STRENGTHENING THE INTERNATIONAL ROLE OF THE EURO

1. The euro is the second most important currency in the international monetary system

1.1. The euro is widely accepted for international payments, but the dollar is the preferred reserve currency

An industry representative emphasised one simple quantitative observation: considering how the international role of the euro has evolved over the past 10 years, the euro is on par with the dollar in terms of international transactions, but it is not on par with the dollar as a reserve currency. A Central Bank official suggested that incumbent international currencies have a substantial advantage which takes a long time to disappear. The existential crisis experienced by the euro area contributed to the decline of the euro's importance. Nevertheless, in terms of transactions, the euro is more or less at par with the dollar. As a reserve currency, however, the euro is far behind; indeed, the euro represents around 21% of international reserves of foreign central banks while the US dollar remains the leading global reserve currency, accounting for 62% of international reserves in foreign central banks.

1.2. Public support for the euro has been reinforced in the euro area

A Central Bank official felt there is a demand among the European population for Europe to play a more important role in the 'international power game', i.e. the new geopolitical environment in which Europe is squeezed between the hegemon and the candidate for a new hegemon (US versus China). This question around the international role of the euro has therefore gained more importance. Bloomberg has recently published an article suggesting that a significant majority of the European population want Europe to play a more important role in international affairs. Over many years, the demand for Europe to play this kind of enhanced role has been higher than governments and politicians have incorporated into their decision making. Another Central Bank official considered that the international popularity of a currency is primarily a market-led process and market participants decide which currency to use. The euro is now the second most popular currency in the world. After 20 years of use it is a successful project, but there is further room for improvement.

1.3. The benefits of a wider use of the euro are well known

A wider international use of the euro would benefit both European citizens and European companies. The latter would benefit from lower cost and risk in international trade and more reliable access to finance through more integrated and liquid financial markets. This greater role for the euro is also desirable because it would provide a greater degree of financial autonomy in the euro area and reduce exposure to third country legal actions through extraterritorial sanctions. A currency with global standing would be a symbol of European unity on the world stage; it would also be a tool to project global finance.

1.3.1. A stronger reserve role for the euro would protect from an uncooperative US approach

An industry representative noted that one obvious benefit of a reserve currency is the development of more autonomous economic policy. Having a reserve currency enables policy stances to be framed independently. Ultimately, the Fed sets the tone for interest rates worldwide. US fiscal policy is less concerned with counterproductive 'crowding out' when supporting demand, given the structural overseas demand for US bonds. The decisions taken by reserve currencies create spill overs for the rest of the world, but a reserve currency is not affected by the same spill overs from the rest of the world. However, the European Central Bank (ECB) has been able to decouple from the Fed very efficiently.

1.3.2. Being a reserve currency comes with potentially problematic conditions

An industry representative pointed out that a reserve currency must also offer a sufficiently large volume of assets for the world to invest in. This often entails running a current account deficit, which the euro area has sought to avoid over the last decade. If the euro were to become a reserve currency with a structural demand while also maintaining a structural current account surplus, this would have to be paid for with even more negative rates and perhaps an appreciation of the euro's exchange rate. The industry representative believed that the euro should become a reserve currency due to what is happening in terms of policy coordination across the world. Indeed, there was a time when monetary easing in one region was seen as a net positive for everyone. When a region engages in easing policy now, it is increasingly seen as a competition instrument notably to favour its exports. In such a context the euro should increase its capacity as a reserve currency in order to further protect itself.

A Central Bank official suggested that Europe's sovereignty is partially linked to the international role of the euro. It will not be hindered by the current account position of Europe. The current account was important until the demise of Bretton Woods, when official liquidity was the liquidity of the international system. Now this is no more the case. Furthermore, Brexit is not an important obstacle here. If anything, Brexit provides another incentive to develop the capital markets in the rest of the EU. London represents between 10% and 15% of the total issuance of both equities and bonds by firms in Europe. This is easily absorbable by increasing capital market activity in the rest of the EU.

