EUROPEAN CENTRAL BANK

EUROSYSTEM

The international role of the euro

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Outline

1. **Recent developments in the international role of the euro**

2. Determinants of the euro's international role

3. Policies supportive of the euro's international role

4. Monetary policy considerations

5. Conclusions

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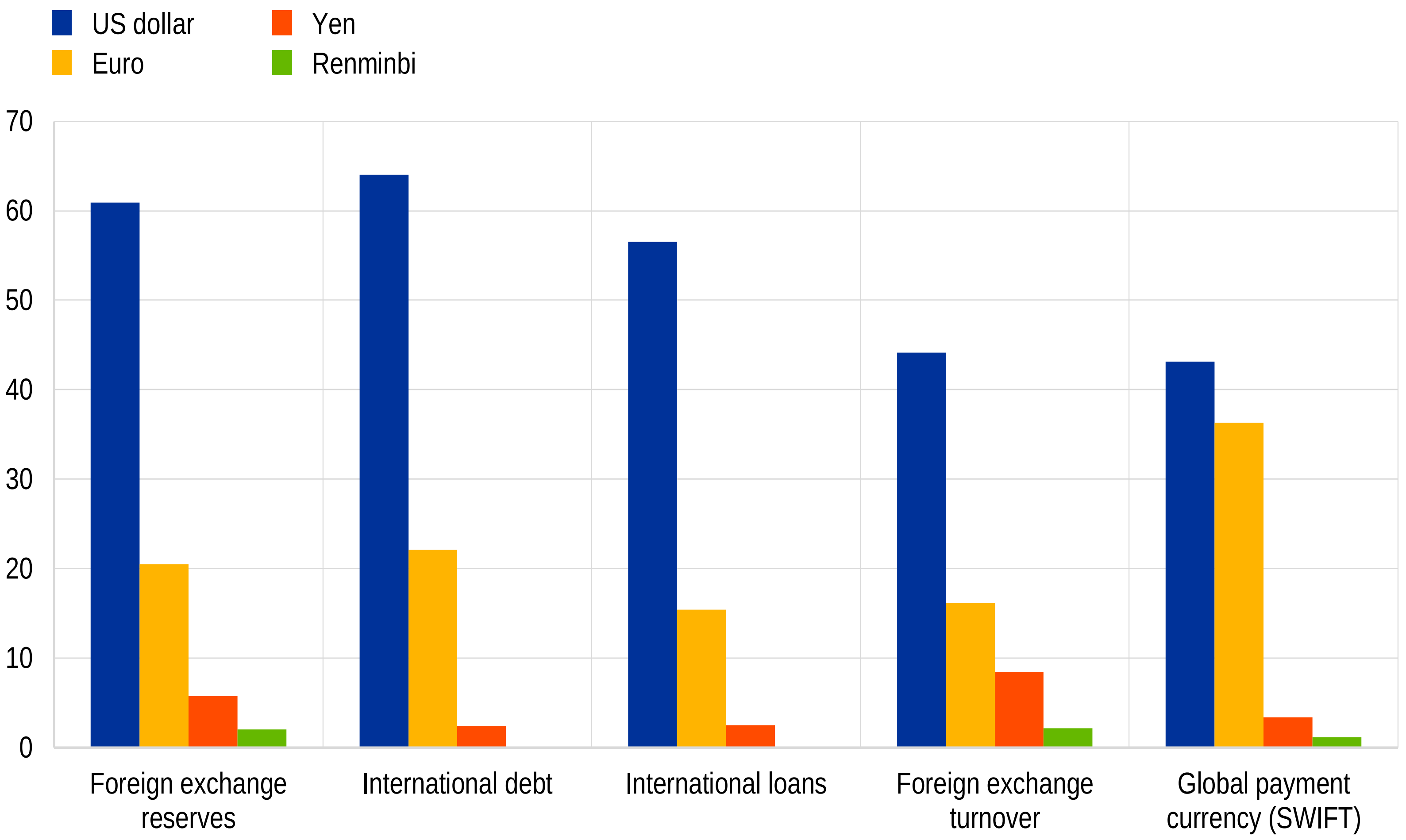
The euro remains the undisputed second most important currency globally

Snapshot of the international monetary system

(percentages)



Sources: BIS, CLS, IMF, SWIFT and ECB calculations.
Note:The latest data are for the fourth quarter of 2019.

