

# Is the Euro Ready for a Global Role?

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# Central Currencies

*“America is becoming England’s successor, which is to say, New York is becoming the central market of world finance”*

Japanese banker Inoue Junnosuke, October 1917 (cited in Metzler, *Lever of Empire*, 2006)

- Dutch florin
  - Amsterdam displaces Antwerp in 16C, Genoa in 17C
  - Central in mid-18C Europe (Flandreau & al 2009)
  - Collapse 1781-1792 (Quinn & Roberds 2014)
- British pound
  - Gold standard from 1821, central in 19C and early 20C
  - Exorbitant privilege (Chen & al 2022)
  - Impaired by WWI, crisis of 1931, WWII
- US dollar since WWI / 1945

# Pillars of USD Centrality

*“Reporting that the US is re-evaluating its participation in the Aukus defence pact is highly relevant for the dollar, in our view [...]. A weaker geopolitical alignment between the US and its allies undermines US inflows”*

Deutsche Bank analyst George Saravelos, cited in *Financial Times* 12/06/2025

- Maury Obstfeld (PIIE panel, 24/04/2025)
  1. Fiscal probity
  2. Fed independence
  3. Government functionality
  4. Global security reach
  5. Trade openness
  6. Rule of law and courts
  7. Financial openness
- #1-6 eroded in 2025; question about #7

# Kindleberger Trap?

*“China nevertheless faces the challenge of reassuring foreign investors that their investments are safe [...] these developments paint a picture of a country that has become the world’s manufacturing hub but still needs to find its place in the global financial system. [...] It is, therefore, hard to see a preordained way for the renminbi to gain in status”*

Martin Mühleisen, “The International Role of the Euro and the Dollar”, 2022

- Charles Kindleberger’s *The World in Depression 1929-1939* (1973)
  - UK no longer able to sustain the global system
  - US not yet willing
  - Global depression
- US sustained global system e.g. 2008, 2020

# Current Status

*“The simple reality is that we live in a dollar world: on the real side, where dollar invoicing is dominant; on the financial side, where dollar funding is essential to global banks and non-financial corporations; and on the policy side, where dollar anchoring and dollar reserves are prevalent.”*

Pierre-Olivier Gourinchas, in Asian Monetary Policy Forum, 2021

- USD still central despite recent erosion
- Investors thinking about alternatives
  - Accelerated since April 2 “Liberation Day”
  - Renminbi not convertible, gold impractical
  - Convertible non-US currencies: euro >> yen > others
- Current equilibrium is fragile
  - Dollar centrality could be restored by sound US policies
  - But unclear what would trigger course correction

# € Strengths & Weaknesses

*“Many of the faults in the functioning of [Europe’s] domestic capital markets, and institutional weaknesses, can be overcome by their progressive integration since the faults of functioning of national security markets are the result principally of their narrowness and compartmentalization”*

Charles Kindleberger, review of the European Commission’s Segré Report, 1967

- Independent central bank
  - Reinforced by weakness on executive side
  - Also as banking supervisor (2023)
- Strong rule of law
  - e.g. Russia’s immobilized reserves
- Experience of overcoming existential crises
- 2010s crisis memories / Greek credit event
- Fragmented fiscal & financial system

# A Change of Stance?

*“Unlike the US where the Treasury and the Fed had for centuries [sic] played the leading role in promoting the dollar’s international status [...], the EU failed to actively design its monetary governance to support the international role of the euro. [...]*

*the year 2018 is pivotal as it marked an incipient geopolitical turn in the life of the single currency [...] ECB President Draghi announced that the ECB would actively support the international role of the euro. [...] However [...] the new discourse – while now emphasizing geopolitics – failed to shift how EU policymakers conceptualise euro internationalisation. [...]*

*EU policymakers continue to neglect offshore money creation, thereby failing to build adequate monetary governance institutions for an international euro [...] the ECB has been reluctant to offer attractive, secure, and predictable backstops to offshore euro deposits”*

*van’t Klooster & Murau, “Rethinking currency internationalisation”, May 2025*

*“The changing landscape could open the door for the euro to play a greater international role. [...] Increasing the international role of the euro can have positive implications for the euro area.*

*It would allow EU governments and businesses to borrow at a lower cost, helping boost our internal demand at a time when external demand is becoming less certain.*

*It would insulate us from exchange rate fluctuations, as more trade would be denominated in euro, protecting Europe from more volatile capital flows.*

*It would protect Europe from sanctions or other coercive measures.*

*In short, it would allow Europe to better control its own destiny [...]*

*by extending swap and repo lines to key partners, we safeguard against euro liquidity shortages abroad disrupting the smooth transmission of our monetary policy – which in turn encourages those partners to transact more in euro.”*

*Christine Lagarde, speech at Hertie School in Berlin, 29/05/2025*

# Work in Progress

*“Europe’s limited capacity to project military and geostrategic power raises doubts on whether the euro could ever compete with the dollar as the world’s dominant reserve currency. [...] As the Ukraine war has underscored, Europe’s geostrategic position remains dependent on the security umbrella provided by the United States [...] in the absence of a strong transatlantic alliance, Europe could be forced into strategic compromises with Russia and China to preserve its standard of living, especially on access to energy and raw materials”*

Martin Mühleisen, “The International Role of the Euro and the Dollar”, 2022

- Geopolitical capacity
  - Continued support to Ukraine despite US disengagement
- Financial & fiscal integration
  - Current agenda: capital market supervisory integration
  - Further away: full banking union; NGEU2; fiscal union
- Rule of law
  - Ongoing challenges in Hungary & elsewhere in EU



# Scenarios

*“There’s growing momentum to remove the barriers holding capital back: faster permitting, less red tape on AI, a single regulatory framework instead of 27, and, most critically, a true savings and investments union. If I were an EU politician, that union would be my top priority. Investors will be watching closely to see if the reforms stick.”*

BlackRock CEO Larry Fink, *Financial Times*, 3/06/2025

- **Baseline scenario**
  - USD keeps current centrality in global system
- **“Extreme and plausible” alternative scenario**
  - USD loses centrality
  - New baseline: euro area / EU safe haven by default in the short term
    - Consequences: euro appreciation, spread compression
  - Further reform needed to cement exorbitant privilege”<sup>9</sup>