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### **Globální ekonomický výhled - březen 2015**

Česká národní banka; Sekce měnová a statistiky; Odbor vnějších ekonomických vztahů  
2015

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# GLOBAL ECONOMIC OUTLOOK - MARCH

Monetary and Statistics Department  
External Economic Relations Division

2015



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**Cut-off date for data**

9 - 13 March 2015

**CF survey date**

9 March 2015

**GEO publication date**

20 March 2015

**Notes to charts**

ECB and Fed: midpoint of the range of forecasts.

The arrows in the GDP and inflation outlooks indicate the direction of revisions compared to the last GEO. If no arrow is shown, no new forecast is available.

Asterisks indicate first published forecasts for given year.

Forecasts for EURIBOR and LIBOR rates are based on implied rates from interbank market yield curve (FRA rates are used from 4M to 15M and adjusted IRS rates for longer horizons). Forecasts for German and US government bond yields (10Y Bund and 10Y Treasury) are taken from CF.

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II.4 Japan	III Economic outlook in BRIC countries	V. Commodity market developments		

The March issue of Global Economic Outlook presents its regular overview of recent and expected developments in selected territories, focusing on key economic variables: inflation, GDP growth, leading indicators, interest rates, exchange rates and commodity prices. In this issue we also examine a major phenomenon in recent economic history – the position of the dollar in the global financial system. The analysis reveals that the dollar has an unprecedented position among reserve currencies and that no other currency will jeopardise its dominance in the near future. The article also shows that the current appreciation of the dollar is by no means unusual from the historical perspective.

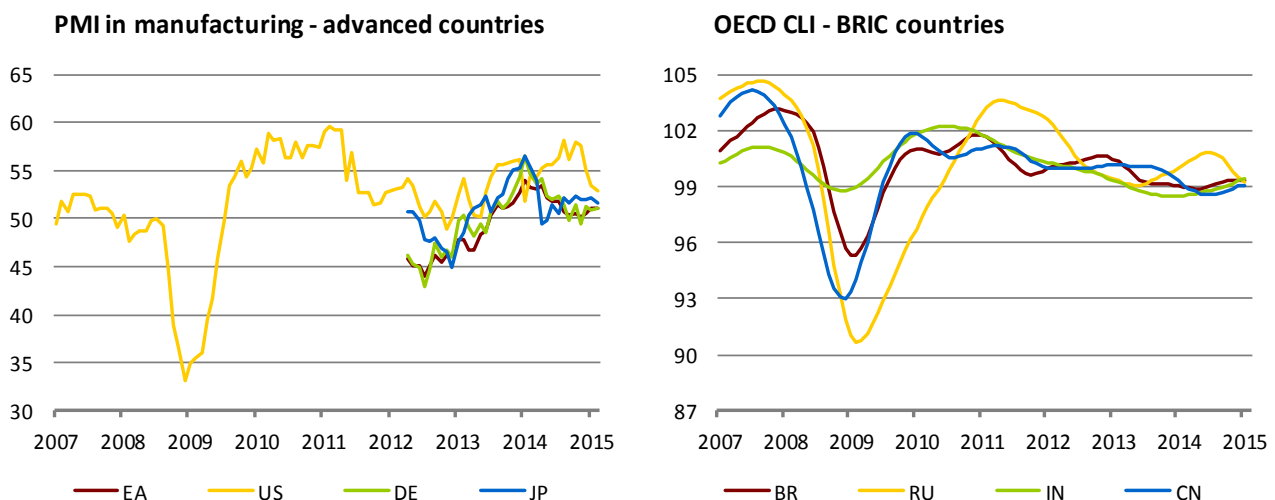
The growth outlooks for the advanced countries under review are fairly positive, especially for 2016, when these countries will record growth of around 2%, or 3% in the case of the USA. The US economy will still be one of the engines of global economic growth, even though its latest expected growth figures have worsened (see the chart below). However, new data have revised consumer inflation expectations in advanced countries significantly downwards. Inflation fell in both the euro area (and its strongest economy – Germany) and the USA. Paradoxically, the Japanese economy should thus record the highest inflation of all the advanced countries under review this year, albeit with an expected figure of less than 1%.

The two-year outlooks for emerging BRIC countries remain mixed. Despite a slight decline in performance, the Chinese economy is doing best. It is expected to maintain growth of around 7% amid relatively low inflation. The accelerating Indian economy will be catching up with it. By contrast, the Russian economy and probably also the Brazilian economy will not avoid recession this year. Moreover, both countries will face high inflation this year (double figures in the case of Russia). The outlooks for the two countries for next year bring some optimism, as economic growth should rebound and inflation should drop visibly.

The outlooks for interest rates in the euro area remain very low, with no sign of growth until the end of 2016. This outlook reflects, among other things, the quantitative easing launched by the ECB in mid-March. In the USA, interest rates might start to go up in the next few months, i.e. roughly in mid-2015. According to CF, the dollar will appreciate slightly at the one-year horizon against all the monitored currencies except the renminbi and the rouble. The Russian currency is expected to correct slightly after declining steeply.

Oil prices started to drop again in March due to the appreciating dollar and the persisting surplus of oil in the market. The price of Brent crude oil will gradually rise to around USD 69 a barrel over the outlook horizon up to the end of 2016. However, the stronger dollar will weaken the effects of cheaper oil for consumers who do not pay in dollars. The outlook for natural gas prices, which tend to lag behind oil prices, indicates a sharp decline (temporarily below USD 200 per 1,000 m<sup>3</sup>) followed by renewed growth. The non-energy commodity price index continued to decline slightly in February and the first half of March, mainly due to a fall in the food commodity index. Commodity indices are broadly flat over the outlook horizon.

## Leading indicators for countries monitored in the GEO

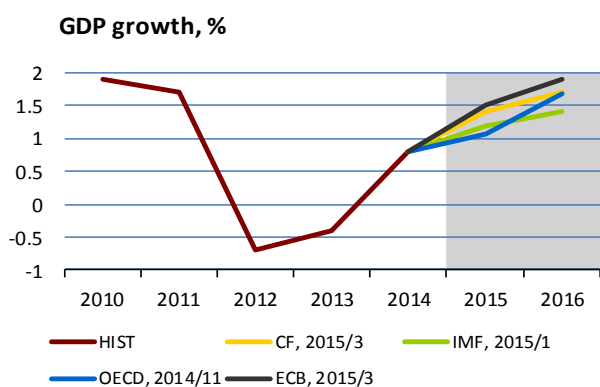


Source: Bloomberg, Datastream

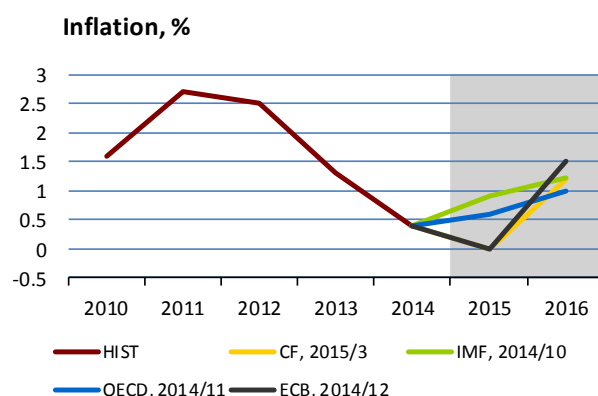
II.1 Euro area

Quarterly GDP growth in the euro area edged up to 0.3% at the end of 2014 and the euro area economy grew by 0.9% in 2014 as a whole. GDP growth will be positively affected by three factors at the forecast horizon – lower oil prices, accommodative ECB monetary policy and a weaker euro exchange rate. However, macroeconomic indicators at the start of the year do not suggest a robust recovery yet. For example, industrial production fell by 0.1% month on month in January. By contrast, real retail sales rose quite sharply. Besides higher household purchasing power due to a decline in energy prices, this may reflect improving household confidence. This is also signalled by economic sentiment indicators. However, leading indicators suggest only a slight improvement in the situation in industry. For example, the PMI in manufacturing was flat at the January level of 51 in February, reflecting the mixed economic situation across euro area countries – solid growth in Ireland and Spain, slight expansion in Germany, Italy and the Netherlands, and contraction in France, Greece and Austria. Growth is expected to reach around 1.5% this year and pick up by a further 0.25 pp or so next year.

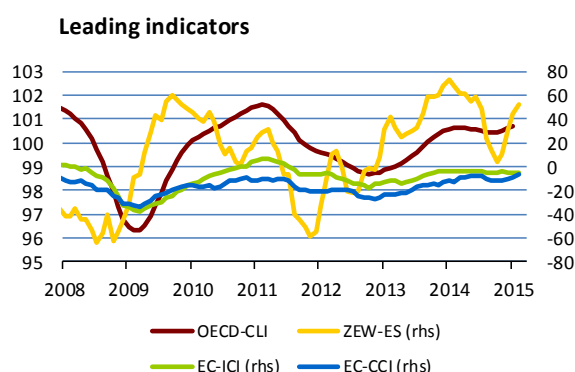
The decline in the price level moderated in February, with HICP inflation reaching -0.3%. Inflation will remain flat this year. The price level will be affected by falling energy prices, while a weaker euro exchange rate and the ECB’s easy monetary policy will act in the opposite direction. In 2016, inflation is expected to rise above 1%. On 9 March 2015, the ECB launched purchases of government bonds under an extended asset purchase programme (EAPP) with a planned monthly size of EUR 60 billion. The EAPP will continue until the end of September 2016 or until the outlook for inflation stabilises below, but close to 2%. Euribor rates with maturities of up to one year and euro area government bond yields responded to the launch of the EAPP by falling.



