



EUROPEAN CENTRAL BANK

EUROSYSTEM

# The international role of the euro – 2017 report

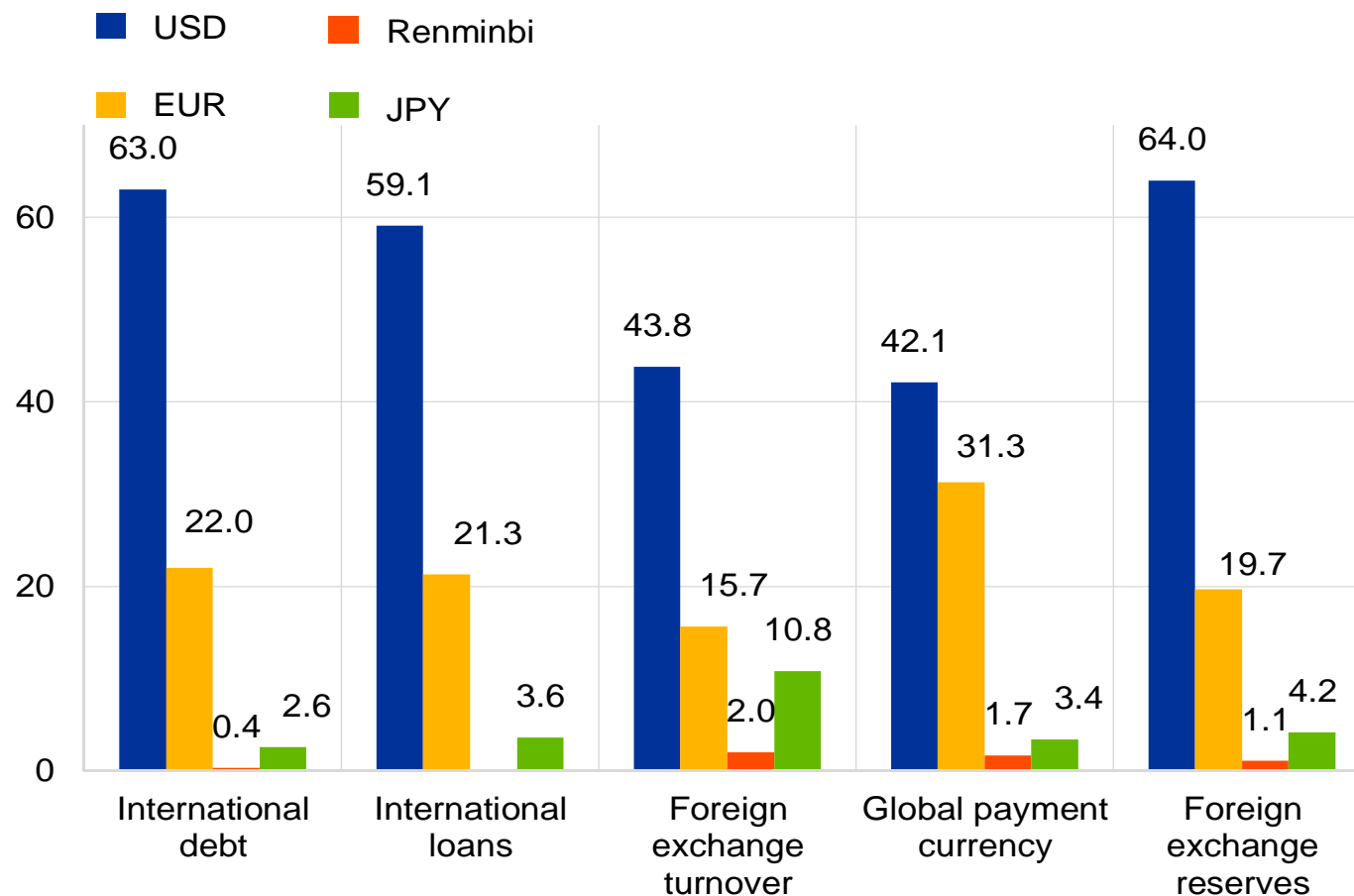
Arnaud Mehl

5 October 2017

# Euro remains second most important currency

## Snapshot of the international monetary system

(percent of total)



Sources: BIS, IMF, SWIFT, and ECB calculations.

Note: Data as at end-2016 or latest available.

# Euro lost some ground in 2016, albeit not uniformly

Indicator	Share of the euro (percentages, unless otherwise indicated)		
	Latest	Comparison period	Difference (percentage points)
<b>Stock of global foreign exchange reserves</b> with known currency composition, at constant exchange rates	19.7 (Q4 2016)	19.4 (Q4 2015)	<b>0.3</b>
<b>Outstanding international debt securities: narrow measure</b> , i.e. excluding home currency issuance, at constant exchange rates	22.0 (Q4 2016)	22.4 (Q4 2015)	<b>-0.4</b>
<b>Outstanding international loans: all cross-border loans</b> , excluding interbank loans, at constant exchange rates	21.3 (Q4 2016)	21.5 (Q4 2015)	<b>-0.2</b>
<b>Outstanding international deposits all cross-border loans</b> , excluding interbank loans, at constant exchange rates	23.4 (Q4 2016)	23.4 (Q4 2015)	<b>0.0</b>
<b>Foreign currency-denominated debt issuance</b> at current exchange rates	20.4 (2016)	24.8 (2015)	<b>-4.4</b>
<b>Daily foreign exchange trading (settled by CLS)</b> , annual averages, at current exchange rates, as a percentage of foreign exchange settlement	36.1 (2016)	37.6 (2015)	<b>-1.5</b>
<b>Foreign currency-denominated loans in CESEE countries</b> , as a percentage of total loans, at current exchange rates <sup>1</sup>	39.6 (2016)	41.2 (2015)	<b>-1.6</b>
<b>Foreign currency-denominated deposits in CESEE countries</b> , as a percentage of total deposits, at current exchange rates <sup>1</sup>	32.5 (2016)	33.0 (2015)	<b>-0.5</b>
<b>Invoicing of goods exported</b> from the euro area to non-euro area countries, at current exchange rates	56.1 (2016)	57.4 (2015)	<b>-1.3</b>
<b>Invoicing of goods imported</b> to the euro area from non-euro area countries, at current exchange rates	47.3 (2016)	47.5 (2015)	<b>-0.2</b>
<b>Foreign holdings of euro area debt</b> denominated in euro (as a percentage of total euro-denominated debt)	17.1 (Q4 2016)	18.6 (Q4 2015)	<b>-1.5</b>



Sources: BIS, Dealogic, IMF, national sources and ECB calculations.