1.3.3. The euro is part of European sovereignty

A Central Bank official stressed that sovereignty is a difficult theme, noting the difference between sovereignty and independence. Independence is sometimes formal, and it exists at the level of the nation state. Sovereignty is real, but in order for it to be for real it must sometimes be shared. This is what was done for monetary sovereignty with the euro. It has been a success, and it is supported by a strong majority of citizens in 19 member states. On average, 76% of euro area citizens want to keep the euro. There is no contradiction between sovereignty, sharing sovereignty in particular cases and maintaining popular support.

2. The obstacles to increased international use of the euro

The lack of progress on banking, capital market and fiscal union, the absence of a joint risk free asset and the persistence of negative interest rates environment are the main obstacles to wider use of the euro.

2.1. The eurozone is not functioning as a truly integrated monetary union

A Central Bank official suggested that the fact an existential crisis in Europe contributed to the euro's decline indicates the first precondition to further development of the euro's importance: establishing a rock solid monetary union which is safe from existential crises. The deepening and strengthening of monetary union is vital for increasing the international role of the euro. Moreover, the euro area's macroeconomic policy mix continues to maintain a pro cyclical bias due to fiscal policy rules. This should be slightly adjusted.

2.3. Europe's capital markets are too fragmented, and the Banking Union is far from complete

2.3.1. There is no integrated banking market

A Central Bank official highlighted the national obstacles to cross border bank mergers in Europe. In the US, the five most important commercial banks have a market share of over 40%; in Europe that number is 20%. This indicates how significant the lack of internal integration is. Additionally, there are internal obstacles. For example, there are too many liquidity waivers within Europe for subsidiary solo based regulatory approaches.

2.3.2. There are too few cross border banking mergers

An industry representative stressed that there are not enough cross border banking mergers. When considering the question of why there is an insufficient level of cross border banking mergers, it is important to consider the fact that people continue to like having sovereign powers. The industry representative reminded the audience of the fallout following the Jérôme Kerviel scandal in 2008. Christine Lagarde, then the French Minister of Finance, held a press conference, and the first question she was asked was, 'Madame Lagarde, would it be possible for Société Générale to be sold outside of France?' She answered, 'No, it is not.' A Central Bank official noted that Madame Lagarde made this statement before the introduction of the Banking Union. Nowadays, the authorisation for mergers and acquisitions lies in Frankfurt with the Single Supervisory Mechanism (SSM). The industry representative suggested, however, that the French authorities do not care about these authorisations. An official reminded the audience that the French authorities comply with all EU and Banking Union rules. To take one simple example, HSBC's main European retail operations are in France; two decades ago, it bought the CCF.

2.4. There are concerns around inertia and the neutrality of the ECB but things are changing

A Central Bank official emphasised the role of two important historical obstacles. Firstly, there is a strong inertia in behaviour. A century ago, sterling was the international currency and the dollar had a very minimal role; 10 years later, however, the dollar was at par with sterling. In between, there was a war. The Central Bank official clarified that this does not mean that war was an appropriate method of developing the international role of the euro, noting however that 10 years is an extremely short period for this change. The second historical obstacle relates to the position taken by the ECB. The development of the euro's international role is not one of the EU's treaty objectives. In the early years of the euro, Wim Duisenberg, the first President of the ECB, indicated that the ECB was neutral towards the international role of the euro.

However, the Central Bank official considered that things are changing, and a more positive stance is being taken on this issue for two reasons. First, there is a growing political concern around the development of the international role of the euro. The dollar is a powerful asset for the United States, and China is keen to develop the international role of the renminbi; Europe should not step aside. Second, Europe is deeply aware that the way forward is through international and internal strengthening of the eurozone, which is clearly part of Europe's internal monetary and financial agenda. Quoting Eurofi's paper on this topic, the Central Bank official stated, 'The barriers to the euro's global role are within Europe.' These barriers are mainly within Europe, and it is in Europe's utmost interest to progress both inwardly and outwardly.