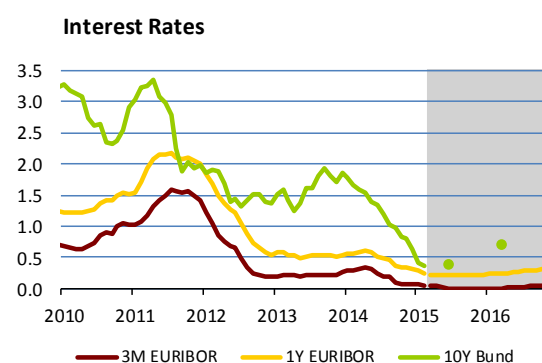
	CF	IMF	OECD	ECB
2015	1.4	1.2	1.1	1.5
2016	1.7	1.4	1.7	1.9



	CF	IMF	OECD	ECB
2015	0.0	0.9	0.6	0.0
2016	1.2	1.2	1.0	1.5



	OECD-CLI	EC-ICI	EC-CCI	ZEW-ES
12/14	100.6	-5.2	-10.9	31.8
1/15	100.7	-4.8	-8.5	45.2
2/15		-4.7	-6.7	52.7

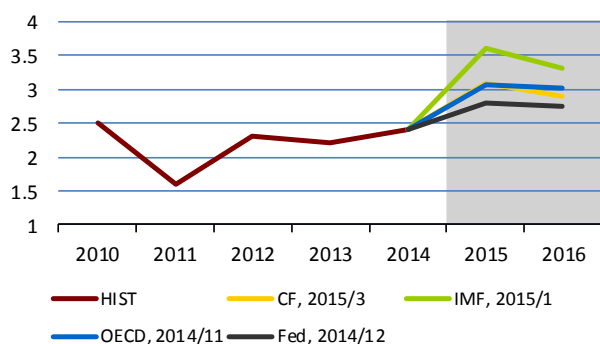


	02/15	03/15	06/15	12/15	06/16	12/16
3M EURIBOR	0.05	0.04	0.01	0.00	0.02	0.07
1Y EURIBOR	0.26	0.23	0.22	0.23	0.27	0.34
10Y Bund	0.35	0.40	0.70			

## II.2 United States

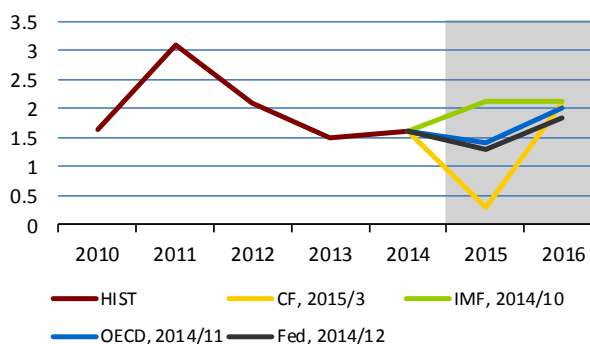
The outlook for GDP growth in the USA this year looks favourable. According to most of the institutions monitored, economic growth will exceed 3% and slow only slightly in 2016. GDP grew by 2.4% last year, recording a quarterly increase of 0.5% in Q4 alone. The growth rate of industrial production also went up in January, although a gradual decline in the PMI leading indicator in manufacturing suggests stabilisation going forward. The leading indicators of consumer confidence declined in February, but remain at long-term highs. This, together with an improving situation in the labour market (the unemployment rate dropped to its lowest level since 2008 in February and the rate of job creation remains solid), is fostering continued fast growth in consumer demand. CF's inflation expectations for 2015 fell sharply to 0.3% due to the decline in oil prices. Next year, however, inflation is expected to return to the Fed's 2% target. The Fed is increasingly inclined towards raising its key interest rates thanks to the improving labour market situation. There is growing speculation that the first rate hike will happen in June 2015 (CF). The market outlook for 3M rates also went up by comparison with the previous month. With the ten-year Bund yield continuing to fall, the differential between U.S. and German ten-year government bond yields reached 1.8 pp in March. This was reflected in appreciation of the dollar against the euro. The rate thus moved significantly closer to parity. However, CF expects a slight correction towards a weaker dollar in the short run.

GDP growth, %



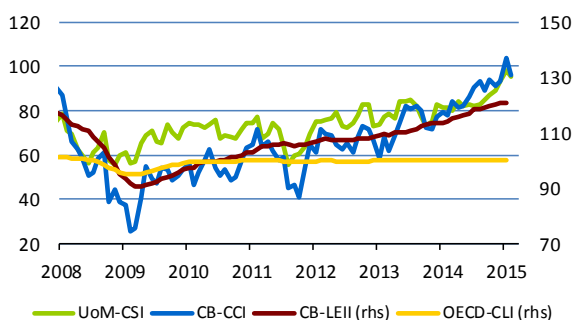
	CF	IMF	OECD	Fed
2015	3.1	3.6	3.1	2.8
2016	2.9	3.3	3.0	2.8

Inflation, %



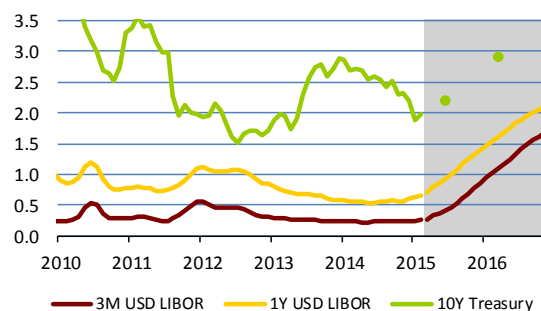
	CF	IMF	OECD	Fed
2015	0.3	2.1	1.4	1.3
2016	2.1	2.1	2.0	1.9

Leading indicators



	CB-LEII	OECD-CLI	UoM-CSI	CB-CCI
12/14	120.8	100.2	93.6	93.1
1/15	121.1	100.2	98.1	103.8
2/15			95.4	96.4

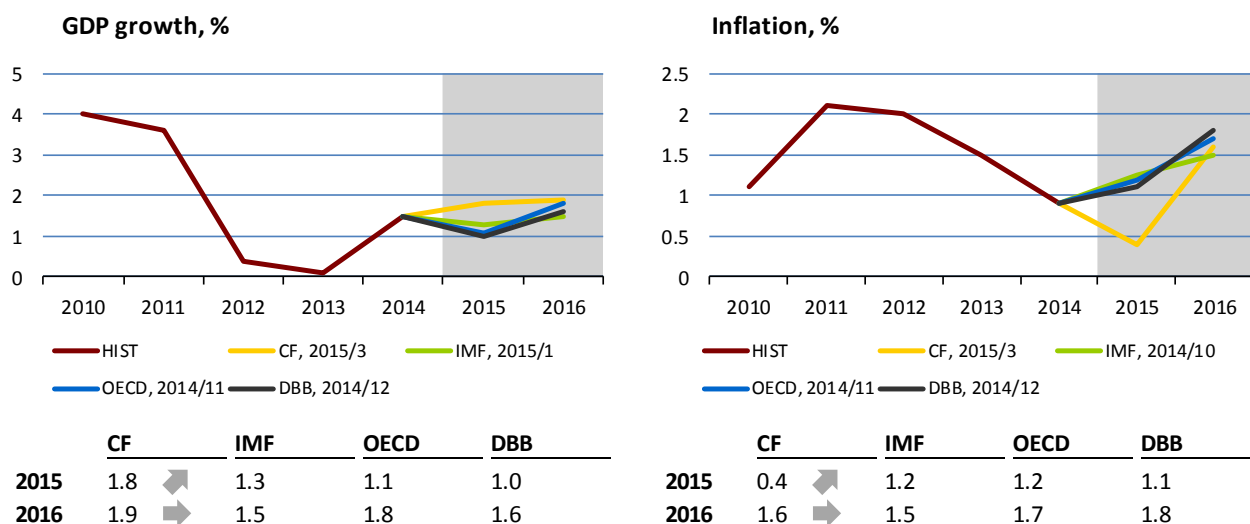
Interest Rates



	02/15	03/15	06/15	12/15	06/16	12/16
3M USD LIBOR	0.26	0.26	0.40	0.86	1.33	1.75
1Y USD LIBOR	0.66	0.70	0.93	1.40	1.83	2.16
10Y Treasury	1.98	2.20	2.90			

