



EUROPEAN CENTRAL BANK

EUROSYSTEM

The euro's global role: past, present and future

Arnaud Mehl

European Economic and Monetary Union: The first and the next 20 years
46th Economics Conference of the OeNB in cooperation with SUERF

Vienna, 2 May 2019

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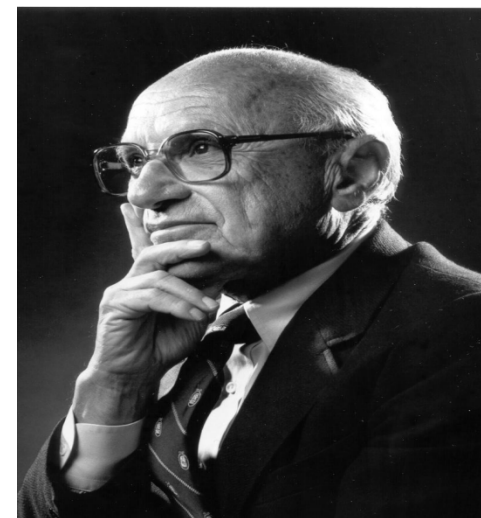
HOW GLOBAL CURRENCIES WORK PAST, PRESENT, AND FUTURE



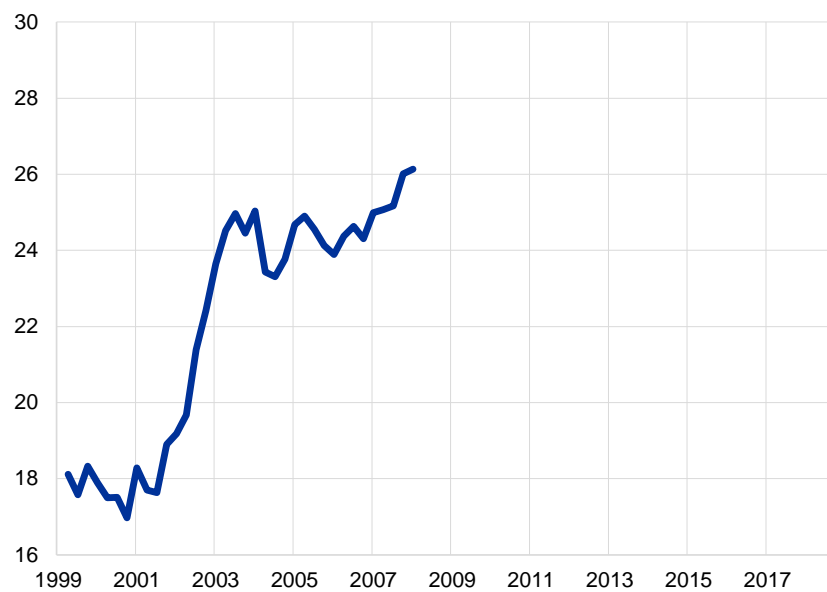
**BARRY EICHENGREEN,
ARNAUD MEHL & LIVIA CHIȚU**

- 1. Historical context**
- 2. Why it matters**
- 3. What's next**

- The euro “will be the strongest [currency] in the world, stronger than the dollar” (**François Mitterrand**, *quoted in Short, 2013, p. 519*)
- The dollar will have “its first real competitor since it surpassed the pound sterling as the world’s dominant currency” (**Fred Bergsten**, 1997)
- “Officials have been outspoken in emphasizing that a primary reason for [the euro] is as a counterweight to the influence of the United States ... in international affairs” (**Martin Feldstein**, 1997)
- The drive for the euro has been motivated by politics, not economics,... to set the stage for a federal United States of Europe. I believe that adoption of the euro would have the opposite effect” (**Milton Friedman**, 1997).

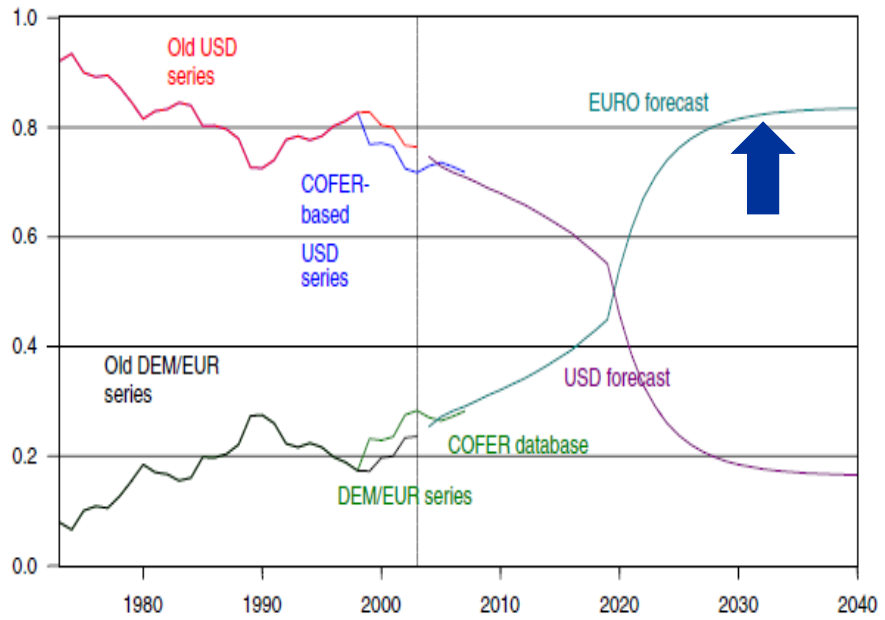


Share of the euro in global foreign exchange reserves (percentages)



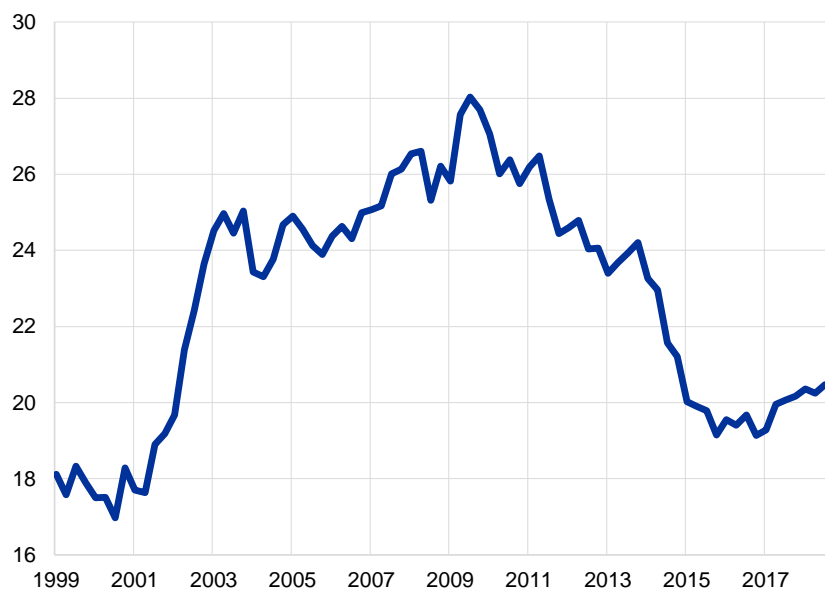
Source: IMF.
 Note: Data at market exchange rates. The latest data is for the fourth quarter of 2007.

