A Critical Evaluation that will the Euro Rival the Us Currency and the Impact on the Euro on Developing Countries Economies

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Background

Historically, prior to the advent of the World War II, the dollar came into limelight as unparalleled leader among international currencies, a progressive in terms of historic significance. As pointed out by Alliber (1966:19-20),'' the war itself-including US lending, UK borrowing and other consequences-had completed the dollar's rise in ascendancy''. The shift in direction demonstrated long –run direction within the economic basics which had currently gone through for the reason that the closer part of the 19 century. The United States of America economy had exceeded the UK economy in magnitude during the 1872. The export of UK was trailing behind until 1915. The success of the financial system was weakening; one of the demonstrations was that the US was in the position to set up a central bank until 1913.

In those years of 1914, the US went through stages of debtor to net creditors while that of Britain shifted from the polar trend. This culminated in Britain borrowing heavily from the US in order to curb World War l. The argument pointed out was that the dollar was the most currency used in converting in to gold with affixed price into the 1920s (Nurkse 1944, Bergsten 1975, pp.53; Eichengreen 1992). The US dollar is currently the most highly used currency in global transactions; nearly 85% of the entire currencies use the dollar. Also, major commodities contract such as crude oil as well as gold are transacted on numerous exchanges' growing number of currencies about twenty-five are pegged to the US Dollar in countries such as New Zealand, Australia, Singapore, Malaysia,. In current financial markets, the US currency is the global's major reserve. For the Euro, it is the single currency use in transaction among the 27 member states of the European Union (EU). The emergence of the Euro was introduced in 1999 and seen as the major triumphant step towards European integration. More than 330 million EU nationals currently use the currency Euro as a means of transacting goods and services and are seen as the second most significant currency after the US dollar (European Commission 2012). In a few months ago, investors were feeling highly optimistic concerning the Eurozone. In July, 2014, Greek Government could borrow money at an interest rate of 6%, a higher than expected projection of 40%. It was making a payment of first quarter of 2014 standing at 1.2% on annualized basis. That was a forecast worry that the Eurozone will wreck to a triple dip financial crisis.

A number of factors have influence for international currency.

Firstly, output and trade is a determinant. The currency of a country which has huge trade share in international l output, trade and finance played a natural importance. The US economies enjoy the greatest world output in that dimension.

A second factor influencing a currency status is the financial market. To attain international currency status, capital as well as money markets in the host state ought not only open and free in terms of control, however, also heavily and well organized. The financial marketplaces of New York and London in assets such as stocks, shares and bonds, that both have taken advantage of dollar-pound at the expense of the euro.

Thirdly, the confidences in the value of the currency have played a crucial role in influencing the currency status. The emergency of the US dollar at the international stage is determined by the nation's economy.

If a country's economy's is doing better, there is the argument that the demand for that nation's currency and the opposite effect. During the period under review, the US economy was the biggest economy accounting for GDP of 10.4 billion that stands for 70% of combined economy of the three giant economies such as Germany, England and France. As at 1913, the economic outlook of the US had become bigger, the GDP had risen to 20% the aggregate GDP of leading European nations. Shortcomings of the GDP growth among others includes nonmarket activities, leisure, improved product quality and underground economy affects its progress. The current value of underground economy is accounted for 8% of recorded GDP within us. That is, GDP in 2009 meant $1.14 Trillion. The IMF World economy outlook published shows US GDP as at 2010 standing at 14.66 trillion accounting for 23.3 % of the global's GDP. That of China stood at $5.88 trillion representing 9.3% of the global's GDP. The remaining follow suit such as Japan $5.46 trillion, Germany $3.32 trillion accounting for 8.7% and that of Germany standing at US$ 3.32 trillion of 5.3% .Zhang and Yuan (2013).

McConnell, Brue and Flynn (2012).

In examining the economic environment, in September of 2008, the financial crisis emerged and caused huge damage to the US economy.

The start of 2008 with current unemployment problem. The Obama administrations have been able to create 74,000 jobs and many American have given up looking for jobs. BBC NEWS (11/ 01/ 2014). A critical look at the US Economy demonstrates three main problems that financial and economic advocates have raised skepticism that the US economy power might such arising rate of unemployment, heavy debt burden and falling real estate prices.

