

Prospects for the Euro: A Role For China and India

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In this paper, an attempt is made to evaluate the prospects of the Euro challenging the current dominant position of the dollar as the world's leading currency. This is done by identifying the factors which lie behind central bank decisions to hold reserves of major currencies. Thus, the determinants of central bank reserve holdings are analyzed for pre-Euro and post-Euro periods. It is expected that developments in major Asian countries will possess greater clout in determining currency relationships in the future. So, the relative world shares of trade and income of Asia, along with other real economic as well as financial variables and oil market developments are used in the estimation process. Different simulations are undertaken to trace possible future scenarios for the euro and the dollar. The simulations indicate that a rise in emerging Asian market share of world output will work towards preserving dollar dominance.

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