Projected currency breakdown of global foreign exchange reserves in 2008 (if UK joins €) (percentages)



Sources: Chinn and Frankel (2008).
 Notes: "Scenario D" i.e. simulation of 'UK entry' and continued depreciation of currencies at their 2001-04 rates.

Share of the euro in global foreign exchange reserves (percentages)

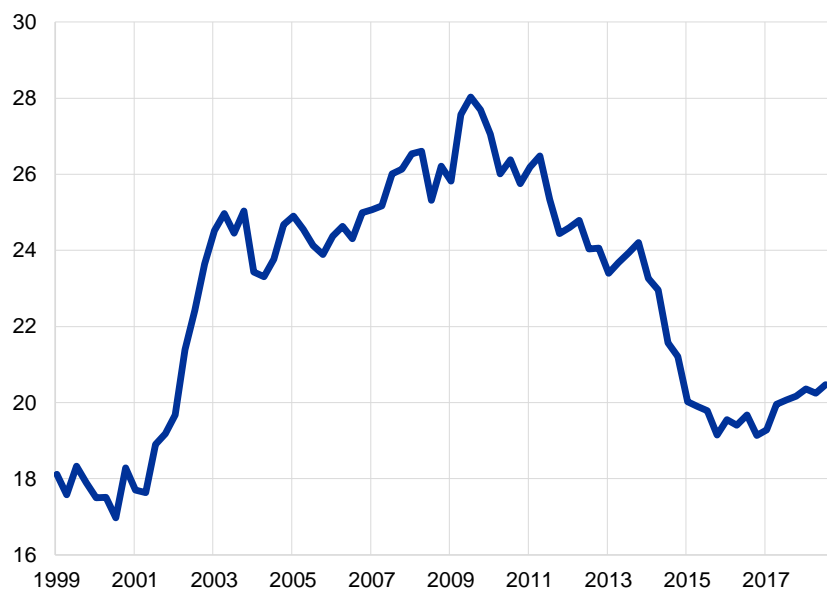


Source: IMF.

Note: Data at market exchange rates. The latest data is for the fourth quarter of 2007.

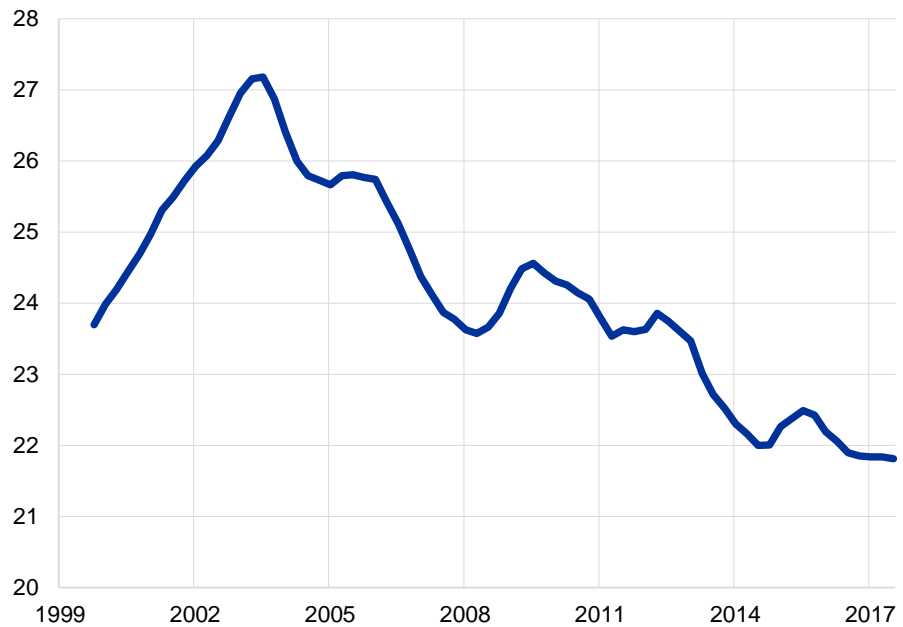


Share of the euro in global foreign exchange reserves (percentages)



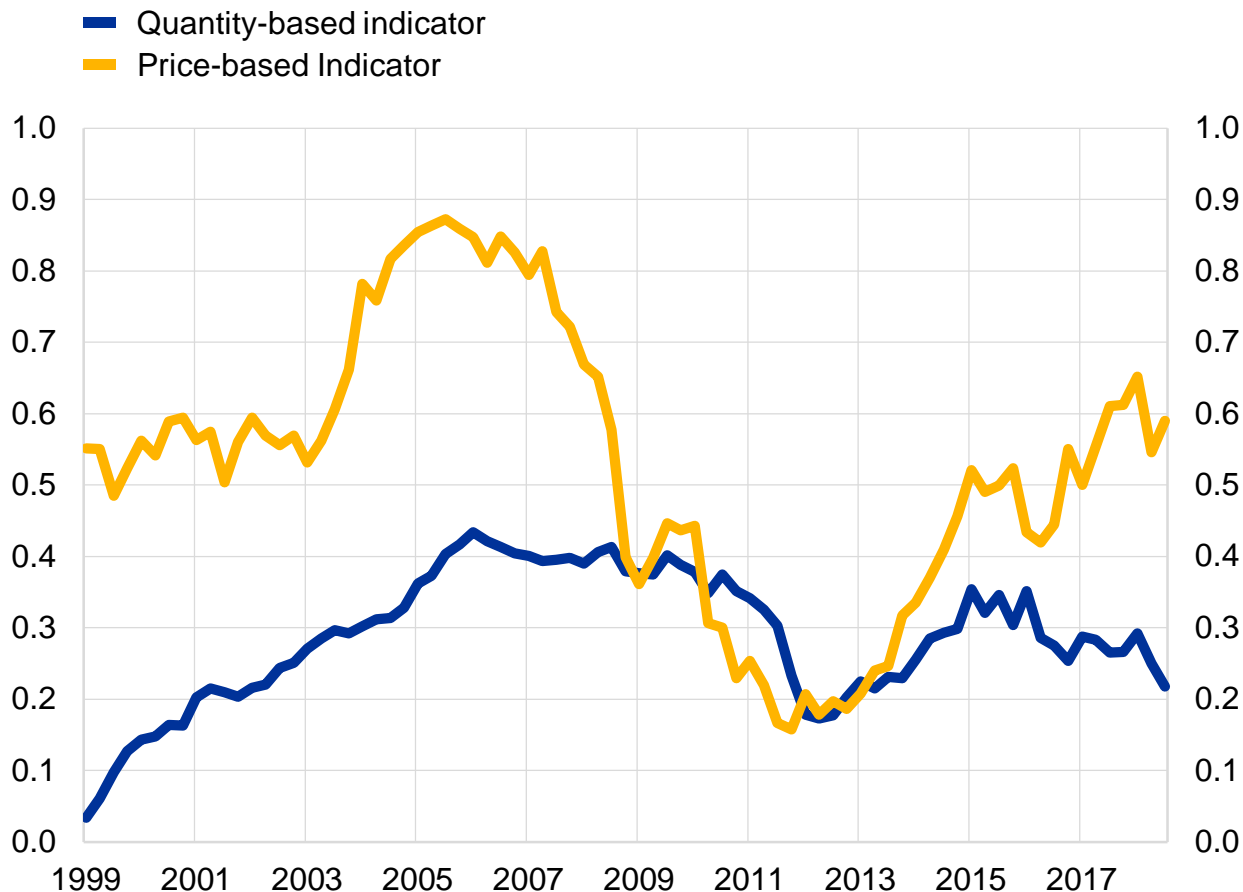
Source: IMF.
Note: Data at market exchange rates. The latest data is for the third quarter of 2018.