2.5. Persistent negative interest rates complicate the re launch of the CMU project

2.5.1. The current monetary environment is detrimental, because it is weakening the EU financial industry and discourages savers from investing in long term assets

An industry representative suggested that they had been invited to this panel to play devil's advocate, noting that there is a large elephant in the room. Other panellists had called for 'rock solid monetary union' in order to increase the international importance of the euro, but this cannot yet be achieved. First, Europe needs competent monetary policies. Without competent monetary policies, the euro will continue to go backwards.

The industry representative explained that the current environment is highly detrimental and emphasised the importance of not destroying the euro with 'really stupid' monetary policies. It is impossible to make the euro an attractive international currency if it is not backed by investment, a powerful life insurance industry and a profitable banking industry. But the lasting low interest rates reduce euro-zone banks' intermediation margins and the return on their excess reserves, leading to low bank profitability. The low interest rates severely also affect life insurers first by increasing the actuarial value of their liabilities, and second by reducing the returns of their assets. The very low interest rates also lead to hardship for savers by reducing the interest they receive, and they tend to keep liquid instruments. Such a preference for liquidity diverts savers away from long-term investment. This misallocation of savings and the weakening of banks reduce potential growth in the euro zone. In addition, the yield spread between the United States and the euro zone is leading capital to flow from the euro zone to the United States.

2.5.2. The unconventional monetary policy of the ECB has avoided deflation

A Central Bank official wanted to comment on the international role of the euro and not EU monetary policy, noting however that it is necessary to comment on the remarks on monetary policy by another panellist. The eurozone would be in a very difficult position if it had experienced deflation or if it had not benefited from the positive effects of growth and employment caused by the unconventional monetary policy of the ECB. In such an environment, any discussion about the international role of the euro would be simply impossible. Secondly, two of the least arguable 'safe haven' currencies are the Swiss franc and the Japanese yen, which both have negative rates. The international role of a currency is not directly linked to its monetary policy. The Central Bank official described how they had been surprised to hear an earlier speaker suggest that their preference would have been for bolder monetary policy and the purchase of larger amounts of securities while also complaining that monetary policy is a negative cause of the obstacles to financial integration and CMU. It is impossible to believe both of these things at once. It is not reasonable to criticise the reality of monetary policy if it should have been bolder earlier. The Central Bank official agreed that the policy should have begun sooner, noting that the monetary policy actions which were taken were what had to be done.

Another Central Bank official agreed with these comments. In reality, there is no single European yield curve but rather 19 separate yield curves. The yield curve of German bonds is different from other curves. The ECB's yield curve is based on considerations of safe assets, which are now mostly bonds. The ECB also published an average yield curve which is not representative of, or useful for, monetary policy. One of the gains of developing a European safe asset would be the establishment of a pan European yield curve. Negative rates are not the obstacle here, however. Sweden, Denmark, Switzerland and Japan also have negative rates. Negative interest rates have not emerged because of monetary policy. The structural conditions in the world economy are important here: there is an excess propensity to save by populations of advanced economies and insufficient private investment, which creates an environment where equilibrium interest rates have become very low or negative in order to restore a measure of macroeconomic stability in these countries.

2.5.3. 'Too little, too late'

An industry representative stressed their desire for more inflation, noting that they had wanted expansion eight years ago. This is too little, too late and Europe has 'screwed up badly'. A Central Bank official observed that it is nothing new for central banks to be blamed. Monetary policy is not a cause of the current situation. The current situation is the result of conditions in the world economy. Central banks do what they must under the current framework; it is important for other actors to do their jobs, especially fiscal authorities.

3. Ways to strengthen the global role of the euro

There is an agreement to recognize that any international currency requires deep, liquid and efficient capital markets. There is no way to develop the role of the euro without a real Capital Markets Union (CMU) and an effective Banking Union. A European safe asset is considered as an urgent necessity. Improving market and electronic retail payments infrastructure is also required. Moreover, deepening the EMU by agreeing on a macroeconomic function (e.g. rainy-day fund) which would not necessary require permanent transfers would certainly strengthen the international use of the euro.

