Competing Currencies

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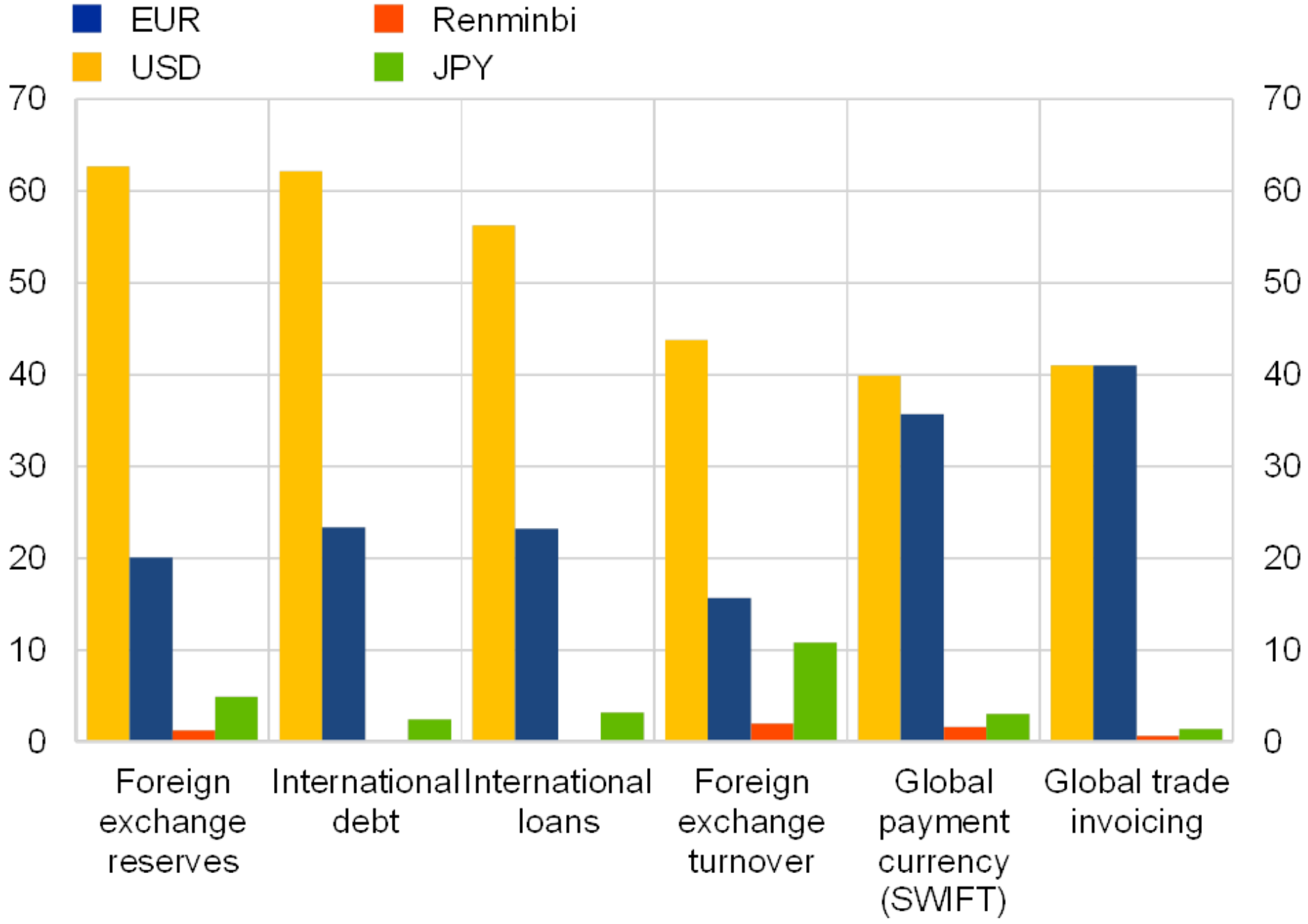
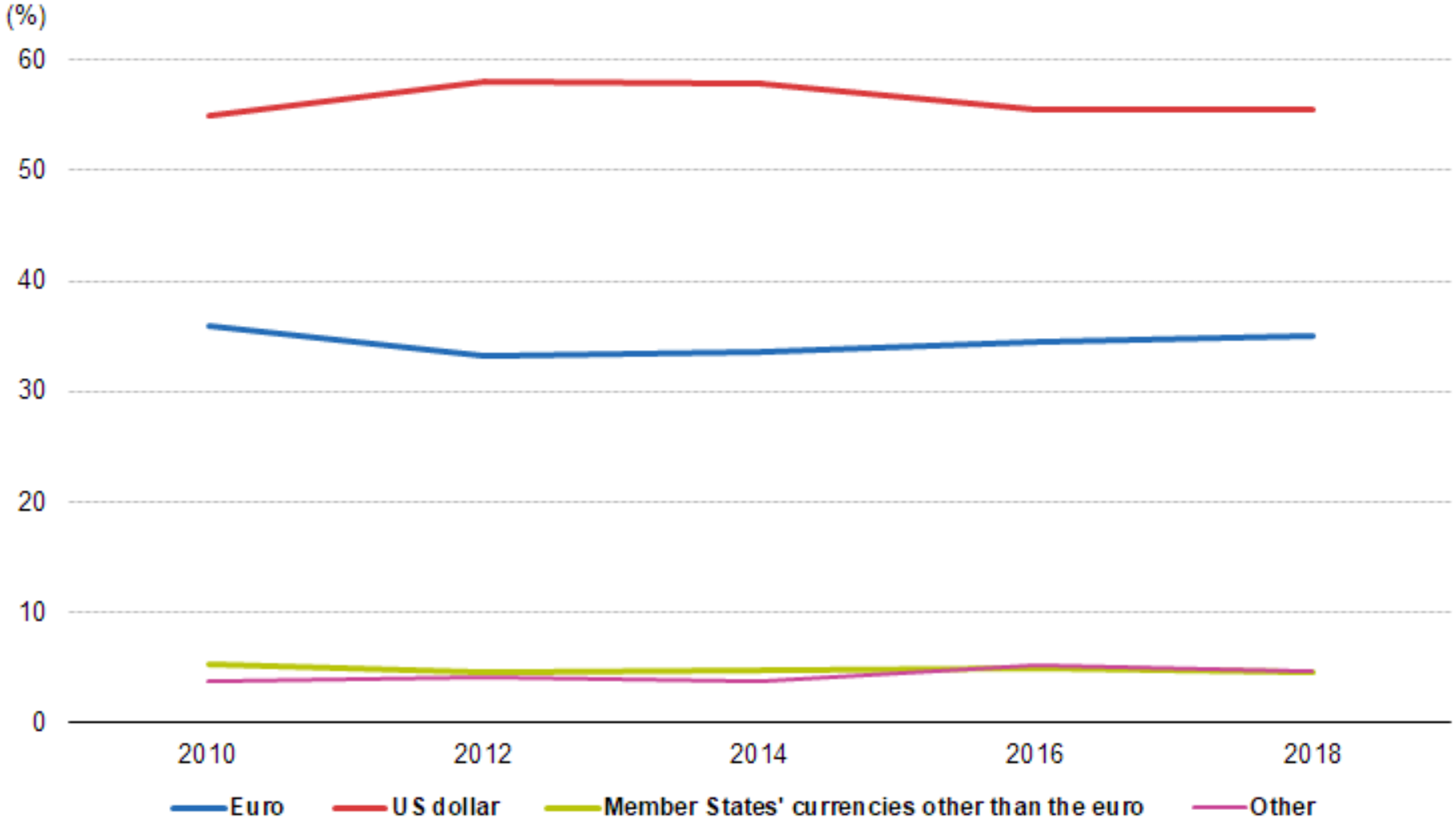

