



# The international role of the euro

## A currency is only as strong as its foundation

Recent shifts in global political and economic powers have pushed the European Commission to identify ways that promote a more diversified and multipolar system of several global currencies, reflecting the Euro area's economic and financial weight. Why is that and what is the role financial market infrastructures can play in this respect?

The European Commission's initiative to increase trust, attractiveness and usage of the euro at the international level provides for an important impetus in relation to the eurozone reforms. The initiative also triggers a renewed push to complete the Capital Markets Union (CMU), as an all-encompassing ecosystem is required when it comes to financing questions.

It can also be considered a key forward looking initiative where the strengthening of the European markets and infrastructures will reinforce the single currency – and vice versa. The debate takes place at the right time: 2019 is a decisive year for the European Union (EU) with Brexit and the European elections ultimately changing the EU's political landscape. This provides a triggering factor for the EU to set new and more ambitious priorities for the EU financial markets over the next five years within a multipolar, rapidly changing and highly competitive world order.

### **The international role of the euro is better than perceived**

Since 1999, the eurozone shares a single currency, the euro. The euro is used as legal tender by the 340 million residents of the 19 eurozone countries. Besides the 19 member states of the EU that are part of the eurozone, according to the EU Treaties, all member states are expected to eventually join the euro and the Economic and Monetary Union (EMU).<sup>1</sup>

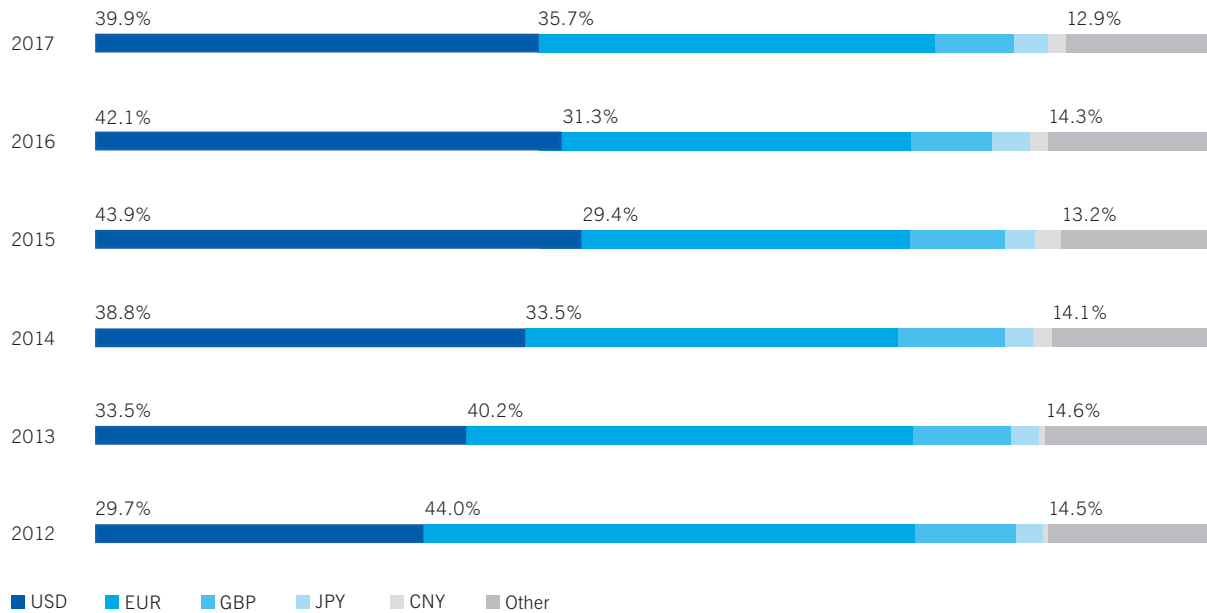
20 years after its introduction, this relatively young currency has acquired a healthy and stable international role: the euro has become the second most important currency in the global monetary and financial system after the US dollar and way ahead of the Japanese yen – despite the gradual rise of the Chinese renminbi. Following a setback since the European debt crisis, the current share of the euro in global payments (over 35 per cent) is significantly higher than the global economic strength of the eurozone (around 11 per cent) or the EU-27<sup>2</sup> (around 14 per cent).

