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PRESS RELEASE

SIGNS OF A TURNAROUND IN THE INTERNATIONAL USE OF THE EURO

The euro area attracted more foreign investment last year than in the year before, but the share of the euro in foreign exchange reserves and its role as currency in international financing slightly declined. These are among the main findings of the report on “The international role of the euro”, which examines developments in the use of the euro by non-euro area residents in 2013 and was published today by the European Central Bank (ECB).

The report finds that, in an environment of improving market sentiment towards the euro area, various indicators used to assess the international use of the euro turned to or remained in positive territory in 2013. In particular, international investors’ interest in euro area securities, which are mostly denominated in euro, grew markedly over the course of the year. Specifically, foreign demand for euro area portfolio investments (debt securities and equities) reached its strongest level since the onset of the financial crisis in 2007, amounting to 3.7% of euro area GDP, compared with 3.0% in 2012. These capital inflows reflected both domestic and external factors, including improving euro area macroeconomic fundamentals, a further reduction in perceived tail risks, and a rebalancing of international investors away from emerging market securities. Sustained capital inflows to the euro area were mirrored in a broad-based and steady strengthening of the euro exchange rate, which appreciated by 7% in nominal effective terms in 2013, the second largest appreciation since 1999.

Also other indicators of the international use of the euro turned to or remained in positive territory in 2013. Foreign demand for euro banknotes increased for a third consecutive year and the sovereign debt crisis had no impact on the use of the euro as parallel currency in central, eastern and south-eastern Europe.

The report also observes that the international use of the euro declined in other market segments. The euro’s share in global foreign exchange reserves decreased by 0.9 percentage point (at constant exchange rates) in 2013 to 24.4%. This notwithstanding, the euro continued to perform its function as a credible store of value for foreign central banks as the second most important international reserve currency. As regards international debt markets, the share of the

euro as an international financing currency declined by 1.4 percentage points (at constant exchange rates), to 25.3%. In this market segment, the euro's share decreased in tandem with that of the Japanese yen and those of the "other" currencies.

The latter developments may be the result of several factors, including structural shifts in the global monetary and financial system, as well as the lingering effects of the euro area sovereign debt crisis. The on-going adjustment and rebalancing process in the euro area and the moves towards a genuine Economic and Monetary Union, including the completion of the banking union, remain therefore of the essence.

The report's first special feature article analyses the role of foreign investors for the international use of the euro at the peak of the euro area sovereign debt crisis. It finds that foreign investments in the bond markets of stressed euro area countries were disproportionately small relative to the predictions of a standard benchmark model of international portfolio allocation, but that this underinvestment disappeared after the announcement of the ECB's OMT programme.

The second special feature provides an overview of the academic literature on the global financial impact of official reserve diversification. It shows in particular that the impact of reserve diversification on global foreign exchange markets is not mechanical, but that it depends on an array of factors, including the degree of substitutability between reserve assets and related changes in interest rates as well as the reaction of private investors.

The third special feature highlights a number of stylised facts on foreign currency bond issuance. It finds that gross bond issuance has reached unprecedented levels since the global financial crisis and that an increasingly large fraction of bonds have been issued in foreign currency, especially in emerging markets.

The report is available on the ECB's website (<http://www.ecb.europa.eu>).

For media queries, please call Peter Ehrlich on +49 69 1344 8320.

European Central Bank

Directorate General Communications and Language Services

Global Media Relations Division

Kaiserstrasse 29, D-60311 Frankfurt am Main

Tel.: +49 69 1344 7455, Fax: +49 69 1344 7404

Internet: <http://www.ecb.europa.eu>

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