Index of the euro's international role (percentages; four-quarter moving averages)



Sources: BIS, IMF, CLS, Ilzetzki, Reinhart and Rogoff (2017) and ECB calculations.
Notes: Simple arithmetic average of the shares of the euro at constant exchange rates in stocks of international bonds, cross-border loans, cross-border deposits, foreign exchange settlements, global foreign exchange reserves and exchange rate regimes. Data at constant exchange rates for foreign exchange settlements and time series observations for the share of the euro as a global invoicing currency were not available. The latest data are for the fourth quarter of 2017.

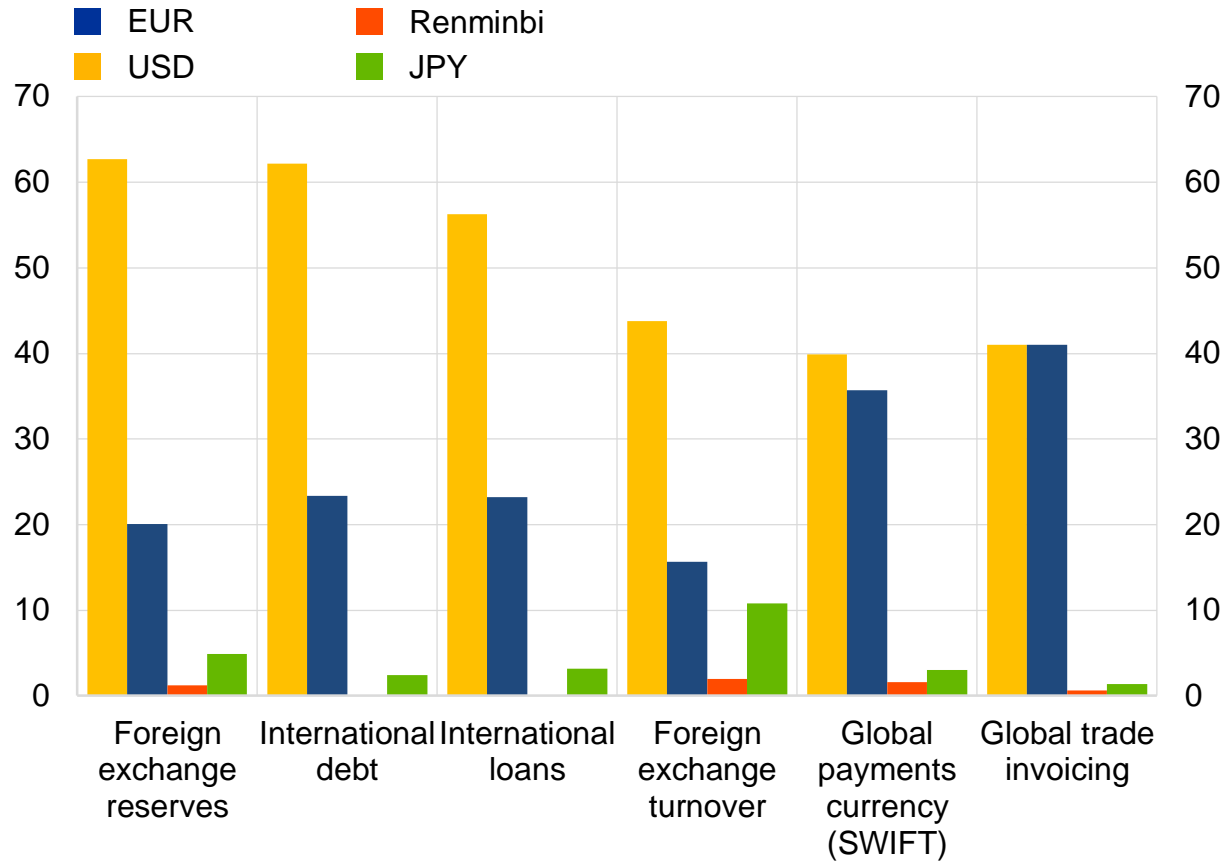
Financial integration in the euro area (indices)



Source: ECB.

Notes: The price-based composite indicator aggregates ten indicators covering the period from the first quarter of 1995 to the fourth quarter of 2017, while the quantity-based composite indicator aggregates five indicators available from the first quarter of 1999 to the third quarter of 2017. The indicators are bounded between zero (full fragmentation) and one (full integration). Increases in the indicators signal greater financial integration. For a detailed description of the indicators and their input data, see ECB (2018), *Financial integration in Europe*, Frankfurt am main. The latest data are for the third quarter of 2018.8

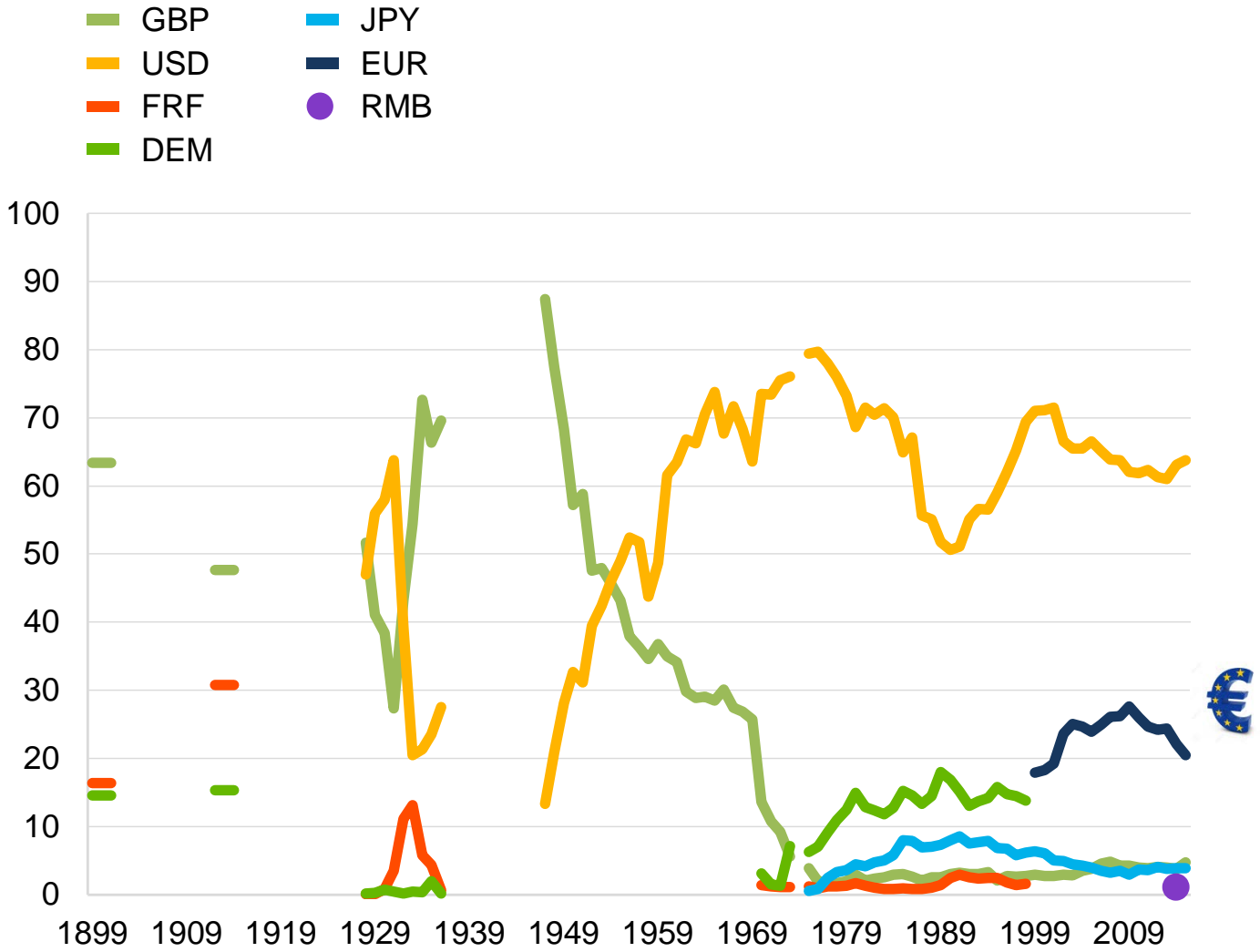
Snapshot of the international monetary system (percentages)



