Can the Euro, the Renminbi challenge the $?

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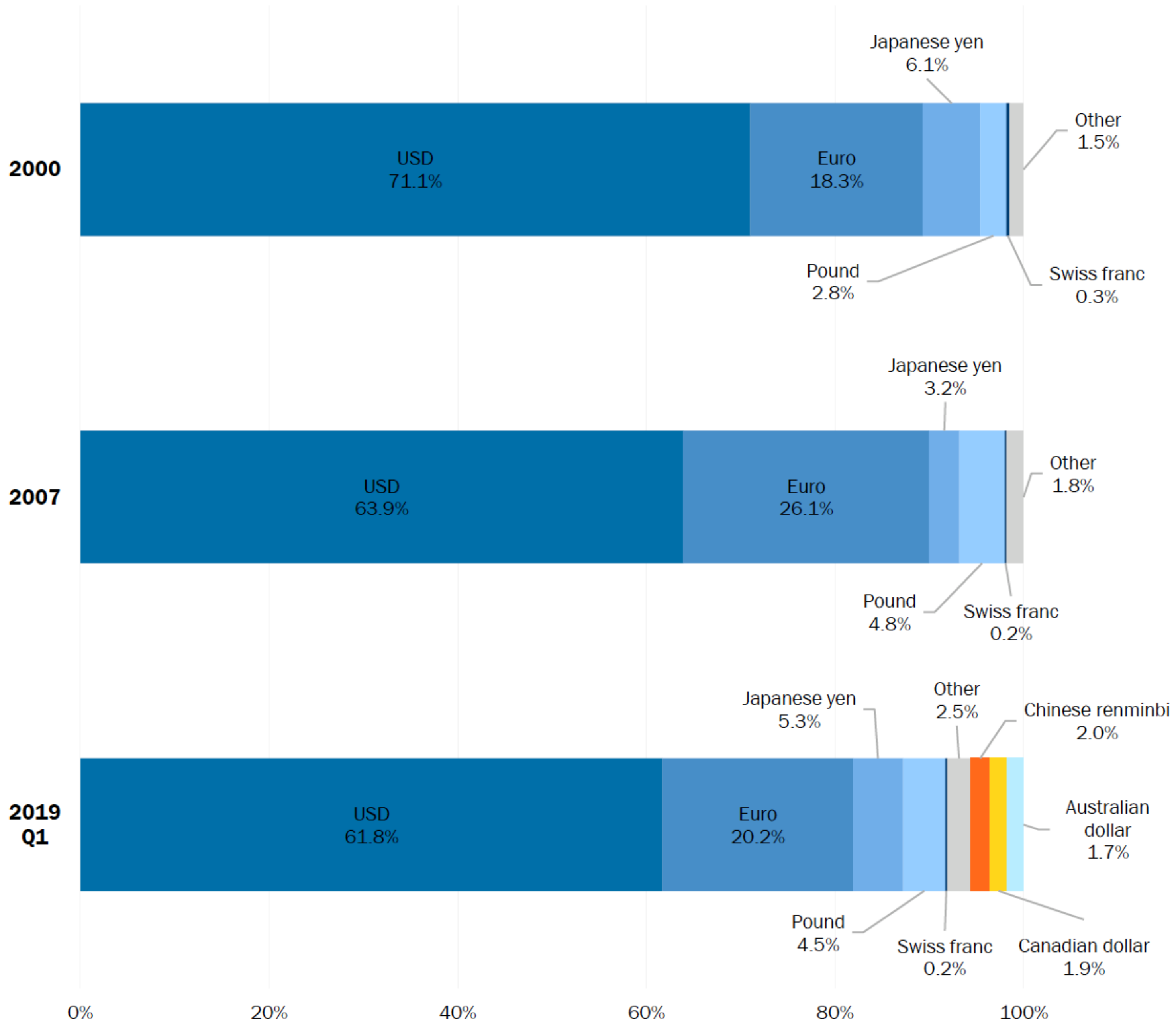
Leading global role of the dollar

