

The International Role of the Euro

Guntram Wolff

Exchange with the European Parliament

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Is international currency status desirable?

Upside

- Central bank seigniorage revenues
- Lower yields for sovereign issuer (safety & liquidity premium)
- Spread between aggregate return on foreign assets & cost of foreign liabilities
- Lower transaction costs for companies and citizens
- Competitive advantage for domestic banks issuing foreign currency
- Less dependence on US-driven global financial cycle (Hélène Rey)
- Geopolitical influence

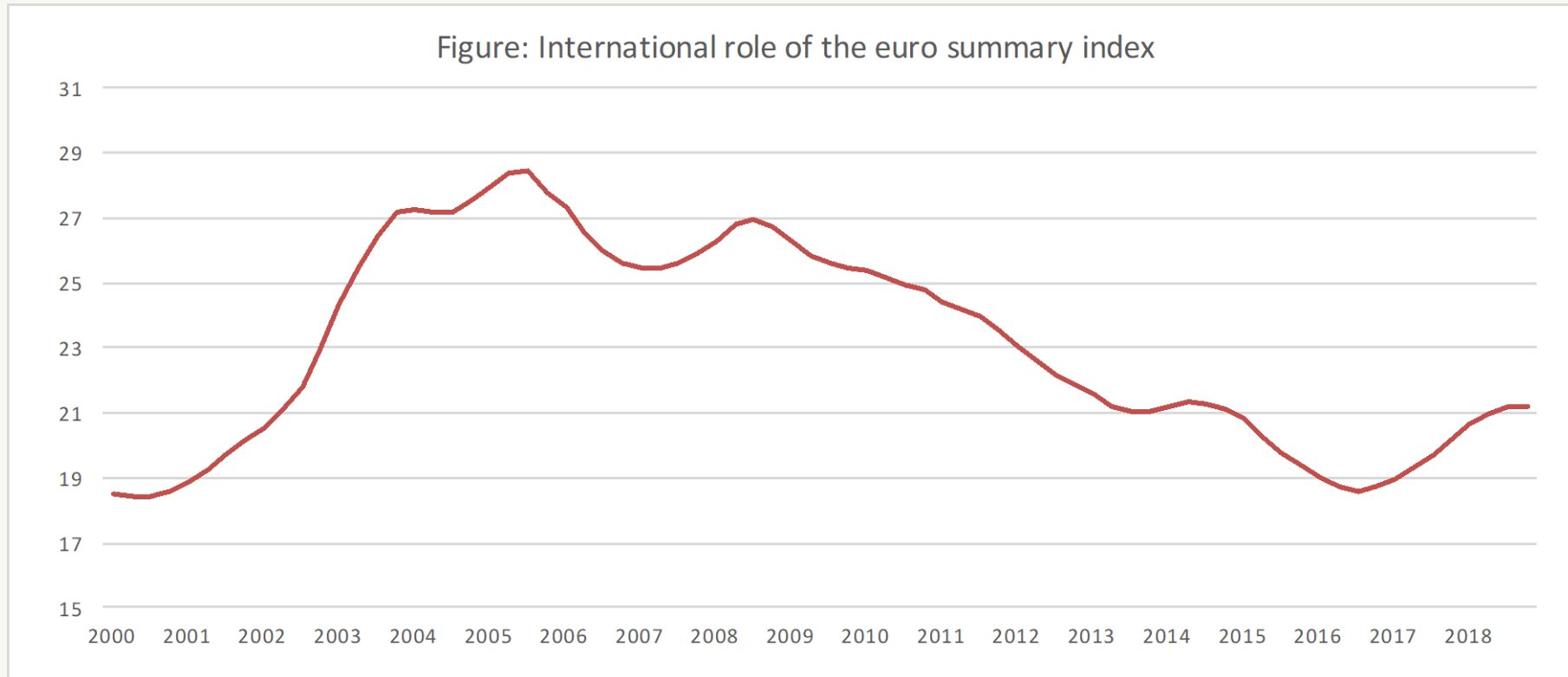
Downside

- Currency appreciation during times of global stress
- Role as international lender of last resort, constraint on domestic policy
- Current account deficit & Triffin dilemma (downside for some, not all in society)

