

# Why is the Euro Punching Below its Weight?

Ethan Ilzetzi, Carmen Reinhart and Kenneth Rogoff

Discussion:

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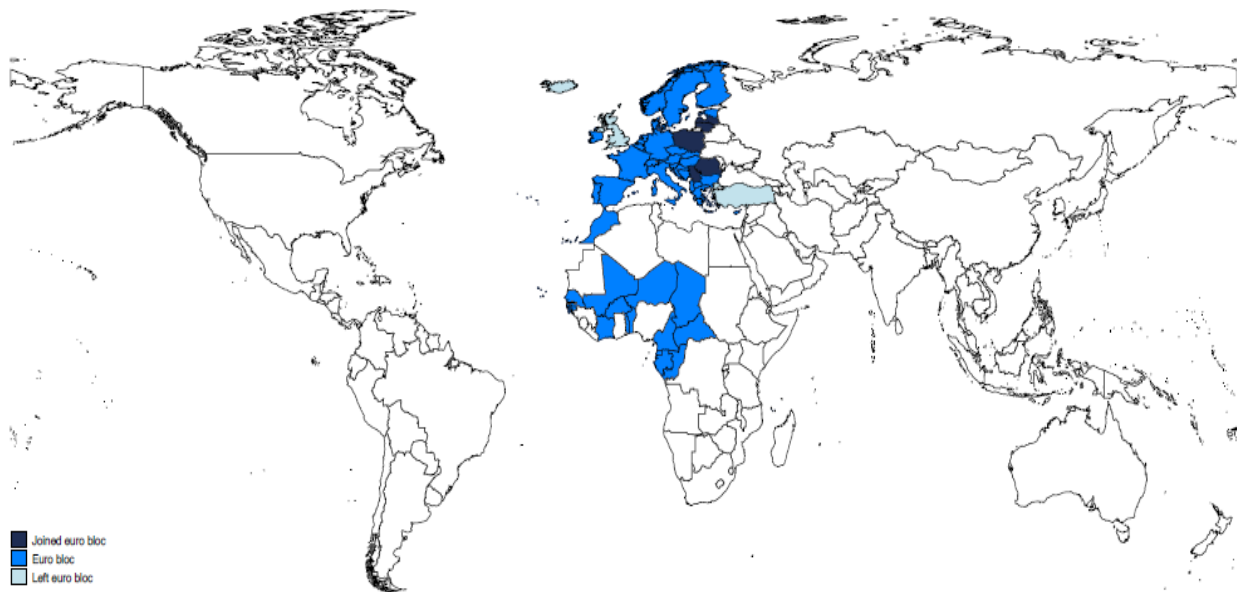
## **Three distinct parts**

- Quantify the (low) weight of the euro as an international currency
- Why is the euro underperforming?
- Analyze (evolving) ECB policy objectives

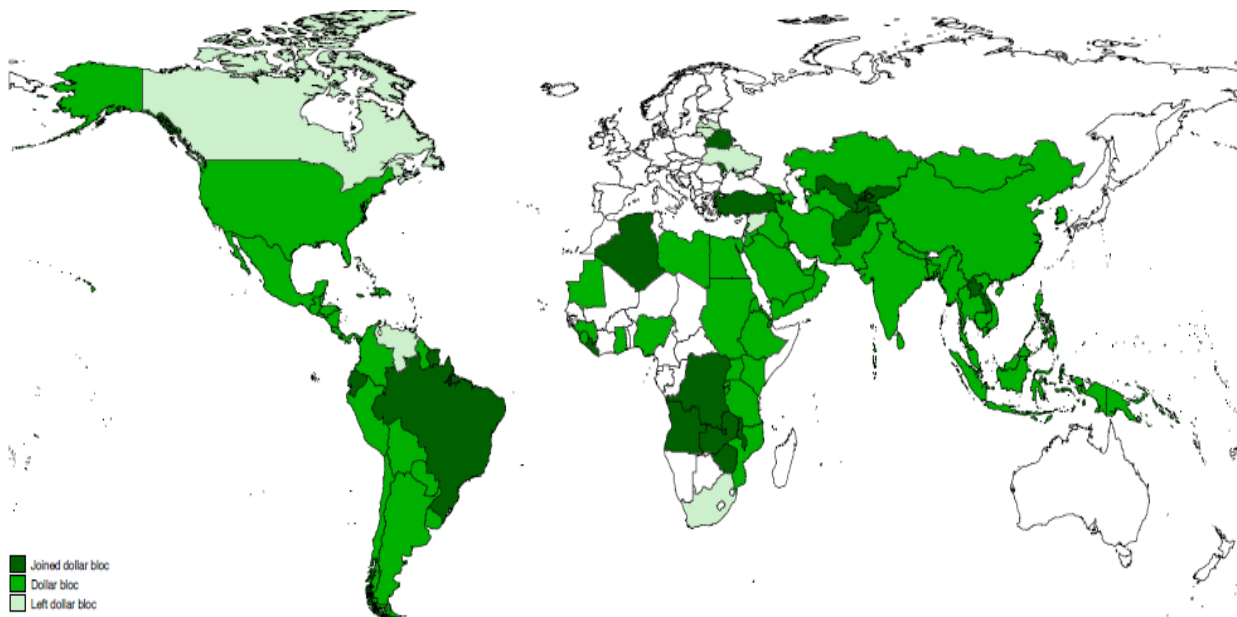
## Weight of the euro as an international currency

