Rise and fall of Dollar and Euro as an Alternative Currency in International Financial Market: A Discussion

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ABSTRACT

The paper aims to explore the rise and fall of Dollar and the alternate currency Euro in the international financial markets and the reasons thereof. Currency has become the symbol of trust for most of the economies and with the launch of Euro the battle of trust has started between Dollar and Euro comprising of bipolar situation between the American economy and the European economy. In the years 2004 to 2006, the strength of the U.S. Dollar has given ground to other currencies like the Euro and Yen, but it still serves as a key barometer of nation's economic and financial health. Euro an alternate currency to the Dollar has played a crucial role in the international financial markets. The paper tried to explore the exchange rate movements between two International giants that is the Dollar and the Euro, and studied the trend of foreign exchange reserves in the world and the changes in the composition of currency and analysed the circulation of Dollar and Euro in the global economy.

Keywords. Dollar Vs Euro, International Currency, Currency war, Currency Appreciation, Currency Devaluation

Introduction

Currency is the heart of international financial market. International trade, finance and investment are generally denominated in a foreign currency and thus the purchase of currency is first step for purchasing of goods or services. Countries have their own symbols of currency for example USD for U.S. Dollar, which may further be distinguished market-wise. British pound sterling referred as £ (pound symbol), GBP (Great Britain Pound), STG (Sterling) or UKL (United Kingdom Pound). A nation denotes its currency by way of three characters out of which normally first two are to a greater extent related to the country and the next one to the name of currency. For example USD denotes united States Dollar, EUR denotes European Union Euro, INR denotes Indian Rupee, AUD denotes Australian Dollar and so on. Currency is the basis of denominating the value of goods and services. It is the medium of international trade and strength of international financial market. There are multiple reasons to promote a international financial market which is the hub for trade and capital movements across the borders. Historically, we used to have a barter system to exchange the goods which then evolved to the Gold Standard followed by US Dollar and then the international currency system like US Dollar, Yen, Pound and the youngest currency Euro which was launched in 1999. Currency is traded at the foreign exchange markets and to facilitate its trade, various centers of financial markets like London, New York and Tokyo have been established.

International Currency

A currency is international when it is used outside the domain in which it is legal tender and then the question arises about its degree of internationalization. The degree of internationalization of a currency depends on the trade transactions and its acceptance and use by other economies. Any currency, which is widely accepted by a large number of countries, can be said to be international currency. For example India is trading with USA and its dependence for trade is high with this particular nation both in terms of exports from India to USA and imports from USA to India. The other sources for flow of foreign currency can be Foreign Direct Investment in home country, M&A (Merger and Acquisition) deals or financial transaction and the role played by the foreign exchange market. From the above it is clear that USD

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is an international currency. European Union has launched its young currency Euro in which the strength of Euro Zone (Members opting for Euro) has increased to 27.

The choice of currency is an important parameter for an economic system. Why do most of the nations support Dollar that means they do not want the Dollar to erode. For example, If in Indian economy, when Dollar depreciated from around 45 INR to 40 INR, it affected the economy to a great extent in terms of exports as well as in terms of employment. The Indian government had to reframe its tariff policies and other special packages were offered, in 2007.

The intervention of central bank plays a crucial role in stabilizing the currency that is the reason we call it as dirty exchange rate system. The significance of the currency creates the need to dig out the facts from the economic and political prospects for the continuous development of the currency that is currency promotion. It would be interesting to explore the American approach for promoting the USD in other parts of the world and what approach Europeans are following for its young currency. It has been accepted that US Dollar is, so far, the most widely used currency in international trade and finance. Many internationally traded goods such as oil are priced and paid for, in Dollars.

Objectives of the Study

The journey of US Dollar started in 1800s in the international markets by the international reserves of central banks and the government. It was Bretton Woods System after World War II which has made the Dollar to become more global and thus the currency progressed into the 80s, 90s and still is a leading international currency. Moreover, the Dollar continued to become supreme as it became the reserve currency amongst a group of countries worldwide. In the mid 90's, the Federal Reserve Bank was forced to intervene in the currency markets and strengthen the Dollar because of its troubling weakness at the time.

Here in this research the focus is on the International Currency US Dollar since 1945 and its comparative study with the young currency Euro. The study will comprise of the evolutionary role of Euro and its use in the international trade and the international financial market. This discussion paper tried to discuss the reason that (1) Why do the nations have different currency? (2) Why European Union decided to go for a common currency termed as Euro? and (3) Why the Dollar is having supremacy in world trade?

The main objectives of this paper are:

- To study the exchange rate movements of Dollar and Euro.
- To study the trend of foreign exchange reserves in the world and the changes in the composition of currency.
- To study the circulation of Dollar and Euro in the global economy.

Discussion and Analysis

The main factors underscoring the international status of a country's currency can be classified in three main groups:

(1) The economic size of the issuing country.

(2) The soundness of its institutional framework.

(3) The previous use of its currency.

