

## [WHY IS THE EURO PUNCHING BELOW ITS WEIGHT?](#)

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On the twentieth anniversary of its inception, the euro has yet to expand its role as an international currency. We document this fact with a wide range of indicators including its role as an anchor or reference in exchange rate arrangements—which we argue is a portmanteau measure—and as a currency for the denomination of trade and assets. On all these dimensions, the euro comprises a far smaller share than that of the US dollar. Furthermore, that share has been roughly constant since 1999.

By some measures, the euro plays no larger a role than the Deutschmark and French franc that it replaced.

The share of world GDP anchored to the euro has declined from nearly 30% to below 20%, smaller than the share of the world that was anchored to the Deutschmark and franc before the advent of the euro. In stark contrast, the US dollar's share has increased from 60% to 70%. The share of US dollar- and euro-denominated central bank reserves is similar and has been stable over the past two decades. Nearly all foreign exchange transactions involve the dollar, with only 20% of these transactions involving an exchange of euros. Nearly all foreign-denominated developing country debt is in dollars (including the rapidly increasing share official Chinese loans), with only a small fraction in euros.

We explore the reasons for this underperformance. While the leading anchor currency may have a natural monopoly, a number of additional factors have limited the euro's reach, including lack of financial center, limited geopolitical reach, and US and Chinese dominance in technology research. Most important, in our view, is the comparatively scarce supply of (safe) euro-denominated assets, which we document. The US government has \$14 trillion in marketable debt outstanding, compared with nearly half that sum from Eurozone governments. This latter figure overstates the supply of Eurozone safe assets, because nearly half of Eurozone bonds are from the crisis countries of southern Europe. US corporate bonds outstanding are nearly 40% of GDP, providing foreign investors with a rich and diverse portfolio to invest in. The corresponding figure for the Eurozone is only 10%, because of European corporations' greater reliance on non-marketable bank finance.

The European Central Bank' lack of policy clarity may have also played a role. We show that the euro era can be divided into a "Bundesbank-plus" period and a "Whatever it Takes" period. The first shows a smooth transition from the European Exchange Rate Mechanism and continued to stabilize German inflation. In this first decade, the ECB's policy rate tracked German inflation and unemployment more

closely than it did that of the Eurozone as a whole. The second period is characterised by an expanding ECB arsenal of credit facilities to European banks and sovereigns.