- Anchor currency
  - to what extent are other countries pegging their currencies to the euro?
  - novel dataset introduced by IRR (2019)

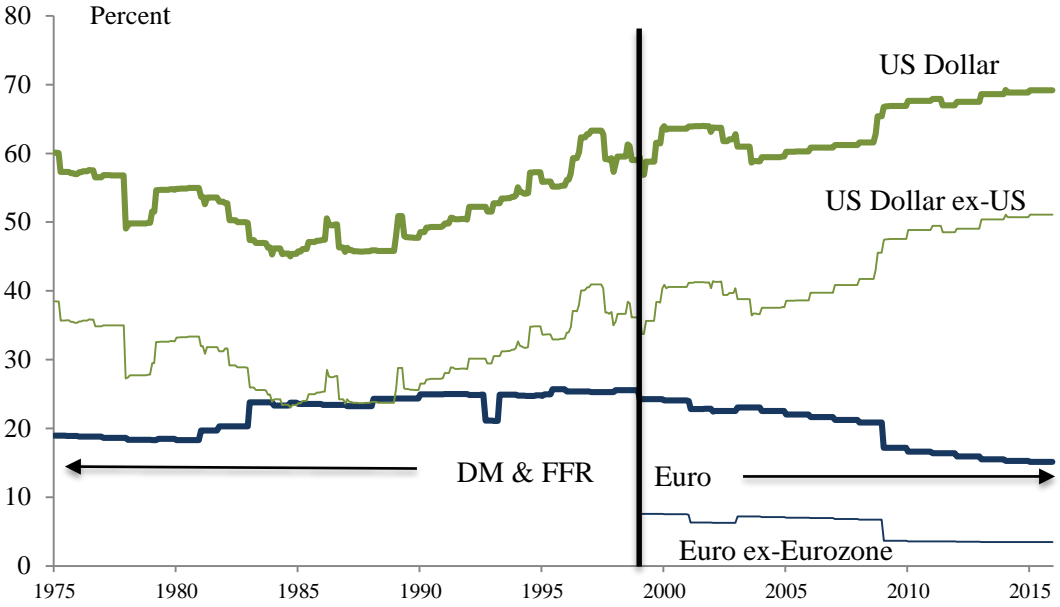
## *Euro Anchors*



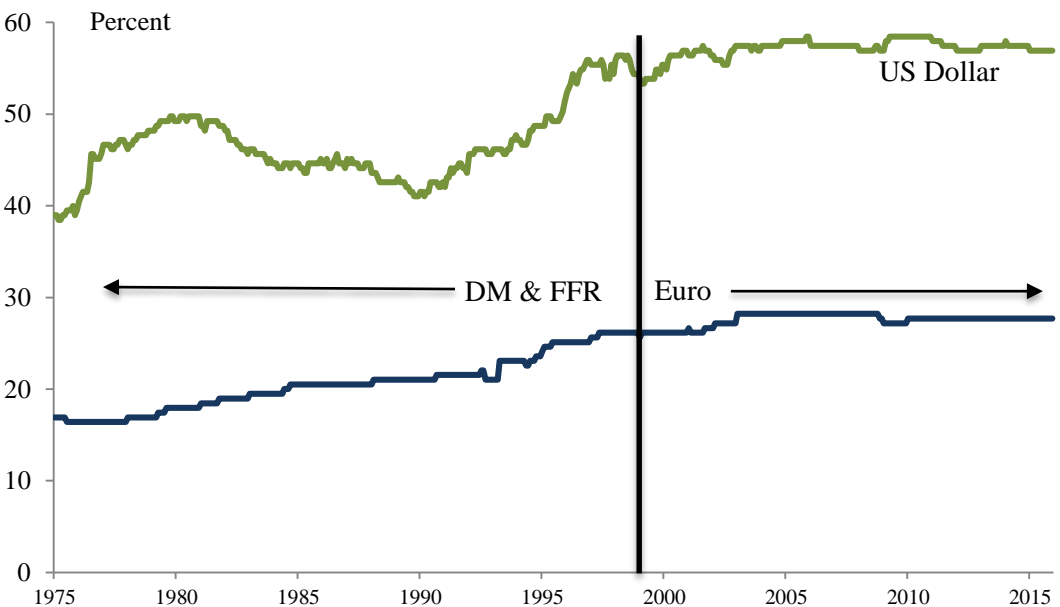
## *Dollar Anchors*



*Number of countries weighted by their share in world GDP, 1975-2015*

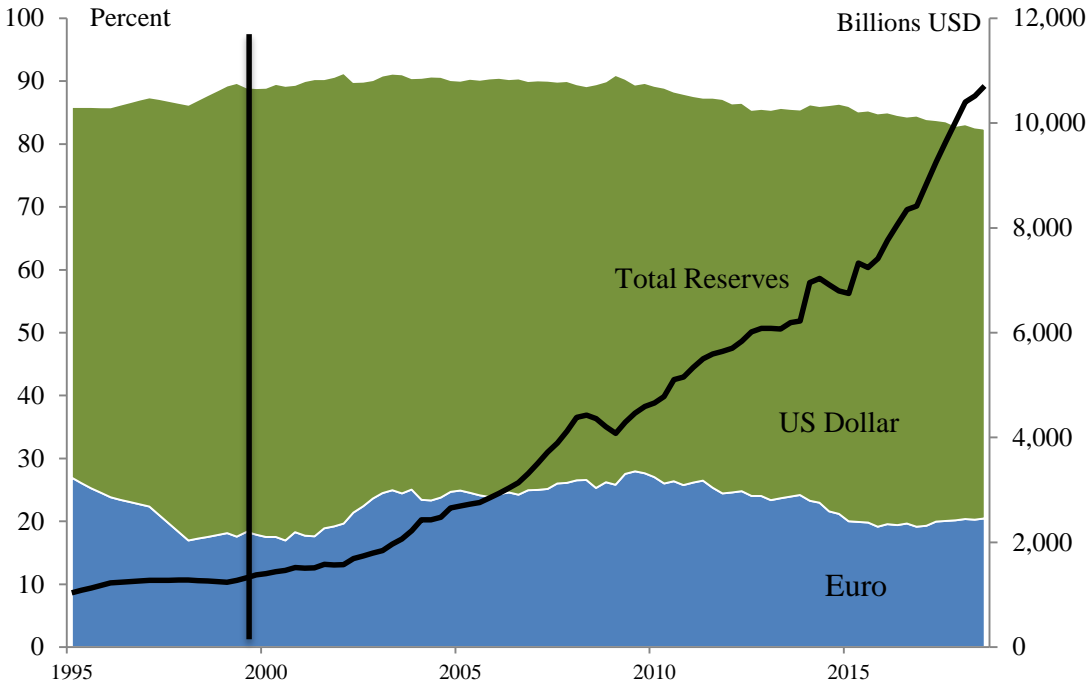


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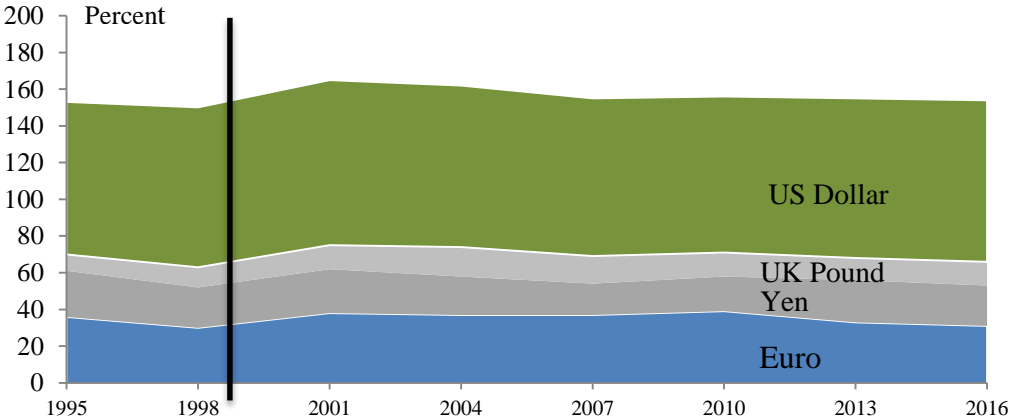


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- Share of Central Bank reserves
- Foreign exchange turnover



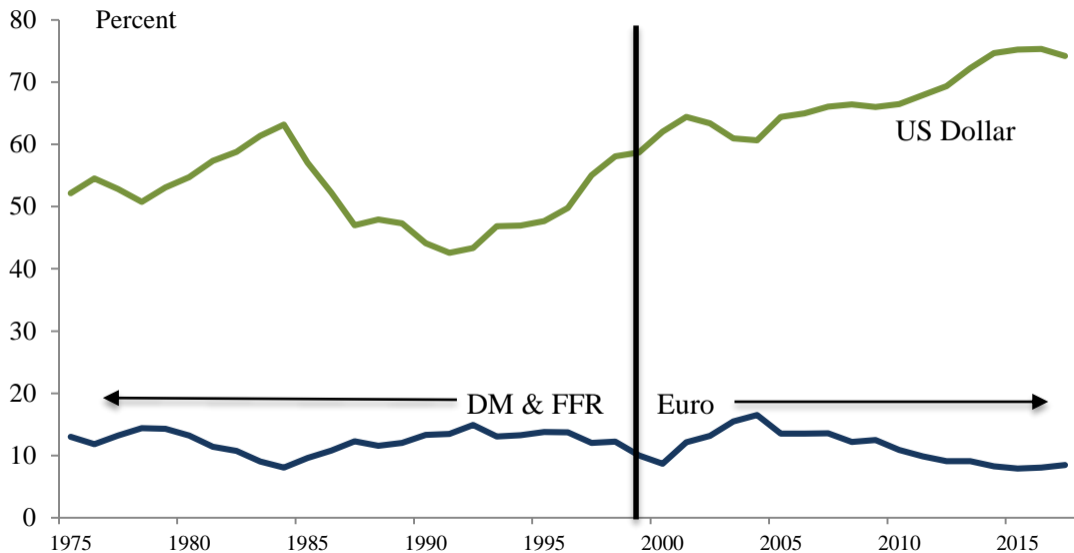
Figure IV. Foreign Exchange Turnover: Shares of Major Currencies, 1995-2016



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- Share of Central Bank reserves
- Foreign exchange turnover
- Developing country public debt denomination

Figure VI. Borrowing in Euros and Dollars: Developing Country Public Debt



## Weight of the euro as an international currency

- Clearly, euro weight is low, especially given
  - size of euro area
  - weight in World trade

Indicator	US/Dollar	Eurozone/Euro
Share of Countries Anchored	59	29
Share of World GDP Anchored	69	15
Share of World Reserves	64	21
Share of Developing Country External Debt	74	8
Share of Bank Assets in Local Currency	85	71
Share of Bank Liabilities in Local Currency	76	59
Trade Invoicing Index	69	56 <sup>53</sup>
<b>Share of World GDP</b>	<b>18</b>	<b>12</b>
<b>Share of World Exports</b>	<b>9</b>	<b>26<sup>54</sup></b>