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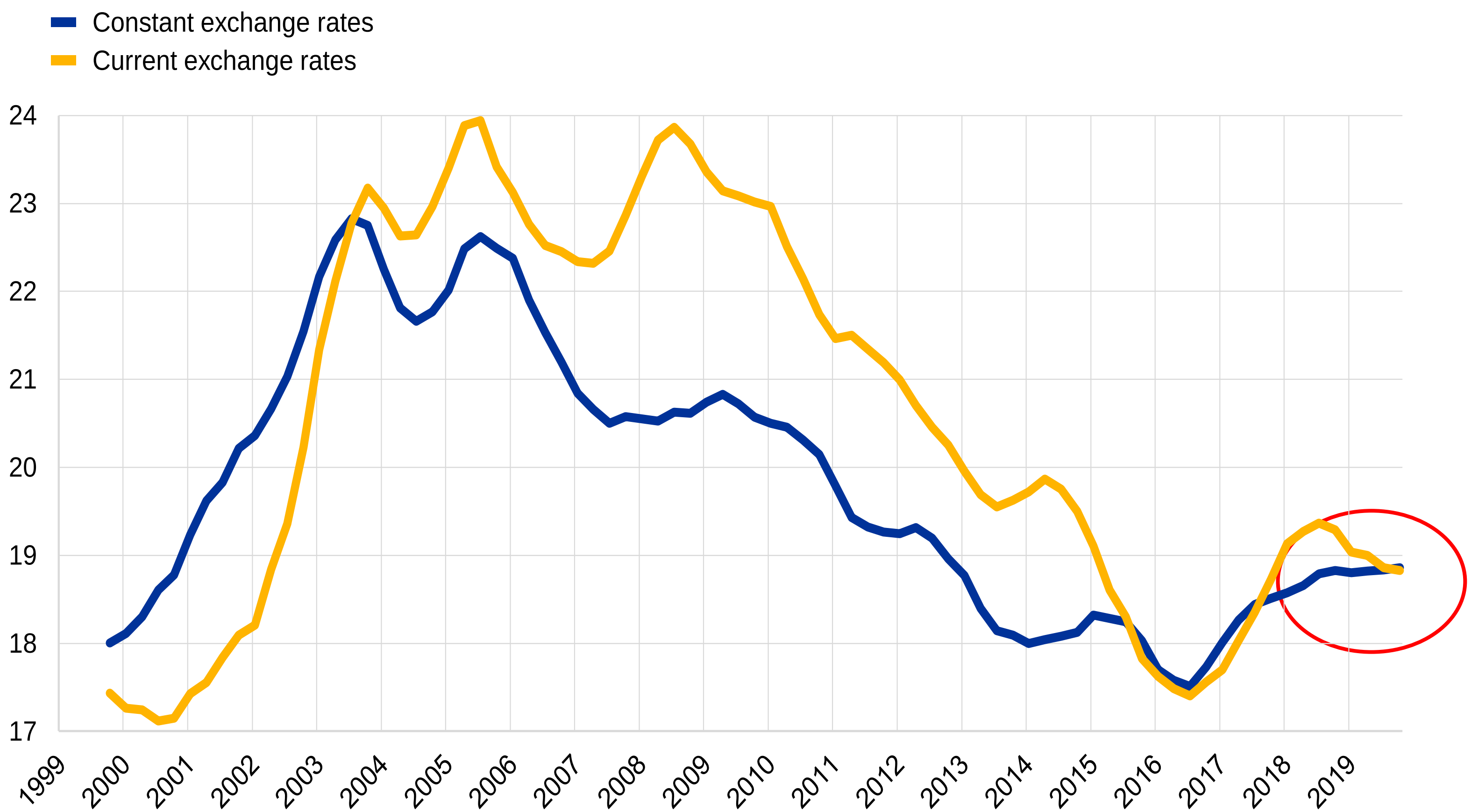
The euro's international role remained stable at a historically low level in 2019

Composite index of the international role of the euro

(percentages; at current and Q4 2019 exchange rates; four-quarter moving averages)



Sources: BIS, IMF, Ilzetzki, Reinhart and Rogoff (2019) and ECB calculations.
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, global foreign exchange turnover, global foreign exchange reserves and in global exchange rate regimes. Data at constant exchange rates are not available for global foreign exchange turnover. The estimates for the share of the euro in global exchange rate regimes between 2016 and 2019 were obtained by ECB staff using the same methodology as Ilzetzki, Ethan, Carmen Reinhart and Kenneth Rogoff (2019), "Exchange Arrangements Entering the 21st Century: Which Anchor Will Hold?" Quarterly Journal of Economics 134 (2), pp. 599-646. The latest observations are for the fourth quarter of 2019.

