Strengthening the international role of the euro

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At the ESM, we have long been in favour of strengthening the international role of the euro. A more prominent international role for the common currency would benefit the euro area and its citizens by ensuring more stable financing conditions and attracting more investors. It would help to finance the recovery after the current pandemic and make our economy fitter for the future. A greater global role of the euro would also lend greater stability to the international financial system as a whole.

European Union (EU) policymakers have recognised the strategic importance of the topic, placing it high on the agenda of the upcoming March Euro summit. In addition, the European Commission has highlighted the need for more geo-political financial sovereignty. We contributed to the debate with a recently published discussion paper that takes a closer look at global financial developments.

The international monetary and financial system is slowly moving towards a 'multipolar' structure. This is a welcome development that reduces risks associated with an excessive reliance on the United States (US) dollar. A more diversified mix of currencies can reduce this dependence.

The European Central Bank's latest report showed that the euro is a strong second to the dollar, but we must ensure it continues to play an important role in a changing environment. In the face of the dollar's dominance, China is determined to elevate the renminbi globally and other emerging markets are also on the rise. At the same time, new digital means of payment could also have substantial implications for both monetary and financial stability.

The euro can play a greater role

The euro is well placed to play a stronger international role, as it is backed by a large economic area, well-advanced financial markets, relatively low currency volatility, and an independent central bank with a clear price stability mandate and a prohibition of monetising government deficits.

Countries that export goods in euros have economic incentives to manage their financial assets and liabilities in euros. Furthermore, the euro area is both an investment destination and a home to global institutional investors, who can foster the global use of the euro. Despite these advantageous features, diversification away from the US dollar has only helped the euro to a limited extent so far. The dollar's predominance remains well established in foreign exchange transactions and debt issuance, as well as central bank reserve holdings.

Strengthening the euro area economy, ensuring the stability of the financial system, as well as improving the liquidity of euro-denominated financial markets can help to elevate the euro's international status. In addition, the international euro has to be underpinned by credible euro area institutions that ensure stability.

Figure: The euro is the world's second most important currency