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The internationalisation of the euro requires CMU and a European safe asset

There are five key conditions for a currency to become a significant international currency. The first is having a very large economy, which engenders network externalities and lowers transaction costs. The second, is given by deep, efficient, and open financial markets for investors to cheaply and easily getting in and out from assets denominated in that currency. Third, good political and macroeconomic governance with low stable inflation to preserve the value of a currency. Fourth, full enforcement of the rule of law is equally crucial as it ensures the protection of investors' property rights. Fifth, one should not overlook the importance of geopolitical influence and political stability.

It is therefore not easy for a currency to fill all the conditions necessary for it to have an international role. Consequently, we will not see a major change in the hegemonic role of the US dollar over the next 10-15 years – though the conclusion may well be different over a longer horizon.

A simple composite indicator of the international place of the euro in different dimensions shows that after a peak in 2005, the euro's position declined until 2016, recovering slightly after that. This clearly indicates that the world financial crisis and its specificities in the Euro Area were the decisive causes of this evolution.

Structurally, it is easy to see that the weakest feature for the euro to have a bigger role as an international currency, lies with low degree of integration and depth of capital markets. Consequently, transactions costs are higher, and periods of lower liquidity may occur more frequently. Both equity and bond markets are still fragmented as a result of legal and tax differences as well as the concerns regarding redenomination risk in the Euro Area. The main initiative to foster the international role of the euro is therefore the implementation of a genuine Capital Markets Union (CMU), a project that unfortunately has not yet been taken seriously by European Governments. We should however, acknowledge that it is a difficult project because it implies deep integration, requiring a European safe asset, the harmonisation of taxes on financial products, a convergence of company law, including on bankruptcy, the creation of a single rule book of regulation for

markets activity and ultimately a European Single Securities Market Supervisor. Another crucial component is the creation of a European safe asset to foster the integration of the bond market. There are proposals to do it without implying mutualisation of national debt. Unfortunately, until now, most of the initiatives related to CMU were directed more to the general development of capital markets than to integrate and unify financial markets in Europe. The new Commission will have to relaunch the CMU project with priority and ambition. ●

¹ See Chart 1 in the ECB Report on "The international role of the euro" at <https://www.ecb.europa.eu/pub/pdf/ire/ecb.ire201906~foda2b823e.en.pdf?5e2f2979de08d8coe2d05b230dad4f11>