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Reasons for the decline in the euro’s role since the global financial crisis

General

- The euro area sovereign debt crisis raised concerns about the euro’s future

Investment currency

- Increased diversification of official portfolios towards other currencies (AUD, CAD, RMB)

- Relatively low interest rates lowered the attractiveness of investments in euro-denominated securities

Financing currency

- Rising share of global debt issuance by emerging market economies (which is traditionally dollar-oriented)

- Higher currency swap costs reduced the attractiveness of the euro as a funding currency for acquiring dollars

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International currency status rests on mutually reinforcing determinants

Economic size

Stability (economic, financial, political)

Sound institutions

Financial openness

Liquidity/depth of financial markets

Efficient financial market infrastructures for payments and settlements

Geopolitical outreach

Inertia and network effects

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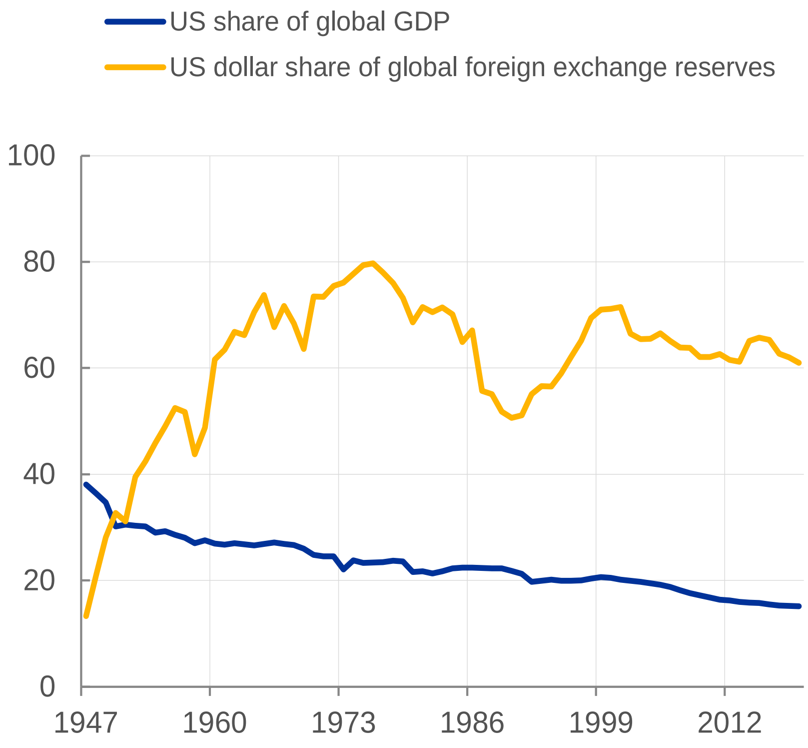
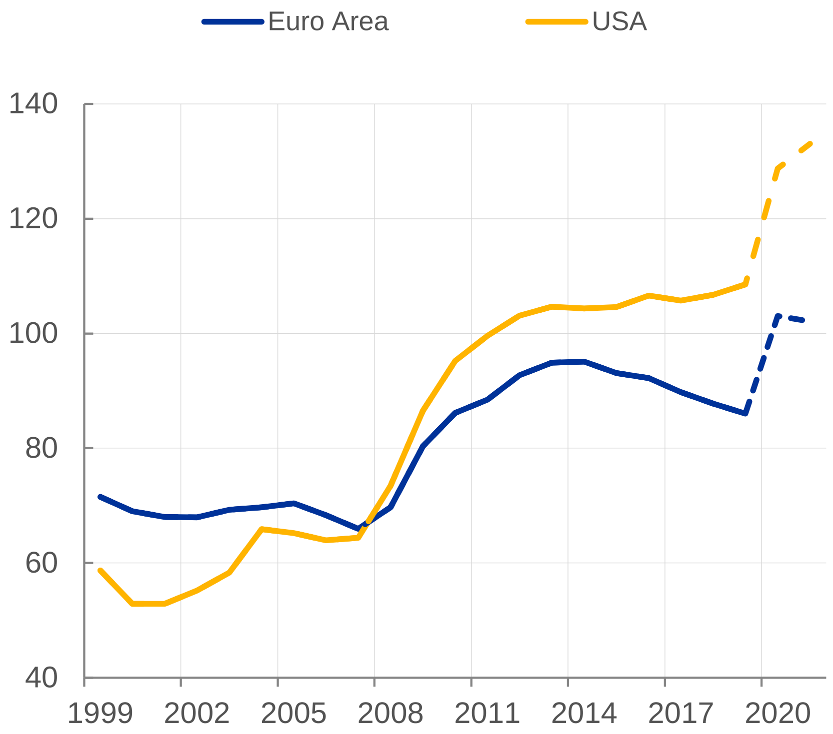
The role of the US in the global economy is shrinking while its public debt is rising

Importance of the US and the US dollar in the global economy
(percentages)



Sources: Maddison project, Haver analytics and Eichengreen, Mehl and Chiţu (2016).
Note: share of the US in global GDP is in PPP terms.
Latest observation: 2019.

