OPENING REMARKS

by

Jörg Asmussen

Member of the Executive Board of the ECB

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'The international role of the euro'

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European Central Bank
Directorate General Communications and Language Services
Press and Information Division
Kaiserstraße 29, D-60311 Frankfurt am Main
Tel.: +49 69 1344 7455, Fax: +49 69 1344 7404
Internet: http://www.ecb.europa.eu

Ladies and Gentlemen,

the main messages coming out of this year's *International role of the euro* report are the following:

The international role of the euro declined moderately in 2012, after having remained relatively resilient in 2011.

Last year's report found that the crisis had resulted in "composition effects" on the international demand for the euro, namely shifts in foreign demand away from stressed to non-stressed euro area countries. As a result, foreign demand for euro-denominated assets had overall remained relatively stable in 2011.

This assessment is still largely valid. However, a moderate decline occurred in 2012 in the following market segments:

- The share of the euro in globally disclosed foreign exchange reserves declined in 2012 by around 1 percentage point, from 25.1% to 23.9% (adjusted for valuation effects).[1]
- Similar developments can be observed with regard to international debt securities, i.e. bonds and notes as well as money market instruments targeted at foreign investors – where the share of the euro declined by 0.7 percentage point in 2012, from 26.2% to 25.5% – and with regard to the invoicing of extra-euro area trade.
- By contrast, foreign demand for euro banknotes increased to EUR 131 billion as at end-2012. Around 25% of euro currency in circulation was circulating outside the euro area at the end of 2012, in particular in neighbouring regions such as Switzerland, the United Kingdom, Russia and northern Africa, according to data available from international wholesale banks.
- The use of the euro as a parallel currency in Central and Eastern Europe and the use of the euro as a vehicle currency in global foreign exchange markets remained by and large the same as last year.

The report identifies financial fragmentation in the euro area as the most plausible driver of these developments, in addition to a number of technical factors which are specific to the respective market segments. This is in line with a long-standing finding of the report, namely that large, deep and liquid capital markets tend to foster the international use of currencies.

[1] Among the emerging market central banks which used to hold higher shares of their foreign exchange reserves in euro compared to the advanced economies, the share of the euro declined by more than three percentage points, from 27.8% to 24.2%.

Following some improvement in the degree of financial fragmentation since the peak reached last summer, several survey indicators suggest that the decline in the international role of the euro might have bottomed out or even partly reversed during the second half of 2012. The report includes a section on exchange rate developments, euro area capital flows and euro area bond yields, which confirms this assessment.

- A first indicator is a regular private sector survey of foreign reserve managers. In this survey, foreign reserve managers were asked between January and March 2013 whether the ECB's announcement of Outright Monetary Transactions (OMTs) had alleviated their concerns about the euro. An overwhelming majority (89%) of the survey respondents answered "yes" to this question.
- Moreover, another private sector survey suggests that prime US money markets funds increased their exposure to short-term debt instruments issued by euro area financial institutions during the second half of 2012.
- Finally, a survey carried out by the Österreichische Nationalbank shows that, among households in Central and Eastern Europe, trust in the euro increased during the second half of 2012 as well.

But this picture remains to be confirmed by hard data on the international role of the euro, which will be coming in mainly in the next months.

The report makes a reference to the role of various policy measures taken at the European and national level, which helped mitigate market concerns about the possible materialisation of so-called “tail risks” in the euro area, in other words financial fragmentation worsening to an extent such that it would lead to a break-up of the euro area.

The decision by European leaders to create a single supervisory mechanism, the announcement by the ECB on Outright Monetary Transactions (OMTs), the restructuring of the Spanish banking system and the success of the Greek debt buyback operation are explicitly mentioned in this context.

At the same time, more needs to be done both at the euro area and national level to tackle the fundamental causes of financial fragmentation in the euro area. In this regard, the report recalls that a further strengthening of the institutional framework of Economic and Monetary Union will contribute positively to that end. Banking Union is a crucial component in this respect.

Considering international monetary system issues, the report devotes two special features to non-traditional reserve currencies, namely the Australian and Canadian dollars on the one hand, and the Chinese renminbi on the other hand.

- With regard to the Australian and Canadian dollars which already play a role as non-traditional reserve currencies, the report finds that their gradually rising importance – to around 1.5% of global reserves for each of these two currencies, i.e. 3.0% in total– is mainly driven by market perceptions of (i) heightened credit risk with respect to traditional reserve currency issuers and (ii) relatively sound fundamentals of Australia and Canada. However, the future international role of these currencies as reserve assets is likely to be constrained by lack of critical market size and liquidity. In addition, many investors consider these currencies as “commodity currencies”, whose value moves along with commodity prices.
- With respect to the Chinese renminbi, the report notes that China’s growing weight in global output and trade, together with policy measures taken by the Chinese authorities, have led to an increasing use of the Chinese currency. For example, the share of China’s international trade in goods settled in renminbi increased from virtually zero in 2010 to about 10% in 2012. However, the lack of sufficiently deep and liquid domestic financial markets, tight financial restrictions, remaining capital controls and insufficient exchange rate flexibility hamper the development of the international use of the renminbi, notably as a reserve currency. Nevertheless, the report acknowledges that the renminbi could play an increasingly prominent role in the medium term, to the extent that the Chinese authorities continue to gradually address these challenges.

The analysis presented on non-traditional reserve currencies underscores the need for credible and ambitious fiscal consolidation plans in the case of all major advanced economies so that they can re-gain full trust of market participants and continue to perform their critical role as issuers of global safe assets.

Let me conclude by summarising the main messages of this year’s report on the international of the euro:

- The crisis continued to weigh on the international use of the euro in 2012, and fragmentation of the euro area financial system is one of the main underlying causes of this development.
- However, survey indicators are signalling a tentative turnaround during the second half of 2012.
- This did not happen by accident. We believe the OMT has played an important role in the process, together with the adoption of several policy measures at both the Euro-

pean and national level. The ECB acted at the monetary policy level, while national governments have carried out or started implementing important reforms.

- We can say that the trend goes in the right direction, but we all have to continue to work to tackle the fundamental causes of financial fragmentation in the euro area. In this respect, moving decisively towards a Banking Union is crucial.