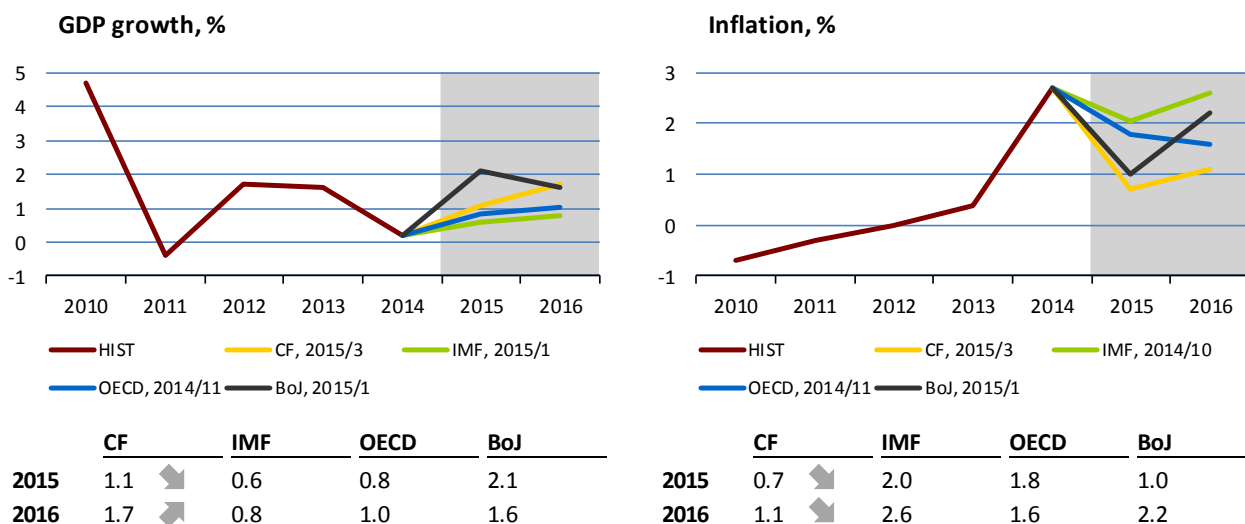
### II.3 Germany

Quarterly GDP growth in Germany rose sharply in the last quarter of 2014, returning to a high pace of 0.7% after six months of almost zero growth. Annual economic growth increased by 0.3 pp to 1.5%, mainly on the back of faster household and government consumption growth. GDP growth in Germany was 1.6% in 2014 as a whole. The March CF expects it to reach 1.8% this year. Owing to low oil prices, a weak euro and low interest rates, the actual growth rate may be higher. This view is supported by leading indicators, whose levels mostly increased in January and February. Conversely, the situation in Ukraine and Greece's potential exit from the euro area might jeopardise the expected growth. Inflation in Germany returned to positive territory, standing at 0.1% after a decline of 0.4% in January. The rise in inflation was fostered by a recovery in oil prices, which was reflected in higher fuel prices, and by rising food prices.



### II.4 Japan

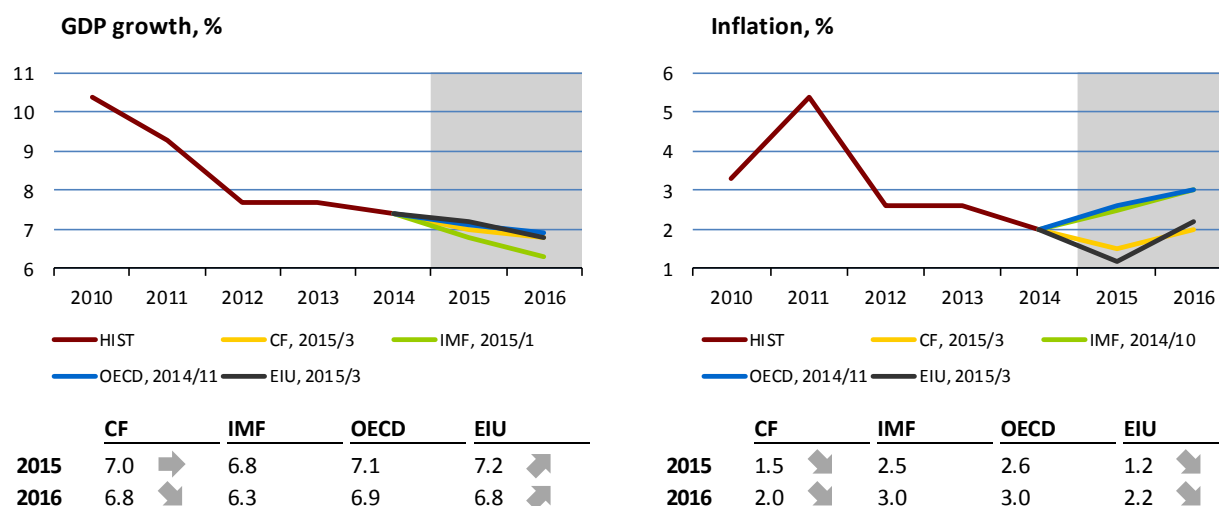
GDP in Japan grew by 0.6% in October–December compared to the previous quarter and the Japanese economy thus emerged from a six-month recession. The growth amounted to 2.2% in year-on-year terms. Although consumer demand lagged behind expectations, exports were a positive surprise. A favourable external effect can also be expected in the new year, as the January data on Japanese exports show a rise of 17%, the highest figure since the end of 2013. Machinery and automobile exports to the USA did well, a fact supported by industrial production data. Moreover, owing to cheap oil, imports recorded a year-on-year decline of 9% and the trade deficit thus improved significantly. Japanese stock markets saw a wave of optimism, with the Nikkei breaking through the psychological threshold of 19,000 points in March for the first time in 15 years. However, inflation slowed further (to 2.2% for inflation excluding food prices). The March CF revised its inflation outlook downwards (by 0.2 pp in 2015 and 0.1 pp in 2016). The GDP forecast was also lowered for 2015 (by 0.2 pp), but raised for 2016 (by 0.1 pp).





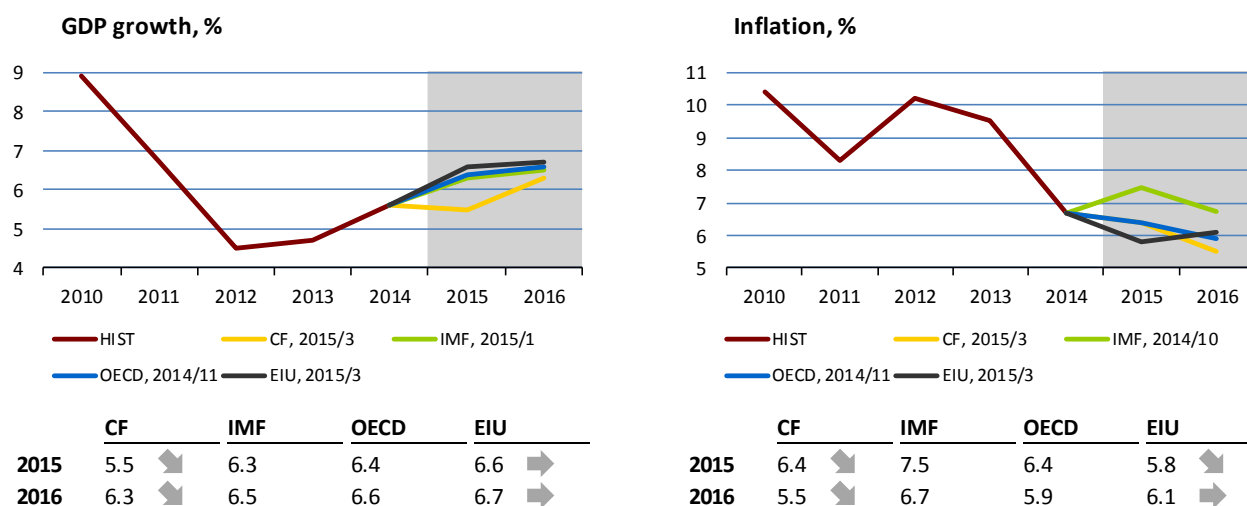
### III.1 China

Faced with persisting disinflationary pressures and slowing economic growth, China's central bank cut interest rates by a further 0.25 pp at the end of February. A further cautious monetary policy easing can be expected if consumer prices fall below 1%. Consumer prices rose by 1.4% year on year in February, but producer prices have been declining steadily, mainly due to lower commodity prices. China's weakening economic performance is confirmed by lower growth in industrial production and retail sales in February (of 6.8% and 10.8% year on year respectively, the lowest figures in five years). At the annual meeting of the Chinese parliament at the start of March, slower growth was declared the "new normal" and the GDP growth target for this year was set at "around 7%". This is in line with the outlooks of international institutions, whose growth forecasts range between 6.8% and 7.2%. The CF and EIU inflation forecasts were revised down to 1.2%–1.5%.



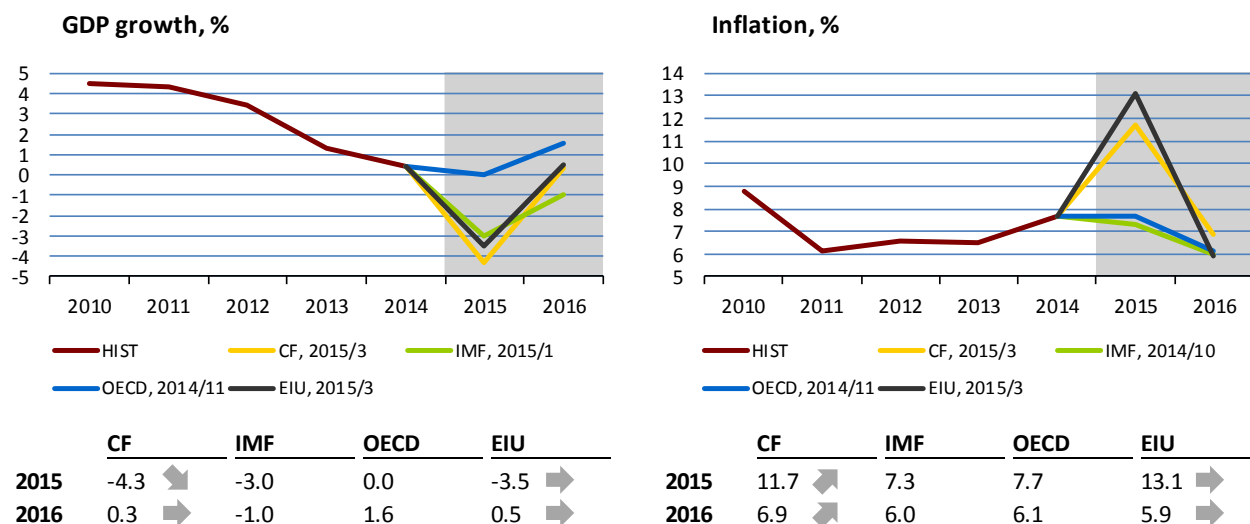
### III.2 India

In February, India formalised its inflation-targeting regime, which had been applied informally by the central bank since September 2013. Under this regime, inflation should not exceed 6% in January 2016, and from fiscal year 2016/2017 onwards the inflation target is 4% with a tolerance band of  $\pm 2\%$ . India's government submitted a budget for fiscal year 2015/2016 whose main priorities are investment support and economic recovery. To this end, the government slightly relaxed fiscal policy, pledged additional spending on infrastructure investment and announced a reduction in corporate tax from 30% to 25% over the next four years. These efforts were supported by the central bank, which in March lowered the interest rate for the second time this year (by 0.25 pp to 7.5%). However, further monetary policy easing may be complicated by rising inflation, which went up by 0.2 pp year on year to 5.4% in February. According to the CF and EIU forecasts, inflation will be 5.5%–5.8% in fiscal year 2015/2016.