1) Except Denmark and the United Kingdom

2) The remaining EU member states after Brexit

### The Euro is the second most important payment currency

Currency composition of global payments (in %)

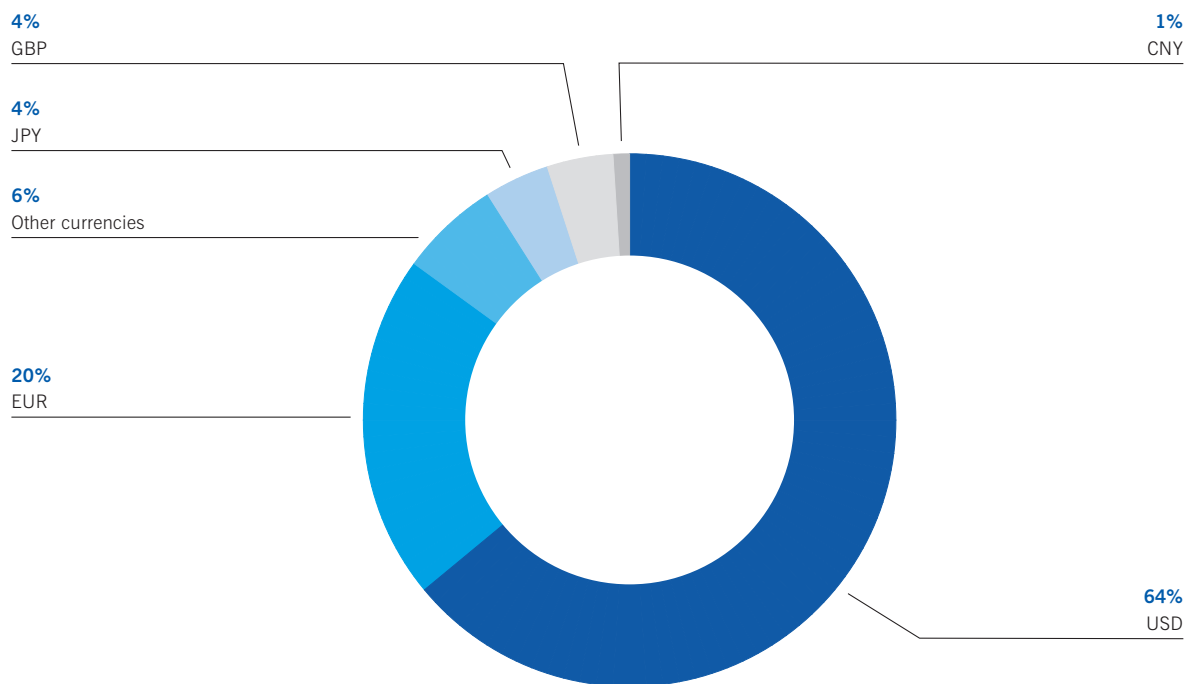


Source: European Central Bank, ECB (2018). The international role of the euro, p. 12–13.

The share of the euro as a reserve currency has been relatively stable since 2014 at slightly over 20 per cent. Especially holding reserve assets reflect to a large extent the confidence and trust of financial market participants in the stability of the political and economic system of the jurisdiction where a currency originates from.

### The Euro accounts for 20 per cent of reserves

Official foreign-exchange reserves – average claims based 2014 to 2017 (in %)



Source: International Monetary Fund, IMF (2019). Currency Composition of Official Foreign Exchange Reserves (COFER). Aggregated end-of-period quarterly data on the currency composition of official foreign exchange reserves.