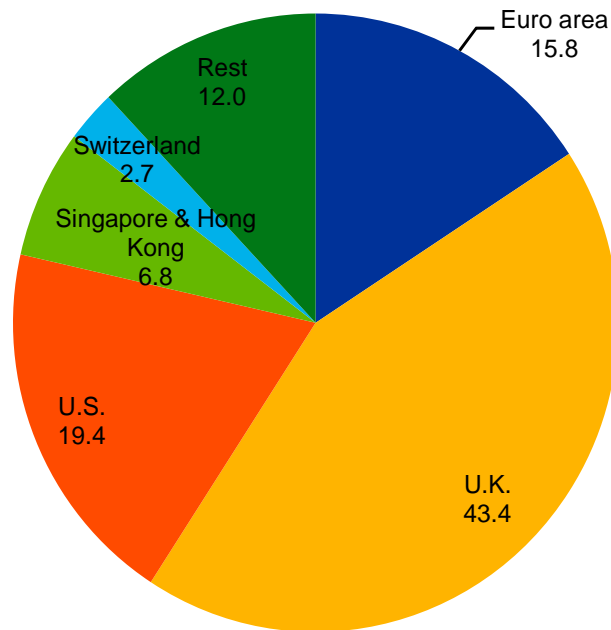
# Conclusions

- **Heightened non-economic risks affected euro's international role in 2016 and early 2017**
  - Geopolitical developments, euro area elections, uncertainty created by Brexit, new US administration, etc.
- **Euro continued to lose some ground, albeit not uniformly so**
  - Share down for most indicators
  - Share up in global FX reserves & payments
- **Euro remained unchallenged as 2<sup>nd</sup> most important currency globally**
- **Capital Markets and Banking Unions could buttress euro area financial markets' depth and liquidity & indirectly the euro's international standing**

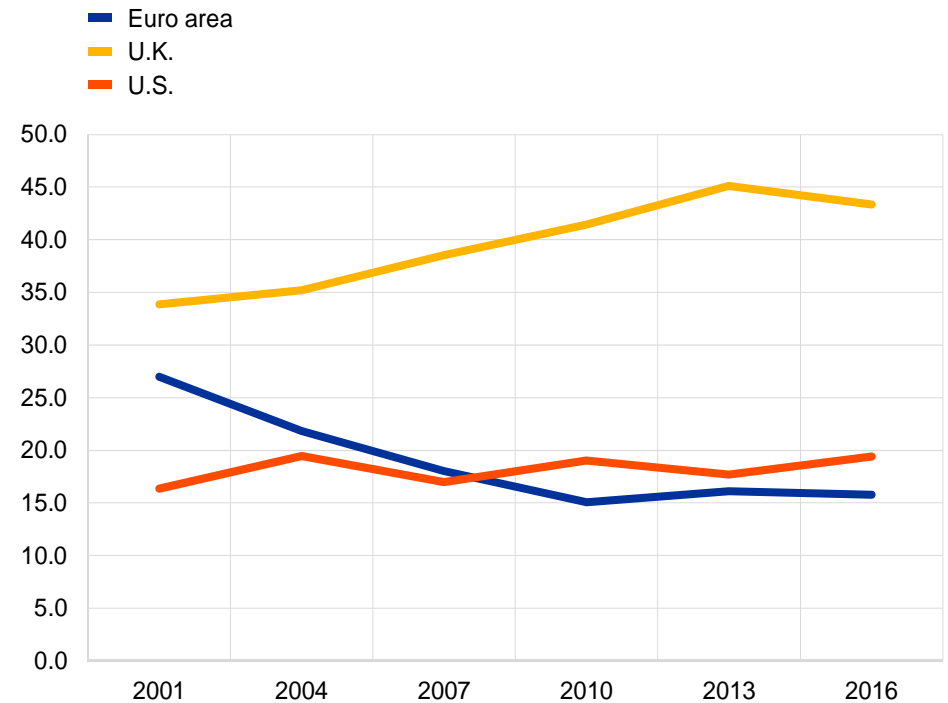
- **The euro and the geography of the foreign exchange market**
  - *Bulk of FX transactions in euros initiated outside the euro area, notably in the City of London; technological change, notably electronic trading, has major implications for the geography of FX trading*

# Key role of the City of London for FX trading in euros

**Bulk of euro FX trades initiated outside the euro area, notably in the City of London**  
(percentages)



**UK share of global FX trading 10 percentage points up since 2001**  
(percentages)



Sources: BIS and ECB calculations.