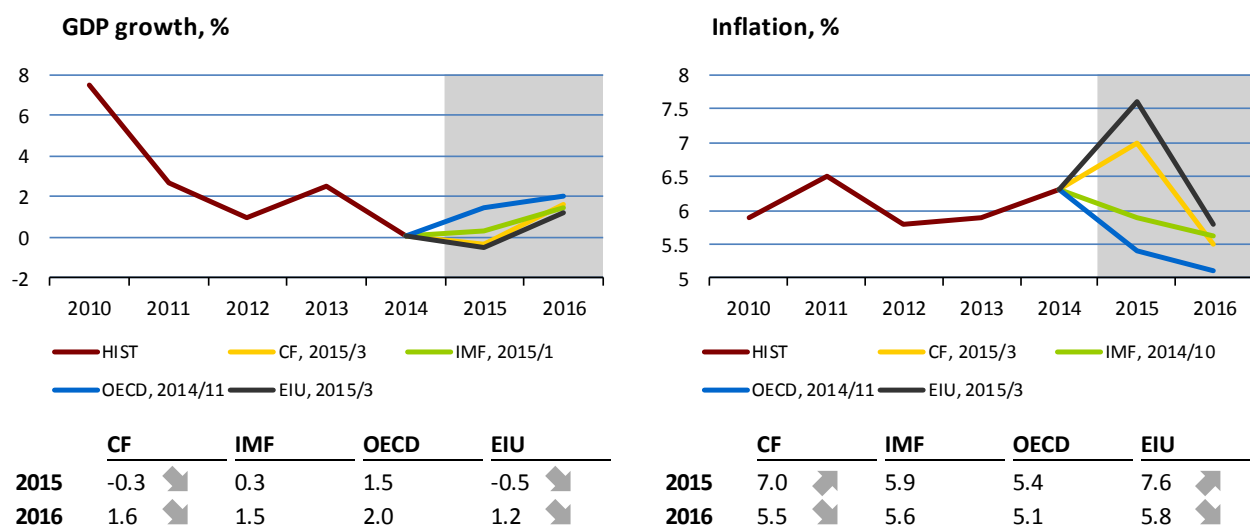
### III.3 Russia

Annual inflation in Russia increased to 16.7% in February (from 15% in January), with food prices rising by a full 26%. A relative stabilisation of the Russian rouble allowed the Russian central bank to cut its interest rate by 1 pp (to 14%) in March to boost the low economic growth. Industrial production recorded negligible annual growth (0.9%) in January. The deteriorating situation in manufacturing is also shown by the February HSBC PMI in this sector, which remains below 50 points. International institutions revised their 2015 GDP outlooks for Russia downwards to a contraction of 3.5%–4.3%. Inflation is forecasted at 11.7%–13.1%. Weak GDP growth of below 0.5% and inflation of around 6% are expected for 2016.



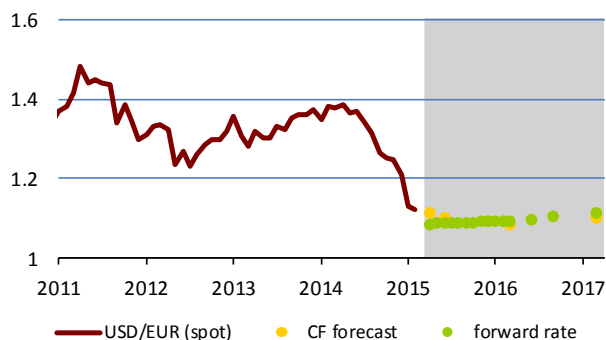
### III.4 Brazil

The Brazilian government is still promoting a policy of fiscal responsibility. It has cut budget spending and, despite opposition from other political parties, is trying to reduce tax relief for companies. The first result of this fiscal discipline was a fiscal surplus of 0.4% of GDP in January. However, the austerity measures have also led to growth in the unemployment rate, which reached 5.3% in January, the highest level since September 2013. The annual decline in industrial production deepened to -5.2% in January. Slowing activity is also evidenced by the PMI leading indicator in manufacturing, which dropped below 50 points in February. Persisting high inflation, which rose to 7.7% in February, forced the Brazilian central bank to increase the interest rate by a further 0.5 pp to 12.75% in March. The bank expects the economy to contract by 0.6% this year. Recession is forecasted by both CF and the EIU, which significantly revised their GDP growth forecasts downwards to a contraction of between -0.3% and -0.5% and increased their inflation outlooks to 7.0%–7.6% in 2015. GDP growth of around 1.5% and inflation of 5.5%–5.8% are expected in 2016.



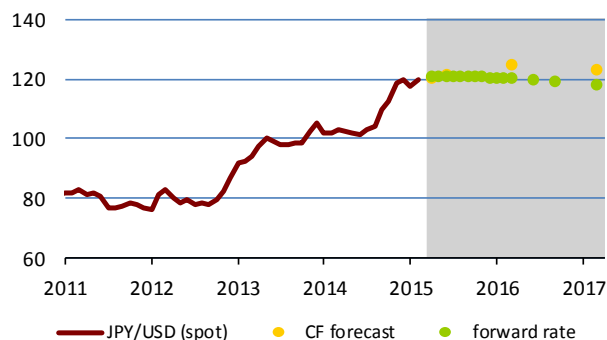
### IV. Outlook of exchange rates vis-à-vis the US dollar

**The euro**



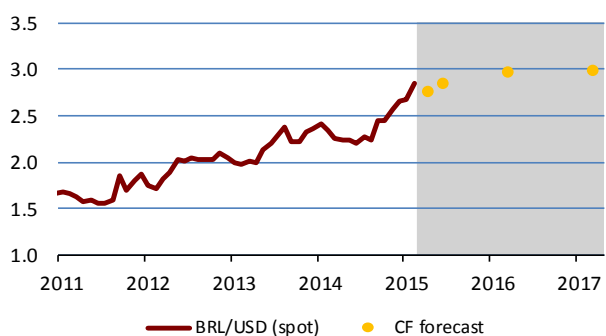
	9/3/15	04/15	06/15	03/16	03/17
spot rate	1.085				
CF forecast		1.114	1.102	1.084	1.099
forward rate		1.086	1.087	1.094	1.113

**The Japanese yen**



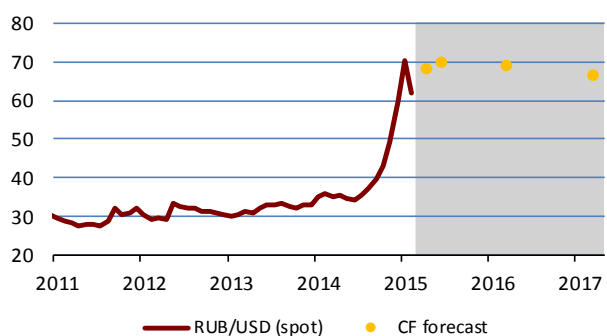
	9/3/15	04/15	06/15	03/16	03/17
spot rate	121.2				
CF forecast		120.5	121.7	125.0	122.9
forward rate		121.1	121.0	120.2	118.0

**The Brazilian real**



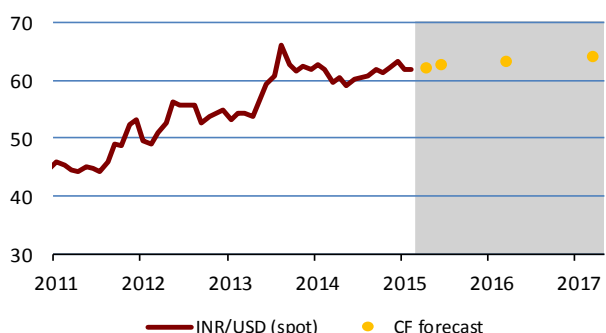
	9/3/15	04/15	06/15	03/16	03/17
spot rate	3.103				
CF forecast		2.767	2.851	2.977	2.987

**The Russian rouble**



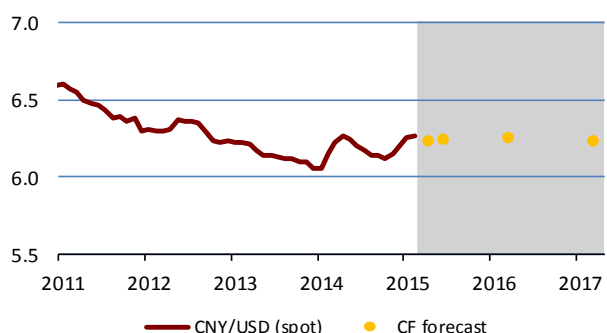
	9/3/15	04/15	06/15	03/16	03/17
spot rate	60.38				
CF forecast		68.14	69.87	68.95	66.42