Sources: BIS, IMF, SWIFT, Gopinath (2015) and ECB calculations.

Note: Data as at the fourth quarter of 2017 or latest available. Data for the euro exclude intra-euro area transactions except for payments and invoicing.

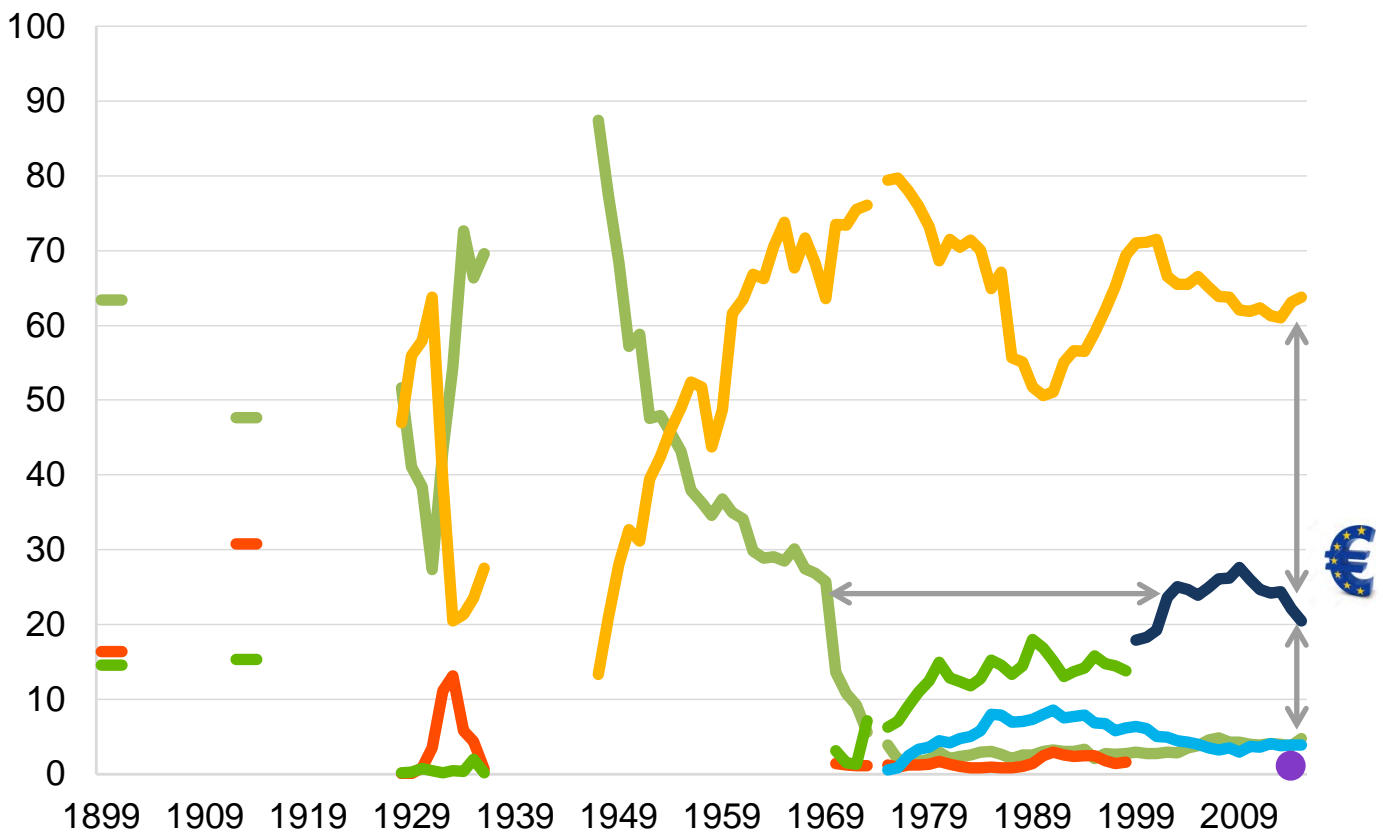
Share of global foreign exchange reserves (percentages, at current exchange rates)



Source: Eichengreen, Mehl and Chitu (2017).

Share of global foreign exchange reserves (percentages, at current exchange rates)

- GBP
- USD
- FRF
- DEM
- JPY
- EUR
- RMB



Source: Eichengreen, Mehl and Chitu (2017).