The future economy saw policies such as strong adjustment as well as resurrected capacity. Within the US, the corporate culture, capital markets, education as well research and development is seen as the best practice. To be able to repair the broken turmoil, the US launched a series of policies known as quantitative easing (QE) policy. The key objective of the quantitative easing is pumping more money into the economy from the Federal Reserve in a bid to stimulate the resurrection of the economy. In a period of the QE, the US Stock market went up from the lowest ebb of 646995 during March 6, 2009 to 12,414.34 index close to end of June, 2011. Source: (http://hk.finance.yahoo.com).

Quantitative easing 3 was launched in Septebemer13, 2012 and witnessed leapfrog in September13, 2012.The US stock market saw a jump and was at 13,661.87 in October 5, 2012. The aim of Federal Reserve was to purchase MBS to maintain low interest rates and cut the problem of the citizens. The Federal Reserve attempts to motivate the citizens to improve on their consumption pattern and thereby boost economic growth in the economy. A second reason was to stimulate the recovery of the US fragile mortgage to the necessary backing regarding the entire economy.

It should be pointed out that so far, the implementation in terms of the QE has generated varying repercussions within the US economy. An s the World Bank had echoed that in recent times, the US economy is accelerating. GDP is forecasted a jump of 2.4% in 2013 and 2.8% in 2014. The establishment of the EU is seen as phenomenal in pursuit of economic and political partnership between 37 European states. It was formed prior to the Second World War and since then continued to grow dramatically. The primarily purpose of the EU is foster economic and political integration among member states and to permit the free trade movement of goods and persons and free border control and restrictions. The EU in furtherance of its noble objectives is to promoting peace, stability as well as prosperity across members of the European states. For that matter, the establishment of the single currency has facilitated trade market as well as the formulation in terms of the single currency. The Euro which is the geographical territory has made it possible to emerge as a key trading power within the globe.

Source: (http://europa.eu/about-eu).

The recent situations across the EU among others include public interest such as ongoing dispute, austerity measures which have engulfed the member states. There has been an implementation with the anticipation of arriving at a cut in the budget deficits. Instances of countries facing the full scale of the austerity measures are Greece, Italy, and Spain etc. Some states such as Ireland, Spain, Greece and Portugal have been bail out by the International Monetary Fund. A number f EU States such as Ireland, Spain, Portugal and Greece has pocketed bailouts from IMF Fund. There seemed to be an anxiety with events that began in Greece having a serious repercussion on the Eurozone. Others include Spain with youth unemployment hitting at 25%. Italy facing similar problems of hardship in the Eurozone economy austerity (Mason 2011).

There is another issue of conflicts of interests between EU Members. The absence of confidence across the Eurozone resulting in increased cost of borrowing. Germany has come out boldly to urge member countries to be self financing as result of the financial crisis by implementing austerity measures. There is the threat of England seceding from the union. In October, 2012, when the labour party was in power, it had put forward a proposal in cut in EU financial support. This will have a serious repercussion on diplomatic relationship, trade and finance among EU.

In a study, Krugman (1984) demonstrated how there is the existence of multiple equilibra in the utilization of the international currency, developing some sort of informal ideas of pervious works from Kindleberger (1881), McKinnon(1979) as well as Swogoda (1969), Matsuyama et al (1993). In his analysis, the side-effects were that little variations in the determinants is not likely to generate into a corresponding variations within the reserve currency numbers at the short run. Economic of scale suggested that despite the long run, measures in terms of the international currency application may not be linear within the determinants.

It is uncertain to set in motion the precise currency composition of the global's foreign exchange reserves. Truman and Wong(2006) offer a voice that that just 23 states just holding 13 % of the global foreign-currency reserves reveal the currency composition in their respective reserve holdings. China and Taiwan, holding 20% and 6% of the global reserves.