Economic size of the issuing country

With regard to economic size, it is common to look at the Gross Domestic Product (GDP) of the issuing country and its global trade. Ceteris paribus, the larger the GDP of a country and the more open its economy, the larger its international trade. A large cross-border trade of a country generally implies lower transaction costs in using this country's currency to channel global trade. If traders find it convenient to use this country's currency as a means of exchange, and also for transactions with other countries' traders, then it becomes a vehicle currency and its status is enhanced to international money. Although GDP and trade are key factors for a currency to acquire international status, recent evidence has given mounting importance to the size of the financial markets too. The deeper and wider the financial markets of a country, the greater the likelihood that its money is chosen as an international currency, as large and liquid markets imply low transaction costs. In other words, to conduct their financial transactions, foreign agents have an economic incentive to use this country's financial markets or financial instruments denominated in its currency as opposed to another currency with larger transaction costs.

The United States of America has had the world's largest aggregate economy for more than a century and continues to lead the world at the beginning of the twenty-first century. The United States has the highest real GDP and the largest capital markets. Both real GDP in 2001 and the sum of stock market capitalization, outstanding debt securities and bank loans outstanding in 2002 in the United States were 70% larger than that in the Euro area. Similarly, these variables in the Euro area were 50% larger than that in Japan. In terms of foreign trade in goods and services, total trade of the United States and the Euro area was roughly the same amounting in 2001 to EUR 2.6 trillions, about 2.7 times the total trade of Japan.

When comparing with other countries, the data relative to economic size suggest that the United States, the Euro area and Japan are the largest economies in the world, thus fulfilling one of the key criteria for their respective currencies to be chosen as international money.

Sound and effective institutions of the issuing country

With regard to the role of institutions, political stability and good governance in the issuing country are important determinants for the international role of currencies. Economic agents must be confident that the country whose currency is chosen to be international money is committed to provide a market friendly regulatory framework and to deliver good governance.

Thus, the country with a wise fiscal authority, a sound legal and judicial system, efficient regulatory authorities (i.e. banking supervision, anti-trust, etc.), and with a monetary authority geared towards achieving price stability is more likely to have its currency used as international money. In this regard, price stability, is an important precondition for the development and maintenance of the international role of a currency. It is a necessary condition for foreign investors' confidence that their purchasing power will be preserved. Internal monetary stability is also a precondition for external stability in the sense of contributing to lower exchange rate volatility and helping in preserving the confidence in the currency.

Floating of Yuan

The United States and other trading partners are pressing China to float its currency, the Yuan, to create fairer trading conditions. At present the Yuan is pegged to the Dollar, and so China benefits enormously from the low Dollar.

The Strong Dollar Policy

The strong Dollar policy was formulated in the year 1995 and the purpose was to build loyalty in the eyes of the investors since a weak Dollar causes higher prices for imported goods(in USA), drives Treasury rates higher, makes vacations in Europe Euro much more expensive, and negatively affects mortgage rates. The fundamental purpose of the strong Dollar policy was to build the confidence of the investors in the greenback in order to remain invested and the central banks to hold and make the currency a reserve currency of the nation. This will make the movements of foreign exchange market in accordance with the US Dollar and also a vehicle for the trade currency. Moreover, the benefits of strong US Dollar also support the American economy in many ways. Strong Dollar supports the importers of the country. On the other hand, a weaker Dollar has certain advantages like stimulating economic growth, exports, and foreign investments in American economy. Therefore, this current flood of stimulus money being injected into American economy serves to help them only in the short run, and may cost them greatly in the longer term. The Dollar typically gains strength on negative economic news, as investors tend to avoid assets that depend on economic growth and seek the safe haven in the greenback. Strength of the Dollar also depends on the satisfaction of the US consumer data.

Political power of Dollar

The Dollar is still ruling the global markets or is set to rule the markets politically. Exploratory research could give the better answer to the ruler of global markets. What is the reason for denomination of Dollar in oil trade and is there any reason for not to use other currency in invoicing the oil trade? One of the major underlying reasons for the invasion of Iraq by the United States was in the defense of the American Dollar. The Iraqi government did the unthinkable a few years ago, it began to sell oil for Euros, not Dollars, establishing a precedent that the American government could not tolerate. The power behind the American Dollar is in its ability to buy and sell oil, it is also the world's "Reserve Currency" which enables central banks of nations to defend its currencies to speculative trading by holding large reserves in American Dollars.

Euro Depreciation 1999-2002

There have been many explanations for the Euro depreciation 1999-2002. Welfens (2001) uses the monetary approach to the exchange rate to demonstrate his case. A depreciation of Euro can be expected due to a higher growth rate of money in the EU; a higher growth of per capita income; a higher growth rate of population; a higher rate of capital accumulation; a faster rising index of stocks or higher interest rates in the US. He points out specially a mistaken fiscal policy leading to a slow growth in Germany and the EU as the reason for the weakness of Euro. This is a simple but not a far reaching explanation. In 2003 the Euro began to appreciate, but as the IMF World Economic Outlook September 2004 states, the fiscal situation in Europe has not improved markedly and the long-term fiscal situation in many countries remains difficult (IMF 2004, P.27).