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- Are all dimensions equally important?
  - the euro area would probably benefit from an increase in the reserves weight (seigniorage?)
  - but not necessarily from trading partners pegging to the euro

## Why is the euro underperforming?

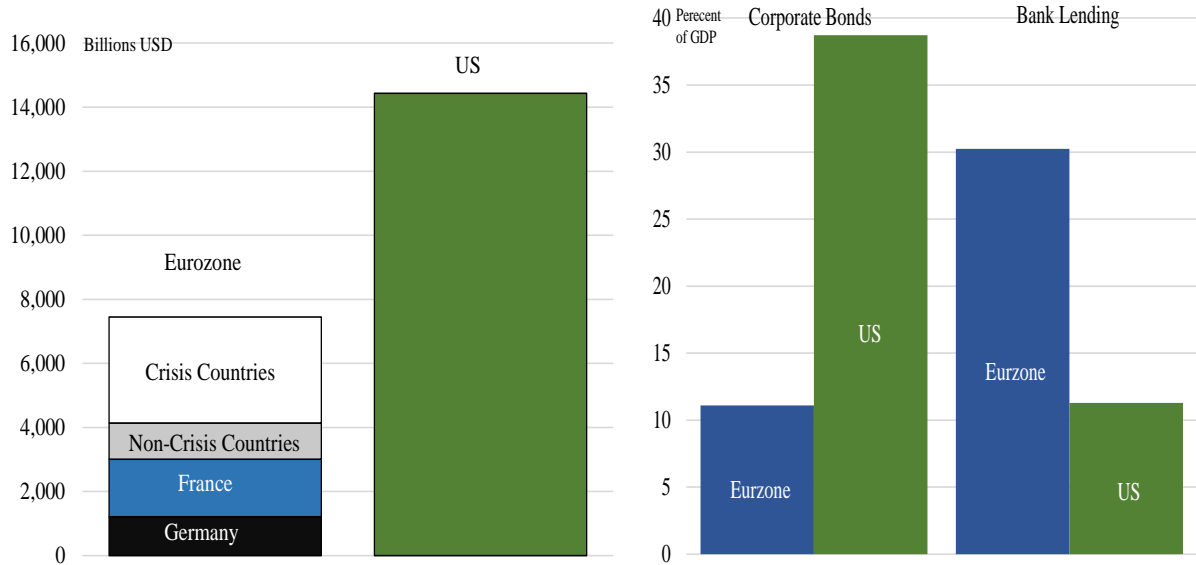
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- The paper favors an alternative: Lack of safe assets in euros
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Figure VII. Marketable Debt Outstanding, 2018



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- But public debt levels were different in, say, 2003
  - U.S.: 4.4 tn
  - safe-euro (Austria+Finland+France+Germany+Netherlands): 3.0 tn
  - "safe"-euro (safe-euro+Belgium+Ireland+Italy+Portugal+Spain): 5.1 tn
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- To what extent is low level of safe assets due to low supply?
  - euro-periphery debt became risky due to drop in demand
- Can low level of safe euro assets be another manifestation of low euro weight rather than a determinant?

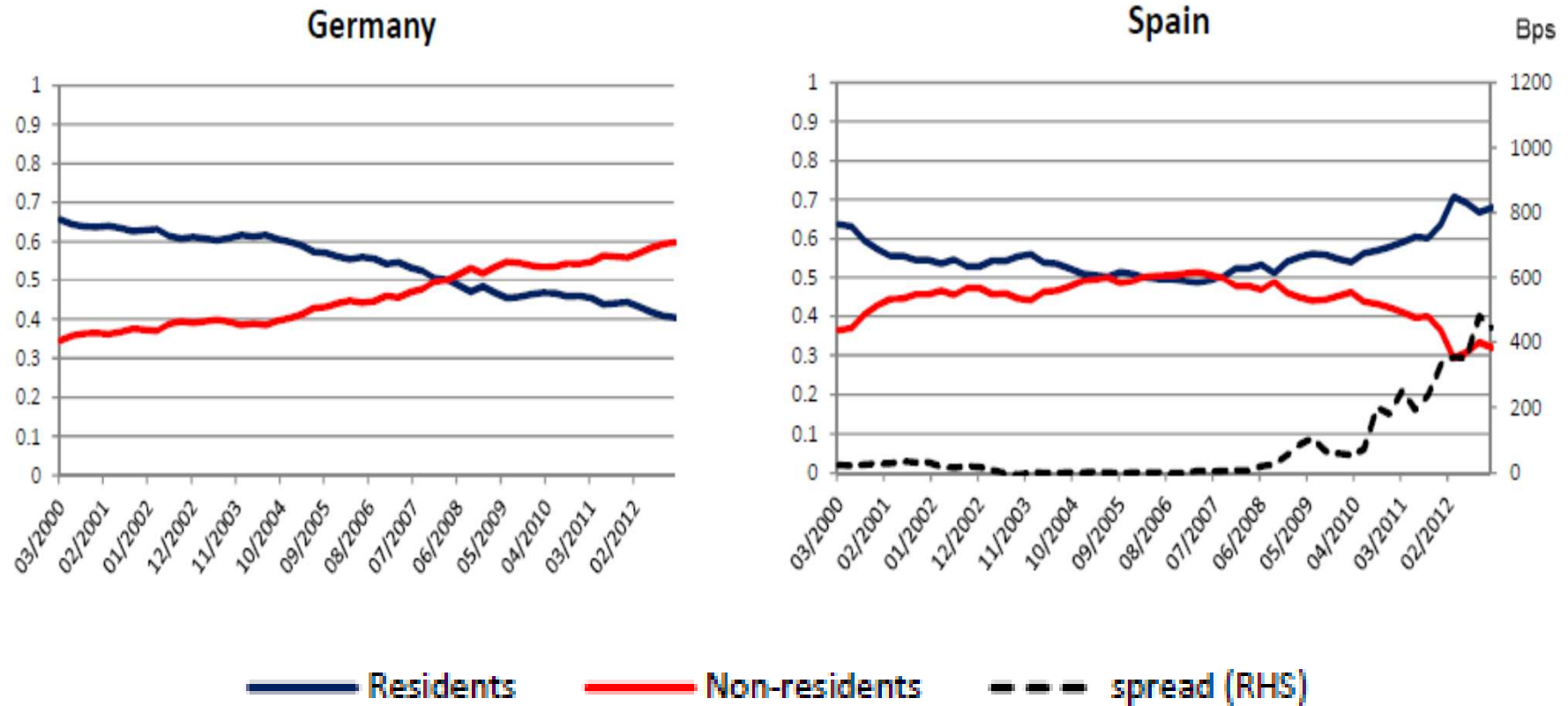
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- Is there strong evidence that this crowding-in effect dominates, particularly outside extreme crisis events?
- Some self-promotion on crowding out of public debt
  - public debt holdings during the euro crisis: Broner, Erce, Martin, Ventura (2014)
  - fiscal multipliers and integration in foreign debt markets: Broner, Clancy, Erce, Martin (2018), Priftis, Zimic (2018)