Gross government debt
(percentage of GDP)

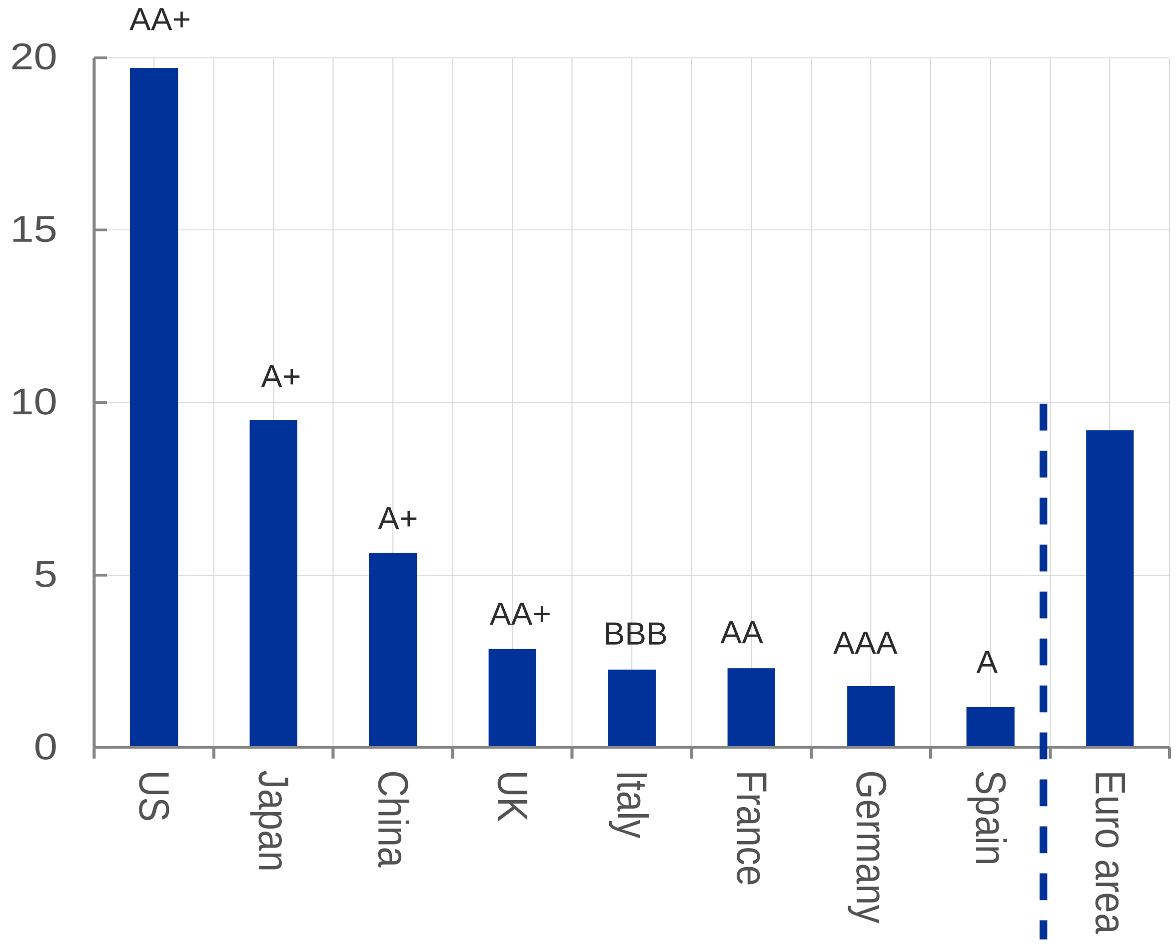


Sources: OECD, Economic Outlook.
Notes: Dashed lines are forecast values. Forecast for the single-hit scenario.
Latest observation: 2019, forecast values for 2020 and 2021.