Some economists look at the productivity differential between Europe and United States as a factor determining the Dollar-Euro exchange rate (Alquist and Chinn 2002, Bailey et al. 2001). An improvement of US-productivity, for example, can increase the rate of return on capital and trigger substantial capital flows out of Europe to United States depreciating the Euro vis-à-vis the Dollar. But Schnatz et al. (2004) using four different measures of average labour productivity could not find any evidence for productivity differential to explain the weakness of the Euro vis-à-vis the Dollar in 2000-01. De Grauwe (2000) studied fundamental variables that have an impact on exchange rate (growth rate, inflation differential, current account etc.), takes as a starting point, he points out the fact that it is the unexpected part of these variables that affect the change in exchange rate. An examination of the fundamental variables for the period 1999 until May 2000 shows that the news about the US economy was less favourable relative to Eurolands's economy. But contrary to expectations, the Dollar increased in value relative to the Euro.

De Grauwe presents his own explanation for this phenomenon. According to him (De Grauwe 2000, P. 14) it is not the news in the fundamentals that drives the exchange rate changes, but rather the other way round. In an uncertain world, changes in the exchange rate lead to a selection of news about the fundamentals that is consistent with the observed exchange rate changes.

When, for example, the Dollar starts moving up, this will be considered as evidence of strength of US economy. Good news about US economy will be searched, and for a while bad news will be disregarded. At the same time a declining Euro will trigger a search for bad news about the European economy. These beliefs then reinforce the movements of the exchange rate. The Dollar increases further and the Euro continues its decline. This process can last for a while. At some points too many discrepancies between facts and beliefs reduce the credibility of the latter and a turn in the market can reverse the process. Applying this theory to the period 1999-2002 would lead to the conclusion that the decline of the Euro since the beginning of the period was set off by mounting bad news about the European economy outright by introduction of the Euro. The beginning appreciation of the Euro two years later, in contrast, would have been caused by accumulation of good news which increasingly were contrary to the beliefs about the weakness of the European economy. But the bad news about the European economy originate from a time well before the introduction of the Euro and continued without major interruptions even today after the Euro has appreciated remarkably.

News must have a basis in the real development of the fundamentals and can not lead their own life for long in spite of accumulating facts. The theory assumes that the agents participating at the market do not learn from their past experiences. Otherwise they would realise very soon that beliefs are contrary to the facts and not for long would revise their beliefs. Periods of appreciation and depreciation of a currency would become shorter and shorter until no serious discrepancy would exist between beliefs and facts. The Period 1999-2004 is a too long period to believe in a rational ignorance of economic agents due to uncertainty about the link between fundamentals and the exchange rate.

In another study, two different approaches are presented to explain the depreciation of the Euro in 1999-2002 (Meredith 2001). The first one is based on the surge in U.S. equity prices since mid-1990s. According to this explanation, this surge in equity prices raised market capitalisation relative to GDP to unprecedented levels. This boosted both consumption and investment, leading to a shock on the demand side. The anticipated future impact of this positive demand shock caused the long-term real interest rate to move up sooner than the short term real interest rates. Since the exchange rate is determined by uncovered interest parity, and thus reflects both the current and all expected future interest, this lead to the appreciation of Dollar vis-à-vis Euro (Meredith 2001, P. 20-33).

Assuming that equity valuations stabilise relative to GDP at the level observed in 2000, the exchange rate would peak in 2000 and decline thereafter. It would not fall back to its initial level until 2040 (Meredith 2001, P. 27). The gradual depreciation of the Dollar is to the fact that U.S. output rises relative to the output in the rest of the world. The depreciation leads to a decline in the relative price of U.S. output to equilibrate world product markets. This is the case because the two outputs are assumed as imperfect substitutes.

The hausse in equity prices reached its highest value at the beginning of 2000 and the equity prices were not stabilising but falling thereafter. In contrast to the results of the model, the appreciation of the Dollar vis-à-vis Euro peaked in 2002. It fell back to its initial value already in the beginning of 2003. In spite of falling equity prices since 2000 a negative demand shock in United States can only be observed for 2000-2001. The American economy experienced the end of the last recession in November 2001 (Deutsche Bundesbank 2003). The Dollar depreciation since 2003 can not be therefore interpreted as being necessary to equilibrate world product markets.

Sinn and Westermann (2001) have another explanation why the Euro has been falling. The starting point is the remarkable stock of DM in Eastern Europe. They estimate, based on Bundesbank sources, that in mid-1990s the stock of DM circulating abroad was between 60 and 90 billion DM, equivalent to 30-45 billion Euros. As another important source of stocks of European currencies they mentioned the black money in Europe. A reduced preference for DM would induce the holder of DM in Eastern Europe and the holder of black money to switch to Dollars. The result would be a depreciation of Euro vis-à-vis Dollar. Sinn and Westermann (2001) understand this as an devaluation of the Euro.

According to Welteke, the then President of the Bundesbank, a comparison between amounts of DM which have been possibly exchanged into a foreign currency and those amounts which are traded daily on the foreign exchange market, shows that the exchange rate of the Euro could be hardly affected by switching in Eastern Europe from DM into Dollars (Deutsche Bundesbank 2001, P. 11). Sinn and Westermann (2001) give as reasons for the holder of DM to switch to Dollars, the lack of information about the currency conversion in 2002 outside Germany and the money laundering laws which hinder the holder of the black money to convert their DM into Euro via official channels (bank counter).