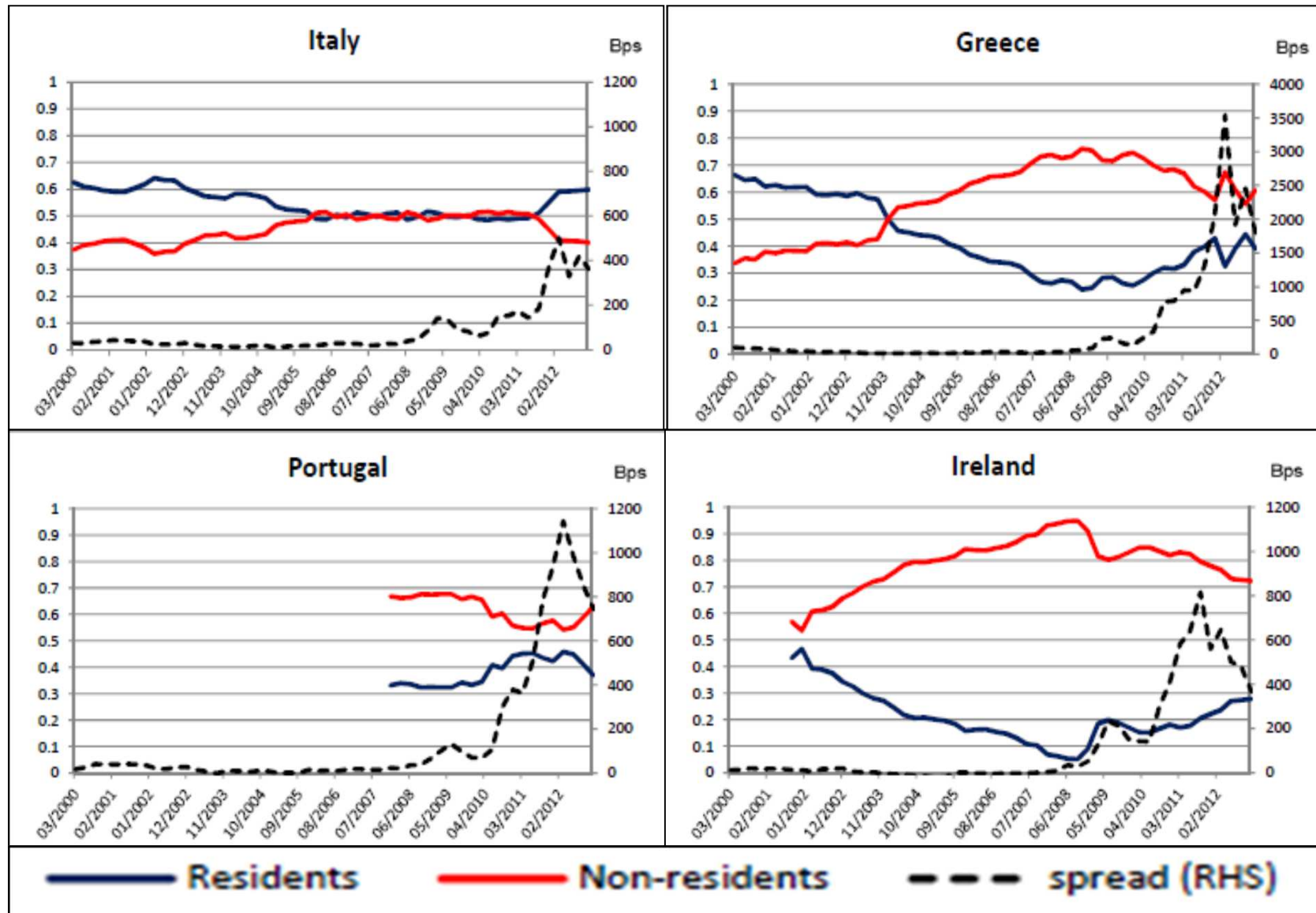
# Sovereign debt holders: Germany vs. Spain