I n measuring the dollar's international role, the question that gives rise is whether the dollar was in the process of falling as currency, as the case may be of the pound prior to the 1992. The yen as well as the mark seemed to have the upper hand in periods of 1970s and 1980s, as a measure in terms of the shares of central banks' holdings within the foreign exchange reserves pegged to the dollar's expense. The powerful basic in terms of the German and Japanese economies, specifically attests to measure of their current account surplus as well as inflation levels offer a clear interpretation.

However, in reality, during the 1990s, put forward the notion that the right antidote to the main question posed was absolutely 'no'. Commentators were at a dilemma as to how the dollar had depreciated in value in foreign exchange in period of 1985-1995.It should be pointed out that the Japanese and German economies and their currencies had risen against the US Dollar. The reason for international currency status is the utilization of currencies invoice, traded, as a denomination for debt and loans etc. Another role of the dollar concentrating on the reserve currency function seemed highly important as compared to others to the useful questions as of whether the US can be in the position to finance the underlying current account deficits which is very huge indeed.

Some other benefits of the dollar which the euro cannot rival are as follows.

The US dollar is seen as the most significant currency on the globe. It plays a positive role in international trade, finance and investment viewed as store of value and as medium of exchange. A number of states have adapted to the exchange rate which has been the benchmark for their home currency pegged to the dollar. But, the dollar leading role has comes under question. Thus, during the current shortages of the dollar during the financial turmoil put much bottlenecks on international firms requiring backing their dollar-denominated assets. And resulted in international companies demanding for variations within the international monetary system.

As exemplified by Goldberg (2010), ''several developing countries, for example, have proposed that for certain transactions the dollar be replaced with a type of 'world' currency based on international Monetary Fund special drawing rights''. Furthermore,, participants who were involved in the 2009 meeting representing 20 finance ministers raised some vital questions concerning the dollar dominance as a reserve currency. The was pressure to move away from US currency in numerous operations.

A shift in the prominence role in terms of the dollar in global markets brings in its wake serious set-backs for the currency issuer as well as the user concurrently. The US currency in international status assist to inject US economy from foreign shock waves cut transaction costs regarding trade and commerce, contribute positively to international transmission of US stock and monetary policy influence. External nations, wider use of the dollar in reserves and in international transaction characterize outcomes in bigger sensitivity about trade, inflation as well as assets values to that of exchange trend between their currencies with that of the dollar. The stability of the US dollar sets the platform and makes it very attractive currency for states which are experiencing turbulent economic as well as political conditions, alternatively having a history of underlying risks. For instance, the stocks of the dollar are held in Russia, Latin American.

The international use of the Euro is its denomination within cross-border financial transactions. The euro quickly emerged in broader use to effective bonds. Across Europe, there was huge rise in issues such as corporate bonds, measure in Euros, combined with a swift integration regarding money markets, equity markets as well as banking. The argument raised is that the euro does not meet the criteria of currency use for the reason that it working inside the domain of the currency's home territory .Gasper and Hartman (2005), Riley (2005). The dollar played a huge function by fixing the exchange rate in relation to the dollar and facilitating a responsibility to monetary as well as fiscal policies geared towards sustaining fiscal policies dimension.

Hartman (2000) make a study of data from the euro's first year in full business activity, performing a good task regarding chalking out intra-euro-territory holding so as to be capable to make reference back of euro currencies within a five-years prior to 1999 which can be compare to the post-1999 magnitudes. The results witnessed a jump in the supply of euro-denominated assets outside Europe as compare to a rise in demand. As elaborated by Riley (2005:114), ''the stock of international debt denominated in Euros increased from about 20% on the eve on international EMU to 30 % in 2003''.

Furthermore, the dollar dominance is a reflection of portfolios about foreign government. The role played by the euro in international dimension has grown in no small proportion. Nearly 50 % of euro land trade with non-euro territory resident that is invoiced within the new currency (Harman 1998). Despite, the political, cultural as well as economic challenges seemed to be formidable, IMF study that the euro has the tendency to remolds European and international markets and hence translate the financial system better. The euro is seen as the second significant international reserve currency, may be accounting for nearly one-quarter of the global reserves. The existence of the euro offers investors another alternative currency for having broad sufficient recognition and greater adequate market to move into should there be a fall in respect of the trust to the dollar.