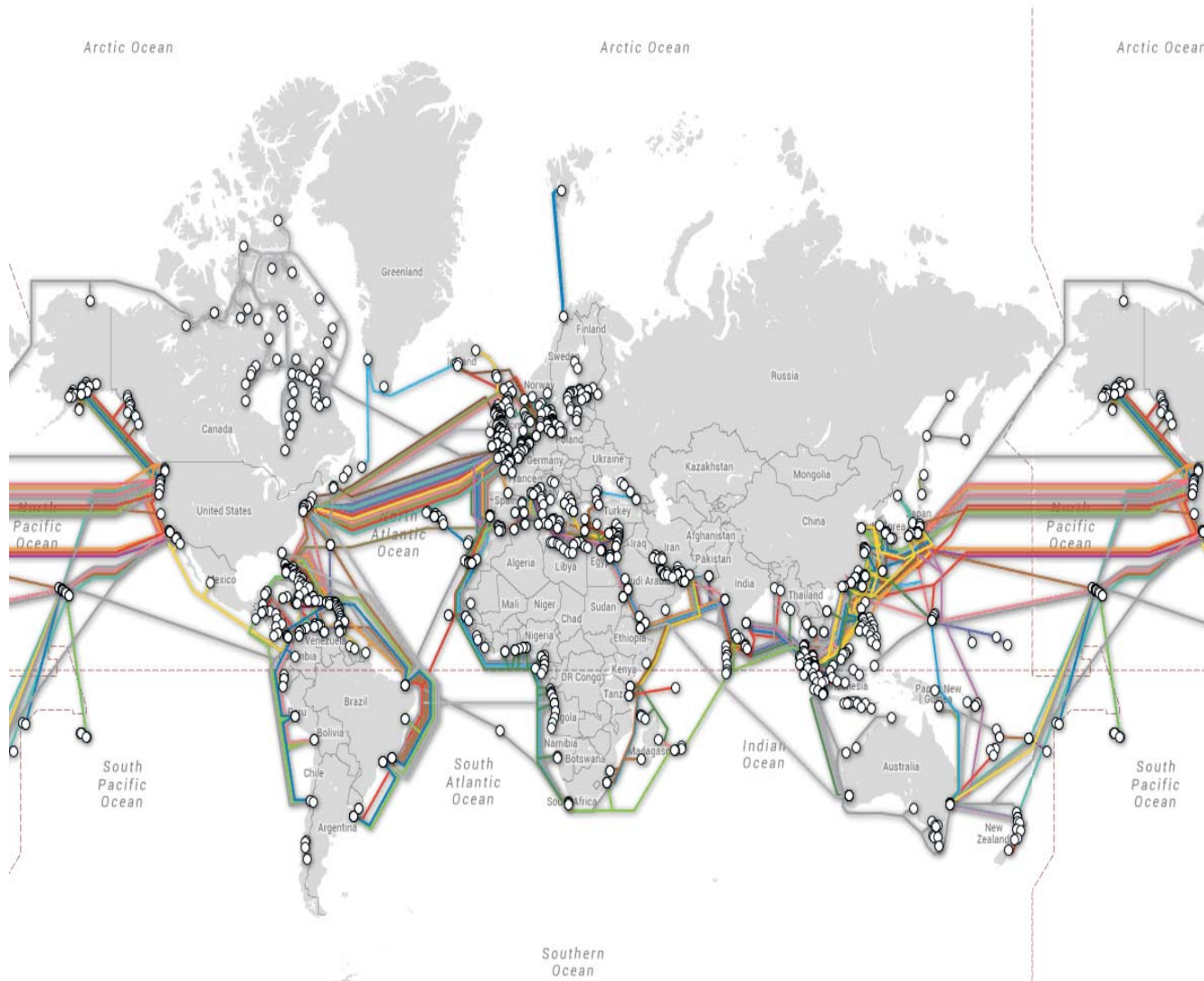
Notes: Share of selected countries in global foreign exchange transactions in euros, 2016. The data include spot, forward, swap and other transactions. They are adjusted for local inter-dealer transactions.

Sources: BIS and ECB calculations

Notes: Evolution of the share of selected countries in global foreign exchange transactions in euros, 2001-2016.

# Identification of technological shocks

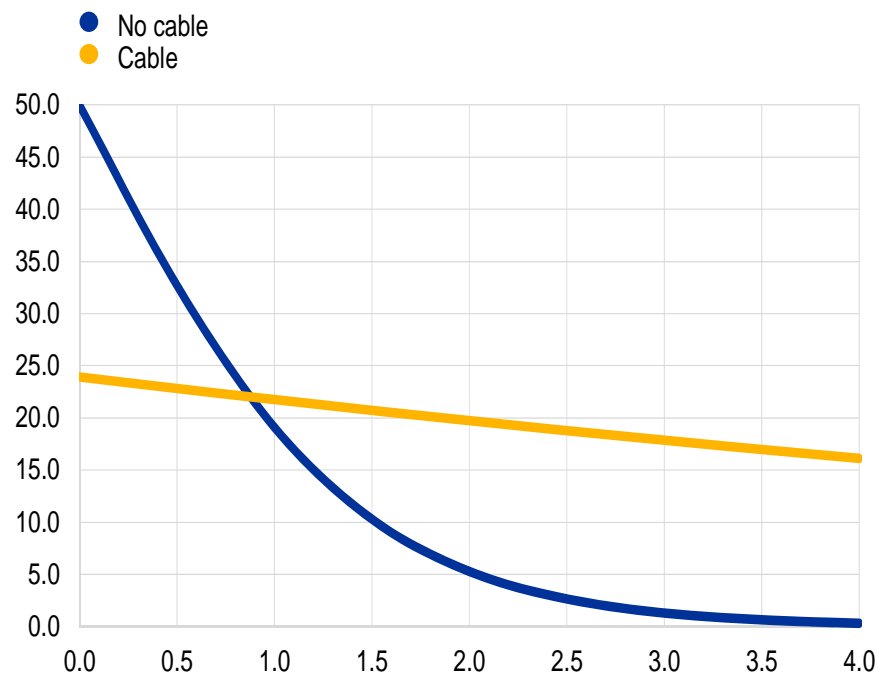
The world's undersea fiber-optic cable network now



# Big effect of technology on geography of FX trading

## Fiber-optic cable connections cause countries to lose trading in their currency to major financial centers, like London

(y-axis: share of trading of currency  $i$  in major financial centres in percentages; x-axis: time zone difference in hours from country  $i$  to closest major financial center)



Source: Eichengreen, Lafarguette and Mehl (2016).

Notes: Estimated impact of submarine fiber-optic cable connections on the effect of time zone distance on the geography of foreign exchange trading.