3 questions

1. Historical context
- 2. Why it matters**
3. What's next

3 questions

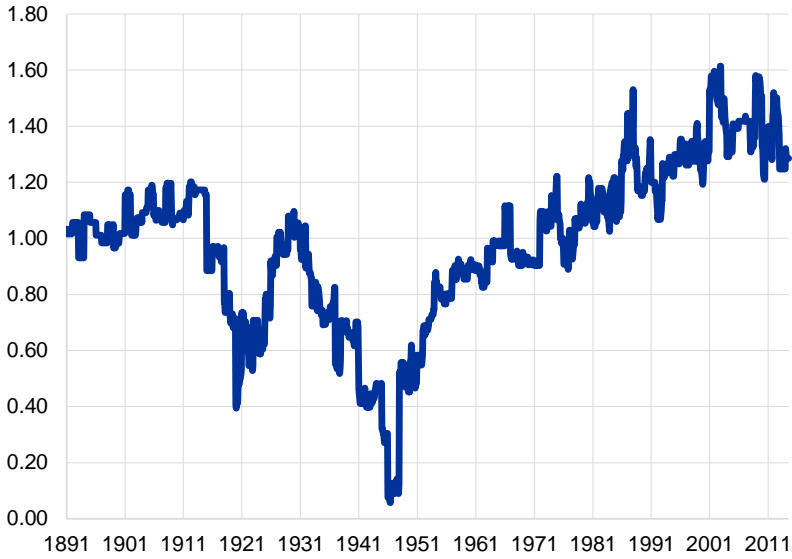
1. Historical context

2. **Why it matters**

3. What's next

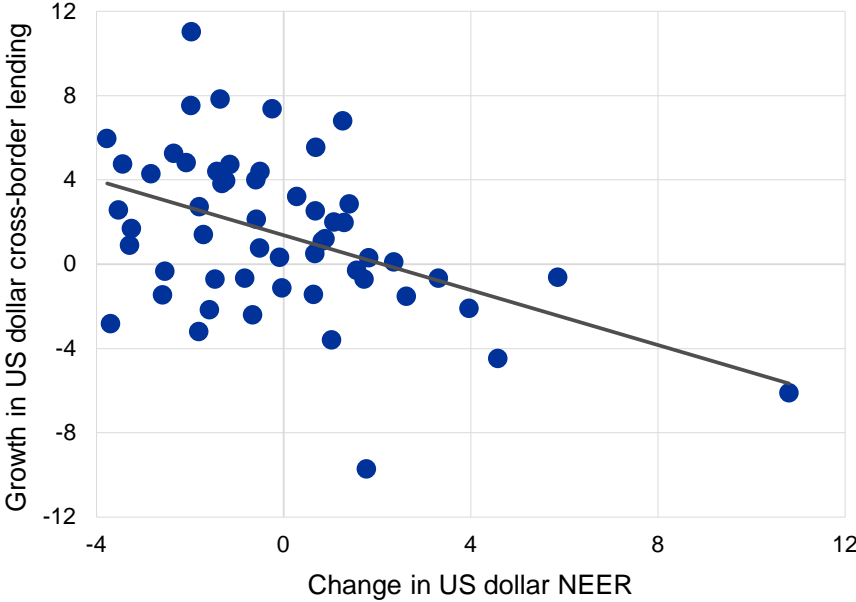


Global financial market integration (index)



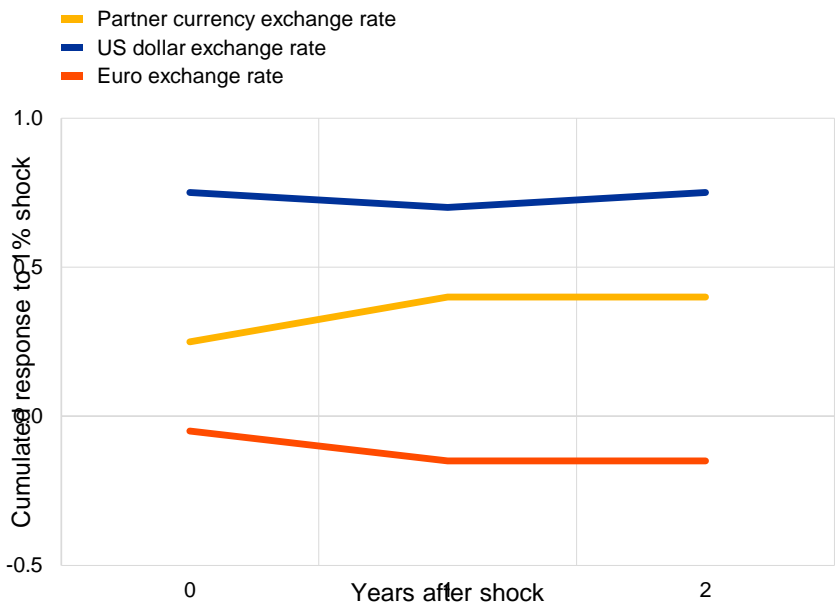
Source: Bekaert and Mehl (2019).
 Note: the figure shows the evolution between 1890 and 2014 of a measures of global financial market integration (up = higher integration) obtained from a global factor model of equity prices for 17 economies.

Evidence that US monetary policy drives international lending in dollars (%)



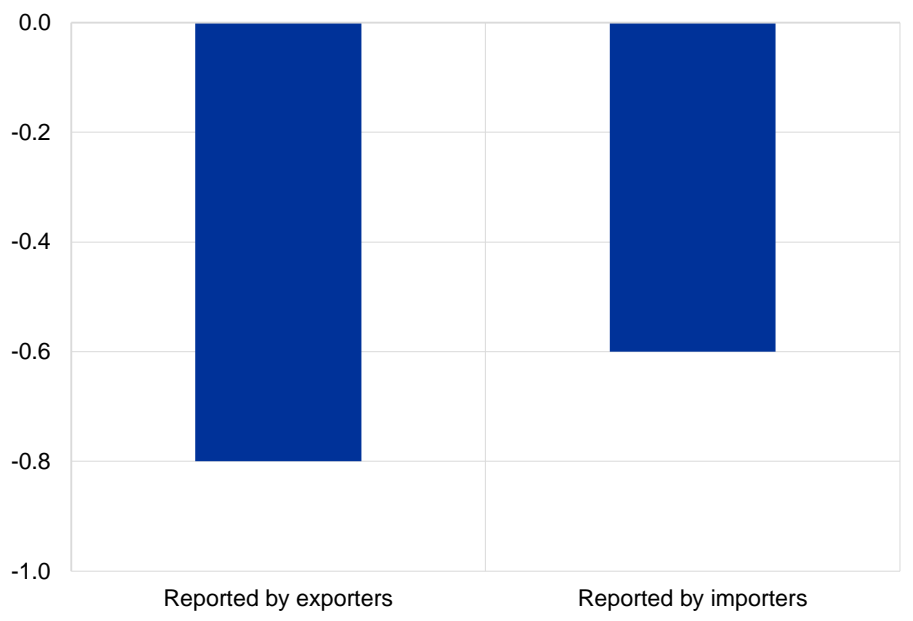
Sources: BIS and ECB staff calculations.
 Notes: Growth in US dollar lending refers to quarterly changes in cross-border loans and deposits in US dollars of BIS reporting banks; NEER stands for the USD nominal effective exchange rate (positive changes indicate a dollar appreciation). The sample period is Q1/2002-Q3/2015 as in Avdjiev, Koch and Shin (2017), "Exchange rates and the transmission of global liquidity", paper presented at the 2018 ASSA Annual Meeting. The black line is a fitted regression line.

Exchange rate pass-through to import prices in the rest of the world (%)



Sources: Boz, Gopinath and Plagborg-Møller (2017), "Global Trade and the US dollar", *NBER Working Paper No. 23988*.
 Notes: Impulse responses of bilateral import price level of country-pair (i,j) to a 1% shock to the bilateral (i,j) exchange rate, (USD, j) exchange rate and (EUR, j) exchange rate obtained from panel regressions with 55 countries over the period 2002-2015.