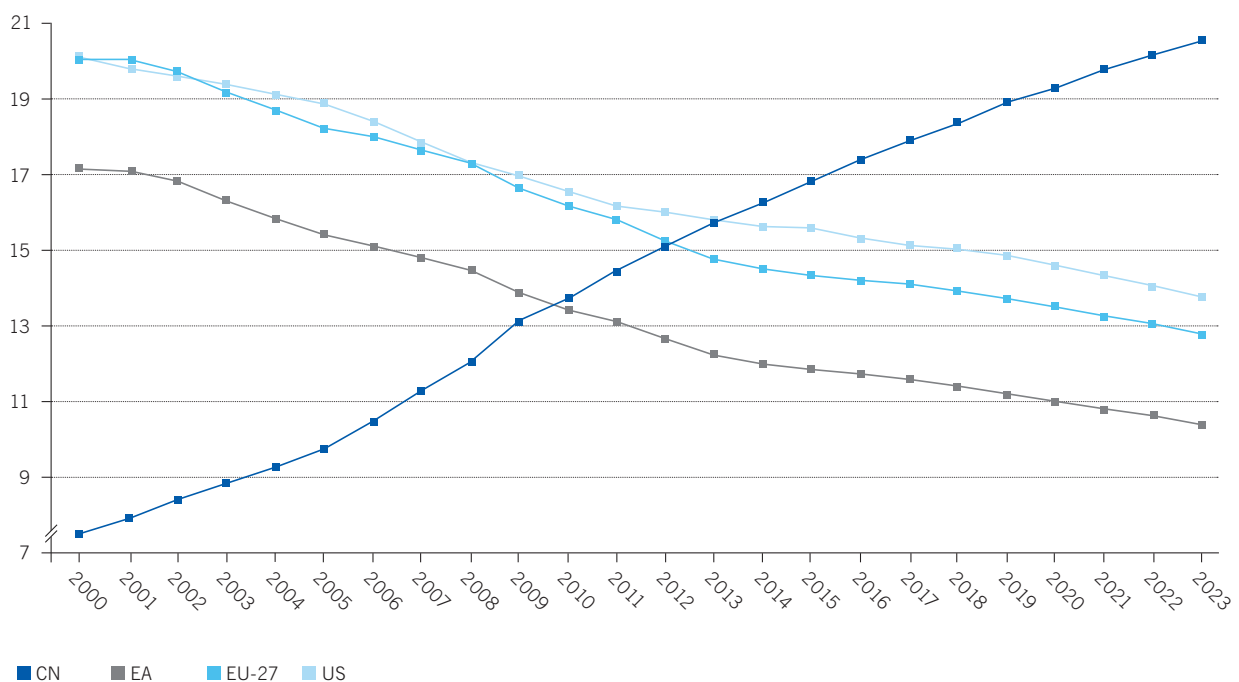
Overall, the main functions of a currency within a jurisdiction and across jurisdictions are to ensure that market participants can execute their transactions efficiently and actors can store value with the respective currency (reserve holdings). Data tells us that the euro provides for these functions. However, there are also political components that have an impact on a currency as well as on the originating jurisdiction and on related companies. For instance, creation of dependencies or sanctions to a third country can be transferred to related economies and thus heavily restrict their scope of action.

### An agenda for the euro means an agenda for the EU

Despite the overall positive picture of the euro, the EU faces major challenges. China has since become the world's largest economy, overtaking both the US and the EU by far. And China's share of the world's gross domestic product (GDP) continues to grow further – even though growth rates are not quite on par with earlier levels.

### Shifting weights in global economy

Share of world's GDP (in %)



Source: IMF (October 2018). IMF DataMapper.

From a European perspective, there are also economic and political uncertainties and changed international relations with regard to the US. Increasing trade conflicts are already perceptible and, last but not least, we can see what it means when political influence is exerted over the worldwide interdependence of trade and currency flows when it comes to sanctions.

The EU has been taking a role-model function when it comes to the implementation of the G20 reforms and the broader global stability agenda. It is important that the results achieved are maintained in the future while at the same time the focus shifts on fostering the attractiveness and competitiveness of EU financial markets as well as their overall growth contribution capacity when it comes to financing questions. It will be critical to establish a more strategic vision on the future of the EU-27 and on the role financial markets can play in this regard – especially, when looking at the social and environmental challenges lying ahead.