**The Indian rupee**



	9/3/15	04/15	06/15	03/16	03/17
spot rate	62.55				
CF forecast		62.15	62.67	63.24	64.14

**The Chinese renminbi**



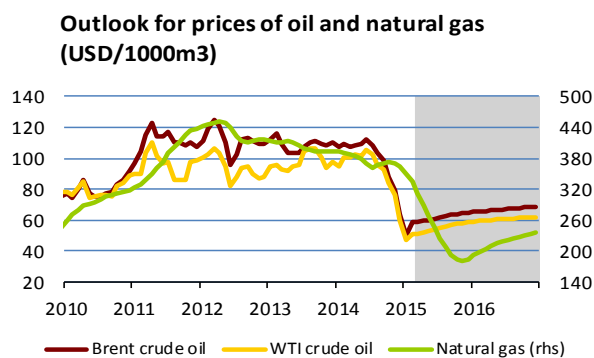
	9/3/15	04/15	06/15	03/16	03/17
spot rate	6.260				
CF forecast		6.238	6.243	6.256	6.228

Exchange rates as of last day of month. Forward rate does not represent outlook; it is based on covered interest parity, i.e. currency of country with higher interest rate is depreciating. Forward rate represents current (as of cut-off date) possibility of hedging future exchange rate.

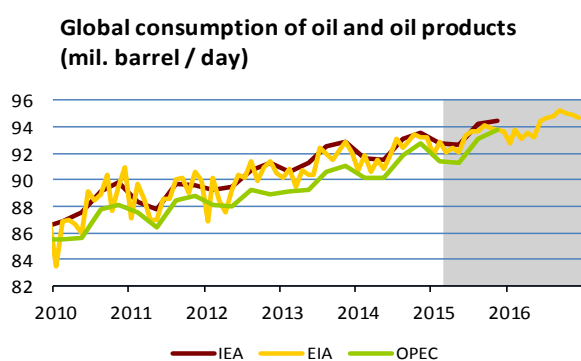
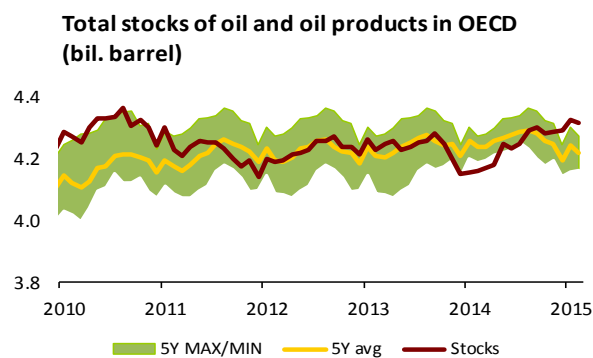
### V.1 Oil and natural gas

The Brent crude oil price was flat at around USD 48.5 a barrel (bbl) in the second half of January, bringing an end to the six-month-long decline. The price surged above USD 60/bbl during the first half of February and fluctuated widely around this level for the rest of the month. The WTI price saw less growth, moving around USD 50/bbl throughout February. The discount to Brent thus rose to about USD 10/bbl from zero in mid-January. The prices of both types of oil started to fall again in the first half of March due to renewed appreciation of the dollar and a continued excess supply of oil over only gradually rising demand, as extraction in the USA continued to grow despite a decline in the number of new rigs. The extraction growth should come to a halt no sooner than June and US production should start to fall in the second half of the year. This could bring the market closer to fundamental equilibrium and stabilise prices. Until then, a (possibly even large) drop in oil prices cannot be ruled out, especially if onshore tanks are filled up.

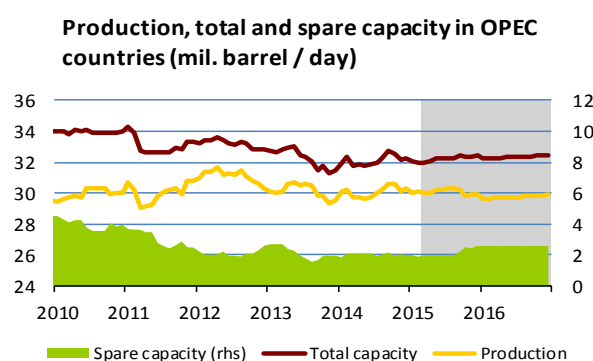
Global market prices of natural gas recorded the greatest convergence in the last five years due to excess supply and falling oil prices. In early February, prices of Asian LNG dropped below European prices (which include a risk premium due to the tensions in Ukraine) for the first time since the Fukushima disaster in 2011. Prices in Europe also rose briefly in response to the Netherlands cutting production limits from the largest reservoir in Groningen. The spread between prices of Asian LNG and natural gas in the USA has fallen so far that the liquefaction and transport costs of around USD 6.5/MBtu are no longer covered. This poses a problem for new LNG projects in the USA and Australia scheduled to go on line this year.



	Brent	WTI	Natural gas
2015	60.70	54.22	247.85
2016	67.07	60.72	217.71



	IEA	EIA	OPEC
2015	93.50	93.13	92.40
2016		94.18	



	Production	Total capacity	Spare capacity
2015	30.08	32.21	2.12
2016	29.75	32.33	2.58

Note: Oil price in USD/barrel, price of Russian natural gas at German border in USD/1,000 m<sup>3</sup> (IMF data, smoothed by the HP filter). Future oil prices (grey area) are derived from futures and future gas prices are derived from oil prices using model. Total oil stocks (commercial and strategic) in OECD countries including average, maximum and minimum in past five years in billions of barrels. Global consumption of oil and oil products in millions of barrels a day. Production and extraction capacity of OPEC in million barrels a day (EIA estimate).

Source: Bloomberg, IEA, EIA, OPEC, CNB calculations

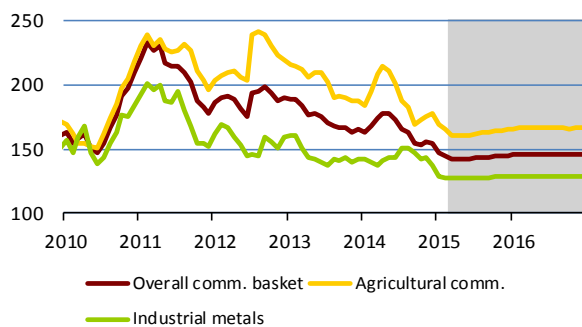
## V.2 Other commodities

The overall non-energy commodity price index continued to edge down in February and the first half of March, mainly due to a fall in the food commodity price index. The industrial metals index declined only moderately in February and was flat in the first half of March.

Grain prices were mostly stagnant in the past month thanks to sufficient stocks, good weather and larger acreage in North America, the Middle East and North Africa, which offset a decrease in acreage in Russia. Extremely low temperatures in the USA resulted in a temporary increase in the wheat price on concerns about damaged crops. The outlook forecasts a slight rise in grain prices. The further decline in the food commodity index was thus due mainly to prices of sugar, coffee, orange concentrate and beef, which should continue to decline. The outlook for prices of cotton and rubber is stagnant at the currently low levels.

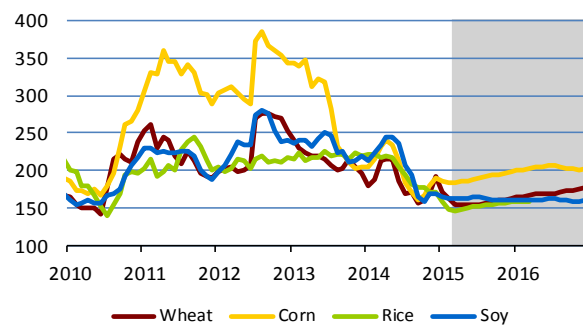
Prices of industrial metals were squeezed by continued weak manufacturing demand. The PMI rose slightly in China, was flat in the euro area and edged down in Japan and the USA. Prices of aluminium, nickel and zinc decreased, while the price of copper rose only slightly owing to energy price growth (after a previous decline due to a rise in stocks at the LME). Prices of iron ore dropped sharply, with large companies continuing to increase their capacity and demand from China falling. Prices of industrial commodities are likely to remain under pressure from the appreciating dollar, which rebounded at the end of February as a result of the ECB's quantitative easing and growing expectations that the Fed is about to increase rates.