3.1. Europe must achieve a Capital Markets Union and complete the Banking Union

A Central Bank official considered Europe's first priority to address CMU. This could possibly be rebranded as a financing union for investment or an innovation, savings and investment union. The rationale for the CMU must be explained; Europe must seek greater political support for the project. Deeper financial integration is necessary to better foster and use its abundant private savings. On the side of economic union, the key priority is the Banking Union and CMU. These should not be separated; having a common brand for them such as a 'financing union' would be useful.

The Central Bank official stressed that Europe should not oppose a model with banks and capital markets. This mistake was made several years ago. After the financial crisis, people in Brussels sought to move Europe from a bank based model to a capital market based model. However, this is a decision for corporates and investors; Europe's task is to facilitate and broaden choice. While the ECB has been traditionally neutral on the international role of the euro, it has never been neutral on internal financial integration and the CMU. There is unanimity between the 19 governors and the Board, but there has never been enough efficiency to drive the CMU. It would be excellent if Europe were able to use the trigger of strengthening the international role of the euro to strengthen internal financial integration and eliminate the obstacles created by national borders.

Another Central Bank official pointed out that the strengthening of the euro is directly related to the ability of Europe to compete globally, which is highly related to internal integration in many different areas.

Regarding the Banking Union an official stated that its most important aspect is its completion. Of the outstanding elements, Europe must tackle the continuing lack of a European deposit insurance scheme (EDIS) and amend the present rules which create ring fencing in capital and liquidity for cross-border banking groups.

3.1.1. The current monetary environment and Brexit complicates the relaunch the CMU project

An industry representative agreed that capital markets are vitally important. Capital markets make a currency, but Europe's capital markets face two problems. First, the euro yield curve is not going anywhere, which significantly complicates the relaunch of the CMU project. Second, Europe is about to destroy the liquidity in its capital markets due to 'stupid measures in connection with Brexit'. Therefore, Europe is facing a huge challenge not merely due to its less than successful monetary policy but also because it is losing its biggest capital market.

An official noted that Brexit removes a significant market from the European Union, which means Europe must be stronger. Additionally, the official felt that the CMU action plan is too complicated. It has 27 or 28 points; this is too many. No political organisation can focus on a topic unless there is a maximum of six points which can be remembered without briefing notes. This is a big challenge for the new Commission: to develop a short action plan focused on the essentials and to secure commitment from member states.

3.1.2. Europe must act to preserve the liquidity of financial markets following Brexit

An industry representative stressed that liquidity is not created by regulation. Liquidity requires solid institutions, but it goes no further. Ultimately, investors bring liquidity. Liquidity is lost very quickly as a single market is split into smaller markets of roughly equal size. This is why Europe has benefited from London, which is the only European financial centre capable of competing with New York. If Europe cannot develop an arrangement which preserves this liquidity, the banks and the European industry will suffer, and Europe will not grow its capital markets. To have an international and 'truly great' euro which is able to compete with the dollar, Europe must have deep and liquid capital markets. This requires CMU, but that is the smaller problem. The bigger problem is creating the market, particularly as Europe is partially dismantling its de facto capital market. The industry representative suggested that people who work in bureaucracies like to deal with the rules of bureaucracies, but markets are not bureaucracies. They are driven by investors, whose greed drives capital markets. If Europe does not understand this, it will not have a proper capital market – and therefore it will not have a truly international euro.

A Central Bank official agreed that liquidity is partly created by private investors and markets, noting however that in more difficult years these private investors were happy for 'bureaucracies' to provide liquidity. If central banks had not existed and done their duty after the great financial crisis, Europe would not be able to have this discussion about strengthening the role of the euro. An official suggested that there is one intermediate conclusion to this discussion: the implementation of CMU is the first priority of the next six months of this Commission. This might be 'too little, too late', but large institutions cannot be turned quickly.