The euro challenge in respect to the dollar is seen as institutional; the collective share of the euro area votes in the IMF and the World Bank is far greater than the US. It is 23% to 17%, however, is fragmented within constituencies that involve collections of euro area member states strengthening their representation in terms of these institutions that is the G-7 conference. In my prediction, cannot provide a flesh reason that the euro cannot rival the dollar in the coming years. Yet with reservation, can argue that the dollar might one day lose its world role in the financial system, trade and development.

Current Impacts of the Euro zone Crisis on Under-Developing Economies

The study identifies poor economies vulnerability to the euro zone crisis. The paths of the impact are as follows: The European debt crisis is likely to hit poor countries hard through the trade channel. Our simulation results show that a drop of 1% in export growth could reduce growth rates in low- and lower-middle income countries by an average of 0.4% and 0.5% respectively. The impact of the crisis on developing countries is already visible in the form of reduction in exports declining portfolio flows, cancelled or postponed investment plans, and falling remittances and aid flows. In Mozambique Portuguese public investments have been reduced; in Nigeria remittances have declined; in Kenya the stock exchange has suffered heavy sell-offs; and in Rwanda foreign investments have been delayed. Nevertheless, the effects of the euro zone crisis so far (at least from a trade and finance perspective) seem to be less severe than those of the 2008–9 global financial crises.

The slowdown in China's growth may, however, increase the risks for developing countries, thus leaving the moverly exposed to the trade- and finance-related adverse impacts of the euro zone crisis. In order to weather the crisis, developing countries should, whilst maintaining fiscal soundness and macroeconomic stability as long-term targets, spur aggregate domestic demand, promote export diversification in both markets and products, improve financial regulation, endorse long-term growth policies, and strengthen social safety nets. For their part, multilateral institutions should ensure that adequate funds and shock facilities are put in place in a coordinated way to provide effective and timely assistance to crisis-affected countries.

Financial Contagion effect: The research assess the nature of spill-over through financial intermediaries, that is banking hedging as well as markets, and in the sorts of movements within the investors markets perspectives as well as variations in the investors' vies of risks. Fiscal Consolidation effects: The series in terms of austerity packages set into motion in a growing proportion of European economies under the study lasted to a greater scale giving rise jobless and fragile growth that had still not maximize the renewed recovery prior to the 2008-2009 global economic and banking turmoil.

This is likely to have had untold repercussion to demand for under-developing economies exports drives, resulting to changes within the trade flows between developed and poor states. It may also have impact on Foreign Direct Investment (FDI) as well as remittances. Flows and aid flows within European economies. Exchange Rate effects: A depreciation in terms of the euro may have untold consequences on trade flows in under-developing countries in two main divergent forms. On the other hand, states whose currency is pegged to the Euro may benefit from a weaker euro that paves the way for their exports to be highly competitive within the global markets. On the other states with dollar-connected exchange rates will absolutely suffer from an appreciation of the dollar against the euro.

Vulnerability Indicators: The EU is the primary trading partner for under-developing economies. The study demonstrated that these countries such as Ghana, Nigeria, Kenya, Pakistan, Jamaica, St Lucia etc nearly 50 % of their aid package is received from Europe. It is also a significant source of remittances and one of the biggest investors in the world economy.

Exposure Characteristics

A significant portion of exports to the crisis affected countries in poor economies that depended on the financial markets. The UK was not an exception as the rely on the financial markets such as the mortgage investment.

Exports of products with increasingly income elasticity.
Heavy reliance on remittances
Heavy dependence on Foreign Direct Investment as well cross-border banking lending is paramount.
Highly dependence on aid.
Limited policy from greater current account deficit, high government deficits, and low reserve level.