**Non-energy commodities price indices**



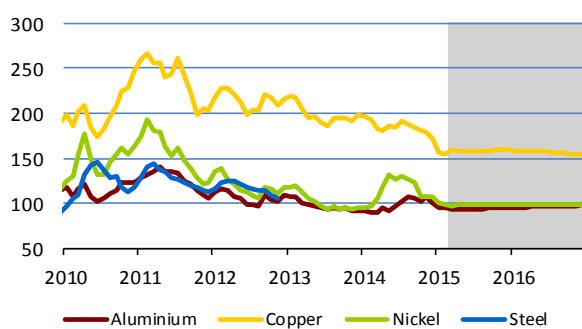
	Overall	Agricultural	Industrial
2015	143.7 ↘	163.2 ↘	127.8 ↘
2016	145.8 ↘	166.2 ↘	128.5 ↘

**Food commodities**



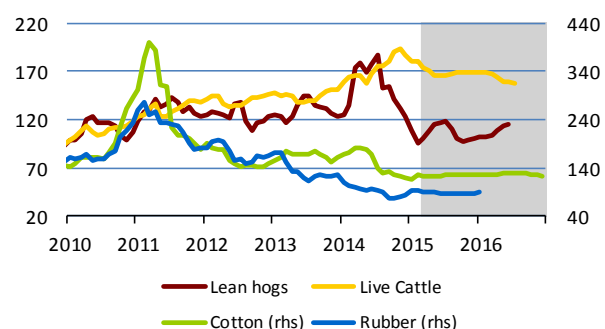
	Wheat	Corn	Rice	Soy
2015	158.8 ↘	189.9 ↘	153.2 ↘	162.7 ↘
2016	170.5 ↘	203.4 ↘	159.3 ↗	160.8 ↗

**Metals**



	Aluminium	Copper	Nickel
2015	94.4 ↘	158.3 ↗	98.8 ↘
2016	96.8 ↘	157.0 ↗	99.3 ↘

**Meat, non-food agricultural commodities**



	Lean hogs	Live Cattle	Cotton	Rubber
2015	105.7 ↘	170.7 ↘	124.4 ↘	88.2 ↘
2016	107.8 ↗	164.0 ↘	127.4 ↘	

Note: Structure of non-energy commodity price indices corresponds to composition of The Economist commodity indices. All prices are given as indices, 2005 = 100 (charts) and percentage changes (tables).

Source: Bloomberg, CNB calculations.

## The US dollar's position in the global financial system<sup>1</sup>

*This article discusses the position of the US dollar (USD) in the global financial system. It demonstrates that the dollar is still the number one reserve currency and its dominance is not under threat from any other currency. The article also discusses the attributes of a dominant global currency, including the advantages and disadvantages that dominant currency status implies for the country concerned. It also shows that the current USD appreciation is by no means unusual from the historical perspective.*

### 1 The US dollar phenomenon

Over its 230-year history, the US dollar has gained a unique position among the world's currencies. For much of its history it was pegged to precious metals – silver (until 1900) and gold (until 1968). It was only with the signing of the 1944 Bretton Woods agreements on the post-war organisation of the international monetary system that the dollar expanded internationally and gradually achieved global dominance. It then continued to gain in strength and became the most important world currency thanks to a combination of tendencies: (i) the provision of post-war dollar assistance to Western European countries and Japan, (ii) the pricing of oil and most other commodity contracts in dollars and the emergence of “petrodollars”, (iii) the gradual waning of the UK's influence as a superpower and the emergence of eurodollars, and (iv) the Cold War and the predominance of dollar-denominated arms contracts.

Even before the financial crisis erupted, many economists had seen the euro as a rival that would strongly weaken, if not replace, the dollar as a means of settlement of international transactions and as the currency unit for reserve assets. Proposals to replace the dollar as a reserve currency with other currencies (the euro, SDRs, etc.) strengthened after the outbreak of the financial crisis. Voices called for a more active role for the Chinese renminbi (RMB) in the international monetary system.<sup>2</sup> Nonetheless, the relatively quick and successful resolution of the financial crisis by the Federal Reserve, the less successful and longer-lasting struggle with the symptoms of the financial crisis in Europe and continuing appreciation of the dollar have postponed these discussions for a while.<sup>3</sup>

Chart 1 plots the nominal exchange rate of the dollar against the other main reserve currencies, i.e. the euro and the yen, over the long term. We observe stable exchange rates in the period of the gold standard, followed by alternating periods of a strong<sup>4</sup> and weak<sup>5</sup> dollar. It is appropriate, however, to supplement this view of the nominal exchange rate of the dollar with that of the real exchange rate (Chart 2), which shows more comprehensively whether the currency is appreciating or depreciating. The course of the real effective exchange rate of the dollar, whether weighted by the position of currencies in the global financial system (REER 1) or by the significance of the USA's trading partners (REER 2), shows that the dollar has been relatively stable in the last ten years. This can be interpreted as meaning that the US economy has successfully withstood the financial crisis and the current USD appreciation is not a visible sign of loss of competitiveness of the US economy.

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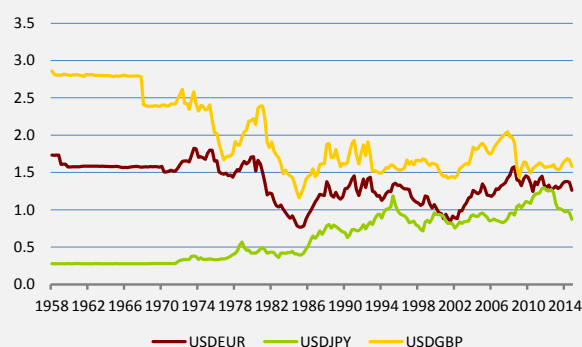
<sup>1</sup> Written by Luboš Komárek (Lubos.Komarek@cnb.cz). The views expressed in this article are those of the author and do not necessarily reflect the official position of the Czech National Bank.

<sup>2</sup> See, for example, Janáček and Komárek (2012).

<sup>3</sup> Following the collapse of the Bretton Woods system, whenever the US dollar went through phases of relatively strong depreciation (1977–1978, 1985–1989, 1993–1995), doubts were cast on its status as the main world reserve currency. Such doubts were always highly hypothetical, as no real alternative to the dollar has emerged in recent times.

<sup>4</sup> i.e. the period before the introduction of the Jamaica currency system in 1975, the period of the Reagan administration in 1980–1985, the 1990s, and developments since the second half of 2014.

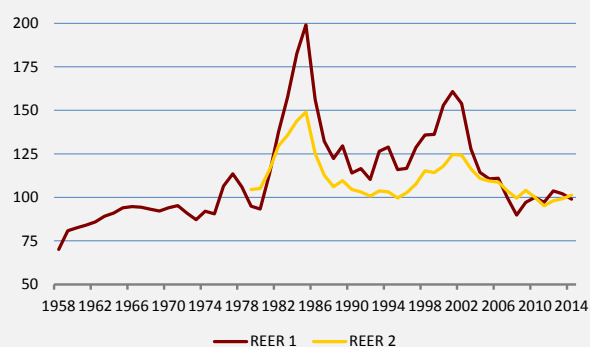
<sup>5</sup> i.e. the period after the discontinuation of gold convertibility of the dollar, the second half of the 1970s, the second half of the 1980s and the first decade of the new millennium.



**Chart 1 USD exchange rate against reserve currencies**

Note: The pre-1999 euro exchange rate is a calculated rate.

Source: EIU



**Chart 2 Real effective USD exchange rate**

Note: REER 1 – real effective USD exchange rate against main reserve currencies (weights EUR – 75%, JPY – 12.5%, GBP – 12.5%). REER 2 – real effective USD exchange rate (weights – US trading partners).

Source: EIU, OECD, IMF-IFS

## 2 Attributes of a dominant global currency

According to Krugman (1999), a global currency is a currency that fulfils, in addition to the three standard functions of a medium of exchange, a unit of account and a store of value, three other functions: (i) an intervention function, i.e. the use of the currency for foreign exchange interventions by central banks, (ii) a peg function, i.e. the use of the currency to fix (anchor) another currency, and (iii) a reserve function. History tells us that if one currency tends to dominate in one of these additional functions, its dominance will also increase in the other functions, thus bolstering its status as global currency.

The factors that determine the international status of a country's currency include: (i) the level of foreign exchange holdings in the currency, (ii) the amount of financial market transactions in the currency, (iii) the amount of commodity market transactions in the currency, (iv) the amount of international trade transactions in the currency, (v) the country's share in the global economy, (vi) macroeconomic stability and confidence in the currency, (vii) the level of development and depth of the financial market, and (viii) "network" externalities given by the number and size of the countries that use the currency. These attributes change very slowly, over timescales of decades. The country's starting position in the global economy is a key factor here, as strong persistence is evident.

Few currencies fulfil these functions. Besides the US dollar, they include the euro, the British pound, the Swiss franc, the Japanese yen and, in a wider sense, the Canadian and Australian dollars.

### Advantages of reserve currency status

A country whose currency has become a global currency has several large advantages over countries whose currencies do not satisfy the above attributes, most notably: (i) a wider scope of activities for domestic financial institutions and their financial development, (ii) seigniorage, (iii) potential currency conversion cost savings, (iv) the elimination of losses on asset holdings due to exchange rate movements, (v) political aspects such as power and prestige.

Financial market development is an indisputable advantage for a country whose currency has become a global currency. It benefits economic entities and also entails political and reputational gains. The exclusive post-war position of the US dollar is supported by the highly liquid US capital markets, which help to eliminate or quickly neutralise speculators' attacks.

### Disadvantages of reserve currency status

The disadvantages for a country with a global reserve currency include (i) fluctuations in demand for the currency leading to money supply and/or interest rate volatility, (ii) rising demand for the currency with the potential for excessive appreciation and the creation of long-term current account deficits, (iii) the incentive for the country with the dominant reserve currency to create high fiscal deficits, (iv) international accountability, (v) limited effectiveness of monetary policy, as external demand affects the interest rate level, (vi) direct interaction with the commodity markets, especially the oil market, as (in the case of the US dollar) currency depreciation coupled with rising oil prices leads to higher penalisation of US residents (who pay a higher dollar price than residents of countries whose currencies appreciate against the dollar).

Keynes and then more exactly Triffin (1964) pointed out that if economies create reserves in the currency of only one country, confidence in that currency erodes. This is because reserves can be understood as promissory notes issued by the reserve currency country to the rest of the world. This can be illustrated on the case of the USA, whose debt to other countries is constantly rising. As the amount of dollars held in central banks' balance sheets rises, the countries concerned are logically asking whether their claims will

ever be paid, or whether they will be paid in dollars which will have lower real value due to potential higher inflation.