Both reasons are unconvincing. It may be true that in spite of given fixed conversion rates between European national currencies and the Euro, a lack of information could lead to uncertainties and a switch to foreign currencies. But right from mid-2001 preparations were made to inform the holder of DM in East Europe and Turkey about the conditions for the conversion of DM to Euro in order to reduce existing uncertainties (Deutsche Bundesbank 2001, pp. 2-6).

Regarding black money in Western Europe, neglecting the question of magnitude, the argument presupposes that switching into Dollars do not pose any problem for black money holders and money laundering laws do not apply in this case. Furthermore black money could be made legal via laundering before conversion into Euro. Switching into Dollars would not be necessary in this case. In World Economic Outlook October 2000 (P. 15), five different reasons for the depreciation of the Euro are discussed. First, the widening of private sector estimates of the differential in growth in 2000 between the Euro area and the United States.is seen as a partly explanation of the Euro depreciation. A second explanation is based on the Euro area-U.S. interest rate differentials. But this would apply only for the period until June 1999. Thereafter, however, the differentials have narrowed while the Euro remained weak. Third, the relative medium and long-term growth prospects are mentioned as a reason for large financial outflows from Europe, especially foreign direct investment, weakening the Euro. A fourth potential reason is seen in the fact that non-residents contributed greatly to an increase in the share of Euro-denominated bonds in global bond issues and switched the proceeds into Dollars. A final reason is cited to be the adverse perceptions of Euro area policy making. These explanations are not very convincing. The first two are realised as fragmentary. The third reason relies on huge capital flows from Europe to United States. But focussing on the DM and Dollar and looking at Table 2 there is, no indication for a dramatic change in the direction of capital flows, neither direct investment nor portfolio investment. Direct investment outflows are higher in 1999, but thereafter inflows surpass outflows or as in 2001 outflows are not too high. Taking other investments into account even the figures for 1999 lose their importance. These figures do not support the view that capital flows have been the source for a continuos depreciation of DM against Dollar. For the Euro area as a whole (Table 3), outflows of direct investment are important in 1999 and 2001 and that of portfolio investments in 2000. But including other investments, net outflows are negligible for 1999 and 2000.

The fourth reason given in the Outlook is much more demanding. It assumes that to raise money in Europe since 1999 was less expensive than in the United States. Switching the proceeds into Dollars would depreciate the Euro and lead automatically to higher costs of issuing Euro-denominated bonds. Why non-residents could, in spite of this fact, continue to raise money in Europe for four years consecutively looks to be at least questionable. As a matter of fact only in 1999 net issuance in Euro exceeded that of in US Dollars. In the year 2000 the issuance in US Dollar was nearly double that of Euro, marking a return to a long-standing pattern in the international debt securities market (BIS Quarterly Review, November 2000, P. 27). Besides this, the largest issuer in Euros were European firms and not the non-residents as the theory suggests (BIS Quarterly Review, November 2000, P.28). Since 2003 the share of Euro-denominated bonds in global bond issues has increased dramatically again (BIS Quarterly Review, November 2000, P. 34) but the Euro appreciated vis-à-vis Dollar.

The May 2001 edition of World Economic Outlook (pp. 66-70) is much more pessimistic. It comes to the general statement that the depreciation of the Euro seems to defy explanations from conventional exchange rate models. Neither changes in current account transactions, nor interest rate differentials or disorderly market conditions and associated bandwagon effects as explanation for the exchange rate movements seems to pass an empirical verification. Also the evidence supporting the view that bilateral equity flows driven by the perception of greater economic growth in the United States is looked at to be anecdotal, and subject to little rigorous analysis.

The depreciation of the Euro from 1999 to 2002 remains therefore a puzzle. We maintain that until the introduction of Euro coins and notes at the beginning of 2002, Euro has not been perceived as a full-fledged money by consumers and investors. This lack of confidence led to a weak demand for the new European money throughout 1999- 2002. The Euro depreciation in this period has been simply due to the depreciation of some of the national European currencies which via fixed conversion rates translated into Euro depreciation. These national currencies existed until January 2002. But in the foreign exchange markets only Euro was notified. The demand and supply for every national currency translated via fixed conversion rates automatically into demand and supply for Euro. The Euro depreciation was therefore the result of the depreciation of at least some of these national currencies. To understand the depreciation of the Euro in this period we had therefore to look at the development of the exchange rate of these national currencies.

But for this purpose no data exist, since these national currencies, although as a matter of principle absolutely possible, were not notified at the foreign exchange markets.

