

The international role of the dollar

The U.S. dollar is considered by many to be the world's preeminent currency: heavy use of the dollar extends far beyond the Nation's borders, making it crucial to international finance and trade. However, since the emergence of the euro in 1999, a large number of commentators have questioned the future of the dollar in such a role. One of these people is economist Linda Goldberg, who asks, "Is the International Role of the Dollar Changing?" (Federal Reserve Bank of New York, *Current Issues in Economics and Finance*, January 2010).

As a relatively stable currency, the dollar serves as a reliable store of value in many countries, especially those countries where the local currency is inflating rapidly. Approximately 65 percent of all U.S. banknotes are in circulation outside the Nation. The United States also benefits from the international role of the dollar, which decreases transaction costs in international finance and trade and aids in insulating the U.S. economy from foreign shocks.

Another sign of the dollar's prominence is that, as of 2007, there are 7 countries that are dollarized or have established currency boards that use the dollar and 89 countries that have a fixed exchange rate with the dollar. In addition, dollars play a role in 86 percent of foreign exchange transactions. Higher transaction volumes lead to lower bid-ask spreads, which reinforces the attractiveness of the dollar in the foreign exchange markets. The dollar is also the currency most commonly used for the invoices of exports in international trade, especially for oil and other commodities. Furthermore, 39 percent of all outstanding

debt securities throughout the world are denominated in dollars. The dollar's share of debt in 1999—42 percent—was only slightly higher.

Goldberg believes that, because of inertia and other factors, the dollar will continue to be the most dominant currency in the world for at least the near future. The recent financial crisis caused a global shortage of dollars, but the situation has since improved. The euro undoubtedly is one of the world's leading currencies, but it has not made many inroads beyond Europe. Nevertheless, the author emphasizes that it certainly appears possible for the dollar to lose its spot at number one sometime further in the future, especially when one considers that the dollar surpassed the pound sterling as the dominant reserve currency during the first half of the 20th century.

Gas prices' effects on the automobile market

The price of gasoline can have a significant effect on the total cost of owning and operating a vehicle. Economists Meghan R. Busse, Christopher R. Knittel, and Florian Zettelmeyer analyze how changes in gas prices affect the selling prices and market shares of new and used vehicles in their working paper titled "Pain at the Pump: The Differential Effect of Gasoline Prices on New and Used Automobile Markets" (NBER Working Paper 15590, December 2009). The results of the study offer insight into consumers' reactions to changes in fuel prices.

The research shows that, when the price of gasoline increased by \$1, the least fuel-efficient quartile of the market for used automobiles suffered a 5-percent decrease in market share.

The same \$1 price increase resulted in a 7-percent increase in market share for the most fuel-efficient quartile of used cars. The market for new vehicles showed a greater response to the price change. The research shows that the \$1 price increase elevated the market share of new vehicles in the upper quartile of fuel efficiency by 20 percent and decreased the market share of new vehicles in the least fuel-efficient quartile by 24 percent.

The study also includes data on the changes in market share for different classes of vehicles in response to a \$1 change in gas prices. The market shares for compact cars, midsize cars, and sporty cars increased by 24.1 percent, 7.9 percent, and 5.5 percent, respectively. The market shares of the larger and less fuel-efficient vehicles decreased as follows: SUVs, by 13.9 percent; pickups, by 11.2 percent; vans, by 10.3 percent; and luxury cars, by 4.0 percent.

New cars in the most fuel-efficient quartile received a relative price increase of \$363 per \$1 rise in gasoline prices. Used cars in the most fuel-efficient quartile had a relative price increase of \$2,839 per \$1 rise in gas prices. The researchers discuss potential explanations as to why there is a seemingly large gap between these figures.

The sample used in this study is made up of sales from car dealerships that sold both new and used vehicles, and it covers about 20 percent of all dealerships in the United States. The data were collected from September 1999 through June 2008. In the study, fuel efficiency was determined by the Environmental Protection Agency's Combined Fuel Economy rating for each vehicle. Gasoline prices were collected for over 15,000 ZIP codes throughout the United States. □