

One Currency, Many Debts: Europe's Fiscal Fragmentation and the Limits of the Euro's Power

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On September 17, 2026, the European Commission announced that it would push for EU-issued bonds to be included in international sovereign bond indexes, arguing that their current exclusion limits demand and liquidity as safe assets (Reuters, 2026a). The move comes at a moment when some of the foundations of the dollar's safe-haven status are facing renewed scrutiny. In August, the dollar fell to a three-month low against the euro as concerns grew over the U.S. Treasury's plans to expand buy-backs of longer-dated government debt, while long-term Treasury yields continued to rise (Sasha S., 2026).

As some of the traditional foundations of dollar dominance face greater scrutiny, Europe is attempting to strengthen the international role of its own currency. However, the euro faces a structural problem. Unlike the

United States, the euro area has a common monetary policy but no single fiscal authority or comparable common pool of sovereign debt. The question, therefore, is whether Europe has the institutional capacity to turn a more fragmented international monetary system into an opportunity for the euro. The importance of this development goes beyond bond-market classification. A currency's international role depends not only on the size and stability of its issuing economy, but also on the availability of deep, liquid and trusted assets denominated in that currency. The United States has long benefited from the scale and liquidity of the Treasury market. Europe, by contrast, has a collection of national sovereign debt markets alongside a much smaller pool of common EU debt. Therefore, the Commission's push to elevate EU bonds points directly toward one of the central constraints on the euro's internationalisation. Europe does have a common currency, but not a fully common fiscal asset.

Safe Assets as a Foundation for Currency Power

Reserve currency status is not simply a reward for economic size; it is supported by the supply of assets that global investors can hold with confidence. Central banks and institutional investors need a liquid, low-risk place to park reserves, and a currency's international appeal depends in part on the depth of that pool. The European Central Bank has made this connection explicit, arguing that global safe assets should be highly liquid and retain their value during periods of market stress (Lane, 2026). Judged by that standard, the euro area's structure remains a poor fit. The German Bund functions as the main de facto euro-denominated safe asset because it is the highest-rated national bond among the large economies in the euro area, but its outstanding stock is small relative to the size of the euro area and the global financial system to satisfy global demand for euro-denominated safe assets (Lane, 2026). This shortfall is measurable. Estimates from 2019 put the supply of euro area sovereign bonds rated AA or higher at only 37% of aggregate EU GDP, compared with 89% of GDP for US government bonds (Gossé & Mourjane, 2021). The gap has persisted despite more than a decade of reform. The euro area's national bond markets have become more integrated since the sovereign debt crisis, but the remaining scope for relative price movements between them means the overall stock of national bonds still does not provide safe-asset services to the same extent as a single Treasury market (Lane, 2026). Proposals to close the gap without full joint liability, such as sovereign-bond-backed securities (SBBs) or ESBies, have circulated for years as alternative ways to create a euro-area safe asset (Leandro & Zettelmeyer, 2018).

An Opportunity Created by Dollar Uncertainty?

The structural case for a European safe asset has existed for over a decade, but what makes the present moment different is not that the dollar has suddenly ceased to be dominant. Rather, some of the assumptions underpinning that dominance are facing greater scrutiny. In August, the dollar fell to a three-month low against the euro as investors responded to concerns surrounding the U.S. Treasury's plans to expand buybacks of longer-dated debt. The 30-year Treasury yield had reached its highest level since 2007, while investors were also focused on the deteriorating U.S. fiscal outlook, heavy government debt issuance and uncertainty surrounding the Federal Reserve's policy path (Yahoo Finance, 2026).

The broader picture is more nuanced. The ECB's 2026 assessment found that the international role of the euro increased moderately in 2025, with the euro's share across a broad set of indicators reaching around 20%. The euro's share of global foreign-exchange reserves remained broadly stable, while international euro-denominated debt issuance reached its highest level since the introduction of the single currency (European Central Bank, 2026). At the same time, the ECB identified geopolitical fragmentation as a challenge to the international monetary system and documented episodes

in which the euro acted as a safe-haven currency during periods of market stress in 2025 and early 2026 (European Central Bank, 2026). This suggests that the international monetary system is becoming more fragmented and that Europe has an opportunity to strengthen the euro's role within that changing environment.

