Motivation

- Dollar is the dominant currency for denoting debt contracts: $11.5 trillion debt outside the US.
- The share of the euro was increasing until 2008, but the financial crisis was a turning point.

This paper in a nutshell

- Why is there a dominant currency?
  - Theoretical: Nominal debt → debt currency choice matters (Fisherian DD channel)
  - DC: depreciate when stock market ↓, corporate debt maturity (6-7y)
  - Role for monetary policy: stimulate in crises → ↑ inflation → FX.

- Why is it the dollar?
  - Empirical: Dollar depreciates when the stock market falls (Horizon > 1 year).
  - Micro data: Choose $ for longer maturity debt.

- What explains the fall and the rise of the dollar in the last 20 years?
  - Theoretical and empirical: Inflation risk premia in the US and the Euro Area.

- Optimal monetary policy?
  - Theoretical: (assigns weights to different countries)
  - Choose weights to reduce the welfare costs of higher dollar leverage.

The intuition of the model

- Firms have nominal debt with face value: \( B_{t} \).
- They receive productivity shocks \( a_{t} \), compact support.

<table>
<thead>
<tr>
<th>Low ( a_{t} )</th>
<th>High ( a_{t} )</th>
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<tbody>
<tr>
<td>Default Threshold (( B_{t}, a_{t} ))</td>
<td>Profit/( a_{t} )</td>
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Higher inflation (→ FX depreciation), thereby CB reduces threshold.

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Firms are better off → ↓ real debt burdens. Ex-ante ↑ leverage.
- Households:
  - Dislike inflation as it lowers their real consumption (dominates).
  - Like it because inflation lowers the default probability.

Conclusion

- We provide a "debt view" for the dollar's dominance.
- International Fisherian debt-deflation in general equilibrium.
- Monetary policy and inflation countercyclicality are key.
- Dollar is dominant: it depreciates in downturns for long horizons.
- If ECB wants euro as a dominant currency → ↑ countercyclicality.
  - Cœure (2019).
- New angle/questions about CBs targeting FX, currency wars.
- Dollar might lose dominance faster than we think. Expectations.

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You can find the latest version of the paper at: https://egemeneren.net/