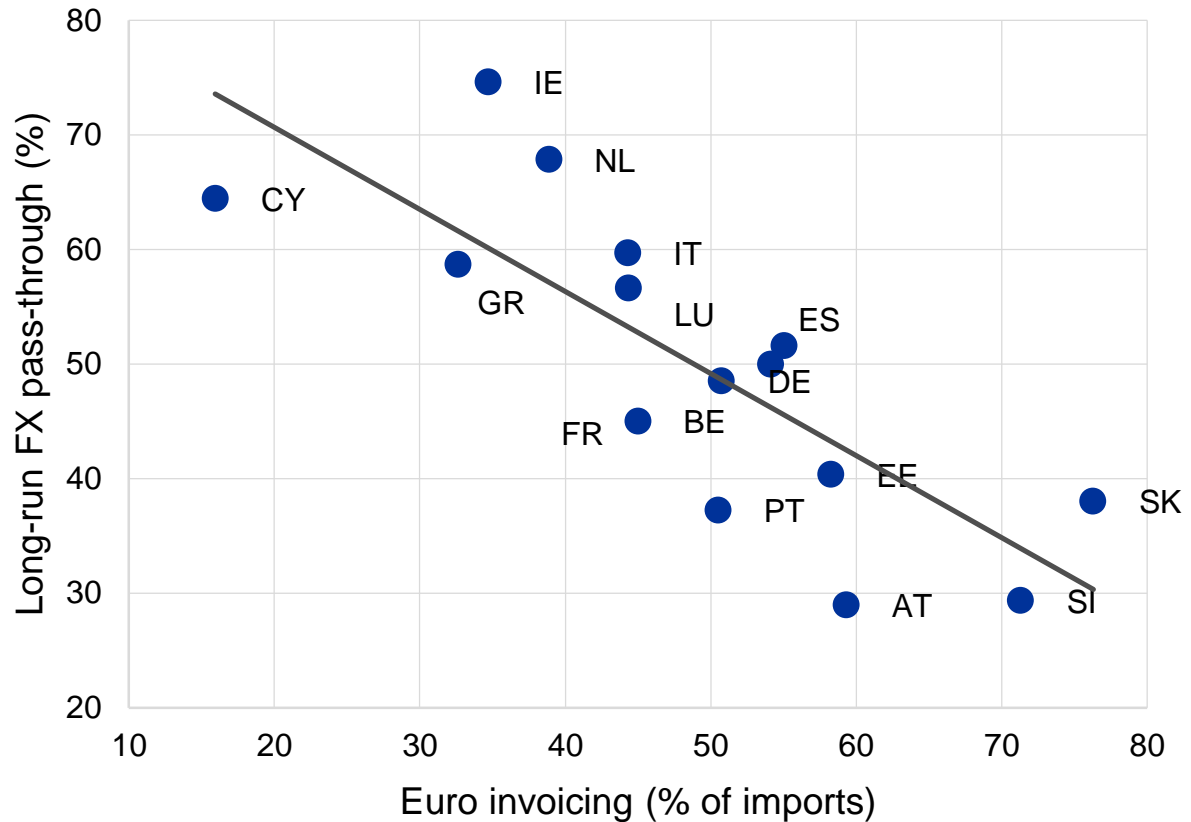
Response of rest of the world trade to a US dollar appreciation (%)



Sources: Boz, Gopinath and Plagborg-Møller (2017), "Global Trade and the US dollar", *NBER Working Paper No. 23988*.
 Notes: Impulse responses of rest-of-world aggregate trade volume to a 1% U.S. dollar appreciation against all other currencies, holding constant all other exchange rates and the global business cycle obtained from panel regressions with 55 countries over the period 2002-2015.

Dominant currency pricing (cont'd)

Exchange rate pass-through to import prices vs. euro invoicing across euro area countries



Sources: *The international role of the euro*, ECB, July 2015.

Notes: Long-run exchange rate pass-through is estimated using a standard log-linear regression model of the quarterly log change in import price unit values on the quarterly changes of the standard broad measure of the NEER-38 of the euro, a quarterly effective measure of inflation in production costs of the euro area's major trading partners and the quarterly log change in industrial production (excluding construction). The estimation sample spans the time period from the first quarter of 2000 to the last quarter of 2014. The share of euro invoicing reported on the x-axis is the average over the sample period. The black line is a fitted regression line.

4/8/2019

How the U.S. Has Made a Weapon of the Dollar - Bloomberg

Economics

How the U.S. Has Weaponized the Dollar

The currency's "exorbitant privilege" gives the nation extraordinary leverage.

By [Satyajit Das](#)

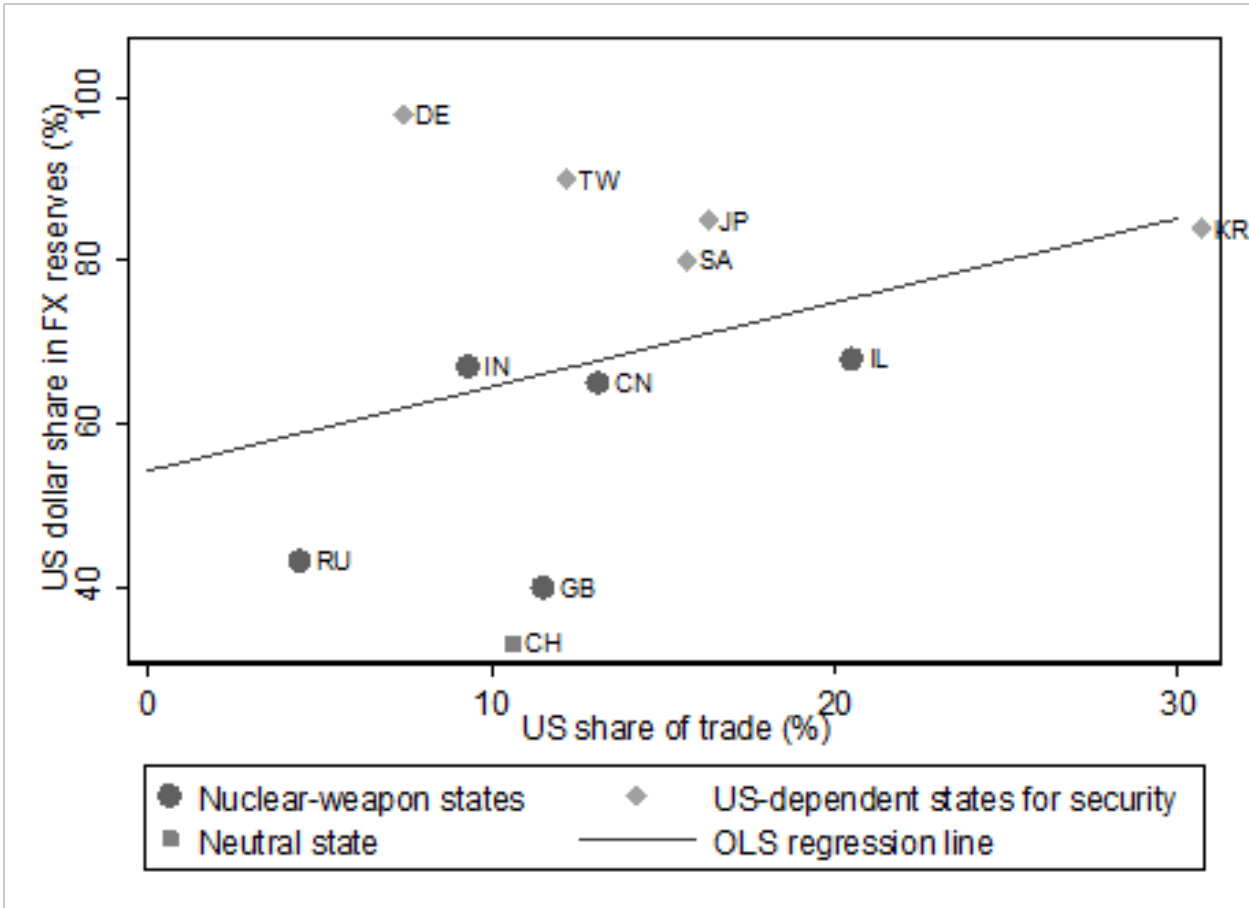
September 7, 2018, 1:00 AM GMT+2



The Mount Washington Hotel, Bretton Woods: Where it all began. *Photographer: Education Images/Universal Images Group Editorial*

Convinced of an existential threat from competitors, America is weaponizing the dollar to preserve its global economic and geopolitical position.

