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Financial Markets in the Financial Structure of Euro Area

Since 1 January 1999 the European Central Bank (ECB) has conducted the single monetary policy for the euro area. The Treaty on European Union assigns the Eurosystem the primary objective of maintaining price stability, reflecting a broad consensus in society that maintaining stable prices is the best contribution that monetary policy can make to economic growth, job creation and social cohesion.

Financial markets play a crucial part in the transmission of monetary policy decisions. In the functioning of the financial system there are financial markets and financial intermediaries which are not separate entities but are strongly interlinked.

Financial markets can be classified according to several criteria, illustrating different essential features of these markets.

One possible classification is whether the financial transaction relates to the first purchase of the issue or is a trade between holders of securities (primary and secondary markets).

Another classification relates to the original maturity of the financial contract. Generally a distinction is made between original maturities of less than one year and those of one year or more (money or capital market). The money market differs somewhat from other financial markets in that it is typically a wholesale interbank market where transactions are large.

A final, commonly used classification is between the form of the Financial instrument (equity or debt market). The main distinction between equity and debt is that equity does not have to de repaid, whereas debt is the financial claim which usually does have to be repaid.

An important category of financial instruments are derivatives, i. e. financial contracts whose value derives from underlying securities prices, interest rates, foreign exchange rates, market indices or commodity prices. The basic classes of derivatives are futures, options, swaps and forward rate agreements. Derivatives markets assist the functioning of the financial markets, because they improve the pricing and allocation of financial risks.

A deep and integrated money market is a precondition for an efficient monetary policy since it ensures an even distribution of central bank liquidity and a homogeneous level of short-term interest rates across the single currency area. In the euro area, this precondition was met practically immediately when the national money markets were successfully integrated into an efficient euro area money market.

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