On January 1, 1999, countries participating in the European Monetary Union will irrevocably link their currencies as a prelude to adopting a single currency, the Euro, in 2002. Many analysts wonder if the Euro will diminish the dollar’s role as an international currency—one held and used by nonresidents.

Although the U.S. and Europe account for roughly the same shares of global output and exports, the dollar is now the preeminent international currency. The integration of European markets probably will reduce the dollar’s role, but the International Monetary Fund expects any change to be modest relative to total U.S. international assets and liabilities ($3.35 trillion and $4.13 trillion, respectively, at the end of 1996).

A currency’s international usefulness depends primarily on the stability of its purchasing power. Although price stability is the European Central Bank’s key policy objective, Europe’s inflation rate has typically exceeded ours. Economic growth, a broad proxy for the expected real return on investments, is similar in the U.S. and Europe. Global investors’ concern about our country’s growing international indebtedness, however, could eventually prompt a dollar depreciation.