

The Global Use of the Dollar and Euro

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Outline

- 1. Limited challenge posed by euro to dollar**
 - ✓ Gradual emergence of euro since 1999
 - ✓ Regional vs global use of euro and dollar
- 2. Subdued impact of global financial crisis**
 - ✓ Global and regional liquidity
 - ✓ Global and regional safe haven
- 3. Drivers behind future developments**
 - ✓ Macroeconomic fundamentals
 - ✓ Microeconomic fundamentals
- 4. Conclusions**

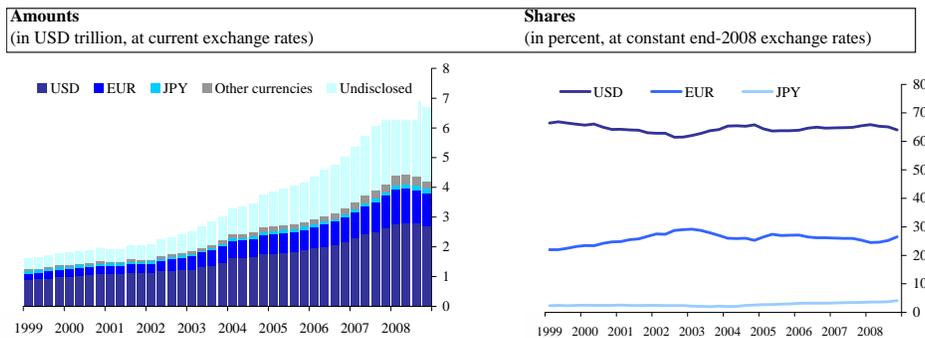
1.1 Gradual emergence

Shares of euro and dollar in global markets (%)

	EUR		USD	
	1999	Latest	1999	Latest
Foreign exchange reserves (with known composition)	18.1	27.5 (Q2 2009)	71.2	62.8 (Q2 2009)
International bonds (narrow measure)	19.5	32.0 (Q2 2009)	50.3	44.6 (Q2 2009)
International loans (narrow measure)	11.8	17.3 (Q1 2009)	57.1	52.8 (Q1 2009)
Foreign exchange trading (settled by CLS, shares sum up to 200%)	42.8 (9/2002)	41.9 (end-2008)	93.1 (9/2002)	90.3 (end-2008)
Invoicing of trade flows (share in known trades only)	18.2 (2001)	28.9 (2007)	55.4 (1999)	48.1 (2007)

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1.1.a Foreign exchange reserves (with known currency composition)*

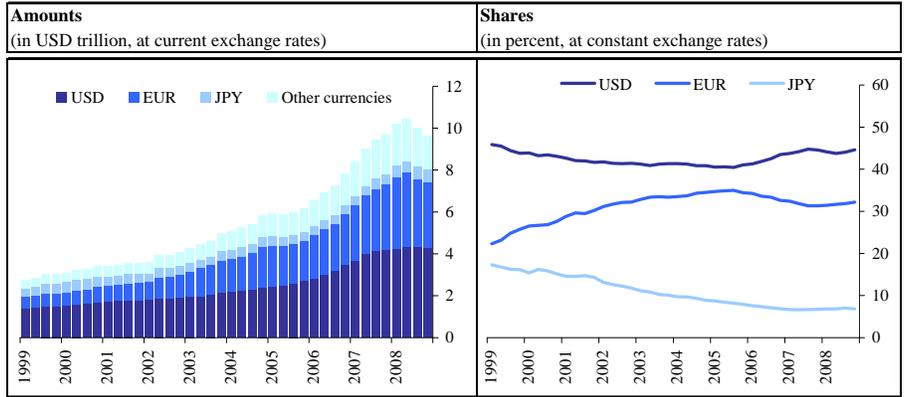


Latest data: 2008Q4.
Sources: IMF and ECB calculations.

* The review reports end-2008 figures as for other market segments. Just released figures for Q1 2009 show only marginal changes compared to Q4 2008.

