's Street and City of London is the largest such market), while others deal with a very narrow local market. As will be explained further, financial markets are more efficient, as are bigger.

Functions of financial markets

The function of financial markets is to make lenders and borrows to meet and provide each entity and each borrower saves the best solution. This, of course, includes the yield, but a scheme available sizes and maturities of assets and ability to sell or buy any amount at any time.

Let us imagine an individual who wishes to save an amount, say, for two years. Any person may submit this amount to the bank, but the interest rate available is too small. She may also do better buying bonds, which offer a fixed interest rate, or actions, which do not offer guarantees and which can be highly paid or may endanger the entire amount. Depending on the inclination to risk and return, the person will choose where he would like to be. May then find an individual to borrow and will provide the mix of profitability and risk analysis on which the person wishes it, to the amount available for the one has in mind for the end of two years.

The person may also be interested to have the opportunity to obtain cash or sooner to keep their savings longer. Then enter the financial markets

This example illustrates how the financial markets indirectly connect millions of people who save and borrow. Efficient financial markets are characterized by deep-liquidity or ability to sell or resell the assets quickly - and expansion - availability for a range of ongoing needs and offers. Those who save will seek different points of the scheme trade-off the return-risk because they have different degrees of aversion to risk. Nobody loves the risk, at least in the financial field, and this observation has two implications. First, risk has a price. Those who hate risk are prepared to compensate players with low aversion to risk that are ready to provide protection against risk situations' solution for those with aversion to risk is to change those who are brave a very active against risky one more secure. Naturally, caeteris paribus, less risky assets will be cheaper. The price difference is price risk. There are many ways, some of them very sophisticated exchange risks. The end result is that markets determine the price of risk attached and that all assets conform to the same risk-return scheme risk-return record set price risk and financial markets allow anyone to negotiate a higher return for higher risk, or conversely, depending on personal preferences.

A second implication is that risk reduction is desirable, and the financial markets carry out this function. The fundamental principle is diversification, which can be described with a simple example. Take two assets, one that brings EUR 100 days of sunshine and one that brings 100 euros in rainy days. Assume further that the average number of days in the sun is equal to the rainy days, so on average each asset to 50 euro per day. Taken separately, each asset is risky: for example, long sunny days leave without the money an investor who holds only active for those rainy days. However, preservation of assets for half of sunny days and rainy days for half completely eliminates risk. Indeed, most of those who keep saving diversified portfolio of assets, in addition, financial markets are large whereas the most effective offers a wide range of risks and enable the saving to reduce the risk they face.

2.2 The characteristics of financial market

Financial markets are created to fulfill the functions described above: namely, putting the needs and preferences contact the lender and the borrower who is establishing the price of allowing risk diversification and risk.

The contact and risk diversification are simple if there is a large number of borrower and lender that person. The financial industry is subject to massive economies of scale, affecting banks and financial markets. Where markets and small banks survive is not difficult to find barriers to competition. Existence of different currencies is one. indeed, an investor who bought Irish assets Portuguese faces currency risk in addition to normal credit risk and this makes the assets more attractive to Irish person. Creating a single currency eliminates this barrier via specific competition.

A response to economies of scale is the development of financial institutions and markets high. Another response, which goes hand in hand with the first, is to strengthen the networks. When a company receives funding to financial savings, it should give loan with these funds as soon as possible because "time is money." With some luck, it will find its customers among anyone who wants to borrow, putting in contact needs and preferences, but most will not happen that way. The solution is to give money to loan to another financial firm may soon find someone willing to loan or identified another financial firm that has found an immediate customer is willing to borrow, etc.. This is why the financial markets operate as a network. Indeed, the switch rapidly from one firm to another to find a home - a convenient customer who wants to borrow it - somewhere in the network and very possible, in a very remote corner of the world.

A financial firm is a telephone connection: if you're the only one who has a connection, the phone does not work. A phone is more useful as more people are connected to the network. This effect is called network externality. A financial firm can provide better opportunities if it is in contact with a large number of other companies working with many customers, investors and individuals who wish to borrow. The best network could be the world, hence the trend toward globalization of financial services.

