

Uncertain dollar creates opportunity for euro. Can it last?

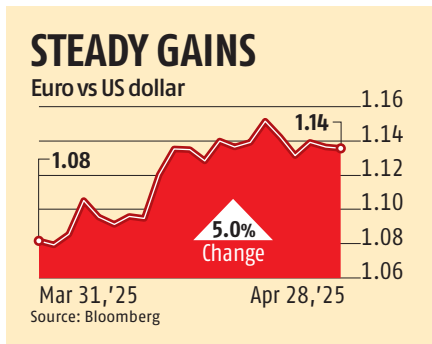
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President Trump's shake-up of the global trade system has sent tremors through the long-held view that the United States is the source of the world's safest financial assets. That's created an opportunity for Europe.

The market tumult in which investors simultaneously sold off the US dollar, American stocks and US Treasury bonds eased last week as Trump backed off his threats to fire the Federal Reserve chair, Jerome H Powell, and Treasury Secretary Scott Bessent tried to reassure foreign officials that trade deals would be struck.

But many European officials attending the spring meetings of the International Monetary Fund and World Bank in Washington last week were sceptical that the uncertainty over Trump's trade policy would dissipate any time soon. They said the unpredictable nature of the Trump administration's approach to setting policy would not easily be forgotten. Instead, they saw the potential to attract investors to European assets, from the euro to the bond market. "We see that our stability, predictability and respect for the rule of law is already proving a strength," Valdis Dombrovskis, the European commissioner responsible for the trade bloc's economy, said



on Wednesday in a discussion on the sidelines of the IMF meetings. "We already have stronger investor interest in euro-denominated assets."

The most comprehensive indication that funds are flowing to Europe: Since the beginning of April, the euro has gained 5.4 per cent against the dollar, rising above \$1.13, the highest level since late 2021.

The question among policymakers and investors is whether the recent jump in the euro and other euro-denominated assets is simply a short-term rebalancing of portfolios that heavily favored the dollar or the beginning of a long-term trend in which the euro firmly encroaches on the dollar's role as the world's dominant currency.

A troubled past

"There's a lot of enthusiasm about Europe," Kristin J Forbes, an economist at the Massachusetts Institute of Technology, said in an interview. She said the excitement about the euro reminded her of the currency's founding in 1999, when some economists and policymakers raised the prospect of it replacing the dollar. In its early years, the euro's international use exceeded the combined use of the currencies it replaced.

But then the euro was hit by crises. Despite having a monetary union of a dozen members, including Germany, Europe's largest economy, the region remained politically fragmented, sapping confidence in the currency. The sovereign debt crisis in 2012, followed by a decade of ultra low interest rates, meant the region's bonds offered low returns.

The euro is now used by 20 member countries and represents about 20 percent of the world's central banks foreign exchange reserves, a figure that has barely budged in the past two decades. Thirty per cent of global exports are invoiced in euros, whereas more than half are in dollars. Improvements have been made on some of the issues that previously deterred foreign investors. Today, European bonds are providing better returns, and investors trust that the European Central Bank will be the lender of last resort, minimising the risk that one country's

economic troubles could affect all euro assets.

For investors, the most promising new development is the prospect of Germany issuing about 1 trillion euros in additional government debt, known as bunds and considered the safest euro-denominated assets. For years, Germany's strict fiscal conservatism has restrained the supply of bunds. But last month, Parliament altered the borrowing limits anchored in its constitution, the so-called debt brake, to allow the government to borrow hundreds of millions of euros to invest in the military and infrastructure. "There are cheers in Europe" because of Germany's fiscal stimulus, said Kristalina Georgieva, the IMF managing director. "And it adds something that is not tangible, but it is important — confidence."

Although there has been confusion and frustration with the Trump's trade policies, many European officials, including central bankers, emphasised the need for Europe to seize this moment. "This will be a time of creativity and pragmatism, getting things moving," Olli Rehn, the governor of the Finnish central bank, said in a speech. "I am very much looking forward to this period as a positive challenge because we are very serious about reinforcing common defense in Europe. Which will, by the way, need safe assets."