From Broner, Erce, Martin, Ventura (2014)

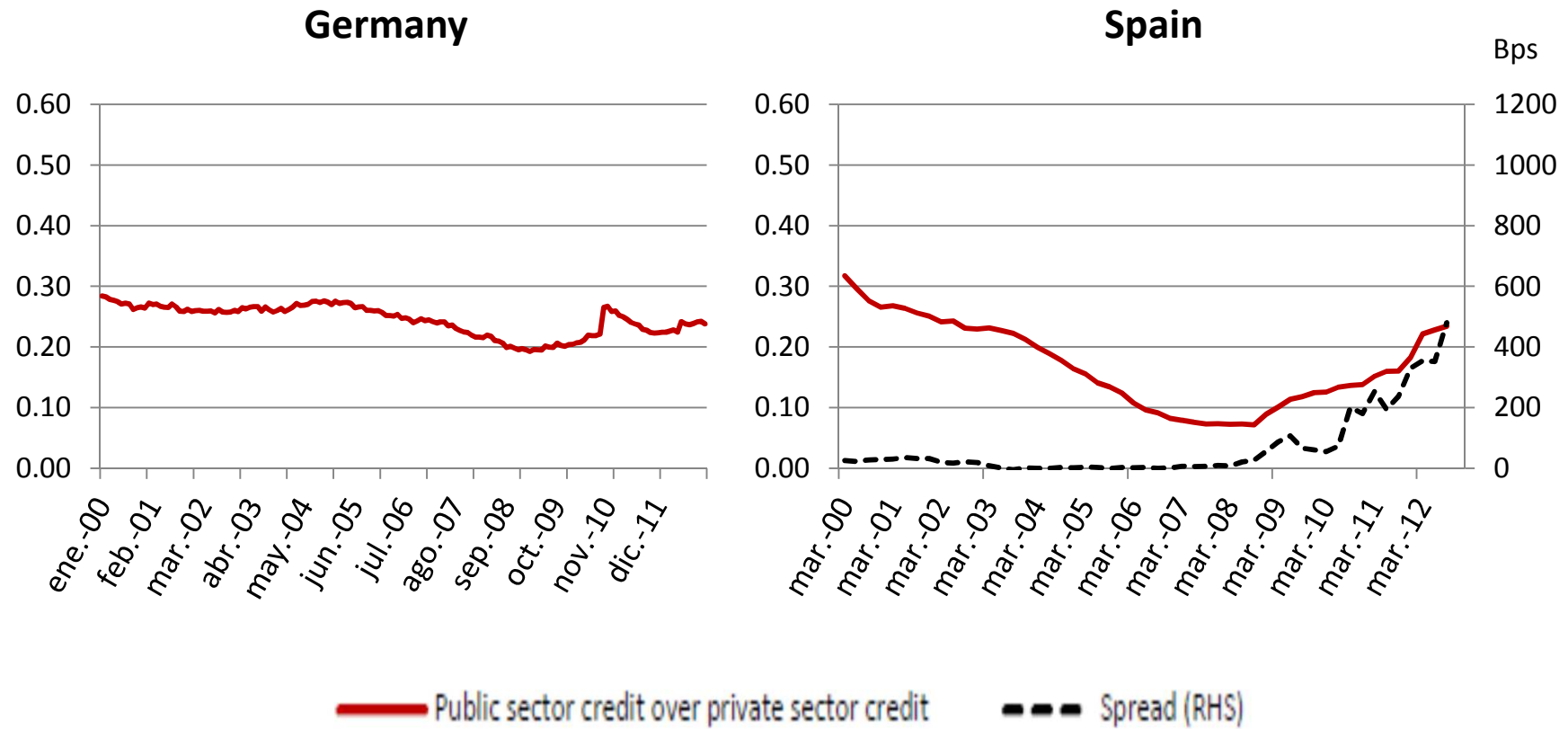


# Sovereign debt holders in the periphery



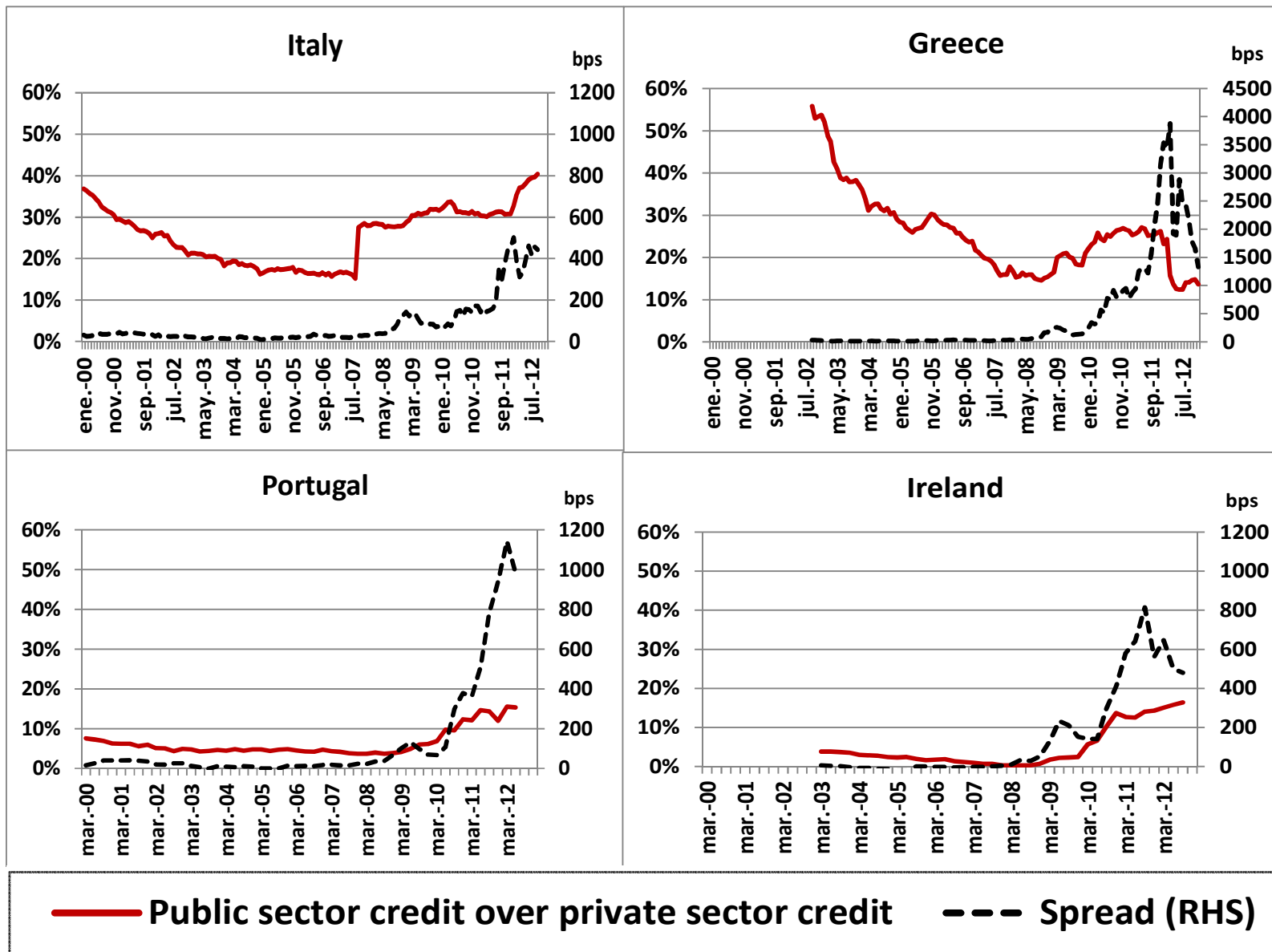
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# Public