Historical dominance

- Natural monopolies are rare (Eichengreen *et al*, 2018)
- Pre-WWI (1890-1914): multipolar system dominated by the British pound sterling, the German mark and the French franc.
- WWI to WWII (1919-39): duopoly of the British pound sterling and the US dollar
- Post-WWII Bretton Woods (1945-1973): US dollar monopoly
- Post-Bretton Woods (1973-today): USD dominance, lesser international role of the euro (previously mark) & Japanese yen.

International role of the euro – ECB summary index



Source: ECB. Notes: ‘Arithmetic average of the shares of the euro at constant (current) exchange rates in stocks of international bonds, loans by banks outside the euro area to borrowers outside the euro area, deposits with banks outside the euro area from creditors outside the euro area, foreign exchange settlements, global foreign exchange reserves and share of the euro in exchange rate regimes globally. Data at constant exchange rates were not available for foreign exchange settlements. Data for 2016 are used for 2017 and 2018 observations for the share of the euro in exchange rate regimes globally. The latest observations are for the fourth quarter of 2018.

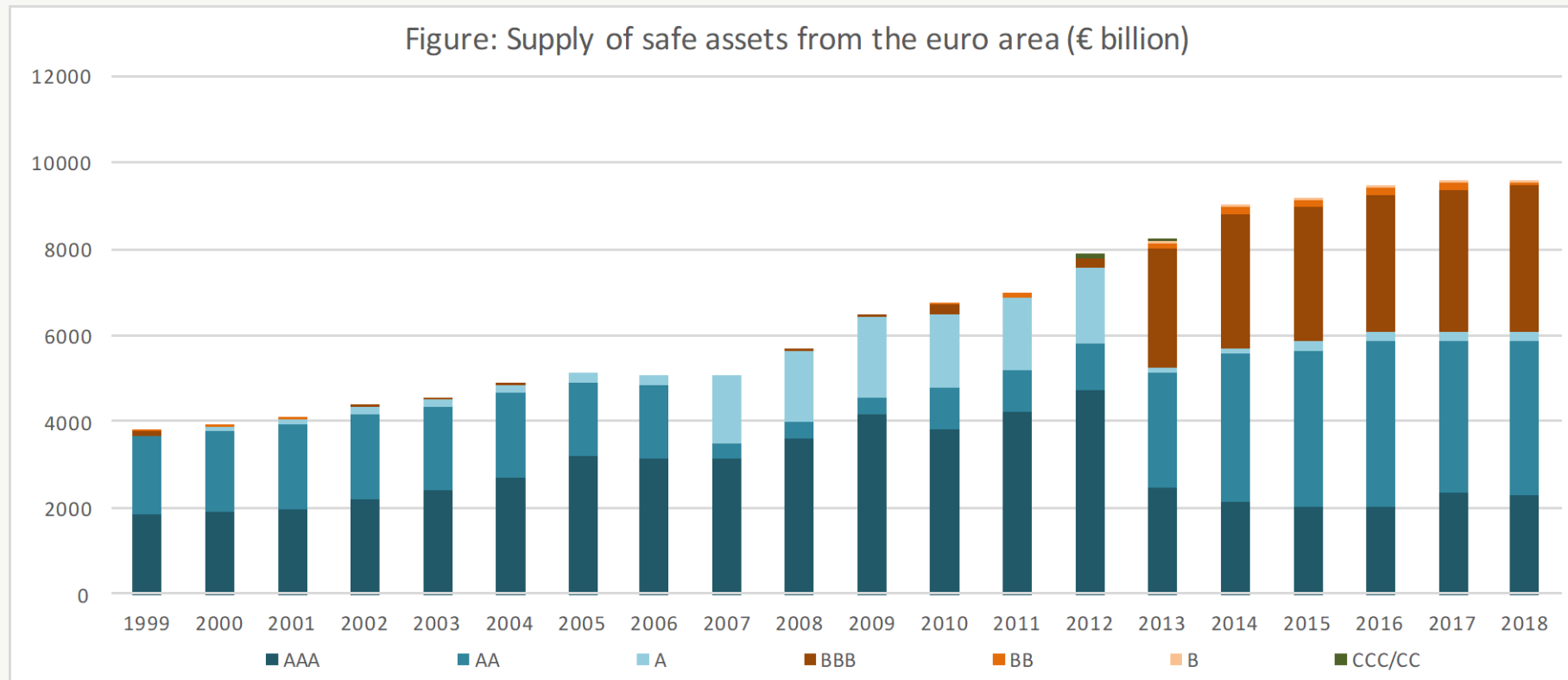
What makes an international currency?