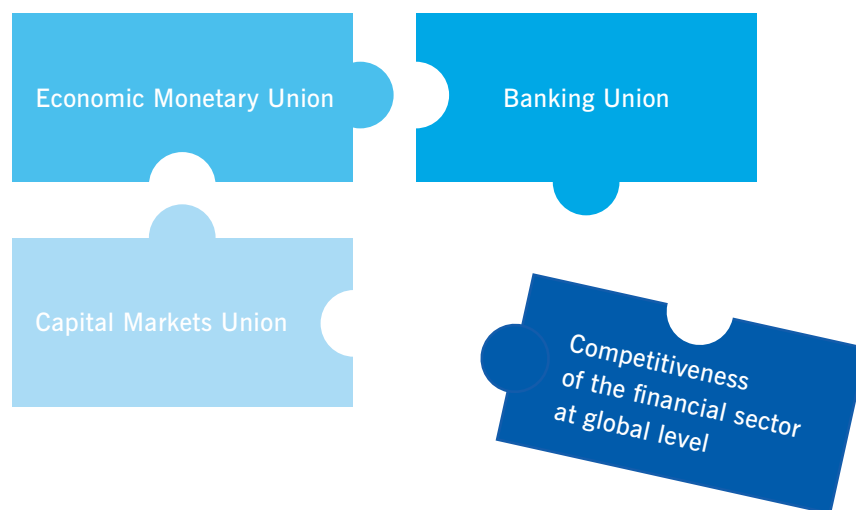
By far, not all the problems of the European financial market have been solved. The euro's good reputation, in particular, is a sound basis to build on in the future in order to take the next steps towards a more strongly integrated EMU, Banking Union and CMU.

In December 2018, around 20 years after the introduction of the single currency, the European Commission published a corresponding communication<sup>3</sup>, which was also welcomed by the finance ministers of the eurozone at the beginning of this year.

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### Increasing the trust and attractiveness of the currency

Eurozone reforms



In this context, strengthening the international role of the single currency may be done through different paths: directly, by increasing trust and attractiveness of the currency itself which will necessarily require reforming the eurozone, and indirectly, by supporting products and services denominated in euro as well as the eurozone's financial market infrastructures.

*"After all, a currency is only as strong as its foundation."*

**Valdis Dombrovskis**

Vice President, European Commission

In a first step, the European Commission has therefore identified areas for action that now need to be filled with life. In the first instance, it proposes the completion of the EMU, the Banking Union and the CMU in order to achieve sustainable growth and greater resilience to shocks.

This includes measures that enable safe and efficient euro markets. The European Commission's second priority is to commit to globally competitive market infrastructures and to explore opportunities for the euro to gain ground in under-represented areas such as energy and raw materials. It is the result of a historical development that, for example, the majority of energy imports into Europe are priced and paid for in US

3) European Commission (December 2018). Communication, "Towards a stronger international role of the euro".

dollars. The US currency benefits from liquidity and network effects on a global scale, which cannot be changed overnight. Thus, the question is in which sectors it makes sense, from an economic perspective, to promote or develop products tradable in euro.

“The decision to use a currency is ultimately made by market participants and there are good reasons why economic actors might wish to invest and hedge in different currencies. The objective is not to interfere in commercial freedom or limit choice, but rather to expand the choice for market participants by ensuring that the euro represents a strong and reliable alternative in all relevant ways.”

#### European Commission

Communication, “Towards a stronger international role of the euro”

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We have established a foreign-exchange (FX) market hub encompassing trading and clearing services for both over-the-counter (OTC) and exchange-traded derivative (ETD) FX instruments



We have extended our trading hours to the Asian time zones so that investors can now hedge their euro exposure in their own time zones



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The EU can play a vital role in creating the regulatory framework that both fosters the liquidity in contracts that are already denominated in euro and promotes new euro-denominated contracts. In doing so, the EU would ensure that the Eurozone is attractive for market participants and its regulatory framework is fit for purpose – ultimately fostering the competitiveness of the EU financial sector at the international level.

**Strengthening confidence for an attractive financial sector in the EU27**

Stable and competitive financial markets should be a joint objective of regulators and the financial sector. The foundation for a strong euro is confidence in the currency – on this basis, all measures that enable an attractive financial sector in the EU-27 should be supported. Stability and competitiveness must go hand in hand. This is the only way to achieve attractive markets in Europe in the long-term, on which sufficient liquidity is available. “The strengthening of the euro’s international role should be conceived as part of Europe’s broader commitment to an open, multilateral and rules-based global economy”, states the European Commission<sup>4</sup>, – and that is worth any support.

“European companies need strong and efficient financial markets for their capital and financing plans. For this we need an efficient financial infrastructure in the EU. The EU financial markets must become even more attractive. The EU’s focus in the coming years should be on developing them further so that they can help achieve growth in Europe and finance challenges such as sustainability, private pensions and digitalisation. The euro is one of the keys to further developing the EU together in this respect.”

**Alexandra Hachmeister**

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**Published by**

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June 2019

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4) European Commission (December 2018). Communication “Towards a stronger international role of the euro”, p.5.