3.2. Building a safe asset: there will be no CMU without a European safe asset

An industry representative considered the requirement for a proper European safe asset to be an 'emergency' due to the benefits it would have on stability and solidity within the euro area. This is necessary because the current risk free assets are disappearing. Indeed, the pool of safe assets is now limited to a few sovereign and supranational issuers. Extrapolating from the current state of fiscal policy in Germany, it is possible to plot bund growth in Germany. Given the current level of interest rates, there will be no more bunds left by 2038. There have been fears concerning the disappearance of risk free assets, such as at the end of the 1990s in the US, when there was a feeling that surpluses would reduce the supply of risk free assets. At the end of the 1990s, banks started creating interesting ways to circumvent the lack of a risk free asset. To some extent, this fuelled the behaviours which led to 'some fairly bad consequences' six or seven years later. Europe must build a safe asset to replace the assets it has been relying on for the last 20 25 years. This is what is sending rates into negative territory more so than the impact of monetary policy.

A Central Bank official stressed that the existence of a European safe asset is a particularly clear requirement. This would increase the size of Europe's debt market, which is vital for a greater international role, because investors want to enter and exit markets quickly. A European safe asset can be built without the mutualisation of debts through two principal ways. The first is through so called sovereign bond backed securities (SBBSs). Without a degree of mutualisation in the junior tranche, however, this is a 'zombie idea'. Second, Europe could build a safe asset on the basis of seniority. This would involve a European entity issuing a layer of securities and then passing these funds on to countries with claims that would be legally senior to the remaining debts of member countries. This would allow an assurance of 20 25% of the GDP of the euro area, which means a safe asset size of over €3 trillion. Ultimately, Europe needs political decisions. Treasuries tend to 'defend their turf' and resist solutions that could disturb what they are used to doing. Top political decision making must force the creation of a European safe asset and take seriously the objective of developing a CMU that offers good prices and includes a workable solution to the over concentration of sovereign debt in banks.

Another Central Bank official agreed on the need for a European safe asset. There is no self evident technical solution here, though Philip Lane has done interesting work on synthetic assets. Ultimately, this is so important that it must not be stopped by bureaucratic obstacles or habits. Debt management agencies and private investors have bad habits; Europe will need a collective will to overcome these obstacles. An industry representative expressed their desire to link the point concerning whether fiscal integration is necessary to the ideas around the creation of new asset classes and the potential for a safe asset. Usually, this idea is conceived of as a European super state taking a chunk of public spending from national governments. Clearly, this would be resisted by national populations. Europe should focus on the issues it lacks at a national level what it needs to develop at a European level and areas where national instruments are underdeveloped. There is an obvious area here: green funding. Everybody in Europe knows that there is a need to fund a major increase in investment due to the Commission's ambitious targets on the transition to a leaner and more ecological economic model. This could trigger the emergence of a new asset class, green bonds, with support at the European level and from national governments. This would create more integration and a more liquid market in Europe without taking anything from the sovereignty of nation states.

3.3. Improving EU market and payments infrastructure

3.3.1. Market infrastructures must be improved at the EU level

A Central Bank official considered that one of the architectural issues which must be improved at the European level is infrastructure. Common infrastructure is essential for the strengthening of a currency. In this context, 'infrastructure' primarily means payments. The euro is quite a popular vehicle for payments. One fourth of global payments are made in Europe. Leveraging this could be an important way to strengthen the role of the euro. To do this, there must be a common payments system in Europe. Steps are being made in that direction, including instant payments. The industry is working on developing a consensus here, especially between main market players. Second, payment infrastructure must be open to third countries, if the euro is going to be used outside Europe.

3.3.2. A European strategy for retail payments will be necessary

A Central Bank official emphasised that Europe needs a strategy for retail payments for technological and strategic reasons. Without such a strategy, the European financial industry, especially the retail sector, will be outcompeted by American or Chinese players. This strategy must also have an international cross border dimension. An industry representative agreed on the importance of payments. The payments system in Europe is efficient and integrated today compared to many other payment systems around the world, which is an extraordinary achievement. It is important not to forget the efforts made by the Commission, the private sector and the ECB to achieve this. Europe is not one country, and payments are a very domestic issue. While it is in a very good position compared to many other economies, Europe cannot simply do nothing. Initiatives such as Libra demonstrate that the world is changing incredibly quickly. It would be wrong to suggest that Europe can rest because it is in a good position today. An official agreed, noting that without an extremely efficient payment system the challenge of crypto assets will be much stronger. Another industry representative disagreed, however, observing that the United States has the most out of date payment system of any country while having the strongest and most powerful currency.