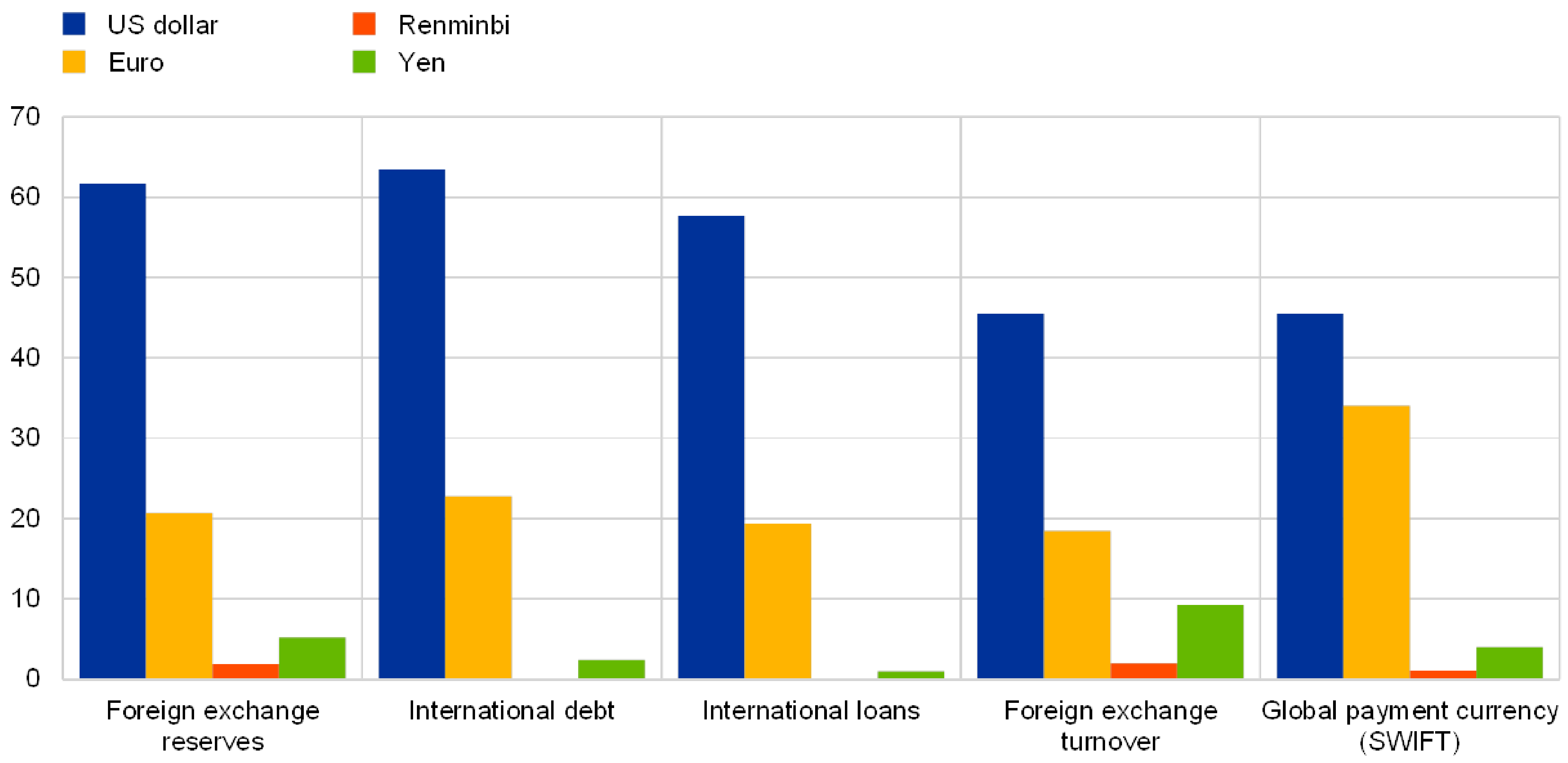
- Reserve currency
- Unit of account &
- Means of payment for international transactions
- Preferred currency of security issuance