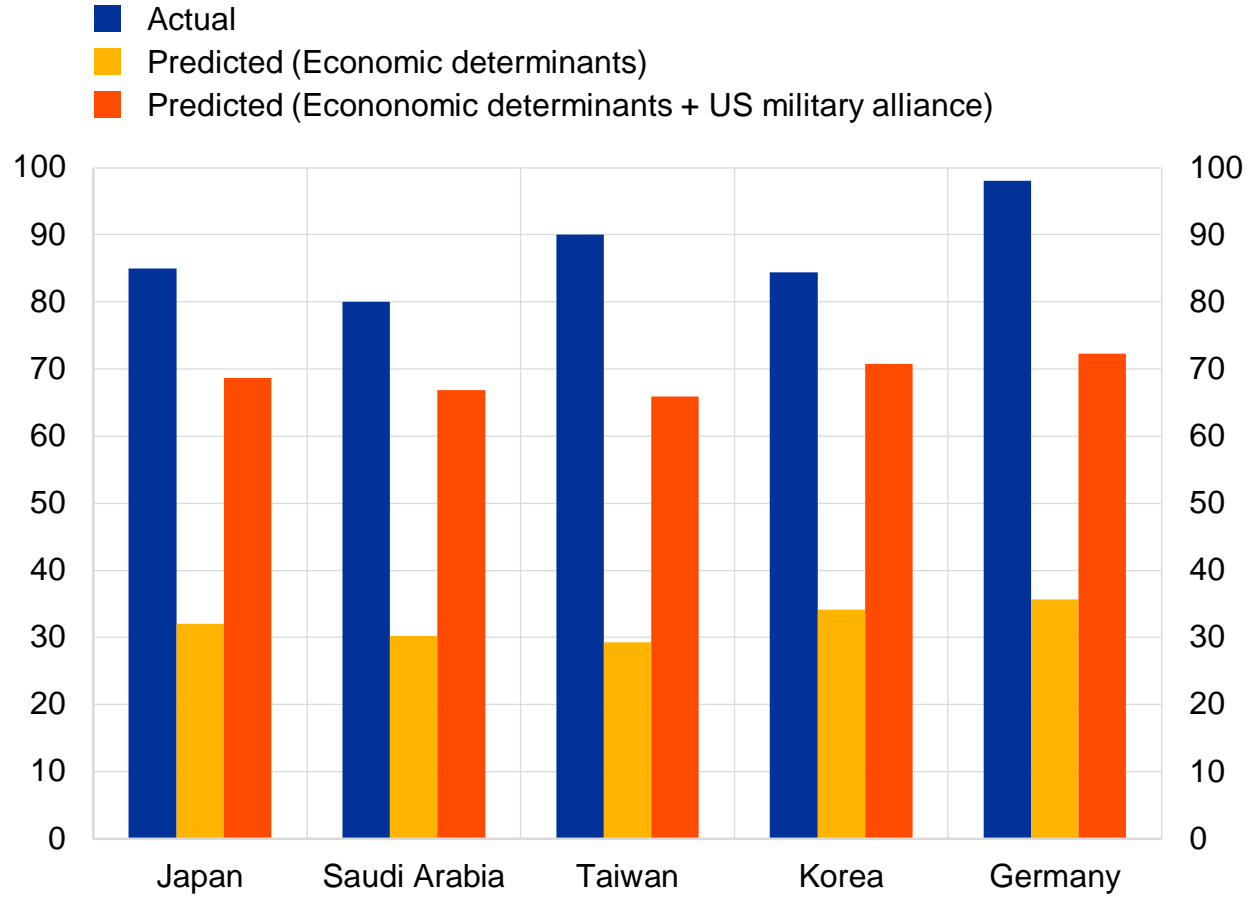
Share of the US dollar in the FX reserves of selected countries (percentages)



Source: Eichengreen, B., A. Mehl and L. Chițu (2019).

Note: The figure plots publicly available estimates of the share of the US dollar in the foreign exchange reserves of nuclear-weapon states (dark grey dot) and US-dependent states for security (light grey diamond) against the share of the US in the trade in goods (exports and imports) of the countries in question (see Table A1 for details and data sources). GB: United Kingdom (estimate for 2004); RU: Russia (estimate for 2016); CN: China (estimate for 2008); IL: Israel (estimate for 2015); IN: India (estimate for 2015); JP: Japan (estimate for 2006); KR: Korea (estimate for 1987); TW: Taiwan (estimate for 2016); SA: Saudi Arabia (guesstimate for 2007); DE: Germany (estimate for 2004); CH: Switzerland (estimate for 2016). France is not reported due to lack of data.

Predicted share of the US dollar in the FX reserves of selected countries (percentages)



Source: Eichengreen, B., A. Mehl and L. Chițu (2019).

Note: The figures show the predicted shares of the US dollar in the foreign reserve holdings of five countries which depend on the US security umbrella. Predicted shares are computed under two scenarios: (i) using estimates from a model restricted to standard economic determinants of international currency choice (shown as yellow bars); and (ii) using estimates from a model expanded to include the effect on international currency choice of the countries' US military alliance (shown as red bars). Actual US dollar shares are shown as blue bars. The actual dollar shares are based on publicly available estimates for the year 1987 (Korea), 2004 (Germany), 2006 (Japan), 2007 (Saudi Arabia) and 2016 (Taiwan); see Eichengreen et al. (2019) for further details on the sources for the data.

3 questions

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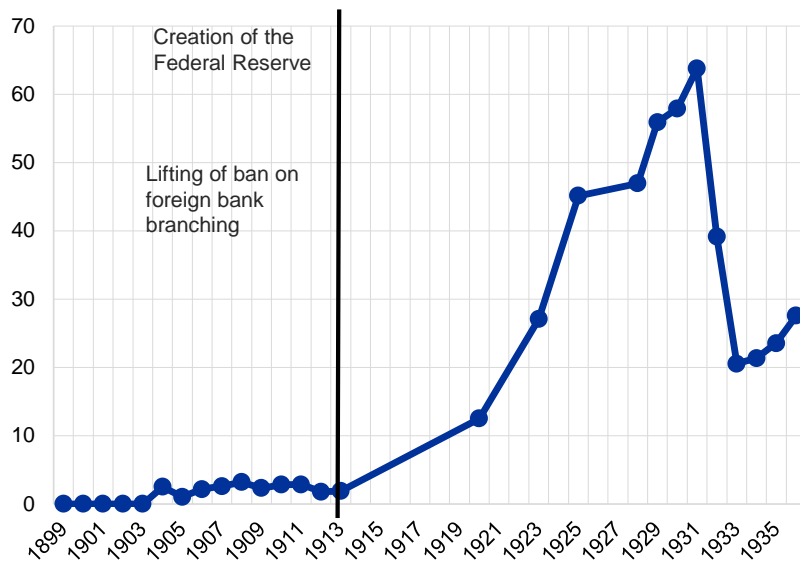
- **Completing the architecture of EMU and the Banking Union will make the euro area more resilient**
- **Economic and Monetary Union – important next steps**
 - Common fiscal capacity
(e.g. budgetary instrument for convergence and competitiveness to provide financial support for key reforms and support public investment; euro area budget can also create common safe assets)
 - Sound fiscal policies and structural reforms in Member States
(incl. review of the 6/2 packs with the aim of making the fiscal policy framework and the economic imbalance procedure more effective)
 - ESM reform
- **Banking Union – important next steps**
 - Making further progress in risk reduction
 - Developing a framework for liquidity in resolution
 - Operationalizing the common backstop to the SRF
 - Making progress towards EDIS
 - Addressing national fragmentation