Euro Appreciation 2002-2004

On February 28, 2002 national banknotes and coins were finally withdrawn from use. Euro was not only a denomination currency but also a store of value and a transactions currency (medium of exchange). Just from this time the Euro begins to appreciate for three consecutive years and stabilises at the end of this period at a high level vis-à-vis Dollar. What explains this creeping appreciation of the Euro? The most recent literature on Euro-Dollar exchange rate is preoccupied with the explanation of the intra-day, daily or monthly rates (Cyree, Griffiths and Winters 2004; Prast and de Vor 2005; Frömmel, MacDonald and Menckhof 2005). Another branch of literature which could be important in this respect discusses the possibility of Euro challenging the international currency position of Dollar. Cohen (2003) is very critical of this possibility. He bases his arguments on the many negative aspects of European economic development weakening the position of the Euro. He specially refers to the fact that Europe's markets for public debt remain segmented, increasing the transactions costs, the anti-growth bias which is built into the institutional structure of the EMU, dampening rates of return on Euro-denominated assets, the Euro area's governance structure which continues to be riddled with ambiguities and obfuscation.

Kenen (2002) and McKinnon (2002), both looking on the use of Euro in trading, bond issues, bank liabilities and official reserves, appreciate the strong role of Euro as an international currency but do not believe, it could be in a position to displace the central role of the Dollar. McKinnon refers to the reinforced Dollar standard by the ongoing price stability in the United States as the main reasons why the Dollar supremacy will continue.

Other Authors (Hartmann and Issing 2002; Huismann, Meesters and Oort 2000; Beckmann, Born and Kösters 2002), looking at the evolving international role of the Euro come to the conclusion that the Euro has indeed a great potential to expand further its international role but that this will be a long run process, not to be realised in the near future. The most optimistic view is held by Bergsten (2002), for him the hitherto existing supremacy of Dollar is explained by the fact that it has had no competition. Comparing Euroland to the United States the Euro will provide the first real competition for the Dollar. Transitional considerations account for the lag in the Euro acquiring its large international role. For Euro to assume its role, according to him, four additional conditions must be fulfilled. Firstly, Euroland need to further integrate its money and capital markets. Secondly, Europe will need to get its act together institutionally. Thirdly, to realise full equivalence with United States it may be necessary for Europe to achieve full political integration, and to become a single nation. Fourthly, a mismanagement of the Dollar by the United States may be necessary for the Euro to realise its potential and reach rough parity with the Dollar. So it is probable that the Dollar will experience a sharp depreciation in future which will induce the necessary structural portfolio diversification with Euro, and mark the arrival of the Euro as a major competitor to Dollar.

From the review of the literature, an adequate explanation is not available for the present situation where the Euro has appreciated vis-'a-vis the Dollar for three years without being still perceived as a competitor or rival in the public in general. To get a more precise understanding of the present situation of the world economy and the status of different national monies as international currencies we have to draw our attention to the sequence of different central countries in the course of the secular and cyclical development of the world economy. Against this background the

Euroland can be considered as an upcoming central country while United States would be viewed as the hitherto dominating economy. While the Dollar, therefore can be seen as an established international currency, the Euro is gaining the status of an emerging international currency. How the respective position of one of these currencies is evolving vis-à-vis the other can only be traced if the structural features of both central countries are carefully evaluated.

After joining together of formerly small and medium-sized economies, the Euro area has emerged as an economy with a large internal market with a share of world GDP of 15% in 1997 and a population of 292 million in 1998. Its degree of openness measured by the ratio of exports of goods to Euro area-wide GDP is standing around 14%, by and large comparable to that of United States and Japan (for figures see ECB Monthly Bulletin, January 1999, P. 11). The most important indicator for the potential status of a national currency as an international currency is, the share of the corresponding area or country in international transactions. The share of the Euro area in total world exports of goods amounts to almost 16%, which substantially exceeds the share of both the United States and Japan. The share of the United States in total world exports was around 12% during the 1990s and it is slowly decreasing since 2000, falling to 9.7% in 2003 (calculated from IMF, International Financial Statistics Yearbook, 2004, P. 82). Looking at these figures, the appreciation of the Euro vis-à-vis the Dollar after it became a full fledged money in February 2002, is not a puzzle any more. Since 2005 the Dollar-Euro exchange rate has stabilised at a level that gives expression to the value of the Euro as an emerging international currency.

Movement of Exchange Rates Euro and Dollar

With the help of Tables 1 to 7, the exchange rate between the Euro and the Dollar on annual basis, has been analysed for period of 3 to 5 years, to have a better understanding of the relationship between the US Dollar and the Euro. The analysis has been done on the monthly basis and depicted in the graphs. The average values of the currency for a year have been taken and shown on the line graph for a period of 5 years to understand the movement of exchange rates across the Euro and the Dollar. Tables 1 to 7 are given along with the analysis showing the strengthening of one currency against the other.

Table 1. Exchange Rate of 1 Euro to Dollar for the Year 2009

Date	1 Euro =?USD
2/1/2009	1.3866
2/2/2009	1.2760
2/3/2009	1.2596
1/4/2009	1.3246
4/5/2009	1.3223
1/6/2009	1.4220
1/7/2009	1.4096
3/8/2009	1.4303
1/9/2009	1.4314
1/10/2009	1.4539
2/11/2009	1.4772
1/12/2009	1.5074
4/1/2010	1.4389
1/2/2010	1.3913

Analysis-1

January 2009 1 Euro = 1.3866 Dollar

January 2010 1 Euro = 1.4389 Dollar

Thus Euro has become stronger to Dollar from January 2009 to January 2010.

