

Yves Mersch: The international role of the euro

Speech by Mr Yves Mersch, Governor of the Central Bank of Luxembourg, at a financial seminar, Hong Kong, 11 November 2004.

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Ladies and Gentlemen,

Since its inception, the euro's international role has grown in a gradual but steady way. At the outset I would like to recall the Eurosystem's policy position vis-à-vis the internationalisation of the euro. The Governing Council of the ECB sees the internationalisation of the euro as a market-driven process. Nevertheless, we analyse developments closely, as we are keen to know how the euro is used and by whom. Thus, I will first review the main developments in more detail. Then, I will turn to the Eurosystem's policy stance towards the international role of the euro. I will conclude by shortly highlighting the Eurosystem's stance on reserve management services.

The gradual development of the international role of the euro

In order to consider the main developments in the international use of the euro for the last 5 years, I will distinguish the varied use of the euro outside the euro area, by public authorities on the one hand and private agents on the other.

Let me start with public authorities. There are about 50 countries with an exchange rate regime linked to the euro, including those EU Member States that have not yet joined the euro area. Non-EU countries that use the euro as an anchor currency are mainly located in the EU's neighbouring regions or are countries that have established special institutional arrangements with the EU or some of the EU Member States. In most of these countries, the euro is also the main or the sole intervention currency used by the authorities to stabilise the exchange rates of their respective currencies. Additionally, in these countries euro-denominated assets account for a substantial share of the foreign exchange reserves held by the respective authorities.

The role of the euro as an anchor currency in third countries outside the euro area has remained stable overall. Changes in exchange rate regimes involving the euro mainly involved the new EU Member States, as three of them joined the Exchange Rate Mechanism II end-June 2004. The global reserve build-up continued at a rapid pace, with Japan and other emerging Asian economies accounting for the largest share in the total increase. Benefiting from the appreciation against other international currencies, the share of the euro in official foreign exchange reserves has continued to increase gradually, from 19.3% in 2002 to 19.7% in 2003. As an intervention currency, the euro was predominantly used in euro area neighbouring countries.

Turning to private users, the internationalisation of the euro has been most visible when it comes to the role of the euro as an international financing currency. In 2003, the share of the euro in the stock of international issues amounts to more than 30%. A significant share of euro-denominated securities have been targeted at, and purchased by, euro area investors. In using the euro as an issuance currency, financial institutions and corporations, mainly from mature economies (USA, UK), have taken advantage of the greater size and liquidity provided by the increasingly integrated euro-denominated bond markets.

With regard to the share of the euro in foreign exchange transactions preliminary results from the 2004 BIS triennial survey, point to a notable increase in activity in foreign exchange trading. Based on these preliminary results, the euro was the second most actively traded currency in foreign exchange markets worldwide, and accounted for 37% of foreign exchange transactions, broadly the same as in 2001. Globally, the euro continued to be traded predominantly against the US dollar, as 76% of total worldwide foreign exchange activity involving the euro was with the US dollar.

To sum up, the euro has been firmly and credibly established as the world's second international currency during the first five years of Monetary Union, and its gradually increased use in several market segments highlights the degree of confidence non-euro area residents have in the euro.

The ECB and the international role of the euro

This brings me to the stance adopted by the Eurosystem on the international role of its currency. I will start by emphasising a key characteristic of the international use of any currency: there is no “sovereign” power that can enforce its use. This is why the international use of a currency is, in essence, a market-driven process. The main economic factors underpinning the internationalisation are:

1. Domestic stability, that is a low inflation rate, making the currency attractive as a store of value;
2. A high degree of openness to international trade and finance. This is a key determinant for the currency’s use as a medium of exchange and a unit of account; and
3. A developed financial system with deep and liquid markets offering participants a wide range of services and products in terms of borrowing, investing and hedging.

Against this background, the Eurosystem takes a neutral stance on the internationalisation of its currency. This means that we neither hinder nor actively promote the development of this role. For example, decisions taken by non-euro area authorities to use the euro as an anchor, reserve or intervention currency have to be fully seen as unilateral measures. They do not involve any commitment on the part of the Eurosystem.

This rule knows only one exception: the Exchange Rate Mechanism II.

With regard to this stance, it has of course to be noted that the Eurosystem contributes to the international role of the euro in indirect ways. Price stability is a key precondition for the development of the international role of a currency. Thus, the stability-oriented monetary policy of the ECB contributes to the euro’s potential for expanding its international role.

The Eurosystem has also been a strong supporter of financial market integration in the EU. The introduction of the euro itself has undoubtedly led to a deeper and more integrated financial market. The evidence strongly suggests that this has supported the development of the international role of the euro. And when we refer to the fact that potential gains from monetary union will only be fully realised when European financial integration is fully achieved, this also applies to the euro’s use as an international financing and investment currency.

Let me stress that by being neutral we are not indifferent to the international role of the euro. Indeed, we pay special attention to the international use of our currency and provide regular information to the public on related developments in the international financial arena, for example the recent build-up in foreign exchange reserves.

The Eurosystem’s reserve management services

This leads me to say a few words on the Eurosystem’s reserve management services. We have seen that the euro has firmly established its role as an important reserve currency, supported by its gradually increasing use at an international level. The Eurosystem has therefore developed a new framework that specifically addresses the type of services required to support the management of euro-denominated reserve portfolios. The new framework builds on the well-established reserve management services infrastructures already in place at certain Eurosystem central banks. Consistent with the manner in which reserve management services have been provided over the years, the new ‘standardized or harmonized’ framework continues to be based on the core principles of financial security, legal security and confidentiality.

This basis allows central bank customers to comprehensively manage their euro-denominated reserve assets in a safe, confidential and reliable environment.

The services themselves are provided by certain national central banks of the Eurosystem, identified as “Eurosystem service providers”, among which the Luxembourg Central Bank. These providers have committed to offering the complete set of reserve management services falling under the new framework. Eurosystem service providers and the other central banks of the Eurosystem may also offer specific reserve management services on an individual basis.

The Eurosystem’s services are tailor-made to address the special needs and concerns of those institutions that operate in the same area of central banking activities as the Eurosystem itself. The services offered under the new framework, as well as other non-standardised and non-harmonised

services offered by those central banks with extended know-how in professional asset management, among which the Luxembourg central bank, help this core group of customers to manage their euro-denominated reserve assets more effectively and with greater flexibility and will thus accompany the deepening of financial markets in Europe and the expanding role of the EU currency.

Thank you for your attention.