

**TARGETED CONSULTATION
OF THE EUROPEAN COMMISSION
ON THE ROLE OF THE EURO
IN THE FIELD OF ENERGY**

AMAFI Contribution

Association française des marchés financiers (AMAFI) is the trade organisation working at national, European and international levels to represent financial market participants in France. It acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located. AMAFI's members operate for their own account or for clients in different segments, particularly organised and over-the-counter markets for equities, fixed-income products and derivatives, including commodities.

The organisation of the commodities market is an important topic for AMAFI's members, which in this area, include investment banks, investment firms as well as corporate actors in the energy industry. AMAFI welcomes the three consultations issued by the Commission on the role of the euro in the fields of energy, agricultural and food commodities, and raw materials.

With respect to this consultation, AMAFI has chosen to respond to the paper providing the more open questions for a trade association. However, the Association would like to outline the following general points before answering to specific questions raised in the Consultation Paper. Those points are relevant for the three different fields subject to consultation, and offer a more global vision representing AMAFI's position on the international role of the euro.

GENERAL COMMENTS

AMAFI has identified a number of difficulties challenging the use of the euro by market operators.

The prominent use of the US dollar:

The transactions between European companies take place on global markets involving a wide range of participants from across the world. Therefore, most of the important actors in heavy global industries would rather deal with their counterparts using only one currency, than manage different payment currencies. The aircraft industry is an example of a global market where the main actors use mostly the dollar for their trades, mainly due to the wide-spread use of the dollar by their business counterparts and clients. The use of the US dollar is also the default choice for ship operators who face costs mainly denominated in US dollar.

Well established benchmarks:

The US dollar stands out as the dominant reference in a multitude of global commodity markets. In the energy markets, the Brent and the WTI, two US dollar denominated benchmarks, are dominating the oil pricing mechanisms worldwide.

The interdependence of supply chains:

The use of the euro in a particular sector should be analysed from a larger perspective, that of the entire supply chain. As stated above, ship operators face a significant part of the costs linked to their activity in US dollar. This may contribute to explain the use of the US dollar as the invoice currency. This element might also be a contributing factor to its use by the main European aircraft manufacturer as the invoice currency. The denomination of some cost items in euro can be leveraged in order to create a virtuous circle, encouraging shifts in practice, in a strategic sector for the competitiveness of the European Union. Taking maximum advantage of the cost approach requires going upstream of the supply chain, which is why a part of the strategy should include focusing efforts on the creation of new benchmarks on some raw materials. This can be observed in the Chinese strategy regarding metals, with the creation of benchmarks on base metals.

In addition, the currency of denomination of revenues can be an important factor for the choice of the invoice currency by a company, as it is the case for airline companies.

Currency hedging:

The markets for currency couples that include the euro are liquid, which means currency hedging costs are relatively low, and should not constitute a strong incentive for market operators to change their practice. However, the maturity of the transactions can determine the strategic interest of the use of the euro. The stake is higher for project finance operations, characterised with longer maturities, and requiring the use of the euro in order to improve the financing conditions offered by European banks.

Consumption basins:

Consumption basins can be very important factors to promote the trading of a raw material using a specific currency. The promotion of the Chinese RMB, supported by the creation of a contract on oil indexed on a RMB Benchmark, and more importantly, the creation of a market for metals and minerals in RMB. The important consumption basin of base metals in China (45% of the World consumption) was a key element for the creation of such a market.

✚ Costs associated with a change of the reference currency:

The contracts on energy raw materials provide that the invoice currency is the US dollar. The “repapering” all of those contracts would induce costs for market operators. In addition, Freight contracts and insurances linked to these operations would have to be aligned to the new invoice currency, triggering new operational and hedging costs.

Encouraging the use of the euro in sectors where the euro zone constitutes a sufficient consumption or production basin

✚ Reinforcing the success of the gas market:

80% of the gas import in the EU are billed based on the TTF, a euro denominated index. The large consumption basin, the existence of a euro denominated benchmark, the regional specificity of the market, the development of delivery facilities and the creation of futures and forwards linked to the physical market.

This market can still be expanded in some member states (South-eastern Europe) that still use US dollar denominated indexes on oil. This could increase the liquidity levels in the market, and would involve a higher level of integration for transportation and storage systems. More effort can be done as well in order to encourage operators in the euro zone to denominate their gas-related finance project operations in euros. The costs associated with the gas imports would then be indexed on the euro as well.

✚ Encouraging the imports of refined products in euro

The imports of refined products are soaring in the EU, led by the refineries closures in the Union and their expansion in oil-producing countries. Although these products have a large basin of consumption in Europe and are used in numerous sectors, there is no prominent benchmark for trading them. The creation of euro-based benchmarks based on the example of the TTF for natural gas could be studied.

✚ Studying the failure of the cocoa contract:

The CME launched a cocoa contract with a euro denominated index in 2016, and ceased offering it a year later. This situation is curious considering that the EU is an important cocoa importer, and that Côte d’Ivoire sells its production in CFA franc, indexed on the euro. This failure shows that the existence of an important consumption or production basin is not the only condition necessary to expand the use of the euro in a given sector.