Figure 3. Shares of allocated reserves



Leading reserve currency

- The dollar remains by far the dominant global reserve currency
- The initial emergence of the euro has been followed by a decreasing share
- Renminbi a distant top-five – stalling at 2% of global FX reserves



Sources: BIS, CLS Bank International, IMF, SWIFT and ECB calculations.
Note: The latest data are for the fourth quarter of 2018 or the latest available.

Means of settlement & payment

- *”The dollar represents the currency of choice for at least half of international trade invoices, around five times greater than the US’s share in world goods imports, and three times its share in world exports*”
- “*From 2012 to 2019 the dollar’s share of cross-border payments intermediated through the SWIFT messaging network has risen by 10 percentage points to 40 percent while the euro’s share has declined by 10 percentage points to 34 percent. Renminbi under 2 percent*”
- The US dollar is also the currency of choice for securities issuance and holdings: “*2/3 of EME external debt; 2/3 of global securities issuance*”
- Rather on the increase than on the decrease!

Reserve currency: key factors

- Central banks want diversification. The shares of euro and renminbi should increase , but …
- Reserves should be backed by a strong economy
- With liquid financial markets,
- Flexible exchange rates
- Free capital flows
- Safe haven characteristics is an advantage
- Network externalities: the efficiency of a common means of payment

Euro & renminbi: the negatives

- Strength of the economy: EU/EMU a hard road to reform!
- The size and liquidity of the treasury market: a euro-bond market as a pre-requisite
- Free capital flows and flexible exchange rate: still a long way for the renminbi?
- Safe asset property? The most puzzling: a multiple equilibria/coordination problem with considerable inertia

The dollar advantages

- None of the weaknesses above
- The advantage of the incumbent: hard to move from one equilibrium to another.
- The US dollar’s widespread use in trade-invoicing and its increasing prominence in global banking and finance are mutually reinforcing

“With large volumes of trades invoiced and paid for in dollars, it makes sense to hold dollar-denominated assets. Increased demand for dollar assets lowers their return, creating an incentive for firms to borrow in dollars. Liquidity and safety encourage this further. Companies with dollar liabilities have an incentive to invoice in dollars to reduce their currency mismatch. More dollar issuance by non-financial companies and more dollar funding for local banks makes it wise for central banks to accumulate dollar reserves.”

An efficient and stable equilibrium?

- The fundamentals would lead to a positive answer, BUT…
- A common means of payment is a public good, benefiting the issuer, that should not be exploited for political advantage
- Misuse of the dollar hegemony provides a strong impetus for change
- Compounded by Trump's unreliability and mistrust of multilateral cooperation
- Can this lead to a new equilibrium?

The beginning of the end of the $ hegemony?

- Increasing euro and renminbi pricing and settlements when the US is not involved (in Europe and between Europe, China & Russia)
- Starting point but weaknesses remain
- Not clear that the rest of the EMEs will follow suit despite them having the most to gain
- Increasing perception that the dollar hegemony is not what the new world needs: leads to a global financial cycle, and an effective loss of monetary sovereignty, notably for EME's

Is technology the answer?

- The weaknesses of the alternative reserve currencies mean that they are not plausible candidate for world dominance, i.e., for replacing the dollar
- Towards a multipolar system?
- Digitalization as the trigger? Could it be the Libra? More plausibly, a new Synthetic Hegemonic Currency (SHC) provided by the public sector?

Note on the SHC

- Could it worsen rather then alleviate the constraints imposed by the global financial cycle?
- Benigno, Schilling & Uhlig (2019): “towards a crypto-enforced monetary policy synchronisation”