A fundamental characteristic of financial activities is that those who borrow always know more about their risk than a creditor. This information asymmetry produces profound implications. Those who can lend intentionally try to hide some damaging information in order to obtain a loan very desirable. As a result, lenders are very careful, not to say suspicious. They can simply refuse the loan rather than to take unlimited risks. as an alternative, they may set a very high price for risk, that may require a larger risk premium. This, in turn, may discourage those who wish to borrow and low risk, but may not report their actual risk, while desperate people who want to borrow are ready to pay any risk premium.

2.3 Effects of the single currency on financial markets

Adoption of the euro eliminated currency risk within the euro area. In principle, therefore, the saving should not worry about where they were issued securities, so long as they are issued in euro and those who lend can explore the whole euro area in euro debt.

There is no reason for financial markets to be Finnish, Greek and German.

A single financial market is, first, greater competition, as long as national currencies that were used as non-tariff barriers are eliminated. Rents associated with dominant positions will disappear, and the need to maintain and attract new customers will push financial institutions to improve their performance. A unified market will also enable a better exploitation of economies of scale with the development of financial institutions and markets expanded. Only three banks in the Euro Zone are in the top ten (until recently, U.S. banks were disadvantaged by the law, which forbade them to operate more than one state). Similarly, the stock exchanges in the Euro Zone (Frankfurt, Paris, Milan, etc..) are small compared with Wall Street and City of London. Moreover, developing a single financial market, accompanied by the elimination rate risk, will allow greater deepening and widening as the market serves several lender and borrowers.

A negative aspect however is that the potential of diversification decrease. before the euro, a Belgian economist able to diversify their portfolio by buying securities German, Italian and other European countries. Now, these securities are less diverse since it is expressed in the same currency, and the cycle becomes more homogeneous. To achieve a high degree of diversification, they should move to places less known in the world. One over another, however, the positive effects of the economy of scale in a unified market on a large scale is likely to exceed the negative effects of reducing diversification.

Thus, more competition and more opportunities will create benefits past users, and recent lender borrowers. This, in turn, will encourage growth as a consequence of better opportunities to borrow. It will also allow countries with significant needs to borrow to feel better savings anywhere in the euro area, adding to the effect of growth.

3. Conclusion

In principle, the introduction of the euro should speed up financial market integration in Europe. The main reason is that the elimination of the exchange risk also eliminates an obstacle to the free flow of financial assets and services. As long as national moneys existed there was an exchange risk preventing full integration of financial markets.

There can be no doubt that the euro has the potential of becoming a major international currency. There are a number of factors that will help the euro to establish a firm position as a world currency. One is the economic size of the Euro zone, the other is the existence of macro and monetary stability. These are necessary conditions for a currency to become widely used in the world. Another condition is the depth and the sophistication of the financial backing the currency markets. Although the creation of the Euro zone has led to a significant integration of the Euro zone financial markets (mainly the money and bond markets) which has increased the depth and the liquidity of these markets, much remains to be done. In particular, the equity and banking markets are still segmented considerably hampering the euro in its quest to become a world currency on a par with the dollar.

We also argued that further financial market integration in the Euro zone should be pursued so as to provide an insurance mechanism against asymmetric shocks, thereby facilitating the smooth functioning of the monetary union. Such integration will require further steps towards integrating legal and regulatory systems. In other words it requires further political integration.

Bibliography:

1. Baldwin, R.; Wyplosz, C. (2006) *"Economia integrării europene",* Ed. Economică, Bucureşti;
2. Miron, D. (coord.) (2008) "*Economia Integrării Europene"* , Ed. Universitară, Bucureşti;
3. Pelkmans, J.(2003) *"Integrare Europeană – Metode şi Analiză Economică"* , Ediţia a II-a, Institutul European din România, Bucureşti;
4. P. de Grauwe (2002), *"The Economics of Monetary Union*" , 7th ed., Oxford;
5. Tofan, M. (2008) *"Integrarea Romaniei in structurile Uniunii Monetare Europene"*, Ed.C.H.Beck, Bucureşti;