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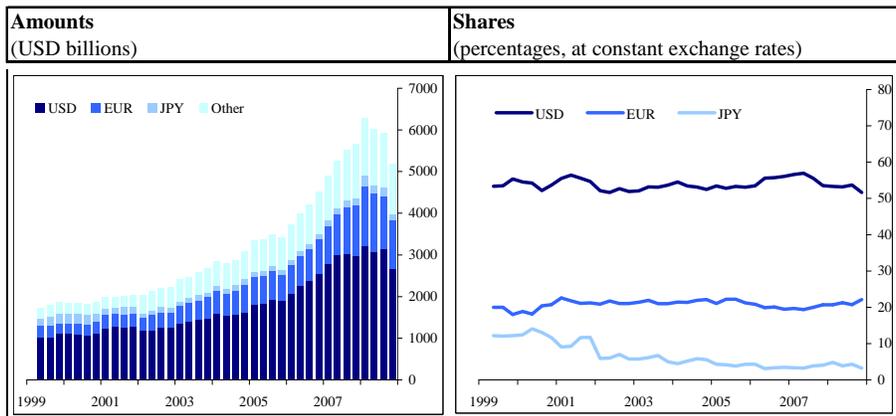
1.1.b International debt securities (narrow measure)



Sources: BIS and ECB calculations.

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1.1.c International loan markets (all cross-border loans)



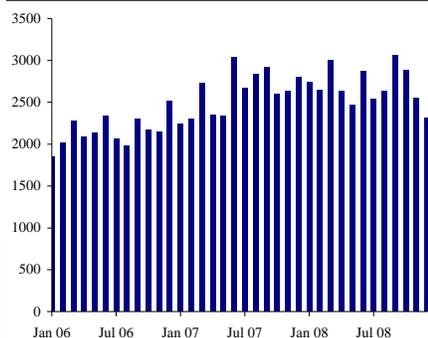
Sources: BIS and ECB calculations.

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1.1.d Foreign exchange markets (Continuous Linked Settlement System, CLS)

Settlement volumes on the CLS system

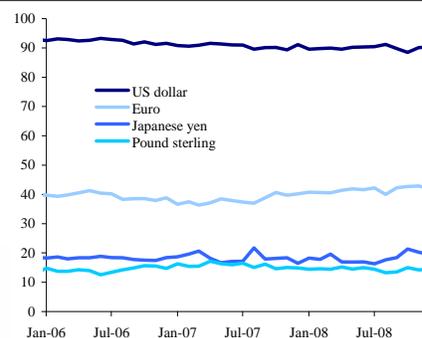
(average daily volume, EUR billions)



Source: CLS.

Currency shares

(average daily volume, percentages¹⁾)



Sources: CLS and ECB calculations.

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1.2 Regional vs global pattern

Reflected in:

- ✓ invoicing of international trade
- ✓ stock of international debt securities
- ✓ use as anchor currency

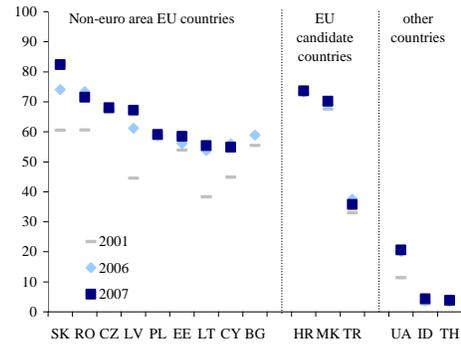
Use of euro skewed to countries geographically and institutionally close to euro area

Use of dollar is global

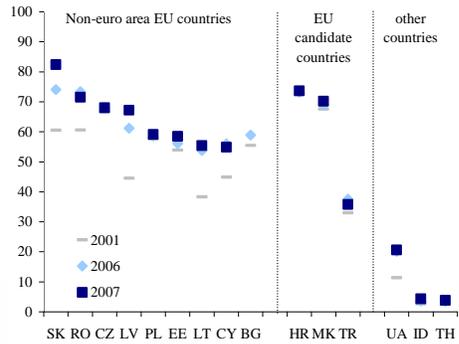
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1.2.a Euro invoicing in international trade

(as a share of total exports)



(as a share of total imports)

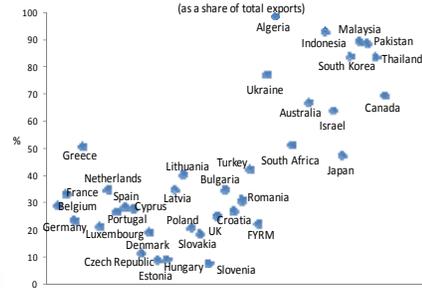


Sources: national sources and ECB calculations.