However, market depth and liquidity still paramount to the US dollar's leading role

Amount outstanding of central government debt securities

(USD trillions)



Sources: BIS and Bloomberg
Notes: The data refer to total debt securities issued by the central government. The latest Standard & Poor's long-term sovereign debt rating is reported above each blue bar.
Latest observation: Dec-2019

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Comparison of determinants of international currency status: USD, EUR, RMB

	Size	Stability	Trade openness	Market depth/liquidity	Financial openness	Global econ. policy influence
	GDP / world GDP	Public debt / GDP	Trade / GDP	Stock of government bonds	Chinn-Ito index	Share in SDR basket
US	**15%**	**106%**	**10%**	**$ 20 trn**	**100%**	**42%**
Euro area	**11%**	**84%**	**19%**	**$ 9 trn**	**100%**	**31%**
China	**19%**	**56%**	**18%**	**$ 6 trn**	**17%**	**11%**

Sources: Haver Analytics, BIS debt securities statistics and ECB staff calculations.
Notes: Size corresponds to GDP as a % of world GDP in PPP. Stability is measured as the general government debt as a % of domestic GDP . Openness corresponds to the share of trade in goods as a % of domestic, excluding intra-euro area trade. Market liquidity is measured as the total outstanding amount of general government debt securities. The Chinn-Ito index is the normalised first principal component of regulatory controls on current or capital account transactions reported to the IMF (100%: economy fully open financially; 0%: economy fully closed financially). The formula used by the IMF to determine currency weights in the SDR basket assigns equal shares to the currency issuer's exports and a composite financial indicator (the financial indicator comprises, in equal shares, official reserves denominated in the member's (or monetary union's) currency that are held by other monetary authorities that are not issuers of the relevant currency, foreign exchange turnover in the currency, and the sum of outstanding international bank liabilities and international debt securities denominated in the currency).
Latest observation: 2019 (2017 for the Chinn-Ito index)

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Determinants can be influenced by policies

Economic size

Stability (economic, financial, political)

Sound institutions

- Price stability, Financial stability
- Sound fiscal & structural policies
- Deeper EMU & Banking Union

Financial openness

Liquidity/depth of financial markets

Efficient financial market infrastructures for payments and settlements

- Capital Markets Union
- Common debt issuance
- ECB euro liquidity lines
- Initiatives on markets and payments infrastructure

Geopolitical outreach

Inertia and network effects

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Stronger euro area resilience is important to raise the euro's global status

- **Need to reduce vulnerabilities of euro area economies**

- **"Next Generation EU" (notably the Recovery Fund) and common European short-term safety nets related to the Covid-19 crisis (ESM, EIB, SURE) should help strengthening the euro area resilience and the euro´s international role.**
- **Associated rise in EU debt issuance will help creating deeper euro market**

- **Completing the architecture of EMU and the Banking Union will make the euro area more resilient**
  - **Banking union – important next steps:**
    - Remove impediments to further integration, such as
      - *Requirements to hold capital/liquidity in subsidiaries rather than at group level*
      - *National options and discretion*
      - *Differences in bank insolvency laws*
    - Establish framework for liquidity to banks in resolution
    - Overcome structural weaknesses in the banking sector
    - Further improve the crisis management framework
    - Finalise the European Deposit Insurance Scheme
  - **Economic and Monetary Union – important next steps:**
    - Make the Stability and Growth Pact and the economic policy instruments (CSRs/MIP) more effective
    - Establish a permanent common fiscal capacity
    - Conclude ESM reform

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The Capital Markets Union is also important to raise the euro’s global status

- **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:**
  - **Harmonisation of framework conditions (e.g. taxation, insolvency regimes)**
  - **Harmonisation of products (e.g. green bonds)**
  - **Harmonisation of market supervision and regulation**
  - **Harmonisation of market infrastructures**

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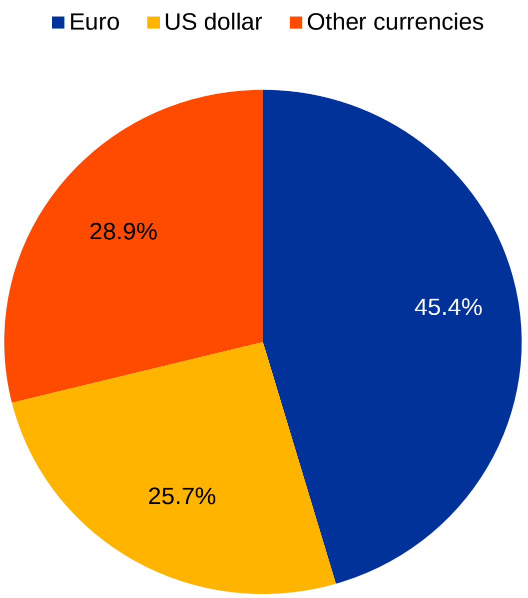
Euro is increasingly used by non-residents for issuing green bonds