Exposure Indicators

-The study demonstrated the degree regarding exposure in the less-developed economies to the shock waves in terms of the euro zone crisis depend on the scale through which these economies rely on trade flows, remittances as private capital flows. For instance FDI as well as cross-border bank lending and aid flows.
-Dependence on trade: On the export side, the EU remains the biggest single trade partner for most under-developing economies. For example, Togo, Somalia, Tanzania, and the Arab Spring. Despite its relative advantage has been falling in current times. Exports shares to Brazil, Russia, India as well China have move up in current years.
-The research examined that the Euro area crisis would result in poorer remittances and exports and capital inflows to South Asia.
-States where remittances represent a huge share of GDP-such as East Salvador, Jaimaica, Honduras, Guayana, Nicaragua, Haiti and Guatemala could be highly vulnerable and a serious risk from a sluggish growth across the EU.
-Human Capital Indicators: States with a high degree of poverty which comes under external pressure shock is likely to experience threshold effects and may have a low level of resilience provided limited human capital and capacity to adapt. Most significantly, states with high degrees of poverty may be struck by an exogenous shock that leads to an economic slow-down, experience further rise in those levels of poverty that is unacceptable from a human welfare perspective.
-Remittances and receipts are serious stimulants for growth within the economies from Philippines to the small island economies. These flows and tourist arrivals could slow due to the weak labour markets and developments in EU.
-Government Indicators: As the experience within the global financial turmoil pinpoints, the general degree of transparency within economies to trade as well as finance may mean not only that they are highly exposed to world shocks but also which they have small level of resistance for the reason of shocks that is likely to transfer with instant effect with small in a way of intermediary. This is unless, of course, structures are made in a manner to be capable to stick swiftly to adverse external circumstances.
Indicators' regarding the ability to adapt to a trade or financial shock and to mitigate it is likely to involve investment environment indicators.

Results and Discussions

Table 1: Trade in Service (% of GDP)

	2005	2006	2007	2008	2009	2010
Less developed countries	13.4	13.6	14.1	15.3	14.0	-
Low Income	13.1	13.7	14.1	14.6	13.1	-
Lower middle Income	13.8	13.8	13.5	14.7	12.6	12.3
Lower middle Income	9.9	9.7	9.7	9.8	9.0	8.3
Middle Income	9.8	9.7	9.6	9.7	9.0	8.3
Sub-Saharan Africa	12.5	13.2	14.1	14.6	13.6	11.2

Source: World Bank, World Development Indicators

The study reveals that Trade in Services encompasses huge share of GDP for LDCs-the highest within the state groups as outlines in the Table 4. The underlying services encompass tourism, which occupies the highest proportion of aggregate exports for LICs as reflected in Table 2.

Table 2: International Tourism receipts (% of total exports, goods & services).

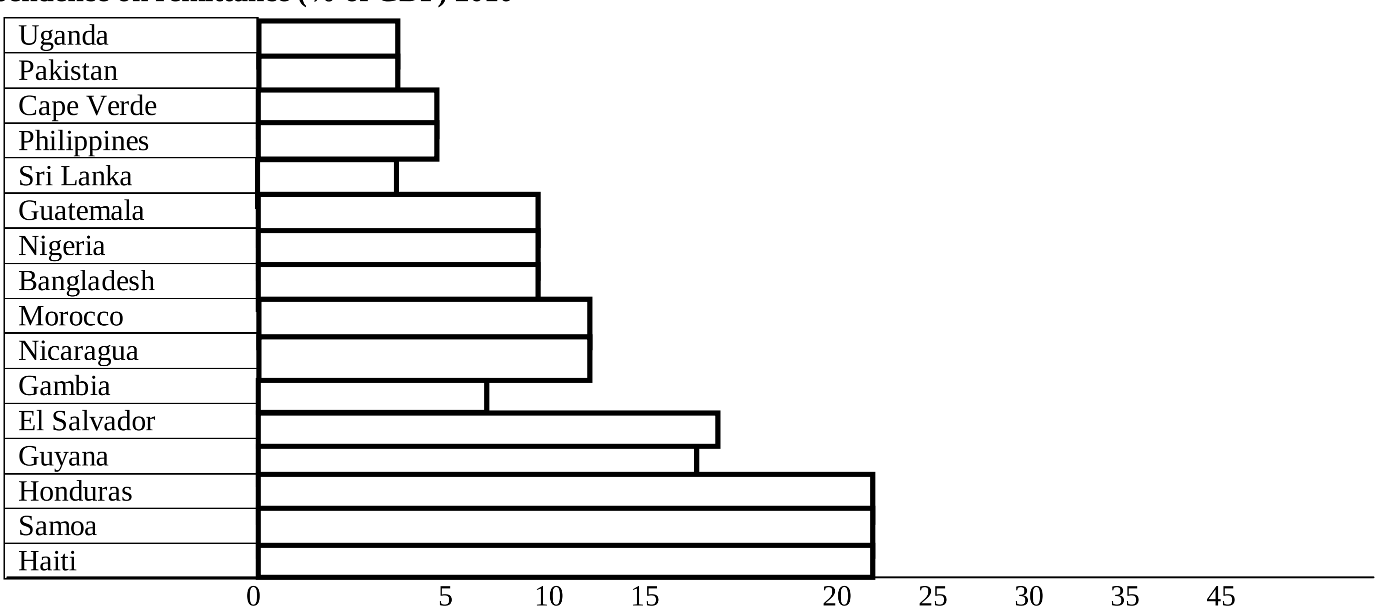
	2005	2006	2007	2008	2009	2010
Less-developed countries	6.7	5.7	6.6	6.5	7.2	5.5
Low Income	12.0	11.3	11.3	13.5	13.8	7.6
Lower mid Income 6.9	6.7	6.7	7.0	7.2	5.3	
Low &Middle Income	6.3	5.9	5.9	5.9	6.3	5.0
Middle Income6.3	5.9	5.9	5.8	6.2	4.9	
Sub Saharan Africa	7.7	7.4	7.4	7.4	7.6	6.9