- **Electronic trading erodes effects of standard spatial frictions (distance, liquidity, capital controls) that make trading more domestic**
- **Sizeable implications for geography of FX trading**
- **City of London big beneficiary as hub for fibre-optic cables**
- **Contribute to limit relocation of FX trading post-Brexit?**

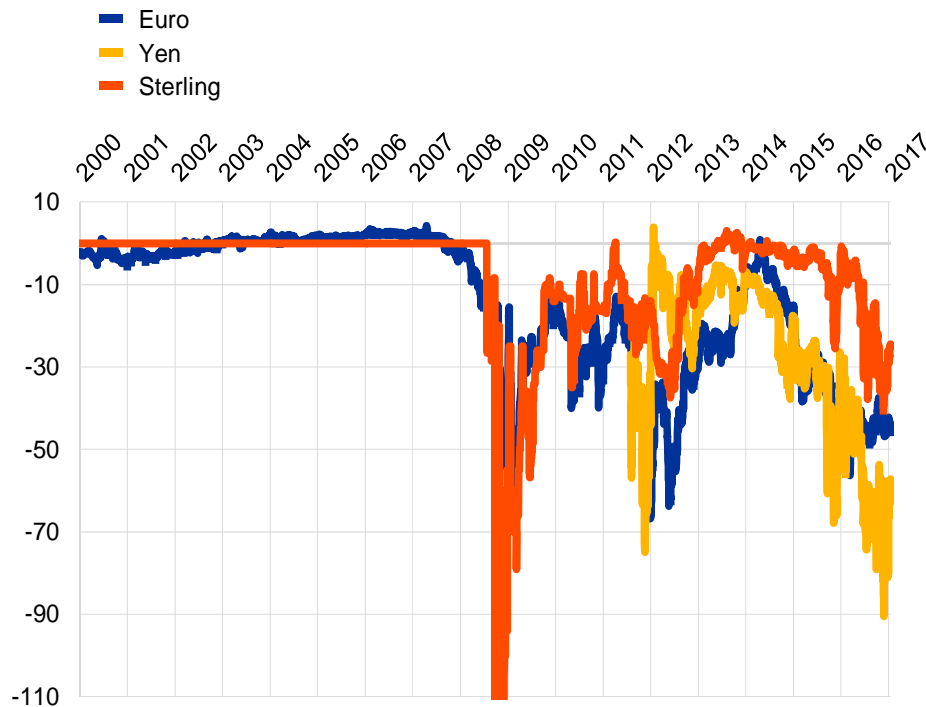


- **The euro and the geography of the foreign exchange market**
  - *Bulk of FX transactions in euros initiated outside the euro area, notably in the City of London; technological change, notably electronic trading, has major implications for the geography of FX trading*
- **Violations in covered interest parity and the euro's role as an international financing currency**
  - *Ambiguous effect of non-standard monetary policy measures on role of the euro as an international financing currency: lower cost of borrowing euros offset by higher costs of swapping euros into dollars to hedge FX risk*

# Increasing cost of swapping euros into dollars

**Swap basis structurally negative since 2008; sharp increase since early 2014**

(basis points)



Source: Bloomberg.

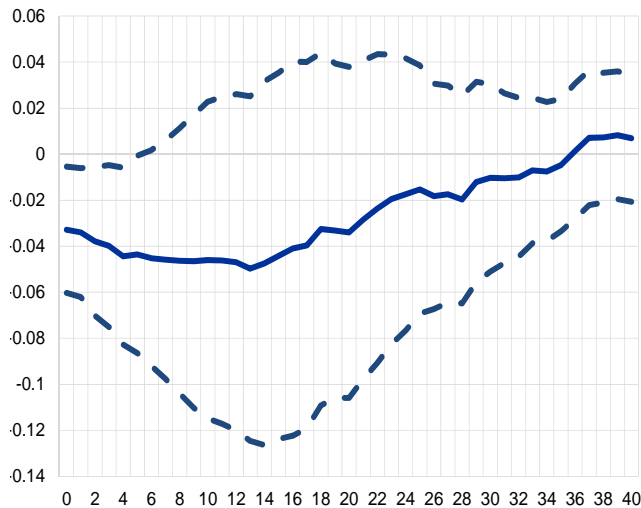
Notes: Cross-currency swap (CCS) basis of major currencies against the US dollar (three-month maturity). The CCS basis is quoted from the perspective of the US dollar-providing counterparty (who receives the basis).

- **Increasing awareness of counterparty risk**
- **Tighter limits to arbitrage** (e.g. costly balance sheet expansion, margin calls, etc.)
- **Regulation changes reducing USD liquidity supply in wholesale markets**
- **Low interest rate environment pushing demand for euro borrowing and FX hedging**

# Neutral impact of ECB's non-standard measures

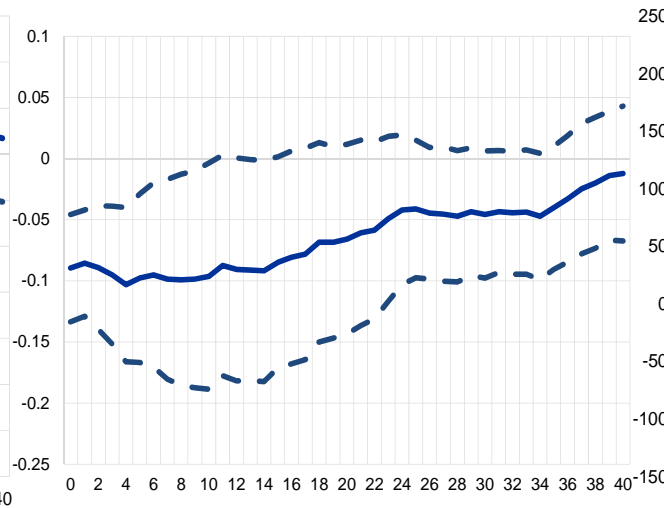
## A. Cost of borrowing euros down

(y-axis: percentages; x-axis: weeks)