- **CMU can support the international role of the euro by both *developing* and *integrating* EU financial markets.**
- **Need to create a truly *single*, *deep* and *liquid* EU capital market.**
- **CMU initiatives supporting the international role of the euro:**
 - Covered bonds Regulation and Directive
 - Simple, transparent and standardized securitization (STSS)
 - Sustainable finance action plan
 - Improving and harmonizing insolvency frameworks in the EU
 - Review of European Supervisory Agencies (ESAs)
 - Adoption of a Common Consolidated Corporate Tax Base (CCCTB)
 - Creation of a Personal European Pension Product (PEPP)
 - Stable and credible financial benchmarks

Policy reforms key for US dollar's ascent as international currency

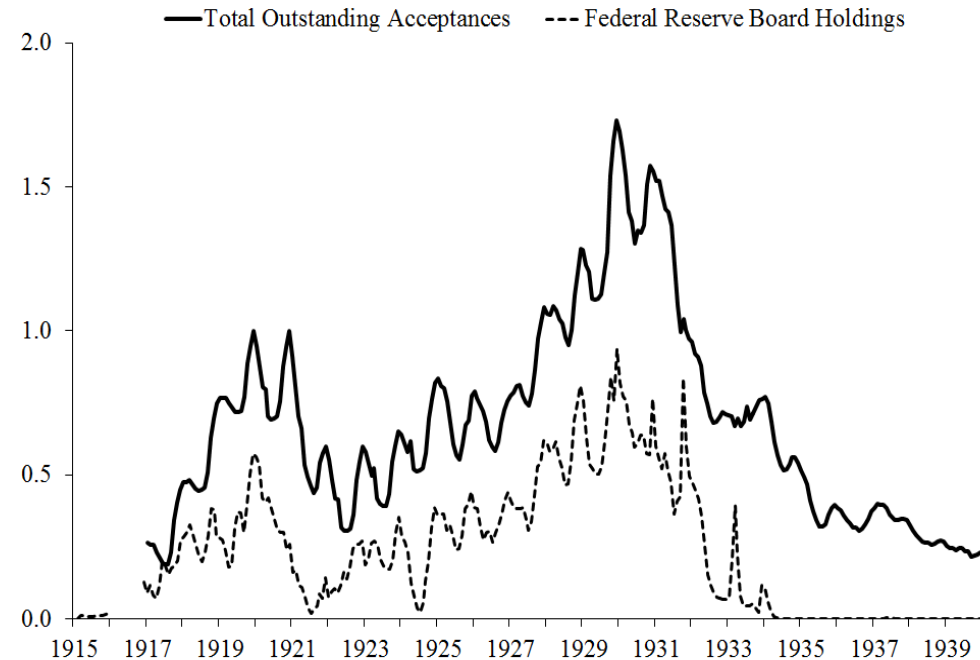
Fed's creation and abolition of foreign bank branching restrictions supportive of USD's ascent

(USD share of global FX reserves, %)



Fed's role a market maker in US dollar debt securities markets also supportive

(USD billion)

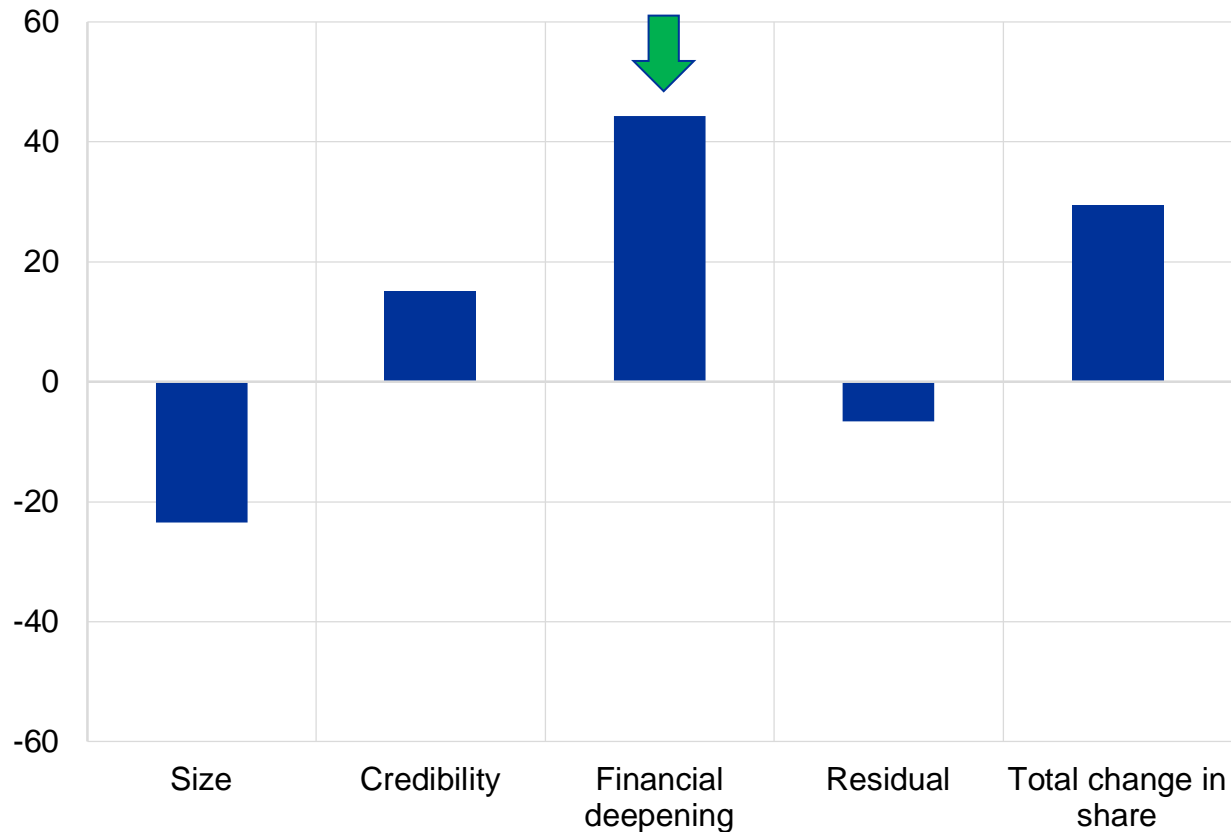


Sources: Eichengreen and Flandreau (2010), Lindert (1969), Eichengreen, Mehl & Chitu (2017).

Source: Eichengreen and Flandreau (2010).

Financial deepening key for US dollar's ascent as international currency

Contributions to the change in the US dollar's share of international debt securities: 1918-1932 (percentage points)



Source: Chițu, Eichengreen and Mehl (2014).

Note: The contributions are calculated as long-run effects from a dynamic regression model (i.e. they include inertia effects).

- **The euro's global role has been declining, not least due to market doubts about the resilience of the euro area.**
- **Sound macro-economic policies and deeper Economic Monetary Union and Capital Markets Union are key factors to support the euro's international role.**

- **The Eurosystem operates infrastructure services facilitating the free flow of cash, securities and collateral across Europe**
 - TARGET2 (real time gross settlement of payments), T2S (securities settlement) and TIPS (instant payments settlement)
- **These services strengthen *efficiency* of market infrastructures and foster financial market *integration***
- **Recent Eurosystem initiatives (e.g. TIPS; TARGET2 and T2S consolidation) will bring us closer to the goal of a truly single financial market in Europe**
- **In turn, euro-denominated financial markets become more attractive to foreign market participants**