Some Remarks on the Euro's International Role

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June 2020

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- "The euro's international role remained broadly stable…"
  - Is this a positive assessment?
  - Or code for lack of progress?
  - It is both, of course.
  - Europe has once again put existential doubts to rest. (The euro isn't going anywhere.)
  - But neither is the euro catching up with the $.
    - (Another meaning of "isn't going anywhere.")

I’m sympathetic to the broad analytical framework.

- When I talk about the “secret sauce” that makes for an international currency, I emphasize four ingredients:
  - Size
  - Stability
  - Liquidity
  - Security

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

	Size	Stability	Openness	Market depth/liquidity
	GDP / world GDP	Public debt / GDP	Trade / GDP	Stock of government bonds
US	15%	106%	10%	$ 20 trn
Euro area	11%	84%	19%	$ 9 trn
China	19%	56%	18%	$ 6 trn

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.
Latest observation: 2019

Missing element: security

- Countries that rely on the US for their security umbrella hold a larger share of their reserves in dollars than their trade and investment in the US would lead one to predict.
- Does the EU need a foreign policy?
- Or does the fraying of US security alliances threaten the dollar's exorbitant privilege?
  - June 15, 2020, Reuters: "Donald Trump confirmed plan to withdraw 9500 US troops from Germany."

Currency reserves

SUMMARY

We assess the role of economic and security considerations in the currency composition of international reserves. We contrast the 'Mercury hypothesis' that currency choice is governed by pecuniary factors familiar to the literature, such as economic size and credibility of major reserve currency issuers, against the 'Mars hypothesis' that this depends on geopolitical factors. Using data on foreign reserves of 19 countries before World War I, for which the currency composition of reserves is known and security alliances proliferated, our results lend support to both hypotheses. We find that military alliances boost the share of a currency in the partner's foreign reserve holdings by about 30 percentage points. These findings speak to the implications of possible US disengagement from global geopolitical affairs. In a hypothetical scenario where the United States withdraws from the world, our estimates suggest that long-term US interest rates could rise by as much as 80 basis points, assuming that the composition of global reserves changes but their level does not.

JEL codes: F30, N20

—Barry Eichengreen, Arnaud Mehl and Livia Chițu

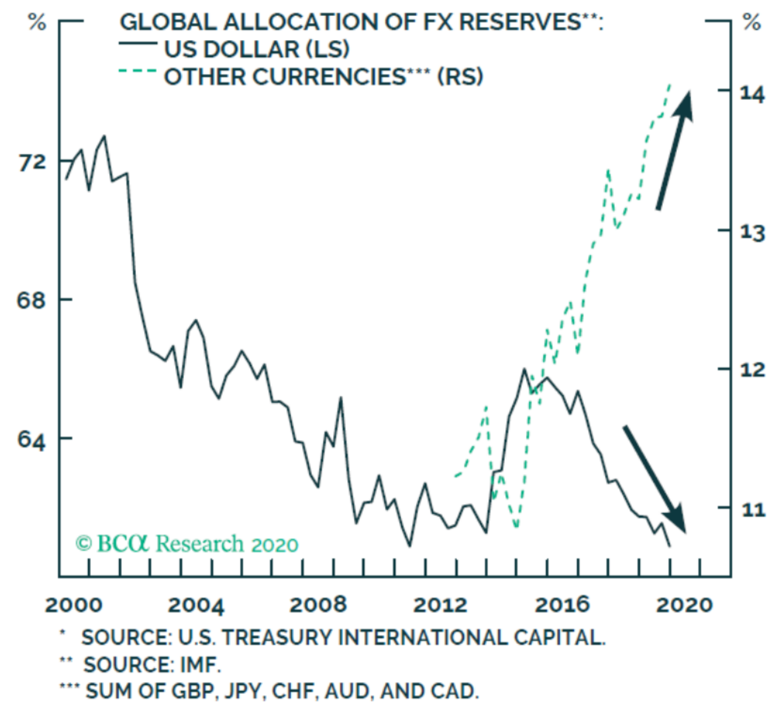
Economic Policy April 2019 Printed in Great Britain

Do things look different post COVID?

- In the short run:
  - Dollar benefitted from the generalized flight to safety.
    - Liquidity is more valuable than ever in a crisis.
  - Dollar is a safe haven (appreciates in bad times).
    - An attractive feature in a volatile environment.
  - Fed's swaps, repos, sweetened terms all helped to solidify its position.
  - (ECB did the same for… … Romania, Bulgaria, Croatia, Denmark – but not more widely. Cause or symptom of the euro's still limited international role?)

Do things look different post COVID?

- We already see some signs of central banks hedging their bets.
- Crazy statements coming out of US Congress.
- Loss of the dollar's "competence premium."
- Role of checks and balances (erosion of US democracy).



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And then there’s this:

- Exceptional (one-time) initiative in response to an exceptional (unique) event?
- Or an important precedent.
- In my view, whether there is a dedicated source of financing (akin to U.S. Customs Service) will tell the tale.

- Thank you.