Average from Jan 2009 to Dec 2009
1 Euro = 1.39507 Dollar

Figure.1 Exchange Rate Movements between Euro and Dollar 2009

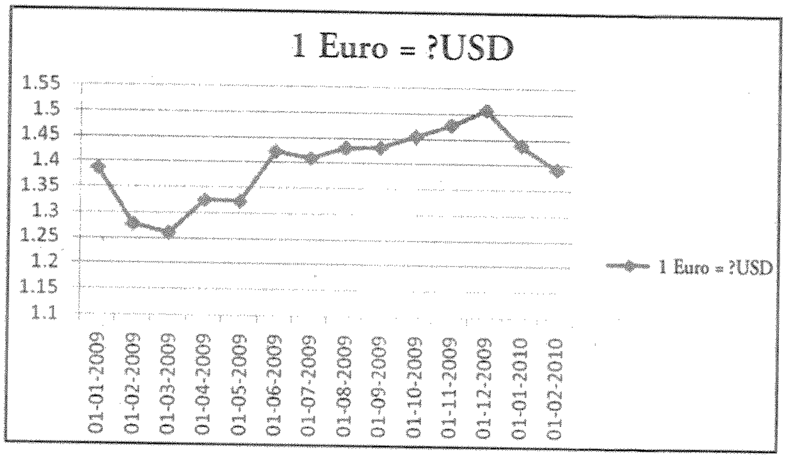

Table 2. Exchange Rate of 1 Euro to Dollar for the Year 2008

Date	1 Euro=?USD
2/1/2008	1.4688
1/2/2008	1.4889
3/3/2008	1.5203
1/4/2008	1.5660
2/5/2008	1.5458
2/6/2008	1.5521
1/7/2008	1.5775
1/8/2008	1.5574
1/9/2008	1.4621
1/10/2008	1.4081
3/11/2008	1.2822
1/12/2008	1.2608
2/1/2009	1.3866

<u>Analysis-2</u>

January 2008 1 Euro = 1.4688 Dollar

January 2009 1 Euro = 1.3886 Dollar

Thus Euro has become weaker to the Dollar.

Average from Jan 2008 to Dec 2008
1 Euro = 1.4674 Dollar

Figure 2. Exchange Rate Movements for Euro and Dollar 2008

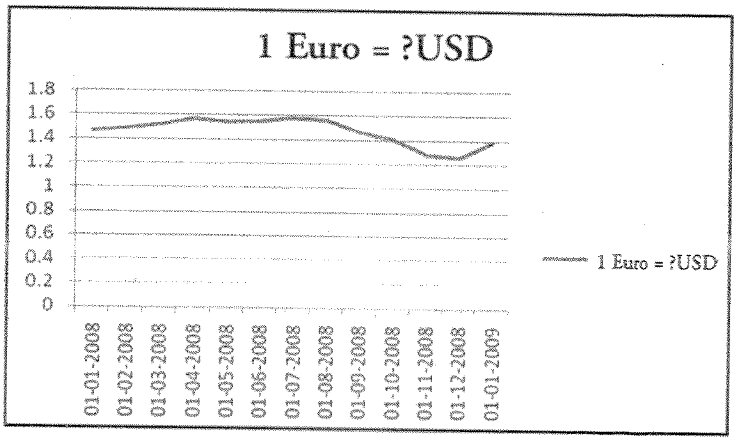

Table 3. Exchange Rate of 1 Euro to Dollar for the Year 2007

Date	1 Euro=?USD
02-01-2007	1.3270
01-02-2007	1.3020
01-03-2007	1.3225
02-04-2007	1.3366
02-05-2007	1.3588
01-06-2007	1.3436
02-07-2007	1.3588
01-08-2007	1.3663
03-09-2007	1.3632
01-10-2007	1.4232
01-11-2007	1.4423
03-12-2007	1.4666
02-01-2008	1.4688

<u>Analysis-3</u>
January 2007 1 Euro = 1.327 Dollar

January 2008 1 Euro = 1.4688 Dollar

Thus Euro has become stronger to the Dollar.

Average from Jan 2007 to Dec 2008
1 Euro = 1.3753 Dollar.