Why Scale Has Not Converted into Shares

The dollar's share of global reserves has declined from its historical peak, yet the euro has captured only a limited portion of the broader diversification away from the dollar. The euro nevertheless remains the world's second most important international currency, accounting for around 20% across the ECB's broad set of indicators (European Central Bank, 2026). Economic scale, therefore, creates potential but does not automatically translate into international monetary power. The euro area has the economic weight and financial markets to support a larger international role, but international investors also need assets capable of absorbing large-scale global demand. This points back to the fragmented supply of the underlying asset. The problem is not simply that Europe lacks government debt; it is that this debt is divided among multiple national issuers rather than concentrated in a single common market. The Commission's own common-debt instrument illustrates the point. EU bonds, used to fund NextGenerationEU, SAFE, and other common European programmes, had grown to roughly €800 billion in outstanding amounts by September 2026 (Reuters, 2026a). The European Commission now argues that these bonds should receive greater recognition in international sovereign-bond indexes, which could support demand and liquidity (Reuters, 2026a). Yet the fact that Europe is seeking greater recognition for a common EU bond market illustrates the underlying institutional gap. Europe has created a common pool of debt, but it remains much smaller than the US Treasury market and does not yet perform all of the functions of a unified sovereign benchmark. Similarly, the ECB argues that the existing supply of common EU debt remains insufficient to provide the scale and liquidity associated with a fully developed safe asset (Lane, 2026).

The deeper issue is therefore institutional. The euro area has a single monetary authority, the ECB, but multiple fiscal authorities issuing separate sovereign debt, with no equivalent of the US Treasury standing behind a single, unified European yield curve. At the same time, Europe has demonstrated that some common fiscal instruments are possible. The European Commission's funding plans show that EU-level borrowing continues on a substantial scale, including financing for NextGenerationEU, SAFE, and support for Ukraine (European Commission, 2026). The European Stability Mechanism also provides financial assistance to euro-area countries facing severe financing problems and forms part of the euro area's crisis-

management architecture (European Stability Mechanism, 2026). The question is whether these instruments could evolve into a sufficiently large and permanent layer of common fiscal capacity to support the euro's international role.

Why This Constraint Is More Costly Now

None of this is new. The euro area has confronted the safe-asset shortfall since the sovereign debt crisis of 2010–2013, when differences between national government bonds exposed the risks created by a monetary union without a single fiscal authority (van Riet, 2021). But the cost of leaving the constraint unaddressed may be changing. In a stable dollar-dominant system, the absence of a competitive euro safe asset represented a missed opportunity; in a more fragmented international monetary system, it could limit Europe's ability to capture new demand for alternatives to the dollar. The ECB itself has identified an opening for the euro to strengthen its global role as geopolitical and monetary fragmentation increases. It has also been argued that joint financing of public goods could help establish a larger pool of safe, liquid EU public debt, while deeper, more integrated capital markets could reinforce the euro's global appeal (European Central Bank, 2026; Lane, 2026). If international investors are increasingly willing to diversify their portfolios, Europe has an opportunity to attract a larger share of that demand. Nevertheless, doing so requires the financial infrastructure to absorb it.

Is Functional Integration Enough?

The European Commission's September 2026 initiative may offer an indication of what such an approach could look like. Its push to have EU-issued bonds included in international sovereign-bond indexes points towards a more targeted form of integration: building common fiscal instruments where their absence limits the international role of the euro. With roughly €800 billion of EU bonds already outstanding, Europe is not starting from scratch (Reuters, 2026a). The question is whether this emerging pool of common debt can become sufficiently large, permanent and liquid to perform some of the functions currently associated with national sovereign debt markets. This raises a more fundamental question: how much fiscal integration is actually needed? There is potentially a middle ground in which Europe builds common fiscal capacity for specific functions, such as providing safe assets, financing collective European priorities and supporting the financial system during major crises, while leaving most taxation, spending and national debt decisions at the national level. However, this middle ground would not be sufficient. A larger common bond market could address one of the euro's most visible structural weaknesses, but a truly global currency may require more than an expanded supply of

safe assets. It may also require permanent crisis-financing mechanisms, deeper capital-market integration and a clearer fiscal backstop capable of supporting the euro during severe financial or geopolitical stress.

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