Source: World Bank, World Development Indicators (2011).

Dependence of remittances

Employee's remittances include the biggest proportion GDP for LICs, as demonstrated in Table 3

Dependence on remittance (% of GDP) 2010



Source (World Bank, Development Indicators)

The table presents some of the states for which data are at disposal and most highly dependent on remittances. As the case may be in these countries for instance, Cape Verde, the Gambia, the Philippines, and Nigeria, the EU is seen as major source of these remittances. This therefore stands to reason that under-developing states are especially prone to the slow-down which was the result of the Euro 2009 meltdown and financial crisis.

Table 4: Workers remittances & Compensation of employees, received (% of GDP)

	2005	2006	2007	2008	2009	2010
Less developed Countries	5.4	5.8	6.0	5.3	6.5	6.4
Low Income	5.4	6.6	7.3	8.1	7.9	8.4
Lower Middle Income	4.1	4.1	4.2	4.4	4.3	3.9
Low & Middle Income	2.0	2.0	2.0	1.9	1.9	1.7
Middle Income	1.9	1.9	1.9	1.8	1.8	1.6
Sub-Saharan Africa	1.6	1.9	2.3	2.3	2.5	2.2

Source: World Bank, World Development Indicators

According to the World Bank (2012a), in respect of share of GDP, Cape Verde, Senegal and Guinea Bissau are the most dependent nation in SSA on remittances movements from the highest spread euro area nations and are therefore certainly to highly weak as demonstrated in the EU. The World Bank's report further states that: -A broadening of the euro area turmoil would result in fragile worker remittances. Thus exports as well as capital inflows.

-States where remittances represent a huge proportion of GDP for instance El Salvador, Jamaica, Honduras, Guayana, Nicaragua, Italy and Guatemala Despite a transparency of an imperfect proxy, they offer some sort of symbols of the capacity of a nation to continue driving investment even in the face of global shocks.

There are issues related to government effectiveness, such as the World Bank's governance indicators, May further offer an indication concerning institutional capacity to adapt to a chosen shock. A key variable to be taken into account when assessing the exposure of poor countries to global shocks such as the euro zone crisis is their dependence on FDI. Indeed, countries and groups of countries heavily dependent on FDI are more exposed to a sudden contraction in or interruption of such flows.