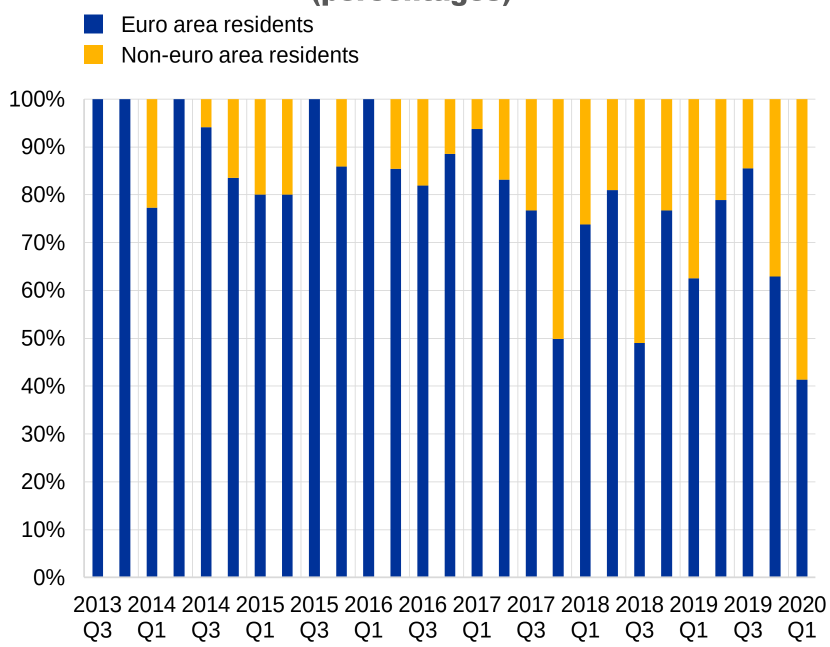
Currency breakdown of green bond issuance in 2019

(percentages)



Breakdown of green bond issuance in euro by issuer residence

(percentages)



Sources: Dealogic and ECB calculations.

Note: Last observation 31 January 2020.

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Efficient market infrastructures & payments raise the euro's global status indirectly

- **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)

  TARGET2 and T2S consolidation will bring us closer to the goal of a truly single financial market in Europe

  As part of the European payments strategy, the Eurosystem supports initiatives towards a pan-European retail payment solution

- **These services strengthen *efficiency* of market infrastructures and foster financial market *integration;* in turn, euro-denominated financial markets become more attractive to foreign market participants**

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CBDC and stablecoins can affect the international role of currencies

- **Growing interest in digital forms of payments**
  - Inconvenience of using banknotes
  - Covid19 has increased demand for contacless forms of payments
  - China's progress on its electronic payment project
  - Innovative private sector initiatives (e.g. Libra)
  - International central bank cooperation on Central Bank Digital Currencies (CBDC)

- **CBDC can affect international role of currencies if use by non-residents is permitted**

- **Libra could affect the international role of currencies as well**
  - Envisaged Libra basket has a rather high share of USD (50%) compared to EUR (18%)
  - Single-currency stablecoins (dollar-libra, euro-libra, etc.) may be more attractive to operate in an environment of non-negative interest rates, favouring the USD at present

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Monetary policy considerations on a stronger international role of the euro

1999 assessment in blue 2020 assessment in red

Benefits

Seigniorage

Lower transaction and hedging costs

Exorbitant privilege

(lower external financing costs)

Greater monetary policy autonomy

Stronger international transmission of monetary policy with positive spillbacks

Lower pass-through reduces impact of FX shocks on CPI

Reduced exposure to unilateral decisions from third countries

Costs

Blurred monetary aggregate signals (?)

Capital flow volatility (?)

Exorbitant duty

(stronger exchange rate and risk of asset fire sales in global stress episodes; need for provision of liquidity backstop)

