

Dr. Duisenberg assesses the future importance of the euro Address by the President of the Netherlands Bank and of the Bank for International Settlements, Dr. W.F. Duisenberg, on the occasion of a dinner hosted by the Board of Directors of the 'Association for the Monetary Union of Europe' (AMUE), at Kasteel De Wittenburg, Wassenaar, 4/3/97.

1 It is a great pleasure for me to be able to address you here tonight in Wassenaar. Your Association has always been among the strongest supporters for speeding up European integration, particularly Economic and Monetary Union (EMU). This emphatic support gives the speaker the luxurious feeling of playing before a home audience.

2 Tonight, I would like to ponder two issues related to the future importance of the euro. First, what are the chances of the euro becoming an important reserve and invoicing currency? Second, how should the European Central Bank deal with the external value of the euro?

Future role of the euro as a reserve and invoicing currency

3 I know that the first issue - the future role of the euro as a reserve and invoicing currency - has been receiving a lot of attention from your Association over the years. As a matter of fact, you very strongly believe in a powerful role for the euro. I quote from your latest report: "By placing Europe in a much stronger position vis-à-vis the United States of America and other countries, the introduction of the euro improves investor climate and ultimately favours employment. Also, the use of the euro will rapidly develop world-wide, in proportion to the external trade of the European Union which already ranks first in the world".

I very much welcome this positive approach to the euro. The internationalization of the euro is only partly in the hands of European policy-makers. Policy-makers can provide for the right incentives by pursuing sound policies, thereby making their currency attractive. But, at the same time, the success of the euro is also in the hands of the markets. In this respect, I would encourage the European business community to take every opportunity to promote the private use of the euro and increase its role as a vehicle currency and store of value.

4 Let me elaborate a little by discussing three major factors that will determine the future importance of the euro: the stability of the euro, the amount of trade conducted in it, and the depth of euro financial markets. Safeguarding the stability of the euro is the biggest responsibility of the European Central Bank. The safest currency for all investors is the currency of the country with the lowest inflation rate over time. Here, the prospects for the euro are good. Over the years, inflation in European core countries has been constantly lower than in the United States, and there is no reason to believe that this would change with the start of EMU. It is also very important that the euro will be strengthened by the institutional independence of the European Central Bank and its objectives of price stability. Furthermore, safeguards have been put in place, such as the Stability Pact, to prevent EMU countries from pursuing unhealthy fiscal policies. All in all, I firmly believe that the euro will be a strong currency.

5 As regards the other major determinants of the future importance of the euro - trade and financial markets - the role policy-makers can play is more limited. This is not to say that the euro's starting position is unfavourable. On the contrary, over the last twenty years international private portfolios have been gradually diversified in the direction of European currencies. Also, European currencies have been increasingly used as vehicle and, to a lesser extent, as invoicing currencies. There is every reason to believe that these trends could be strengthened by the introduction of the euro. After all, the euro will eventually cover an

economy whose gross domestic product is larger than that of the United States. If intra-EU trade is excluded, the EU and the US both account for around 20 percent of world trade. Furthermore, with 350 million inhabitants the EU is the largest consumer market in the OECD area, consumers whose needs will partly have to be met by trading with the rest of the world. Companies which trade principally with European counterparties may be inclined to invoice and pay in euros. If the euro is going to be widely used in international trade transactions, exporters and importers within the European Union will no longer be exposed to exchange rate risks nor have to hedge against such risks. The European business community thus has ample opportunities to reap the benefits provided by the introduction of the euro.

6 It is more difficult to predict the future role of the euro in international financial markets. Fortunately, at the European level agreement has been reached on legal provisions that guarantee the continuity of ECU contracts. This provides a good starting point for euro capital markets. Ultimately, however, the choice of currency in which to borrow and lend depends on the depth and liquidity of the underlying market. Presumably, some segments of the euro market will become deeper. For instance, government bond markets are likely to become deeper and more liquid, and will offer international investors more instruments than current national markets. It is also important that experience in the last few years has shown that financial markets can put increasing pressure on political authorities to conduct prudent macroeconomic policies. In such an environment, governments can no longer afford to outrun the constable, and credit spreads between different debtors may in practice be rather small.

The external value of the euro

7 Let me now briefly discuss the issue of the external value of the euro. Recently, there has been a great deal of attention on this issue. Should the ECB, for instance, set an exchange rate target vis-à-vis the dollar?

In my view, this is not the appropriate way to go. The primary task of the ECB is to guarantee internal price stability. As I have mentioned earlier, the euro area will have an economic and commercial weight comparable to that of the United States. This means a huge, but relatively closed economy. With a low import ratio, the effect of exchange rate movements on internal price developments will be limited compared to what currently holds for individual EU countries. Therefore, it is simply wiser for the ECB to focus on euro-wide indicators, such as money growth for the whole euro area. Put differently, the internal value of the euro is the objective of monetary policy and the external value the outcome.

8 This is not to say, of course, that Europe could adopt an attitude of benign neglect with regard to the external value of the euro. As is the case now, exchange rate developments will continue to be informally monitored by the major global players. Indeed, the introduction of the euro may even enhance the opportunity for strengthened policy coordination. With Europe speaking with one voice, the players on the global field are being put on a more equal footing. This could add to globally balanced and stable policies, which is in the interest of the three poles concerned.

Furthermore, there is the relationship between the euro and the currencies of those countries which will not participate in EMU from the beginning. A new Exchange Rate Mechanism has been designed which aims to ensure that the EU Member States stay together and that the working of the Internal Market is not frustrated by exchange rate fluctuations between the euro zone and other EU currencies. It will also help those countries which will not join EMU right from the start to orient their policies towards convergence, in order to enable them to qualify for participation as soon as possible.

To conclude...

..., there are reasons to believe that over time the euro could develop into an important reserve and invoicing currency. Good opportunities for the euro arise from the fact that the EU economy is even larger than that of the United States. Furthermore, it is the responsibility of European policy-makers to safeguard the attractiveness of the European currency by pursuing sound policies. In this respect, the stability of the euro is in the good hands of the ECB. At the same time, I would like to emphasize that the success of the euro is also in the hands of the markets. It should be borne in mind that it took the dollar half a century and two world wars to replace sterling as the international currency, despite the fact that the United States had been the major economic power since the beginning of this century. All in all, these are challenging times for Europe. Let me, therefore, propose a toast to the future success of the euro.