Dependence on FDI can be measured by the ratio between a country's FDI inflows and its GDP. It shows that among the different groups of developing countries considered in this study, small island developing states (SIDS) are the most exposed to possible FDI shocks due to the crisis in the euro area, with inward FDI accounting for about 9% of their GDP in 2010. LDCs and commodity dependent developing countries (CDDCs) follow, with FDI inflows representing in both cases a 6%share of GDP over the same year. Note that compared to 2007, the year before the outbreak of the global financial crisis, in 2010 both LDCs and CDDCs were in a slightly worse situation being more exposed to possible FDI shocks. The exposure of SIDS and LMICs diminished between 2007 and 2010, but it is still particularly high for SIDS.

Possible Implications If the Dollar Is Dethroned

In current years, external central banks have been funded by accumulation of dollar reserves can increasingly lead to a portion for instance the US current account deficit, as compared to the initial years, when the capital inflows emerged from the private sector. However, the US cannot necessarily depend on the backing of foreign central banks indefinitely. One motive for this, which sustains despite China and other oil exporters persistently to absorb their currencies undervalued, is that they can change their currency holdings in replacement of the dollars, without necessarily permitting appreciation on a traded-weighted basis. The argument raised is that there is currently prevailing, a credible competitor in terms of lead international reserve currency, the euro that has many of the desirable features in respect of the international currency.

It is real that each Asian central bank represents to lose considerably, in the value of its recent holdings, if dollar sales precipitate a dollar crash. However we accept with Barry Eichengreen (2005) that each individual participant will accept it stands to lose greatly if it holds .It suffice to say that if the US is depending on the economic interests of other states, it is not in the position to count on being rescued out indefinitely. Economic fundamentals have influenced the path of the D-E rate, especially after the creation of the single currency on Jan 1, 1999. What are the implications of this finding for the design of the Euro exchange rate mechanism and, in general, for the international role of the Euro? Before answering this question, we briefly outline the advances the Euro has made in the international monetary system.

The internationalization of the Euro can be approached from the alternative perspectives of the private and the official uses of the currency. First, the Euro has been used increasingly by private agents across the world, especially in international debt and bank transactions. The share of Euro-denominated debt has kept pace with the growth of debt markets while USD-denominated debt has contracted. The share of Euro-denominated bonds issued by non-residents has increased from less than 20 per cent prior to the launch of the Euro9to more than 30 per cent by mid-2003. 10 Meanwhile, the Bank of International Settlements (2003) estimates that total Euro-denominated cross-border claims of banks have increased by approximately 75 per cent between 2001 and 2003 while the corresponding dollar-denominated claims remained nearly constant. The modest abatement in the private use of the Euro as vehicle currency may reflect the fact that intra-European trade no longer requires the use of a vehicle currency.

- Secondly, the US dollar has remained the principal reserve currency since the advent of the Euro. It accounted, in 2002, for 70 and 60 per cent of total reserves held by developed and developing countries, respectively. However, indications of a compositional change in the reserve portfolios of developing countries in favour of the Euro are already evident. Click (2006) shows that at the end of 2004 the Euro accounted for about one-third of total foreign reserves of East Asian countries, and that this ratio is increasing. Nearly 50% of flow changes, i.e. of the stock increase of international reserves, in the region consist of Euro since 1999. This portfolio substitution is quantitatively significant because developing countries are the majority holders of international reserves. It should also be noted that the retention of U.S. dollar-denominated reserve holdings may reflect more on the increasing international indebtedness of the U.S. and the exchange rate objectives of the rest of the world than on underlying portfolio preferences. Central banks, especially in Asia, may have sought to prevent appreciation of their domestic currencies against the dollar in order to protect their US export markets. Progressive exploitation of the export opportunities afforded by the Euro area is likely to erode the pivotal trade role of the USD and change the portfolio preferences of central bankers in favour of other currencies including the Euro.

Another possible explanation of the relative prominence of US dollar reserves is that the creation of the Euro has obviated the need for European countries to hold reserves of the former European national currencies. Lastly, the Euro is catching up with the U.S. dollar as the popular international currency anchor. Further expansion of the EU is likely to consolidate the position of the Euro as prospective member countries seek to enhance their financial credentials by pegging to the Euro.