1. Large economy, both in GDP and trade terms, economic dynamism
2. Free movement of capital
3. Willingness of authorities to play an international role
4. Stability (monetary, financial, fiscal, institutional, judicial, etc.)
5. Large and elastic supply of safe assets
6. Developed – liquid and deep – financial markets
7. Geopolitical or military power, strong state

Limitations for full international currency status

- The euro has been the world's second's most prominent currency since its inception, yet its rise as an international currency peaked in 2005
- Its international role was damaged by the euro crisis, the loss in confidence has not been entirely restored
- The euro meets partially the 1st & 2nd (large economy, free movement of capital) & recently the 3rd (promotion of internationalisation) criteria for international currencies
- BUT:
 - The euro's incomplete financial and fiscal infrastructure hampers stability
 - The supply of safe assets remains small (20% of GDP)
 - Financial markets are fragmented and incomplete
 - The EU is hardly a military power and its geopolitical influence is topic of debate

Supply of safe assets from the euro area



Source: Bruegel using data from Bloomberg for bonds issued by EFSF, EU, ESM and EIB, S&P for credit ratings and Eurostat for government debt securities. Notes: Includes bonds issued by 19 EA countries, European Financial Stability Facility, European Union, European Stability Mechanism and European Investment Bank.

How to enhance the international role of the euro?

- Ambitious strategic recovery & growth plan - increase the attractiveness of the euro area as an investment destination
- Increasing the supply of safe assets, joint issuance (NGEU, SURE, etc.) is a positive step
 - Be careful about Green Bonds and negative liquidity effects
- General improvement in the institutional set-up of EMU (to increase stability & credibility).
- Completing Banking Union & substantial progress on Capital Markets Union
- Active promotion of the euro's international role (eg. ECB swap lines)
- Strengthen the geopolitical (and military) role of the EU

Thank you!