credit, private credit & sovereign spreads



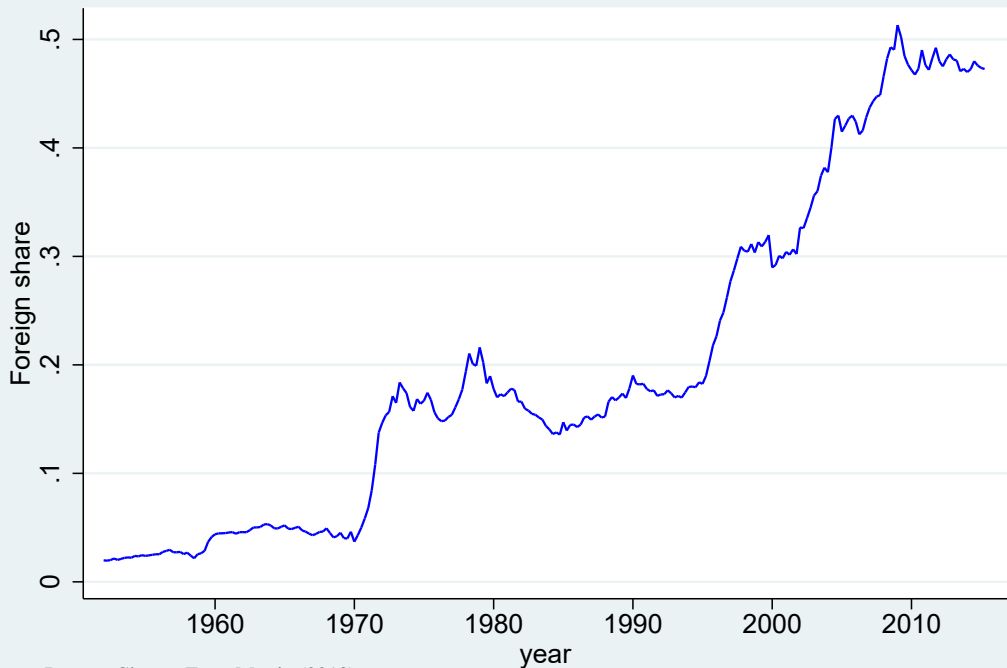
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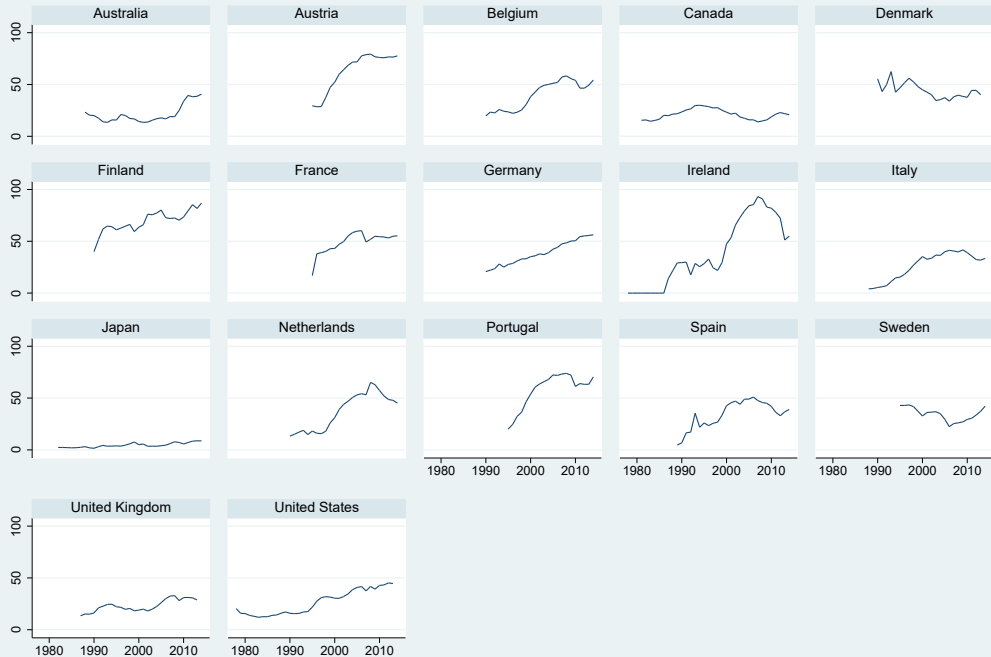