Additional macroeconomic tools are necessary

On a more general scale, a prominent international role for the euro also depends on the macroeconomic tools put in place by the authorities. The independence of the European Central Bank and the introduction of a common framework in charge of insolvency management are good indicators of the stability of the currency and its issuer. However, the tools at the disposal of the European Central Bank can seem limited when compared to those of the United States Federal Reserve, notably regarding fiscal measures necessary to balance the monetary effort put in place in order to support the macroeconomic aggregates. More efforts should also be put in place to pursue a deeper integration of the capital markets, with the objective of fostering the liquidity.

The emergence of a euro denominated secure asset capable of providing a benchmark for international investors regarding their other euro denominated investments, will require a deep reform of the euro zone, notably on the fiscal matters.

However, the diffusion of euro denominated assets could gain from a clear-cut development of the European capital markets, and the advent of a current account deficit in the euro zone. The current surplus situation due to the abundance of domestic savings creates a crowding-out effect, leaving little space for substantial foreign investments.

Last but not least, the display of a clear political will to incite operators to the use of the euro is also necessary, at least for activities in which there is a clear path to improvement (gas, cocoa contracts, refined products...).

RESPONSES TO THE EUROPEAN COMMISSION QUESTIONS

Wider use of the euro in energy-related transactions of European market participants

Point 4 of the Recommendation reads as follows: “Member States should encourage and facilitate a wider use of the euro by European market participants in transactions in the field of energy”.

What would be the key concrete measures through which the Member States could encourage and facilitate a wider use of the euro by European market participants in transactions in the field of energy?

The imports of refined products are soaring in the EU, led by the refineries closures in the Union and their expansion in oil-producing countries. Although these products have a large basin of consumption in Europe and are used in numerous sectors, there is no prominent benchmark for trading them. The creation of euro-based benchmarks based on the example of the TTF for natural gas could be studied. The use of the euro for the payment of the imports of refined products should also be encouraged.

What could be done to maximise the opportunities stemming from Member States encouraging and facilitating a wider use of the euro by European market participants in transactions in the field of energy?

AMAFI has no specific input to provide on this issue.

If Member States encourage and facilitate a wider use of the euro by European market participants in transactions in the field of energy, what would be the challenges?

AMAFI has no specific input to provide on this issue.

What should be the concrete measures to overcome these challenges?

AMAFI has no specific input to provide on this issue.

Point 7 of the Recommendation reads as follows: “Market participants should facilitate the emergence of and promote liquid gas hubs in the EU, with prices for underlying and derived products denominated in euro, to support the wider use of hub-indexed prices and, as a consequence, the denomination of such contracts in euro”.

What could be done to maximise the opportunities stemming from the market participants promoting gas hubs and euro-denominated prices?

The large use of the TTF index could help promote further use of the euro in gas contracts. A local index could be considered in order to expand the market to some South-eastern member states that are still using dollar-denominated prices based on oil benchmarks. This could increase the liquidity levels in the market, and would involve a higher level of integration for transportation and storage systems.

What are the challenges of market participants facilitating gas hub pricing and euro denominated contracts?

AMAFI has no specific input to provide on this issue.

What should be the concrete measures to overcome these challenges?

AMAFI has no specific input to provide on this issue.

To help in establishing a euro-denominated benchmark in the globalising gas market, please propose concrete set of measures:

at European level:

AMAFI has no specific input to provide on this issue.

at Member States' level

AMAFI has no specific input to provide on this issue.

at price-reporting agencies level

AMAFI has no specific input to provide on this issue.

What are the specific gas-related challenges to overcome to extend the role of the euro globally in gas exploration and production, supply agreements, infrastructure projects and transportation?

AMAFI has no specific input to provide on this issue.

What could be the specific gas-related incentives to extend the role of the euro globally in gas exploration and production, supply agreements, infrastructure projects and transportation?

AMAFI has no specific input to provide on this issue.

Wider use of the euro for energy related projects and transactions by companies providing financial services

Point 10 of the Recommendation reads as follows: *"Member States and European companies providing financial services should encourage a wider use of the euro for energy related projects and financial transactions."*

To encourage a wider use of the euro for energy related projects and financial transactions, please propose concrete set of measures and/or tools:

at European level

AMAFI has no specific input to provide on this issue.

at Member States' level

AMAFI has no specific input to provide on this issue.

at European companies providing financial services level

One of the measures could be to encourage the euro zone operators to denominate and fund their gas-related investments in euro. The costs associated with the gas imports could be indexed to the euro. Those include transportation costs and operating costs of the gas fields.

What could be done to maximise the opportunities stemming from Member States and European companies providing financial services encouraging a wider use of the euro for energy related projects and financial transactions?

AMAFI has no specific input to provide on this issue.

If Member States and European companies providing financial services encourage a wider use of the euro for energy related projects and financial transactions, what would be the challenges?

AMAFI has no specific input to provide on this issue.

What would be the concrete measures to overcome these challenges?

AMAFI has no specific input to provide on this issue.

What are the main challenges to overcome to extend euro-denominated financing to investment projects along the entire value chain of oil and natural gas?

The main challenges are the propensity of global industries such as shipbuilding and aircraft to use a unique currency, avoiding managing multiple currencies. The currency of reference in this case, is the dollar, since it is the main currency used by these companies to deal with their suppliers. Tankers for example, are subject to important fuel costs, denominated in US dollar.

What could be the incentives to extend euro-denominated financing to investment projects along the entire value chain of oil and natural gas?

AMAFI has no specific input to provide on this issue.

