4-29-25

Dollar's weakness creates opportunity for euro

BY ESHE NELSON

THE NEW YORK TIMES

WASHINGTON>> President Donald 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 U.S. dollar, American stocks and U.S. Treasury bonds eased last week as Trump backed off his threats to fire Federal Reserve Chair Jerome Powell and as 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 skeptical 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 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% 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% of the world's central banks' foreign exchange reserves, a figure that has barely budged in the past two decades. Thirty percent of global exports are invoiced in euros, whereas more than half are in dollars.

Speculation about new dominant currencies should be taken "cautiously," Forbes said, but there is more momentum behind the euro.

"This feels like it does have more legs because it is a combination of a stronger, more unified Europe," she said. "At the same time, there are more problems emerging with U.S. dollar assets."

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, minimizing the risk that one country's economic troubles could affect all euro assets.

More safe 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."

The demand for German debt has preceded any additional issuance. During the recent market turmoil, bund prices rose, pushing down the yields, a clear sign of investor interest. At the same time, yields on U.S. government bonds have moved in the other direction.

By the end of last week, the yield on 10-year bunds was 2.47%, reversing nearly all the increase that followed the stimulus announcement.

Investors are also anticipating an increase in debt issued jointly by European governments, an idea that has been proposed to finance more military spending across the bloc. Economists have pointed out that this happened before: The European Union issued more than 600 billion euros in bonds to finance postpandemic recovery programs. But that borrowing faced fierce opposition, and future issuance would also struggle to win the backing of all the member states.

Although there has been confusion and frustration with Trump's trade policies, many European officials, including central bankers, emphasized the need for Europe to seize this moment.

"This will be a time of creativity and pragmatism, getting things moving," Olli Rehn, 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."

'A long and hard road'

Optimism is growing about the role of the euro. Klaas Knot, the governor of the Dutch central bank, said he had gone from being agnostic about the international use of the euro to a "cautious believer."

But he added that "the external strength" of the euro "is a reflection of internal strength" in Europe, and governments need to go further to increase that strength, he said in a speech on the sidelines of the meetings in Washington.

Officials must continue to deepen the single market that connects the bloc's more than 448 million people and enable them to trade and do businesses freely, Knot said. Lawmakers, he said, also needed to build a single capital market that would make it easier for money to cross European borders. "We still have quite some work to do in Europe."

Alfred Krammer, director of the IMF's European department, warned against "over-interpreting" the recent shift toward the euro. A "move to European exceptionalism," he said, is "still a long and hard road away."

The region, he said, needed many more structural changes that would enable a more dynamic business sector in which companies could reach larger markets and pools of capital.

Many officials said it was more likely that the euro would be one of several assets that become more prominent as investors reduce their holdings in dollars.