In short, the Euro has made significant headway as an international currency since its recent creation. As illustrated by the past experience of the Japanese Yen and German Mark, sustained stability of the exchange rate and a sound domestic economy can greatly promote the internationalization of a currency. Our hybrid monetary model indicates a co integration relationship between the D-E rate and economic fundamentals with a prominent role for the money supply and interest rates. Hence, our results imply that the ECB can influence the D-E rate by adjusting money supply or changing interest rates. While observers generally agree that the ECB should treat exchange rates with benign neglect. The fact remains that the Bank should monitor exchange rate developments. Persistent deviation of the exchange rate from its long-run equilibrium is likely to affect adversely the economic performance of the Euro area and the credibility of the ECB, with prejudicial consequences for the international role of the Euro.

However, in reality, the ECB has been pursuing a “two-pillar” strategy to achieve its primary task of keeping the inflation rate below 2 per cent per annum. The first pillar represents setting a fixed monetary growth rate and the second pillar refers to a broad assessment of other variables which the ECB deems significant. This approach presents significant challenges. Specific monetary growth targets may be incompatible with the optimal conduct of monetary policy (De Grauwe, 2002 and Fritz, 2002).

At the same time, the pursuit of internal price stability clearly constrains opportunities for active exchange rate management. Therefore, it would be a remarkable achievement for European monetary authority to implement well-designed policies aiming at strong economic growth and moderate inflation within Euro land without compromising the stability of Dollar/Euro exchange rate.

Conclusion

This study sets out to track the evolution of the Dollar/Euro exchange rate and the implications of the advent of the Euro currency for monetary policy in the Euro area and for international monetary arrangements. The key motivation of this exercise is to test the traditional monetary model of exchange rate determination in the novel setting by the launch of the Euro. We employ the hybrid monetary model to examine the evolution of the D-E rate using co integration and ECM techniques. Our results indicate that the D-E rate is co integrated with fundamental economic variables, interfering not to reject the conjecture that movements in the D-E rate conform to the generic characteristics of the hybrid monetary model.

In addition, our results reveal that both short-run (price stickiness) and long-run (secular growth) fundamentals affect the exchange rate path and our findings support a relatively broad-based policy approach to promote collective economic interest of the EU-zone. To the extent that such policies succeed in strengthening and stabilizing the Euro-zone economy, these policies are likely to buttress and possibly accelerate the internationalization of the Euro.

The Euro has been playing an increasingly important role in the global monetary system displacing. This may be an immediate consequence of the greater integration of financial markets in the Euro area following the adoption of the single currency. Since this institutional change is unlikely to be unwound, the Euro may well consolidate its prominent position in the financing area. In a parallel development, public use of the Euro has expanded as developing countries progressively diversify their portfolios to increase the share of Euros in their currency reserves. At the same time, we find that the Euro has yet to rival the Dollar in other functions. This persistence conforms to the stylized fact that the structure of international currencies tends to resist change unless dramatic shocks shake the existing system.

Finally, economic considerations influence the shape of the evolution of the international role of the Euro. Political developments in the Euro area and in the U.S. may well carry potentially important consequences for their international roles. For example, Rogoff (2005) noted that “the euro has taken on a political role in European economic integration far beyond its economic role”. Eichengreen (2005) also hinted at the crucial importance of political integration within Europe for the advancement of the Euro currency. Lastly, albeit observing uniform monetary policy, EU countries can, contingent on economic status, pursue their own specific fiscal policies which may affect the effectiveness of common monetary policies. Therefore, further consolidation and expansion of the international role of the Euro largely hinges on the successful reconciliation of common monetary policy and diverse fiscal policies of the EU countries.

The euro rival the US currency cannot be attainable. The dollar has far bigger size in respect of global finance as shown easily by the operation of the economy. The long run jump trajectory in respect of the euro role’s in global finance will greatly emerged from the costs to the US of the euro rivaling the dollar seemed too tiny thus ,in other sectors such as representation of the euro in international forums, there are some elements of benefits and costs to the US. Most striking and significantly, the adoption of the euro implies that the US fiscal ill-minded financial regulatory remedies in America markets will have greater and increasing negative impact than in a situation of lack of realistic rival currency adopted.

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