E U Exchanges Vie for an Edge in Currency Uni ι

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As the political squabbles over the issue of a European currency intensify, the battle lines are being drawn for an equally heated confrontation — the fight to emerge as Europe's top futures and options exchange after monetary union.

While it's still far from certain which countries will be part of this union — or whether it will be accomplished on schedule in 1999 — the scramble is on to develop new "Euro-contracts," futures and options products that will allow users to hedge or speculate on the direction of the new currency, the Euro, or on European interest rates following monetary union.

The grand prize will be a surge in trading volumes and fees, rewarding the exchange itself as well as the member firms that will execute trades in the new products. As a range of traditional products based on domestic currencies and interest-rate yield curves disappear or as their liquidity falls off, the losers will have to quickly develop new niche products or face extinction. In Europe, where futures exchanges have evolved over the past 15 to 20 years based on financial products rather than on commodities, as in the U.S., the upheaval is likely to be enormous.

"There will be a big revolution, a big bang," said Gerard Pfauwadel, chairman of France's futures exchange, Matif SA. "Most of our European financial-futures products will be affected dramatically. Products will disappear, and we will have to question if it has to be that we have 15 European futures exchanges with 15 different ranges of domestic products."

The outlook for futures exchanges is very different than for exchanges which trade stocks in EU countries. Stock markets, offering shares in companies domiciled in their own countries, are likely to remain little affected by monetary union, since it is unlikely that a German stock exchange will suddenly begin marketing Italian stocks to investors across Europe. But the rationale for many of Europe's exchange-traded currency and interest-rate products will disappear as local currencies give way to the Euro, and the interest-rate curves of participants' bond markets mesh more closely. The result, Mr. Pfauwadel argues, will be consolidation of futures exchanges — and even more heated competition for big new products.

The two main rivals for Euro-contracts are, in one corner, Matif and the futures-trading arm of Deutsche Borse in Frankfurt, and in the other, the London International Financial Futures and Options Exchange. While Britain isn't likely to be part of monetary union for many years, Liffe officials are confident that they'll manage to translate their position as Europe's largest futures exchange into market dominance in the new Euro-contracts.

"The new 'great game' will be to grab the liquidity in new long-term and short-term bond contracts," said Daniel Hodson, president of the Liffe. The exchange t is able to develop a range of suc ful

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Euro-based currency contracts also will benefit, he said.

The battle could be won in one of two ways, industry participants say. Either an exchange will launch completely new products based on a "Eurobond" and the Euro itself, which will attract trading volumes, or users will flock to existing products as a widely accepted benchmarks.

"The benchmarks will be fewer, but bigger and more important," however they come about, says Matif's Mr. Pfauwadel.

For now, exchanges won't discuss plans to launch Euro-contracts. Mr. Pfauwadel added he plans to keep his plans for Matif close to his chest "as if I were in a poker game." But both camps admit they're likely to start marketing existing products as proxies for a Euro-contract.

Take the German bond, or bund, contract, for instance. Currently, it can be traded on the Liffe's open-outcry trading floors, or through the electronic trading system operated by Deutsche Terminborse. Since Germany is likely to be the linchpin of monetary union, as well as the single largest economy, both exchanges are eager to make a case that the bund could take on a new role as the new European interest-rate futures contract after 1999.

Shrugging off the political brouhaha surrounding monetary union, the Liffe already has made changes to its bund contract to allow for settlement in Euros rather than marks after the Jan. 1, 1999 deadline. The exchange is gambling that it can turn its 70% market share in bund-futures trading into a commanding lead in the race to develop new Euro-contracts.

The Liffe's hopes may not be far-fetched. On both the British and German exchanges, the bund contract already serves the role of a benchmark for financial institutions in countries such as the Netherlands. Their domestic interest-rate curve closely parallels that of Germany, but their domestic bond-futures contract is much less liquid, making it more attractive to hedge using the bund, industry participants say.

The Liffe also is working to ensure that it has currency contracts covering the three main world currencies: the yen, the dollar and the "Euro," currently slated to replace or supplement the mark, the French franc and the currencies of other charter members of monetary union.

But Matif and DTB haven't been sitting idly by. A planned link between them, now in the final stages of negotiations, is part of the strategy of both to seize the leading role. That would give outside participants one point of access to the vast majority of trading in continental Europe.

"It would seem that Matif has really taken a lead in both the currency and bond side, since they've really aggressively been supporting their ECU contract," said Richard Reinert, managing director of Refco Overseas Ltd., the London-based unit of Refco Inc., a Chicago-based futures trading company.

Matif's ECU product is actually a bond-futures contract which is based on an artificial 10-year bond issue with a 5.5% coupon, denominated in the European Currency Unit, a benchmark basket of currencies that includes those of all 12 EU members. Open interest, or the number of positions in the contract, has jumped fourfold since its launch in October 1990.

Still, Mr. Reinert cautioned, it has been difficult for any exchange to develop currency contracts capable of winning out in a competition with the highly liquid interbank foreign-exchange markets.

Smaller exchanges, meanwhile, face different challenges. Some are turning to new commodity contracts to guarantee the future of their exchanges, as the EU moves to deregulate the agricultural marketplace. Matif, for instance, already has a rapeseed contract in place and hopes to launch a wheat-futures product by the end of the year. Interest in agricultural products has been expressed by other Northern European exchanges.

Even in Spain, which isn't likely to be a charter member of the currency union, futures-exchange participants are already experiencign Euro jit . Manuel de la Torre, deputy marketing manager for Meff Renta Variable, the Madrid stock exchange division of Meff, Spain's futures market, says he expects the Barcelona division, Meff Renta Fija, which trades currency and bond futures based on the peseta and Spanish bonds, to eventually be folded into the Madrid operation as its products' raison d'etre disappears.

"The way of possibly developing this exchange division is by looking at products like a swaps depository," said Mr. de la Torre, referring to a recent initiative by the Spanish exchange to offer services to the over-the-counter derivatives market, ranging from collateral management to mark-to-market services.

Awaiting monetary union, however, most market participants are elated at the prospect of increased volatility as nervous investors try to react to the latest political twitches from European capitals. That should translate into larger trading volumes, and more revenue for futures-trading firms.

"The level of tension is great, and that will create trading opportunities and risk-management needs that we can meet," said Refco's Mr. Reinert.

COMMODITY INDEXES

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	Close	Net Chg.	Yr. Ago
Dow Jones Futures	149.64	− 0.63	151.16
Dow Jones Spot	148.00	− 0.28	149.39
Reuter United Kingdom	2110.4	+ 1.3	2308.9
K R-C R B Futures*	252.38	+ 0.17	235.37

*Division of Knight-Ridder.