Lower effects of monetary policy on import prices

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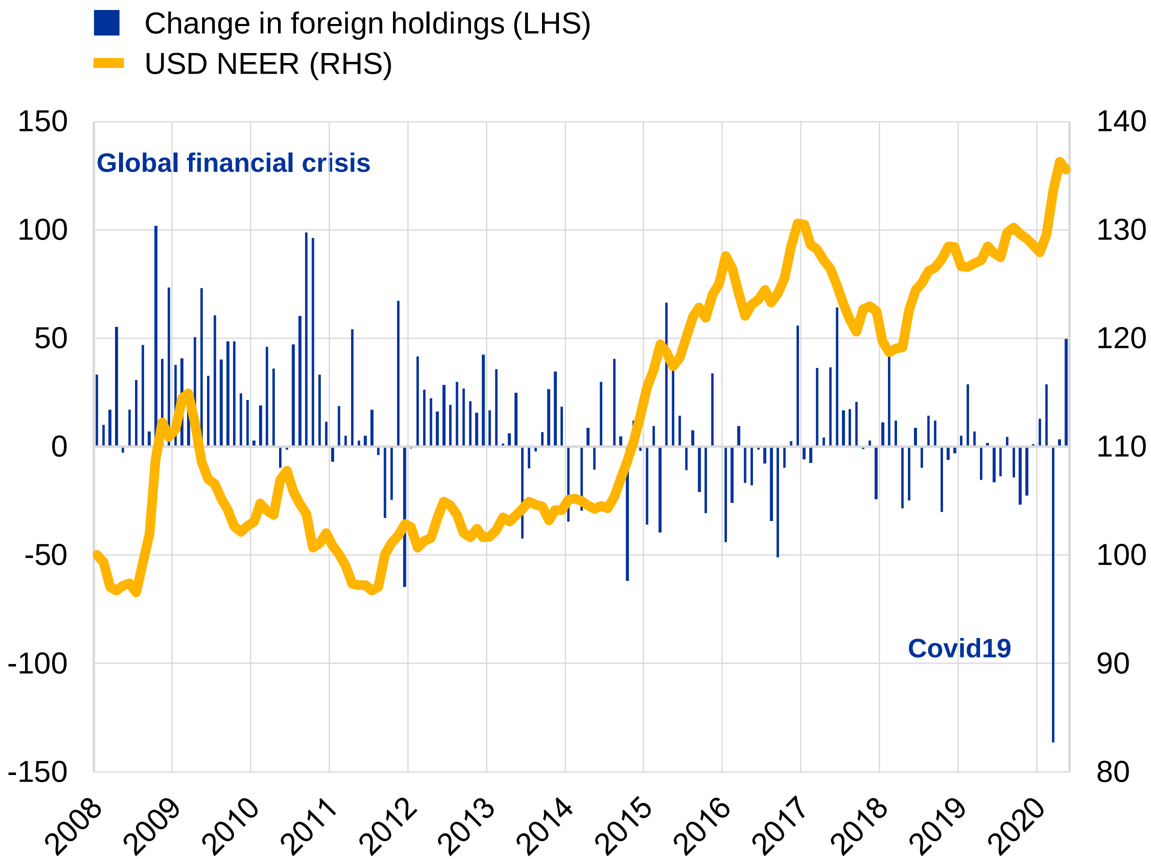
Covid led to search for USD liquidity

USD NEER and changes in foreign official holdings of US Treasury securities at the New York Fed

(left-hand side: USD billions; right-hand side: index: 2008 = 100)



Sources: Haver Analytics
Latest observation: May 2020.

Fed reactions:

15 March 2020: reduced swap pricing, 84-day operations
(with Bank of Canada, Bank of England, Bank of Japan, ECB and Swiss National Bank)

19 March 2020: temporary swap lines with central banks of 9 other countries
(Australia, Brazil, Denmark, Korea, Mexico, Singapore, Sweden, New Zealand; Norway)

31 March 2020: temporary FIMA facility
(repos offered to foreign monetary international authority account holders at NY Fed)

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ECB framework for liquidity lines with non-euro area central banks

- **Standing swap line network with countries** whose currencies play a significant role in global financial markets *(Canada, Japan, Switzerland, UK, US)*

- **Bilateral swap line agreements** where the Eurosystem exchanges euro against another currency *(China; Bulgaria, Croatia, Denmark; temporary)*

- **Bilateral repo lines agreements** where the Eurosystem provides euro liquidity against euro-denominated collateral to foreign central banks of countries *(Romania; temporary)*

- **EUREP (Eurosystem repo facility for central banks):** temporary, precautionary backstop facility accessible to a broad range of non-euro area central banks

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ECB liquidity lines are motivated by monetary policy objectives

- The provision of euro liquidity to non-euro area central banks aims at **addressing euro liquidity needs of banks and companies located in these countries** in a stressed market environment.

- Providing euro liquidity to non-euro area central banks in crisis times **reduces risks related to a) sell-off episodes of euro-denominated assets and b) adverse spill-overs** from other economies to the euro area economy, including through global confidence effects

- Overall, these arrangements **aim to facilitate a smooth transmission of monetary policy**, which benefits all euro area citizens.