The creation of current account deficits, especially on the goods and services balance, is associated with an increase in the fiscal deficit of the country with the dominant reserve currency. Large deficits are fostered by the possibility of easy borrowing, as other countries are willing to hold promissory notes of reserve currency countries even though their yields are close to zero. One such example is the USA, which has generated high government debt.

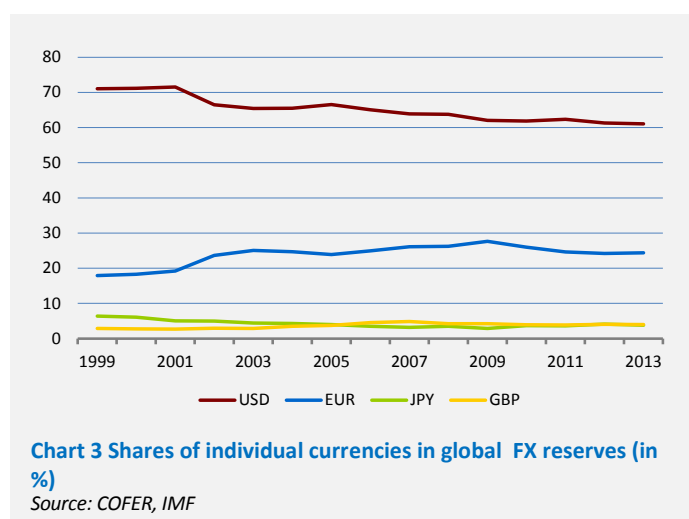
### 3 The dominance of the dollar

A currency's level of global dominance can be illustrated using simple indices demonstrating measurable aspects of its importance to the international economy. Here, we show three such indices for the four most important global reserve currencies (the US dollar, the euro, the yen and the British pound).

1) The share of global forex reserves denominated in the currency of country A (converted into USD,  $FXR_A^{USD}$ ) in total global forex reserves (converted into USD,  $FXR_W^{USD}$ ):

$$i^{FXR} = \frac{FXR_A^{USD}}{FXR_W^{USD}}$$

Chart 3 convincingly confirms the dominant role of the US dollar, as the share of forex reserves in US dollars in total global forex reserves is 60%–70%, i.e. more than two and a half times higher than that of the euro. The shares of the yen and the pound are below 5%.



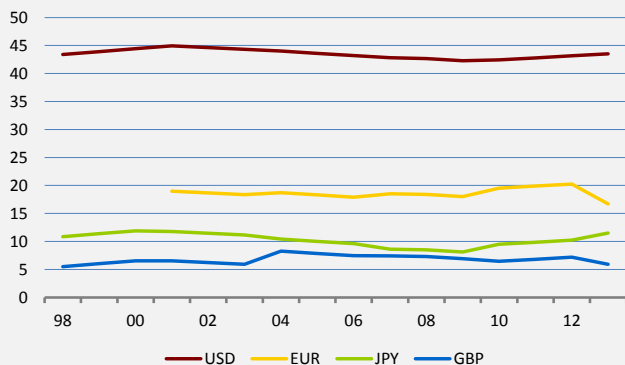
2) The share of transactions in individual markets of assets denominated in the currency of country A (converted into USD,  $T_A^{USD}$ ) in total transactions (converted into USD,  $T_W^{USD}$ ).

$$i^T = \frac{T_A^{USD}}{T_W^{USD}}$$

Chart 4 illustrates the degree of use of the currencies under review for transaction purposes. For reasons of data availability, we present foreign exchange turnover data. The turnover on this market, which covers trading in the spot, forward and swap markets, is higher than in any other financial market segment. The chart shows that the market is around 45% dominated by USD transactions, with an average daily turnover of USD 3,200 billion.



a) Main reserve currencies



b) Other reserve currencies

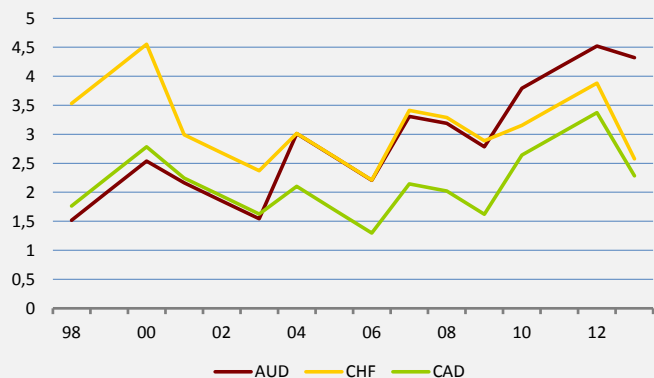


Chart 4 Shares of trade volumes in individual currencies in total trade volumes on the forex market (in %)

Note: Three-year questionnaire periodicity (April 1998, 2001, 2004, 2007, 2010 and 2013).

Source: BIS

### Box 1. The implications of oil trading in US dollars

The US dollar also plays a highly dominant role as a transaction currency in the commodity markets, especially the oil market. The pricing of oil in only one currency, USD, has far-reaching implications. Although some oil-producing countries require their customers to pay for oil in euros or some other currency, the price of their oil is still set in dollars. Oil exporters collect revenues in US dollars or the equivalent in some other currency, but use a wider range of currencies to import goods and services. USD fluctuations thus directly affect real income, i.e. the purchasing power of oil-exporting countries.

International oil companies, which bill for oil in USD, but pay part of their costs in the national currency in countries with a different national currency, are in a similar situation as oil exporters. The relationship between the value of the dollar and oil prices is quite complicated and differs in the short and long run.

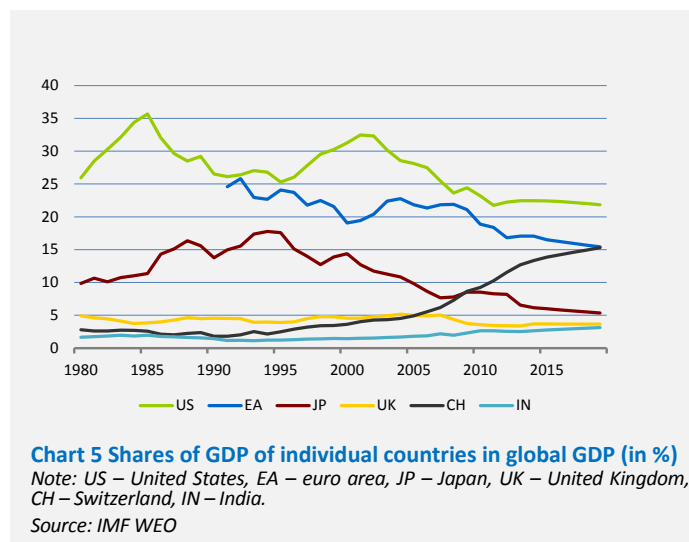
A short-term depreciation of the dollar will not affect the oil supply-demand balance, but will affect speculation on oil futures markets. USD depreciation makes commodities, including oil, more popular among investors, who hedge against the weakening dollar in this way. In the longer run, a weaker dollar leads to lower supply and production of oil. However, the weak dollar stimulates demand for oil, especially outside the USA, and this, in turn, increases oil consumption. Ultimately, then, the weak dollar generates opposite movements on the supply and demand sides, i.e. it has a downward effect on oil supply and an upward effect on oil demand, leading to an increase in dollar prices of oil. However, a weaker dollar has differential impacts on consumers in the USA and those outside the USA. Countries whose currencies are appreciating against the dollar can neutralise the higher dollar oil prices. This, however, does not apply to US residents.

However, the dollar's role as a transaction currency would be even stronger if we were to take into account the difficult-to-quantify fact of its very dominant role on the commodity markets, especially the oil market (see Box 1).

3) The share of the GDP of country A expressed in USD ( $GDP_A^{USD}$ ) in global GDP expressed in USD ( $GDP_W^{USD}$ ):

$$i^{GDP} = \frac{GDP_A^{USD}}{GDP_W^{USD}}$$

Chart 5 illustrates the shares of the countries under review in global GDP. Here, the dominance of the USA is not as significant as in the previous two indices, especially when compared to the euro area.



Using the above indices, this article shows that although the USA is not the dominant global economic power it used to be, the US dollar clearly fulfils the function of global currency and will not lose this status in the foreseeable future. Past attempts to reduce the dollar's dominance – be they only theoretical (Keynes's bancor, for example) or partially implemented in practice (special drawing rights, SDR) – have come to nothing. This is because changing investors' currency portfolios is a costly and complicated process even if there is an equivalent alternative to the dollar. Countries with large current account deficits thus continue to hoard their reserves in dollars despite simultaneously expressing concerns about the safety of holding their assets in dollars (this goes especially for China). This trend is continuing in spite of the fact that the financial crisis and economic recession is fading in the advanced world.