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# Foreign share of U.S. public debt holdings

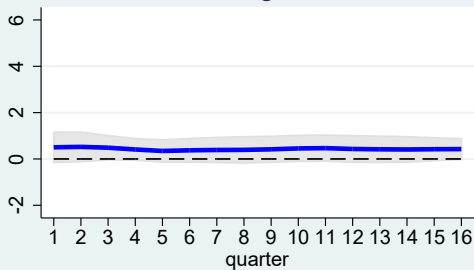


# International: Foreign share of public debt holdings

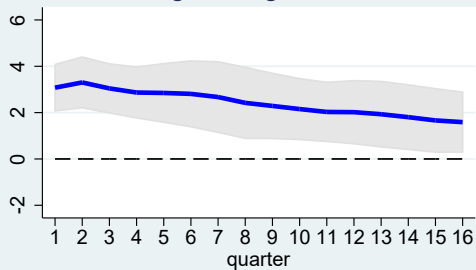


# Foreign share: U.S. output multiplier

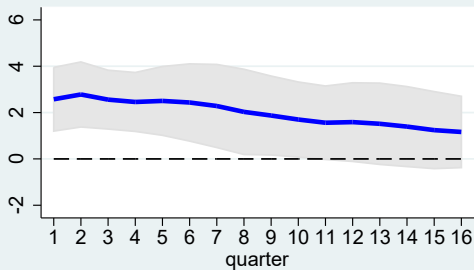
## Low foreign share



## High foreign share

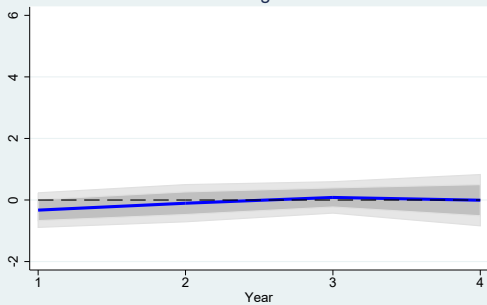


## Difference

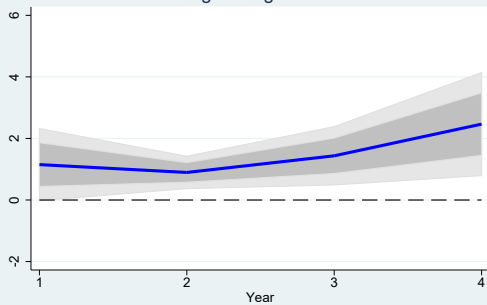


# International foreign share: output multiplier

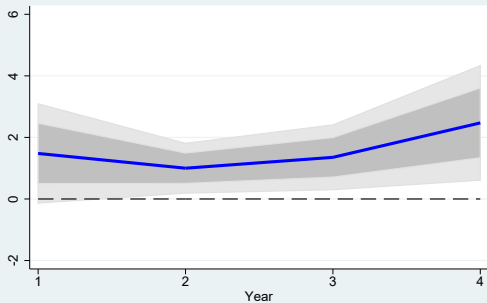
## Low foreign share



## High foreign share



## Difference



## Why is the euro underperforming?

- Other determinant: Lack of financial center
  - is the pound doing better than the euro?



## ECB policy objectives

- Assume the ECB follows

$$i_t = i_0 + \beta \cdot (E_t \pi_{t+1} - \bar{\pi}) + \gamma \cdot E_t y_{t+1}$$

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- Could there be a downward trend in the "natural" real interest rate?
  - this might strengthen the view that M-policy is too Germany-centered
  - and weaken the extent of the shift in objectives since 2012

## Final comments

- The paper convincingly shows that the euro is punching below its weight
  - lots of interesting data and institutional details
- It also advances some hypotheses to explain this underperformance
  - this part is somewhat more speculative, but it is still informative and thought provoking
- Overall, this paper is essential reading for anybody interested in the past and future performance of the euro