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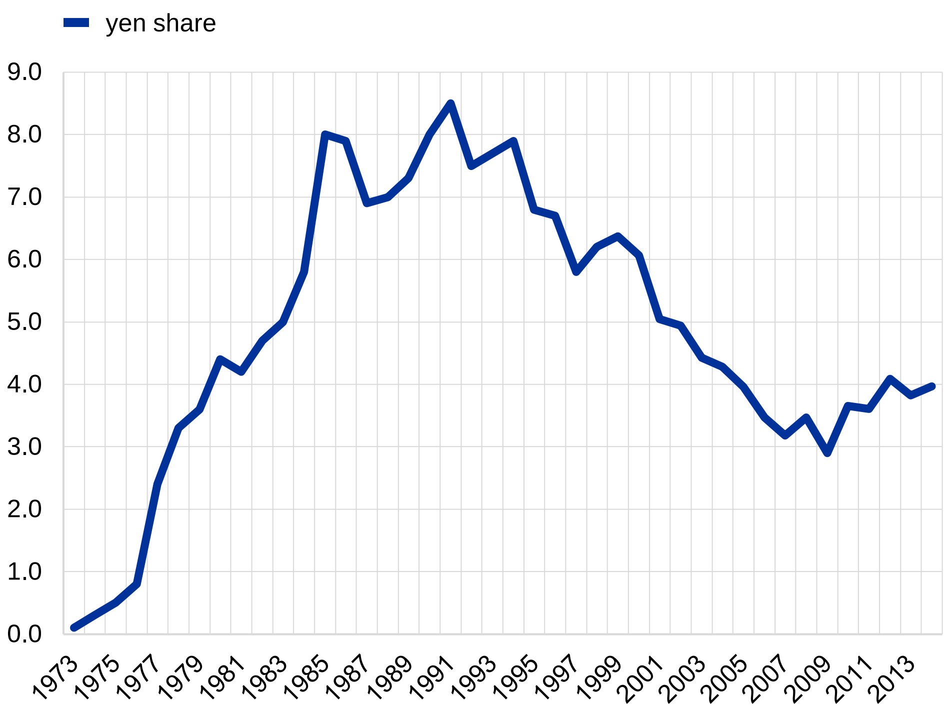
Experience shows that it is difficult to foster international role politically

Yen

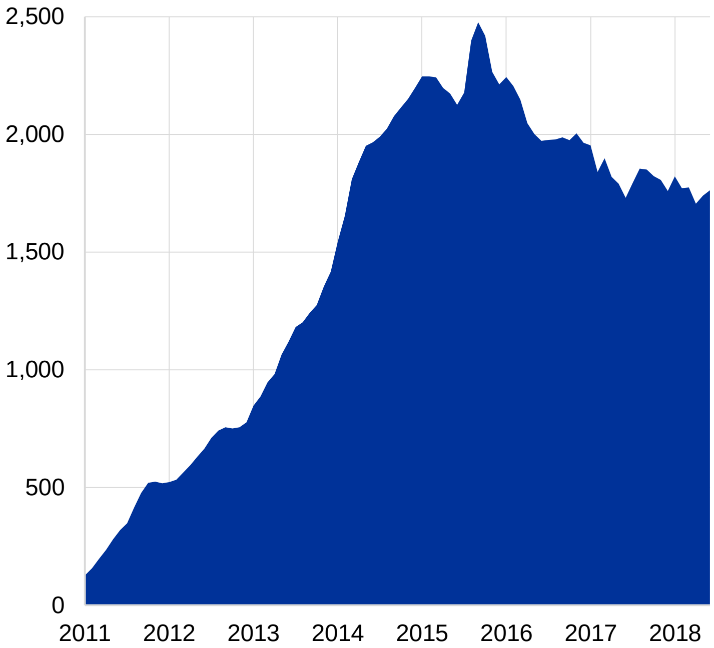
(share of yen in global FX reserves, %)



Source: IMF.

Renminbi

(RMB internationalisation index)



Sources: Bloomberg, Standard Chartered.
Notes: The Renminbi Globalisation Index (RGI) tracks four components with weights inversely proportional to their variance (CNY deposits; trade settlement and other international payments; "Dim Sum" bonds and certificates of deposit issued; foreign exchange turnover – all from an offshore perspective and denominated in renminbi) in several countries. Latest observation: June 2019.

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Conclusions

- **The euro's global role has been hampered by market doubts about the resilience of the euro area.**

- **The euro's global role can be increased lastingly only by strengthening the fundamentals of the euro area**

- **Sound macro-economic policies, deeper Economic Monetary Union and Capital Markets Union are key factors to support the euro's international role**

- **The EU´s response to the Covid-19 crisis should help strengthening the euro area resilience and the euro's international role**

- **The ECB´s resolute pursuit of price stability and financial stability is a key factor supporting the global role of the euro**

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