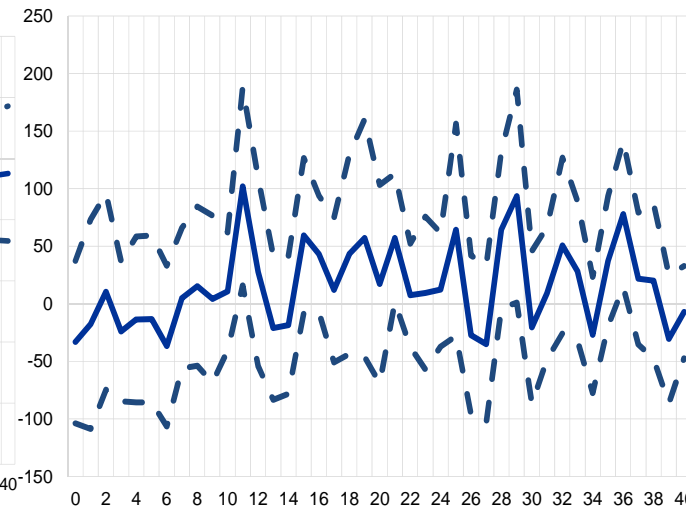
## B. Cost of swapping euros into dollars up

(y-axis: percentages; x-axis: weeks)



## C. Impact on international bond issues in euro neutral

(y-axis: USD mio; x-axis: weeks)



Sources: Dedola et al. (2017), Haver, Dealogic and ECB staff estimates.

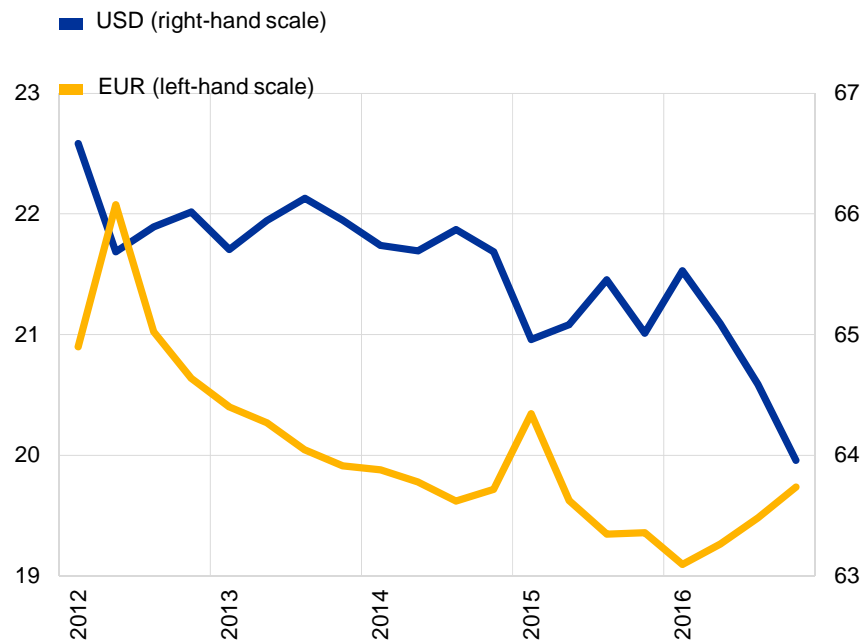
Notes: Impulse response function of (A) 2-year interest rate differential (euro area-US), (B) 2-year CCS basis, and (C) euro-denominated international bond issuance to an exogenous shock in the ECB's balance sheet relative to the Federal Reserve balance sheet. Prior announcements of non-standard monetary policy measures are used as instruments to identify innovations in central bank balance sheets due to liquidity supply shocks. The dynamic responses of variables (A), (B) and (C) to liquidity supply shocks are estimated with local projection methods à la Jordá (2005).

- **The euro and the geography of the foreign exchange market**
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- **Violations in covered interest parity and the euro's role as an international financing currency**
  - *Ambiguous effect of non-standard monetary policy measures on role of the euro as an international financing currency: lower cost of borrowing euros offset by higher costs of swapping euros into dollars to hedge FX risk*
- **Unofficial euroisation in CESEE countries**
  - *Tentative signs that local currency use is progressing in the countries concerned, albeit slowly and largely restricted to loans and cash*

# Slight rebound in euro share of global FX reserves

## The share of the euro in global FX reserves rebounded slightly in 2016

(percentages, at constant end-2016 exchange rates)

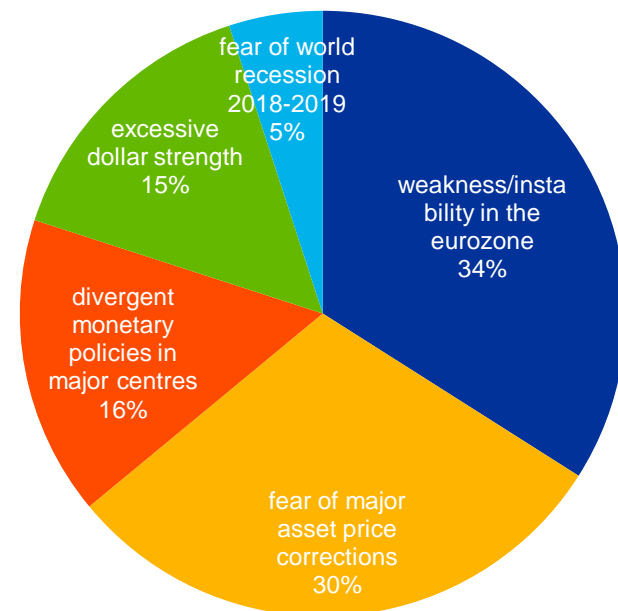


Sources: IMF and ECB calculations.

Notes: Currency composition of global foreign exchange reserves whose composition is disclosed. The latest data are for the final quarter of 2016.