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## A1. Change in GDP predictions for 2015

	CF		IMF		OECD		CB / EIU	
EA	<b>0.2</b>	2015/3	<b>-0.1</b>	2015/1	<b>0.0</b>	2014/11	<b>0.5</b>	2015/3
		2015/2				2014/10		
US	<b>-0.1</b>	2015/3	<b>0.5</b>	2015/1	<b>0.0</b>	2014/11	<b>0.0</b>	2014/12
				2015/2				2014/10
DE	<b>0.3</b>	2015/3	<b>-0.2</b>	2015/1	<b>-0.4</b>	2014/11	<b>-1.0</b>	2014/12
				2015/2				2014/10
JP	<b>-0.2</b>	2015/3	<b>-0.2</b>	2015/1	<b>-0.3</b>	2014/11	<b>0.6</b>	2015/1
				2015/2				2014/10
BR	<b>-0.7</b>	2015/3	<b>-1.1</b>	2015/1	<b>0.1</b>	2014/11	<b>-1.0</b>	2015/3
				2015/2				2014/10
RU	<b>-0.2</b>	2015/3	<b>-3.5</b>	2015/1	<b>-1.8</b>	2014/11	<b>0.0</b>	2015/3
				2015/2				2014/10
IN	<b>-0.1</b>	2015/3	<b>-0.1</b>	2015/1	<b>0.5</b>	2014/11	<b>0.0</b>	2015/3
				2015/2				2014/10
CN	<b>0</b>	2015/3	<b>-0.3</b>	2015/1	<b>-0.2</b>	2014/11	<b>0.1</b>	2015/3
				2015/2				2014/10

## A2. Change in inflation predictions for 2015

	CF		IMF		OECD		CB/EIU	
EA	<b>0.1</b>	2015/3	<b>-0.3</b>	2014/10	<b>-0.5</b>	2014/11	<b>-0.7</b>	2015/3
		2015/2				2014/4		
US	<b>0</b>	2015/3	<b>0.5</b>	2014/10	<b>-0.3</b>	2014/11	<b>-0.5</b>	2014/12
				2015/2				2014/4
DE	<b>0.1</b>	2015/3	<b>-0.2</b>	2014/10	<b>-0.6</b>	2014/11	<b>-0.4</b>	2014/12
				2015/2				2014/4
JP	<b>-0.2</b>	2015/3	<b>0.3</b>	2014/10	<b>-0.2</b>	2014/11	<b>-1.4</b>	2015/1
				2015/2				2014/4
BR	<b>0.6</b>	2015/3	<b>0.4</b>	2014/10	<b>-0.1</b>	2014/11	<b>0.9</b>	2015/3
				2015/2				2014/4
RU	<b>0.9</b>	2015/3	<b>2.0</b>	2014/10	<b>3.1</b>	2014/11	<b>0.0</b>	2015/3
				2015/2				2014/4
IN	<b>-0.2</b>	2015/3	<b>0.0</b>	2014/10	<b>-0.3</b>	2014/11	<b>-0.4</b>	2015/3
				2015/2				2014/4
CN	<b>-0.2</b>	2015/3	<b>-0.5</b>	2014/10	<b>-0.4</b>	2014/11	<b>-0.6</b>	2015/3
				2015/2				2014/4

### A3. List of abbreviations

<b>ABS</b>	asset-backed securities	<b>HICP</b>	harmonised index of consumer prices
<b>BoJ</b>	Bank of Japan	<b>CHF</b>	Swiss franc
<b>BR</b>	Brazil	<b>ICE</b>	Intercontinental Exchange
<b>BRIC</b>	countries of Brazil, Russia, India and China	<b>IFO</b>	Institute for Economic Research
<b>BRL</b>	brazilian real	<b>IFO-BE</b>	IFO Business Expectations
<b>CB-CCI</b>	Conference Board Consumer Confidence Index	<b>IMF</b>	International Monetary Fund
<b>CB-LEII</b>	Conference Board Leading Economic Indicator Index	<b>IN</b>	India
<b>CBOT</b>	Chicago Board of Trade	<b>INR</b>	Indian rupee
<b>CBR</b>	Central Bank of Russia	<b>IRS</b>	Interest Rate swap
<b>CF</b>	Consensus Forecasts	<b>JP</b>	Japan
<b>CN</b>	China	<b>JPY</b>	Japanese yen
<b>CNB</b>	Czech National Bank	<b>LI</b>	leading indicators
<b>CNY</b>	Chinese renminbi	<b>LIBOR</b>	London Interbank Offered Rate
<b>DBB</b>	Deutsche Bundesbank	<b>MER</b>	Ministry of Economic Development (of Russia)
<b>DE</b>	Germany	<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>EA</b>	euro area	<b>OECD-CLI</b>	OECD Composite Leading Indicator
<b>EC</b>	European Commission	<b>PMI</b>	Purchasing Managers' Index
<b>ECB</b>	European Central Bank	<b>PPI</b>	producer price index
<b>EC-CCI</b>	European Commission Consumer Confidence Indicator	<b>RU</b>	Russia
<b>EC-ICI</b>	European Commission Industrial Confidence Indicator	<b>RUB</b>	Russian rouble
<b>EIA</b>	Energy Information Administration	<b>TLTRO</b>	targeted longer-term refinancing operations
<b>EIU</b>	Economist Intelligence Unit	<b>UoM</b>	University of Michigan
<b>EIU</b>	The Economist Intelligence Unit database	<b>UoM-CSI</b>	University of Michigan Consumer Sentiment Index
<b>EU</b>	European Union	<b>US</b>	United States
<b>EUR</b>	the euro	<b>USD</b>	US dollar
<b>EURIBOR</b>	Euro Interbank Offered Rate	<b>WEO</b>	World Economic Outlook
<b>Fed</b>	Federal Reserve System (the US central bank)	<b>WTI</b>	West Texas Intermediate (crude oil used as a benchmark in oil pricing)
<b>FRA</b>	forward rate agreement	<b>ZEW-ES</b>	ZEW Economic Sentiment
<b>GBP</b>	pound sterling		
<b>GDP</b>	gross domestic product		

## A4. List of thematic articles published in the GEO

### 2015

	<b>Issue</b>
The US dollar's position in the global financial system	2015-3
The crisis and post-crisis experience with Swiss franc loans outside Switzerland (Alexis Derviz)	2015-2
The effect of oil prices on inflation from a GVAR model perspective (Soňa Benecká and Jan Hošek)	2015-1

### 2014

	<b>Issue</b>
Applicability of Okun's law to OECD countries and other economies (Oxana Babecká Kucharčuková and Luboš Komárek)	2014-12
Monetary policy normalisation in the USA (Soňa Benecká)	2014-11
Changes in FDI inflows and FDI returns in the Czech Republic and Central European countries (Vladimír Žďárský)	2014-10
Competitiveness and export growth in selected Central European countries (Oxana Babecká Kucharčuková)	2014-9
Developments and the structure of part-time employment by European comparison (Eva Hromádková)	2014-8
The future of natural gas (Jan Hošek)	2014-7
Annual assessment of the forecasts included in GEO (Filip Novotný)	2014-6
How far the V4 countries are from Austria: A detailed look using CPLs (Václav Žďárek)	2014-5
Heterogeneity of financial conditions in euro area countries (Tomáš Adam)	2014-4
The impacts of the financial crisis on price levels in Visegrad Group countries (Václav Žďárek)	2014-3
Is the threat of deflation real? (Soňa Benecká and Luboš Komárek)	2014-2
Forward guidance – another central bank instrument? (Milan Klíma and Luboš Komárek)	2014-1

### 2013

	<b>Issue</b>
Financialisation of commodities and the structure of participants on commodity futures markets (Martin Motl)	2013-12
The internationalisation of the renminbi (Soňa Benecká)	2013-11
Unemployment during the crisis (Oxana Babecká and Luboš Komárek)	2013-10
Drought and its impact on food prices and headline inflation (Viktor Zeisel)	2013-9
The effect of globalisation on deviations between GDP and GNP in selected countries over the last two decades (Vladimír Žďárský)	2013-8
Competitiveness and determinants of travel and tourism (Oxana Babecká)	2013-7
Annual assessment of the forecasts included in GEO (Filip Novotný)	2013-6
Apartment price trends in selected CESEE countries and cities (Michal Hlaváček and Luboš Komárek)	2013-5
Selected leading indicators for the euro area, Germany and the United States (Filip Novotný)	2013-4
Financial stress in advanced economies (Tomáš Adam and Soňa Benecká)	2013-3

	<b>Issue</b>
Natural gas market developments (Jan Hošek)	2013-2
Economic potential of the BRIC countries (Luboš Komárek and Viktor Zeisel)	2013-1

## 2012

	<b>Issue</b>
Global trends in the services balance 2005–2011 (Ladislav Prokop)	2012-12
A look back at the 2012 IIF annual membership meeting (Luboš Komárek)	2012-11
The relationship between the oil price and key macroeconomic variables (Jan Hošek, Luboš Komárek and Martin Motl)	2012-10
US holdings of foreign securities versus foreign holdings of securities in the US: What is the trend? (Narcisa Kadlčáková)	2012-9
Changes in the Czech Republic's balance of payments caused by the global financial crisis (Vladimír Žďárský)	2012-8
Annual assessment of the forecasts included in the GEO (Filip Novotný)	2012-7
A look back at the IIF spring membership meeting (Filip Novotný)	2012-6
An overview of the world's most frequently used commodity indices (Jan Hošek)	2012-5
Property price misalignment around the world (Michal Hlaváček and Luboš Komárek)	2012-4
A macrofinancial view of asset price misalignment (Luboš Komárek)	2012-3
The euro area bond market during the debt crisis (Tomáš Adam and Soňa Benecká)	2012-2
Liquidity risk in the euro area money market and ECB operations (Soňa Benecká)	2012-1

## 2011

	<b>Issue</b>
An empirical analysis of monetary policy transmission in the Russian Federation (Oxana Babecká)	2011-12
The widening spread between prices of North Sea Brent crude oil and US WTI crude oil (Jan Hošek and Filip Novotný)	2011-11
A look back at the IIF annual membership meeting (Luboš Komárek)	2011-10
Where to look for a safe haven currency (Soňa Benecká)	2011-9
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