3.4. Deepening Economic and Monetary Union is essential, but it could take a very long time

3.4.1. This is a difficult issue

Europe has no common fiscal power, and it will not have this in the coming years. However, there are some fiscal rules contained in the Stability and Growth Pact. This Stability and Growth Pact has many drawbacks, but it also introduces some appropriate limitations in terms of excessive deficits. There does need to be further discussion about whether this should be slightly more symmetric, which is essentially the aim of the so called macroeconomic imbalances procedure. Europe has a common monetary union with great gains for everybody, but there are still separate fiscal powers. However, there should be common rules on both sides (for member states with unsustainable surpluses and deficits). This difference causes a risk when some countries introduce overly restrictive fiscal policies which are inconsistent with the common monetary union.

3.4.2. A genuine monetary union does not require fiscal union but a macroeconomic stabilisation instrument

The fiscal debate is another difficult topic. A Central Bank official stated that monetary union does not require fiscal union and a high degree of budgetary integration. However, a macroeconomic stabilisation is necessary at the Eurozone level. The stabilisation instrument could be a 'rainy day fund'. It is substantial, but this does not imply full fiscal union or even permanent transfers. A Central Bank official explained that, historically, all unions take time to integrate. Taking the example of the US, it started as a confederation and then became a federation over 200 years. Europe needs more time. An official agreed with these remarks. 2012 was a landmark year in the sense that Europe decided to try to achieve Banking Union. The official reminded the audience of the words from the famous speech, 'Whatever it takes. The euro is irreversible.' Europe must now have the same kind of breakthrough for the CMU. An industry representative considered it fascinating that so many people in Europe point to the idea that monetary union requires economic union and a heavy integration of fiscal policies, when fiscal policies do not matter anywhere. The industry representative admitted that they are an 'unreconstructed Chicagoan', expressing the need to make a 'more fundamental sort of poly etiological comment': economic policy is up to the people of Europe. Europe is made up of sovereign powers, and they have sovereign power over their budgets and fiscal policies. For this reason, it will take an extremely long time for any real integration of economic policies, because the populations within Europe are not in favour of this. The most important task is to fix the problems with the euro which emanate from recent monetary policy decisions.

3.5. A reserve currency should offer remuneration, which is no longer the case in Europe

A Central Bank official noted that a reserve currency must be stable, adding however that it is also necessary for a reserve currency to offer good remuneration for those who invest in it. An industry representative considered that the ECB has ensured the stability of the eurozone as a construct while diminishing its attractiveness as an investment vehicle. While this might be an optimal solution, a fundamental element of being a reserve currency is accepting investment from the rest of the world. Negative rates send the message that a currency is not interested in this investment, even for non-profit seeking reserve managers.

3.6. Sovereignty and immunity are necessary but not sufficient conditions for strengthening the euro: Europe must also become a political and military power

An industry representative highlighted the importance of sovereignty. Sovereignty and immunity are very important in the context of coercive measures and sanctions. It is possible to have sovereign control over an economy or a currency if a country is closed off – such as North Korea, or perhaps Great Britain – but financial, economic and military giants impose their will on others through their currency. It is possible to imagine a future world in which international currency usage is divided by three, reflecting the three major trade blocks of euro, RMB and dollar. In this very happy future, these three financial systems would be heavily interlinked, which means that any one of the three can impose its will on the other two, short of those other two uniting against the third. To that extent, growing the euro's international usage to be one of these three does not bestow on it this immunity. Europe must be more ambitious and ensure the euro displaces the other two currencies and any other currencies, becoming a primus inter pares like the US dollar. When there has been a single supreme currency historically, it has also been accompanied by military supremacy and significant patronage or colonisation. While the ECB may have demonstrated its ability to 'wield a bazooka' handily, this 'bazooka' will not take the ECB and the euro to this point. Sovereignty and immunity will not be enough.