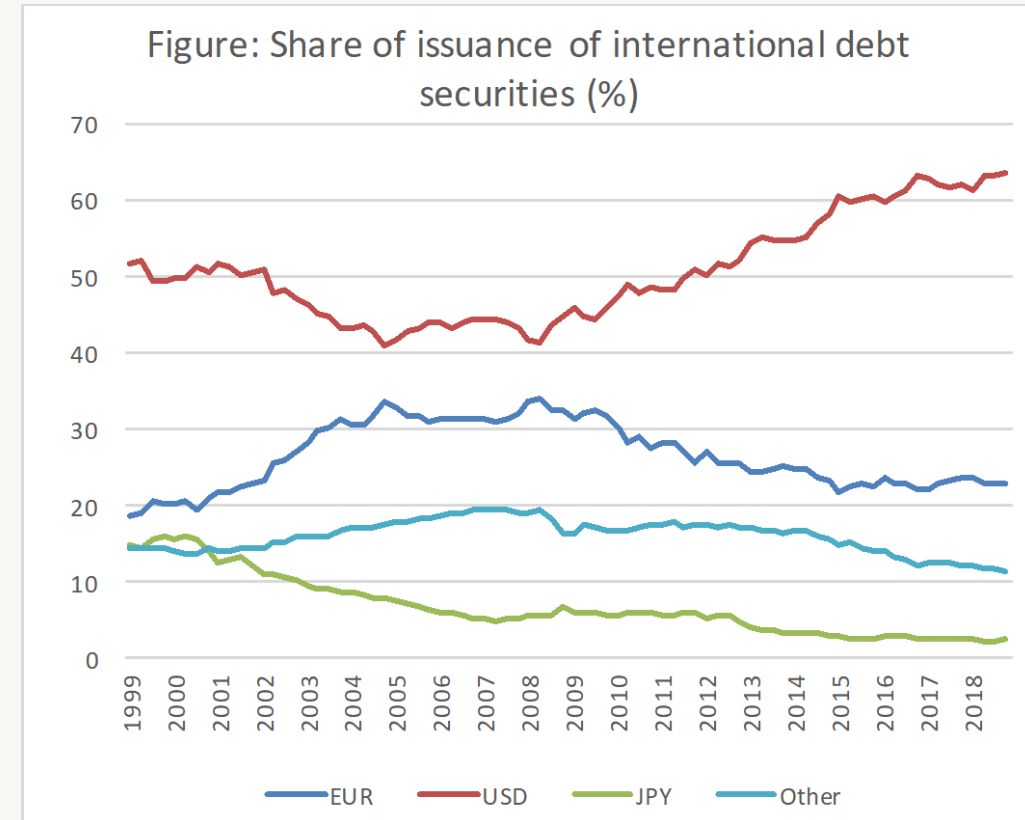
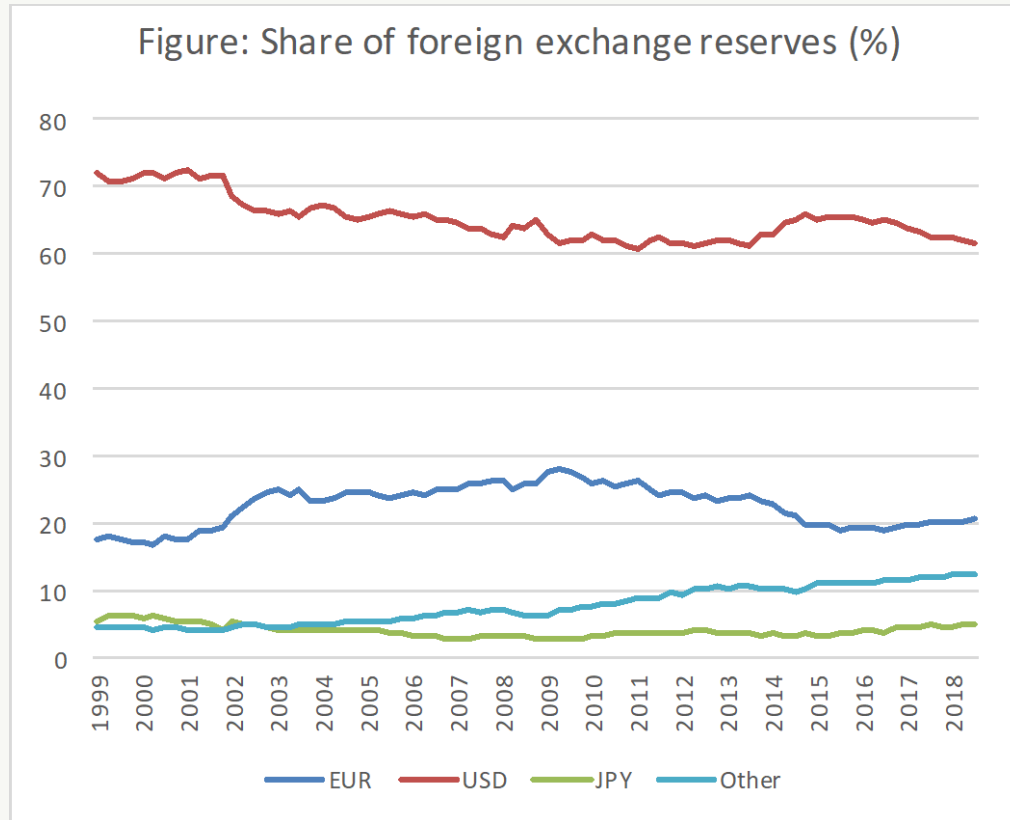
Reference: Claeys and Wolff, 2020, Is the Covid-19 crisis an opportunity to boost the international role of the euro as a global currency?, Bruegel policy contribution, <https://www.bruegel.org/2020/06/is-the-covid-19-crisis-an-opportunity-to-boost-the-euro-as-a-global-currency/>