## Survey evidence points to several concerns for reserve managers in 2017

(percentage of respondents)



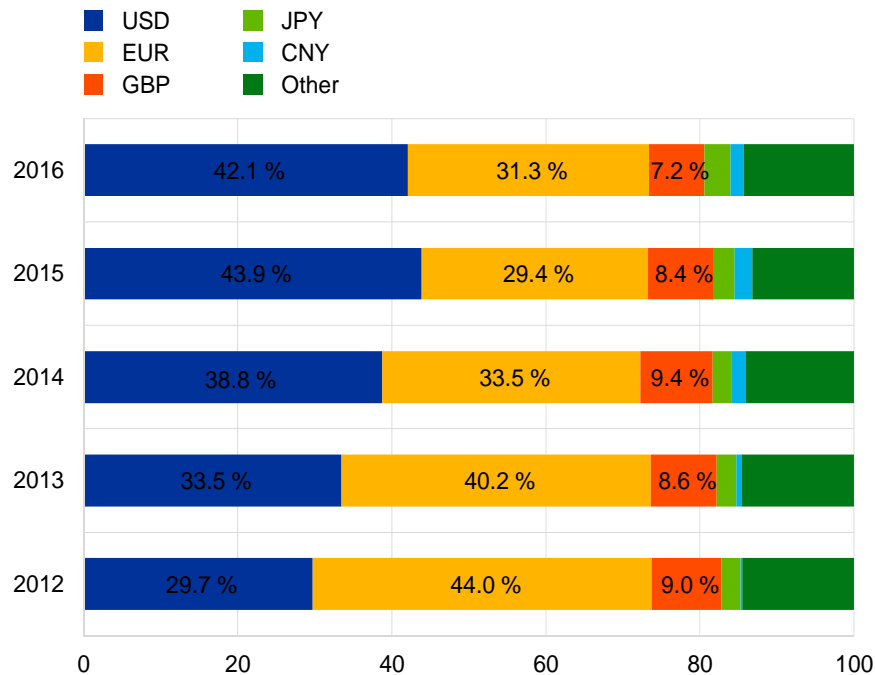
Sources: HSBC and Central Banking Publications.

Note: Prospective determinants of global reserve allocations according to a central bank survey.

# Euro share up in global payments, down in FX turnover

## The share of the euro in global payments increased in 2016

(percentages)

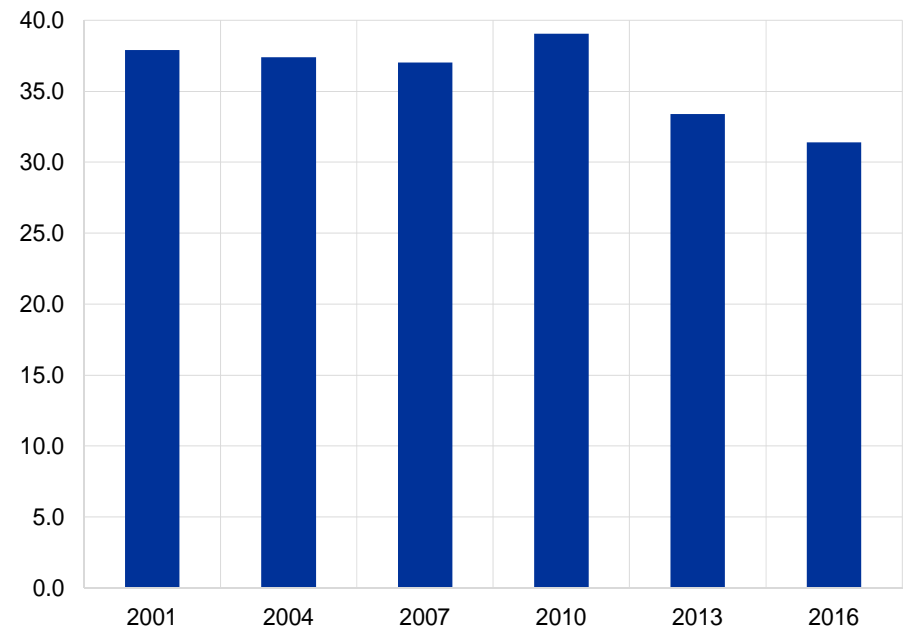


Source: SWIFT.

Notes: Currency composition of global payments. Inbound plus outbound traffic. Based on value.

## The share of the euro in global foreign exchange turnover declined in 2016

(percentages, in April of the corresponding year shown on the x-axis)



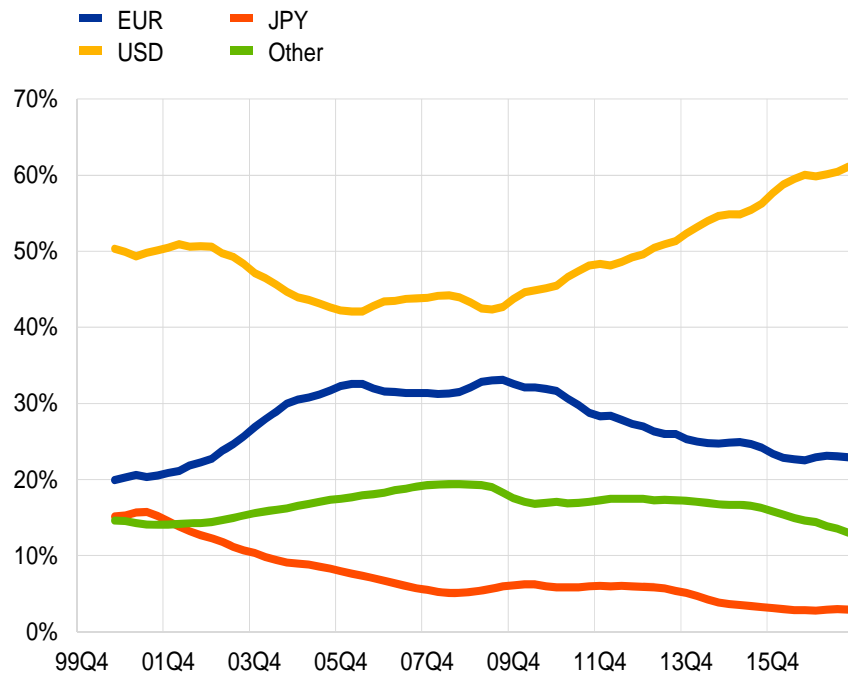
Sources: HSBC and Central Banking Publications.