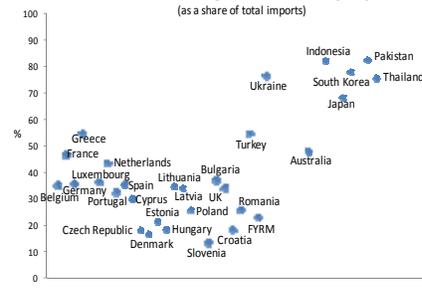
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1.2.b Dollar invoicing in international trade

U.S. dollar invoicing share in country exports



U.S. dollar invoicing share in country imports

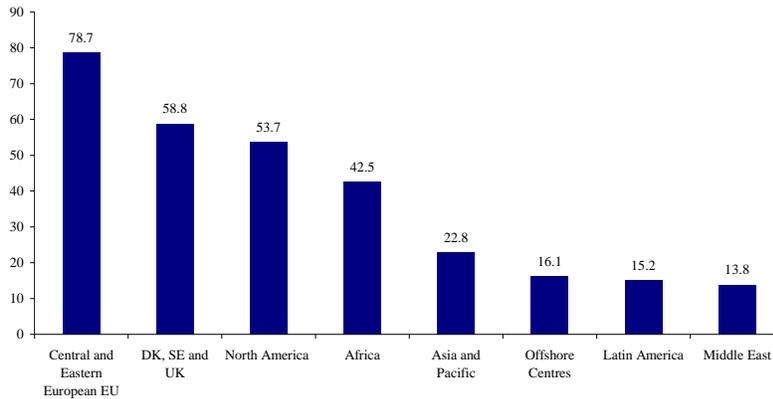


Source: national sources and ECB calculations

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1.2.c Share of euro in stock of international debt securities

(narrow measure, i.e. excluding home currency issuance, as a percentage of the total amount outstanding)

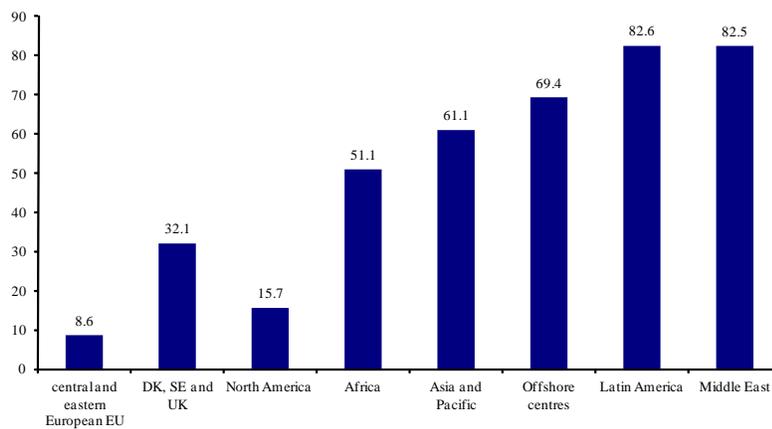


Sources: BIS and ECB calculations.

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1.2.d Share of dollar in stock of international debt securities

(narrow measure, i.e. excluding home currency issuance, as a percentage of the total amount outstanding)



Sources: BIS and ECB calculations.

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1.2.e Use of euro and dollar as anchor

Euro		Dollar	
Euro based currency board + euroisation	10	Dollar based currency board + dollarization	7
Pegs and managed floats with euro as reference	27	Pegs and managed floats with dollar as reference	97
GDP linked to euro	1.7%	GDP linked to dollar	36%

Source: ECB, Goldberg (2010)

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2. Subdued impact of global financial crisis

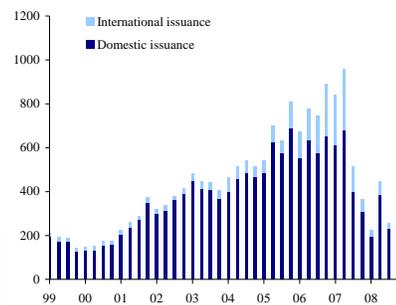
Overall stability with limited shocks:

- ✓ ABS market with collapsing/rising dollar/euro segments
- ✓ shortage of dollar wholesale funding faced by euro area banks
- ✓ increased/stable use of euro/dollar banknotes outside EA/US

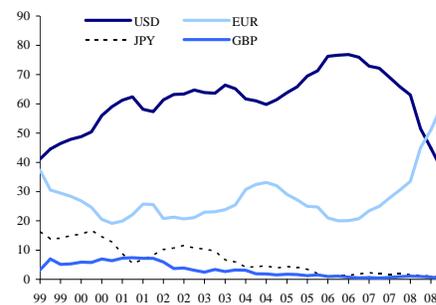
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2.1 ABS markets

Issuance of asset-backed securities
Volume
(USD billions)



Issuance of international asset-backed securities
Currency shares
(percentages, at constant exchange rates)



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2.2 Reliance of EA banks on the dollar for wholesale funding

Size and structure of banks foreign operations
(end 2007)

	EA	US
Total assets (USD bn)	34,532	9,904
Foreign claims (USD bn)	17,162	2,285
- over total assets (%)	50	23
- dollar share (%)	29	52

Source: BIS Quarterly Review (March 2010)

- ✓ In mid-2007, the dollar funding gap of EA banks estimated at USD 680 billion (USD 1.2 trillion with Switzerland and UK).
- ✓ The peak use of FED-financed dollar swaps amounted to USD 580 billion at end 2008 (USD 290 billion by EA).

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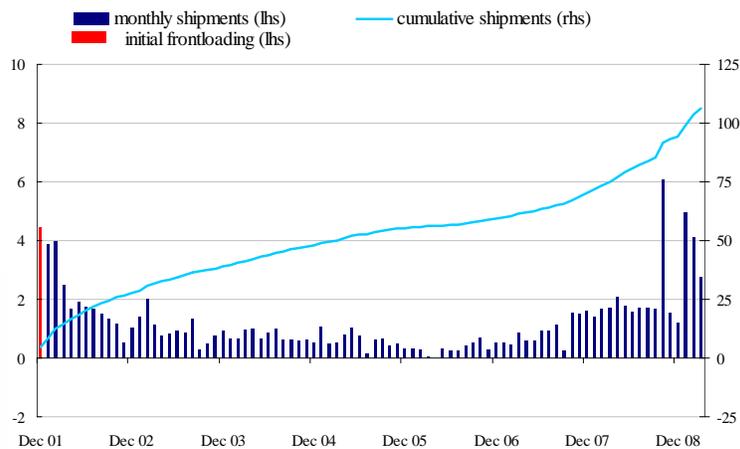
2.3.a Increased/stable use of euro/dollar banknotes outside EA/US

- ✓ Significant increase in euro banknotes used outside EA in 2008 (around 17% compared with 14%)
- ✓ Stability of dollar banknotes circulating outside US (65%)
- ✓ Potential for growth given much lower initial level
- ✓ EA neighbouring countries using euro banknotes more affected by crisis than Latin America may explain stronger safe haven effect

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2.3.b Net shipments of euro banknotes increased during the crisis

Shipments to destinations outside the euro area (mainly CEE)



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3. Drivers behind future developments

- **Macroeconomic fundamentals:**
 - ✓ Size and stability of economies
 - ✓ Size, scope and depth of financial markets
- **Microeconomic fundamentals:**
 - ✓ Global inertia in currency use through network externalities
 - ✓ Regional changes through gravity model effects

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3.1.a Macroeconomic perspective

Changes likely given rapid economic catching up of systemic EMEs:

- ✓ Share in current global GDP (2009):
 - EMEs (G-20)¹⁾ – **20.4%** (market prices), **30.6%** (PPP-weighted)
 - major AEs²⁾ – **55.2%** (market prices), **41.7%** (PPP-weighted)
- ✓ PPP-weighted global GDP contribution (2004-2008):
 - EMEs (G-20)¹⁾ – **49.5%**
 - major AEs²⁾ – **22%**
- ✓ Projected annual output growth (2010-2014):
 - EMEs (G-20)¹⁾ – **4.9%**
 - major AEs²⁾ – **1.9%**