Figure 3. Exchange Rate Movements between Euro and the Dollar 2007

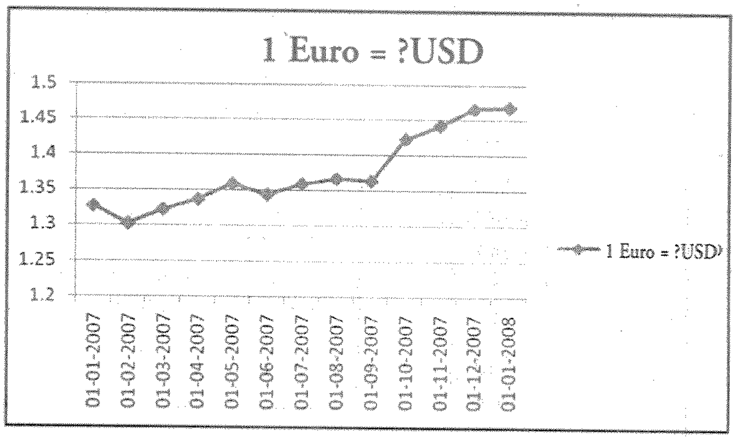

Table 4. Exchange Rate of 1 Euro to Dollar for the Year 2006

Date	1 Euro=?USD
02-01-2006	1.1826
01-02-2006	1.2092
01-03-2006	1.1954
03-04-2006	1.2063
02-05-2006	1.2643
01-06-2006	1.2736
03-07-2006	1.2790
01-08-2006	1.2759
01-09-2006	1.2817
02-10-2006	1.2685
01-11-2006	1.2757
01-12-2006	1.3244
02-01-2007	1.3270

<u>Analysis-4</u>
January 2006 1 Euro = 1.1826 Dollar

January 2007 1 Euro = 1.327 Dollar

Thus Euro has become stronger to the Dollar.

Average from Jan 2006 to Dec 2006
1 Euro = 1.2587 Dollar.

Figure 4.Exchange Rate Movements between Euro and the Dollar 2006

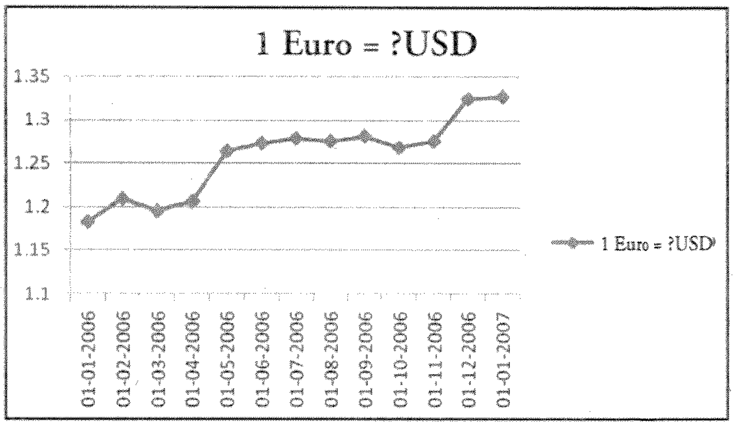

Table 5. Exchange Rate of 1 Euro to Dollar for the Year 2005

Date	1 Euro=?USD
03-01-2005	1.3507
01-02-2005	1.3027
01-03-2005	1.3216
01-04-2005	1.2959
02-05-2005	1.2863
01-06-2005	1.2228
01-07-2005	1.2087
01-08-2005	1.2219
01-09-2005	1.2388
03-10-2005	1.1933
01-11-2005	1.2008
01-12-2005	1.1745
02-01-2006	1.1826

Analysis-5
January 2005 1 Euro = 1.3507 Dollar

January 2006 1 Euro = 1.1826 Dollar

Thus Euro has become weaker to the Dollar.

Average from Jan 2005 to Dec 2005
1 Euro = 1.2462 Dollar

Figure 5 Exchange Rate Movements between Euro and the Dollar 2005

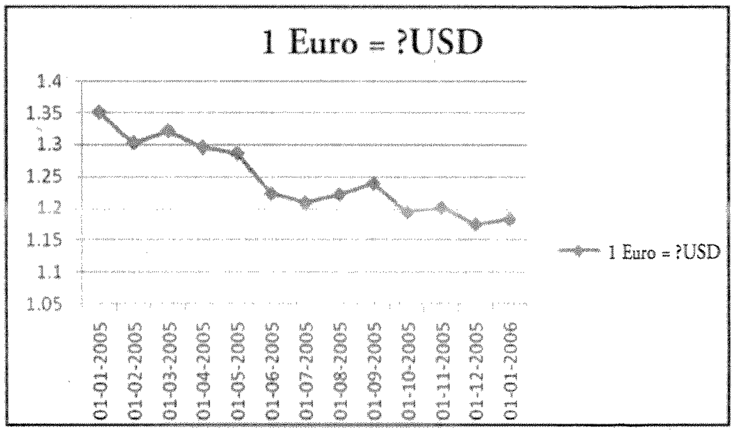

Table 6. Exchange Rate of 1 Euro to Dollar for the Year 2005 -2009

Year(Avg)	1 EURO=?USD
2005 (Avg)	1.2462
2006 (Avg)	1.2587
2007 (Avg)	1.3753
2008 (Avg)	1.4674
2009 (Avg)	1.3950

Analysis-6

Average Value of Euro Appreciating From 2005 to 2008.

Average Value of Euro depreciating from 2008 to 2009.