Notes: Share of global OTC foreign exchange transactions, on a net-net basis.

# Decline in euro share of international debt securities

## The share of the euro in the stock of international debt securities declined in 2016

(percentages)

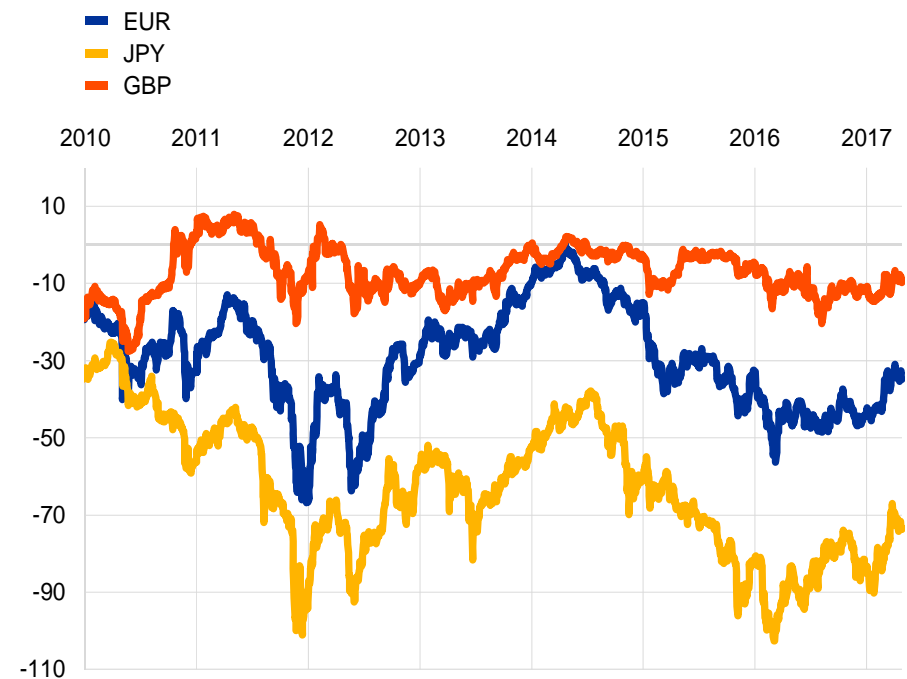


Sources: BIS and ECB calculations.

Notes: Currency composition of the stock of international debt securities. The latest data are for the final quarter of 2016.

## FX swap costs increased markedly since mid-2014 hence discouraging use of euro as vehicle funding currency

(basis points)



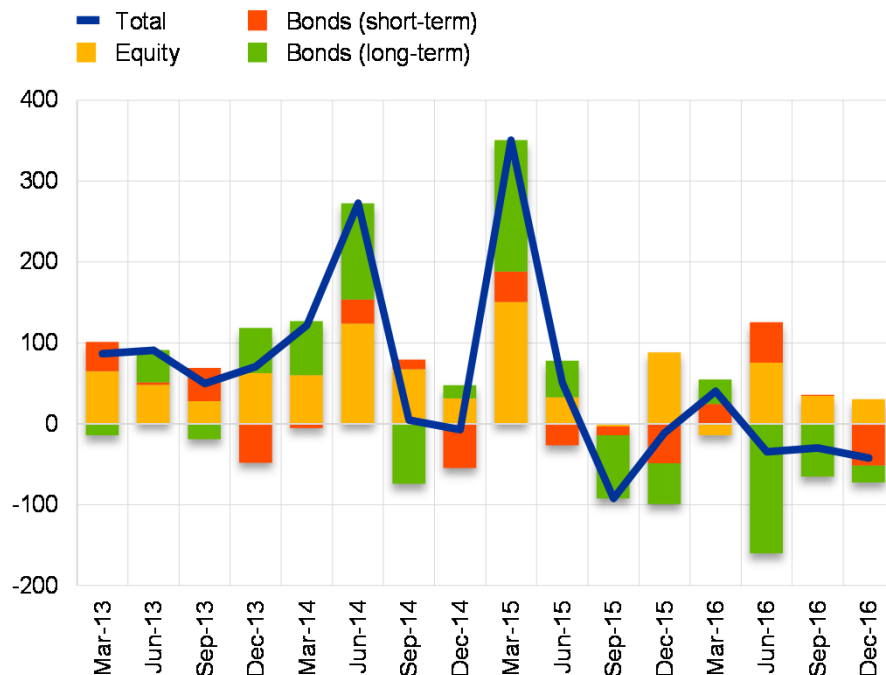
Sources: Bloomberg and ECB calculations.

Notes: Cross-currency swap basis of the euro against the US dollar at the five-year maturity. The latest data are for 28 April 2017.

# Decline in foreign demand for euro area bonds & cash

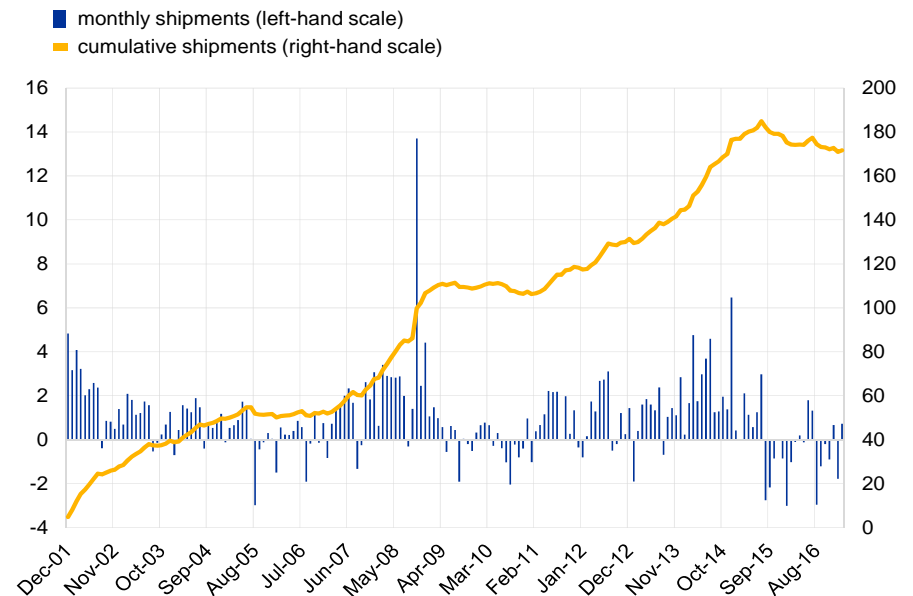
## Mixed developments in foreign demand for euro area securities in 2016 (equities up, bonds down)

(volumes in EUR billions)



## Foreign demand for euro banknotes declined in 2016

(EUR billions; adjusted for seasonal effect)



Sources: ECB and ECB calculations.

