

The Euro as an international currency : implications for the exchange rate

Intervention de
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sur le thème

« 50 YEARS AFTER THE ROME TREATY : STRENGTHENING THE ECONOMIC LEG OF EMU »

Before giving the floor to the members of the panel, I would like to recall and put in perspective a few facts concerning the international role of the euro.

1. The Euro has become one of the most important currencies in which international debt securities are denominated :

If one adds up the bonds issued by “non resident” companies, foreign governments, multilateral institutions, on external markets (this is, in markets outside the countries or the monetary zones where these issuers are headquartered), it appears that the issues of this type in euros represented from 1999 to the end of 2006 a cumulative amount practically equal to that of the comparable issues in dollars (5,1 billion euros compared to 5,7 billion euros).

But, if one adds to these figures (which only comprise bonds of more than two years maturity) short term-bonds and notes issued by non-residents, the euro denominated instruments represent some 48 % of the world total against 37 % for the dollar.¹

Thus, in terms of debt securities issued by international borrowers, we now live in a bipolar world.

2. The role of the euro in international trade transactions has remained limited :

The use of the euro in trade transactions is, on the whole, geographically limited to countries that have regional ties to the euro area including EU accession countries, EU countries that have not adopted the euro, and the CFA franc zone in Africa.

¹ By end september 2006, euro issues comprised nearly half the outstanding global stock of international bonds and notes (see : “The Euro : ever more global” by Axel Bertuch-Samuels and Parmeshwar Ramlogan”, “ Finance and Development”, IMF, March 2007). See also : Jacques de Larosière : “The achievements and challenges of European Union : Financial Integration and its implications for the US” (Group of Thirty, June 2007)..

3. The role of the euro as an international currency is increasing albeit slowly :

“In official use roughly one third of countries that peg their currency in one form or another, use the euro as their anchor currency” (in particular, EU accession or potential accession countries, CFA countries...)².

Most of the remaining two thirds (Asia, Western hemisphere...) anchor their pegs to the dollar. But their weight in world GDP is significantly higher.

This can be compared with the composition of official foreign reserves (in spite of the statistical shortcomings of these figures):

65 % : dollar denominated
24 % : euros
7 % : yen and sterling.

It has to be observed that the role of the euro as an international currency has been slowly expanding over the last years and that developing countries hold a larger -albeit still limited- share of their reserves in euros than do industrial countries. Since emerging countries are the dominant factor in the build up of reserves, this may be the sign of a larger role for the euro in the future.

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To conclude, I will make a few simple remarks :

To become an international reserve (which can have advantages but also drawbacks and which the ECB is not seeking as an objective) a currency must combine different criteria :

- it has to master domestic inflation so that its “real value” is preserved. In this respect, the euro is obviously well placed ;
- it has to be appealing for international investors in terms of potential growth and political stability (in this respect, the US is in a favourable position vis a vis Europe) ;
- it has to take advantage of a deep, liquid and open financial market where investors don't feel trapped and can transact easily. In this respect, the euro zone is very well placed even if there are still many reforms needed to improve the integration of European financial markets, especially in the regulatory field ;
- it has to attract the confidence of external investors. In this regard, “it is a promising sign for the euro that net foreign capital inflows into the euro area have risen since its introduction, reflected in a more than doubling of the stock of net assets held by non-residents between 1999 and the end of 2006³”;

² See : “The Euro : ever more global” by Axel Bertuch-Samuels and Parmeshwar Ramlogan, « Finance and Development », IMF , March 2007.

³ See : « Finance and Development » (quoted above)

- the magnitude of the possible shift of international reserves towards the euro will very much depend on the way global imbalances will be reduced. If the movement were to be smooth and based on “real adjustment” (in terms of rebuilding US households savings and of favouring domestic consumption in China), one could expect relatively moderate changes in the US exchange rate and consequently only a very gradual shift in global asset allocation towards the euro. But a precipitous adjustment combined with a sharp depreciation of the dollar -with its macroeconomic, trade and protectionist consequences- could, on the contrary, significantly alter the relative preferences for holding dollars and euros, and exacerbate reserve diversification - which has been up to now relatively subdued⁴- and compound exchange rate volatility and misalignments ;
- last, if the euro were to become one day a large international reserve currency (implying in the event for the euro area a more efficient and growth oriented economy, a current account deficit and a position of net external capital inflows), this new allocation of assets would, in any case, take time if only because of the strength of habits (as has been observed in the past with the slow move from the sterling to the dollar).

⁴ See Edwin Truman and Anna Wong : « The case for an international reserve diversification standard », Institute for International Economics, May 2006.