Figure 6. Exchange Rate Movements between Euro and the Dollar 2005-2009

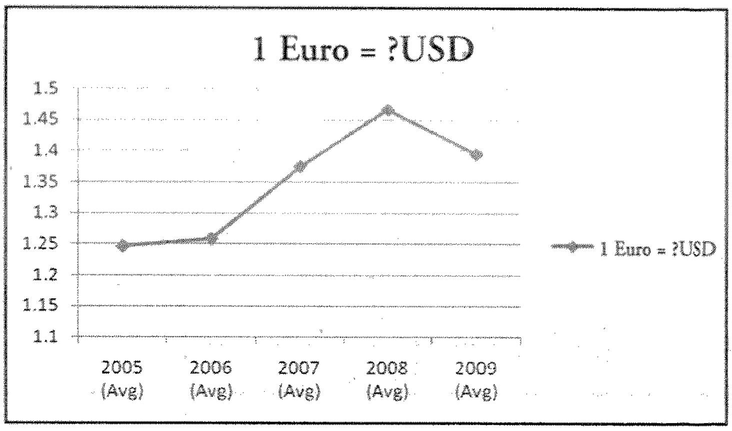

Table 7. Dollar Euro Exchange Rates -1999-2004

Euro to 1 USD

	1999	2000	2001	2002	2003	2004
January	0.862814	0.987351	1.0667	1.13226	0.941605	0.791328
April	0.934604	1.05862	1.12048	1.12846	0.920756	0.834161
July	0.964629	1.06551	1.16103	1.00665	0.879984	0.815356
September	0.952685	1.17338	1.10531	1.01924	0.854156	0.799695

Source-Historic outlook, x-rates.com-website 20 January 2005

The above table clearly shows that the Dollar has appreciated from 1999 to 2002 and thereafter the Euro (2002-2004) is gradually rising against the Dollar.

Table 8. Global Foreign Exchange Reserves in US Dollar

1995	1996	1997	1998	1999	2000
59%	62.10%	65.20%	69.30%	70.90%	70.50%
Source : IMF					

Analysing the data from Table 8 states that the foreign exchange reserve in dollar has steadily moved up from 59% in 1995 to 70% in 2000, and one of the reason could be its monopoly of achieving the major stake in the international market. Since the Euro was not put to circulation till the year 2000 the share of dollar was increasing in the central banks reserve.

Table 9. International Currency Composition at a Glance

	1999	2001	2003	2005	2006
USD	70.9%	70.7%	65.8%	66.4%	65.7%
EUR	17.9%	19.8%	25.3%	24.3%	25.2%
JPY	6.4%	5.2%	4.1%	3.7%	3.2%
GBP	2.9%	2.7%	2.6%	3.6%	4.2%
Source IMF					

International reserves in US Dollar are losing its ground, it declined from 70.9% in 1999 to 65.7% in 2006 as shown in Table 9. Euro is on the rising trend from 1999 to 2006 as reflected in Table 9. On a global basis, the demand for international reserves depends on two related factors: one the monetary value of international transactions and second the disequilibrium that can arise in balance of payments

Table 10. Bank Notes in Circulation (in Billions)

Date (As on...)	Euro	Dollar
Dec 2003	354.5	584.3
Dec 2004	501.3	564.2
Dec 2005	565.2	668.0
Dec 2006	628.2	618.9
Mar 2007	608.5	571.0

Source : ECB federal Reserve Bank

It is clear from Table 10, that circulation of Euro has surpassed that of Euro in the year 2006 where the circulation of Dollar was 619.9 billion and that of Euro being 628.2 billion.

Costs and Benefits of Running an International Currency

There are multiple reasons to assess the costs and benefits for the issuer of an international currency. We can assess the international currency on the basis of economic, political and financial basis. Moreover, the benefits also depend on the transaction cost and the transaction exposures as well. There could be reasons to maintain the status of currency in the international markets which may be treated as the socio-political cause for an economy. We will discuss a few of the parameters to assess the cost and benefits -

- Financial assessment could be done based on the return on the currency that is the investment denominated in which form of currency would yield better. We can also compare the investment done in the currency as well as in the Gold. It is again a subject of extensive study but an important point to note is that china has purchased the Gold in major quantity and many of the economies are diversifying the currency composition by investing more in Gold as well. However, the trade off has to be studied between the major currencies like Dollar, Euro, Yen or Pound.
- Lower transaction costs for households.
- Lower transaction costs in financial markets.
- Effects on the terms of trade.
- Hedging exchange-rate risk.
- Stability of the demand for money. Here one might look at the United States to try to identify any problem that may have been created for monetary policy by international holdings of dollars. It is not clear that this has been of any concern to the Federal Reserve Bank.
- Effects on exchange-rate volatility. The literature on the costs of exchange-rate volatility is extensive and was for a long time rather inconclusive. Recent contributions do seem to identify a cost to firms.
- Related to this are the stability of foreign portfolios and the potential consequences of portfolio shifts between currencies.

Conclusion

International giant economies like America and Europe have tried to build the global trust in the International financial markets through their currencies the Dollar and the Euro. The trend of changes has signaled that the infant currency the Euro is catching up the Dollar and the trend of currency appreciation and depreciation has taken place in different times and at different rates depending on the market sentiments and the trade, forex and the capital transactions. However, the world is still looking forward to the stability and the long run success of the major currencies in reference to returns and the trade transactions and the global monetary organizations inputs. The circulation of Euro has indicated that it has established itself on to the platform and gained new heights in the International financial markets.

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