EUR
Renminbi
USD
JPY
70
60
50
40
30
20
10
0
Foreign exchange reserves
International debt
International loans
Foreign exchange turnover
Global payment currency (SWIFT)
Global trade invoicing

Extra-EU imports of goods by invoicing currency, 2010-2018



Source: Eurostat (online data code: ext_lt_invcur)

eurostat

Perspectives on global currency

- **International Trade**:
  - Dominant Currency Pricing
  - The Chinese Paradox.

- **International Finance**:
  - International Capital Flows
    - Debt Pricing (Currency Mistmatch)
  - International Reserves

Old Paradigms in International Trade Currency Pricing

- Producer Currency Pricing: Law of one price
  - a nominal depreciation raises the price of imports relative to exports (the terms-of-trade) thus improving competitiveness.
- Local Currency Pricing: Law of one price fails.
  - a nominal depreciation lowers the price of imports relative to exports, a decline in the terms-of-trade, thus worsening competitiveness.
- Instead, the vast majority of trade is invoiced in a small number of 'dominant currencies,'

Dominant Currency Paradigm (Gopinath, Gourinchas et al., 2019)

- Under DCP, firms set export prices in a dominant currency and change them infrequently.
- The stability of the terms-of-trade under DCP follows from the pricing of imports and exports in a common currency and the low sensitivity of these prices to ER fluctuations.
- DCP stabilizes terms-of-trade
  - Monetary Policy stabilizes financial shocks, target domestic sources of inflation.

Dominant Currency Paradigm

- For non-dominant countries: high exchange rate pass-through
- For the dominant, low pass-through into import prices
- When the dominant ER appreciates uniformly against all other currencies, it should lead to a decline in trade between countries in the rest of the world (i.e. excluding the dominant).
- Contractionary Monetary Policy Shocks in the dominant country have strong spillovers to MP in the rest-of-the world and reduce Rest of the World and global trade
- MP shocks in non-dominant currency countries generate only weak spillovers and have little impact on world trade.

Implication for the Euro

- Dominant Currency Pricing with more than one dominant currency is not very well understood.
  - Currency Choice
  - Coordination of Monetary policy amond dominants.
- Asymmetry Dollar vs. Euro
- Import-Price Channel of Monetary Policy and Pass Through
  - As of today, more than 90% of US imports are invoiced in US dollars.
  - By comparison, less than 50% of extra-euro area imports are invoiced in euro.
  - If this share were to increase to, say, 70%, the sensitivity of import prices to exchange rate movements would decline by around one-third.

The Chinese Paradox

- China in order to manipulate the value of its currency cannot not be fully integrated in international capital market.
- With global dominant currency pricing, the exports gains from currency manipulation are more limited.
- China does not want to be on the wrong side of the dominant currency divide.
- Trade War substituting Currency War

Collateral Damages of Global Currencies

- Effect on non-global currency players
- **Trade**
  - Large fluctuations in trade for non-global currency player
  - Implications for global trade and global demand.
- **Crisis Risk**
  - Currency mistmatch
  - Boom-bust cycles and crises

Currency Mismatch Paradigm Tornell-Ranciere (2008, 2016)

- Emerging Markets Perspective
- Currency Mismatch: Revenues in Domestic Currency; Debt Issuances in Foreign Currencies.
- Less True for Sovereigns
  - Local Currency
- Still True for Corporates
  - Discipline on government.

Currency Mismatch Paradigm

- Currency Mismatch and the Real Exchange Rate
- Non-Tradable Sector borrow in foreign currency
- Self-reinforcing mechansim in good times (cheaper cost of funds) and in bad times (default risk)
- Boom-bust Cycles.
- Bad: not necessarily: crisis risk is a way to go around financial bottleneck and can boost investment and growth (Tornell-Ranciere)

International Reserves (Jeanne-Ranciere, 2011)

- Reserves as insurance agains sudden stop in capital flows:
  - More reserves lower the probability of sudden stops
  - Reserves are used to mitigate the sudden stop.
  - Central Bank liquidity as a buffer.
- Composition of reserves
  - Liquidity needs in different currencies
  - Exchange Rate depreciation (hedging)