Notes: Balance-of-payments statistics. The latest observation is for December 2016.

Source: Eurosystem.

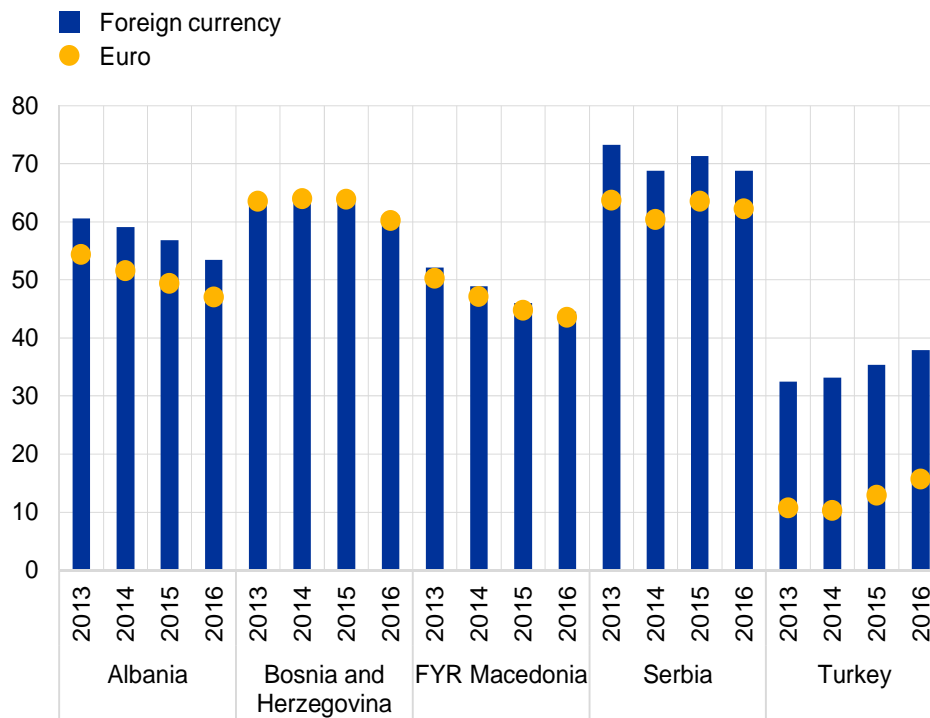
Notes: Net monthly shipments of euro banknotes to destinations outside the euro area. The latest observation is for February 2017.



# De-euroization in Central, East & Southeast Europe?

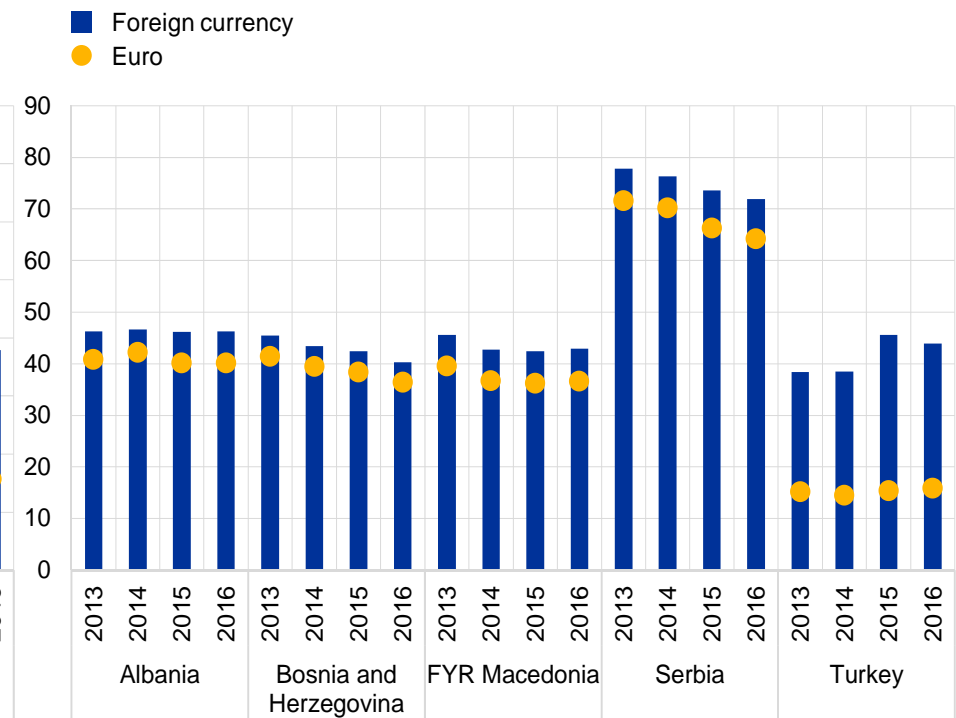
## Signs of de-euroization in some countries on lending side

(percentages)



## Progress on deposit side more limited

(percentages)



Sources: Haver Analytics, national central banks and ECB staff calculations.

Notes: Share of foreign currency loans (outright or indexed) in total loans.

Sources: Haver Analytics, national central banks and ECB staff calculations.

Notes: Share of foreign currency deposits (outright or indexed) in total deposits.