What is an international currency?

Three primary functions of money at an international level

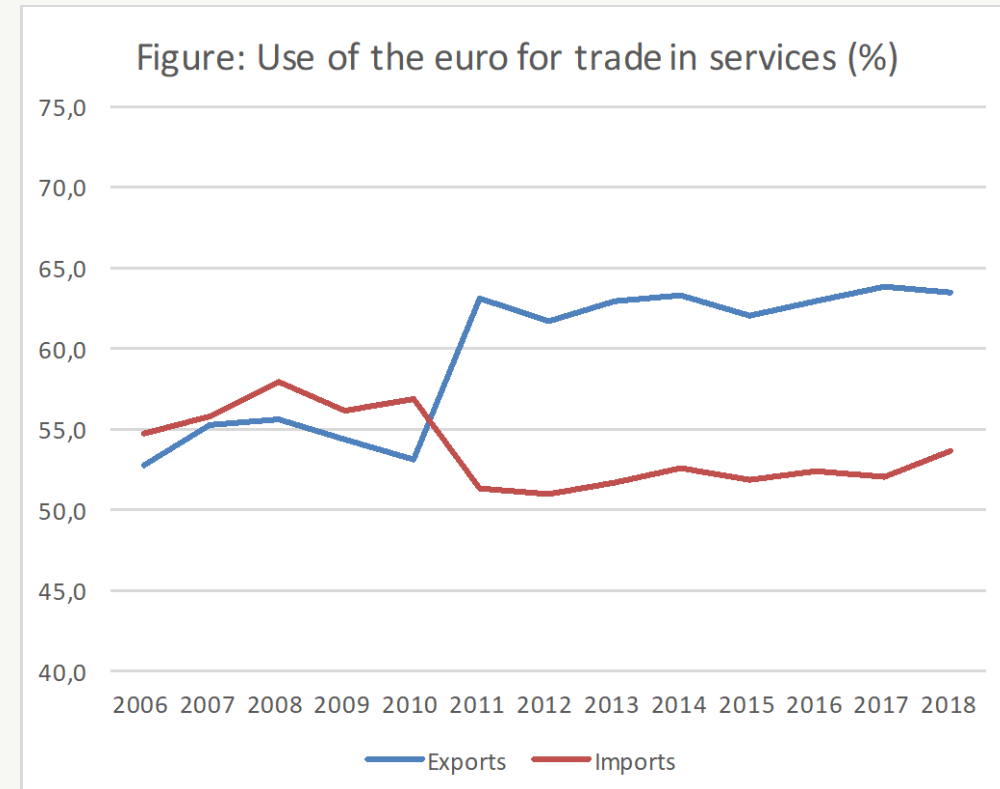
- **Unit of account:** international invoicing of goods, international market prices, international bonds and exchange rate pegs abroad.
- **Medium of exchange:** payments of cross-border trade.
- **Store of value:** reserve currency for foreign central banks and jurisdictions, investment/financing vehicle.

International functions of the euro – FX reserves & international debt securities



Source: ECB. Notes: Current exchange rates, end of period.

International functions of the euro - international trade



Source: ECB. Notes: Use of the euro as a settlement/invoicing currency in extra-euro area exports and imports of goods and services