¹⁾ Argentina, Brazil, China, India, Indonesia, Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey

²⁾ US, Euro area, Japan

Source: IMF

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3.1.b Macroeconomic perspective

However, lack of financial development in systemic EMEs bound to hinder rapid global changes:

- ✓ The weight of AEs' economies in global financial markets well above their share in global GDP or global trade:
 - **90%** of global debt securities outstanding
 - **80%** of the global stock market capitalisation
- ✓ The degree of institutional development (captured by 'structural indicators') significantly more advanced in AEs than in most systemic EMEs:

	Structural indicator (US=100)	Capital account openness
US dollar	100	100
Euro	104.2	96.6
EMEs' currencies	70.5	45.6

Source: Thimann (2009)

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3.2.a Microeconomic perspective

Network externalities

- ✓ commodity pricing
- ✓ FX reserves
- ✓ FX market turnover
- ✓ bank loans/deposits

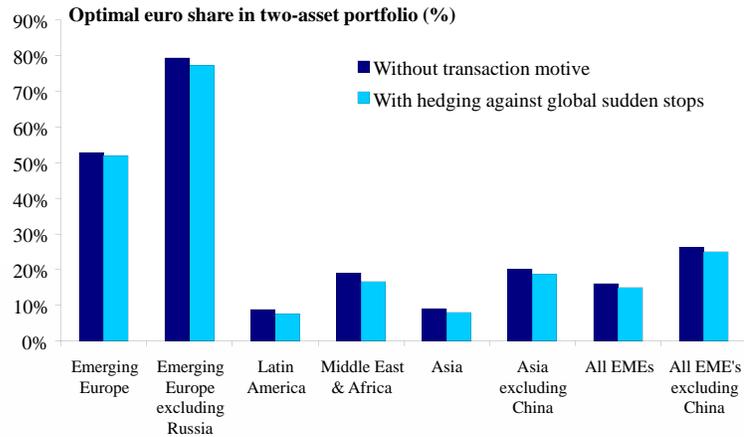
Gravity model

- ✓ trade invoicing
- ✓ anchor currency
- ✓ currency substitution
- ✓ debt securities markets

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3.2.b Illustration of network externalities

FX reserves: US dollar may hedge against global sudden stops (Beck and Rahbari, 2008)



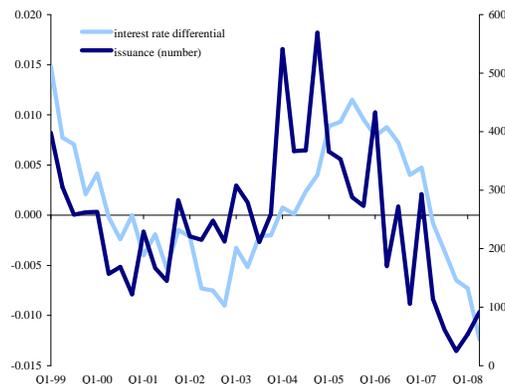
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3.2.c Illustration of gravity model

International bond issuance (Habib & Joy, 2008)

- Focus on the *role* of lower borrowing costs exploiting deviations from uncovered interest rate parity
- Econometric analysis suggests that issuers, in particular investment banks prefer to borrow in currencies with low nominal interest rates

Interest rate differential for the euro vs issuance (number) of euro-denominated foreign-currency bonds
(5y maturity; narrow measure, ie, excluding home currency issuance)



Sources: Bondware and ECB calculations.

Note: Interest-rate differential equals weighted average of other interest rates minus euro interest rate, as defined in Habib & Joy (2008). Issuance is number of bonds issued. Includes only fixed-interest-rate securities.

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4. Conclusions

Limited erosion of dollar status, since emergence of euro both gradual and regional

Impact of crisis confined to specific segments, without affecting established pattern

Future changes likely given rapid economic catching up of systemic EMEs

Lack of financial development in systemic EMEs bound to hinder rapid changes

By contrast, further financial/monetary integration in Asia would speed up changes

Need to monitor and analyse, in particular microeconomic determinants (network externalities/gravity model)

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