

Safe haven status and international shock transmission

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What are the macro-financial implications of a potential shift in safe haven status from the United States to the euro area (EA)? Utilizing a two-block DSGE model, we find that a safe haven status of the EA mitigates the impact of flight-to-safety shocks on domestic aggregate demand and financial conditions but exacerbates them for production. Following the US tariff announcements on April 2, 2025, the EA's safe-haven status likely had a sizeable effect on the transmission of the shock. However, in a crisis with a relatively smaller international flight to safety, such as during the 2008-09 financial crisis, the impact of a European safe haven status would be limited.

Flight to safety was important element both after April 2, 2025, and the financial crisis

Periods of heightened global uncertainty often trigger a flight to safety, where investors reallocate capital towards assets and currencies perceived as safe havens. Historically, the US dollar and US treasuries have often taken on this role, appreciating in value and experiencing a drop in yields during financial stress. However, recent events, particularly following the US tariff announcements on April 2, 2025, have revealed atypical market reactions. During this period, the euro appreciated against the US dollar, while US treasury yields rose and yields on EA government bonds declined, suggesting a potential shift of the safe haven status towards the EA.

In this paper, we analyze the macro-financial impact of being a safe haven for the transmission of international shocks. In a medium sized two-country open-economy DSGE model calibrated to the US and the EA, we look at two historical episodes: The aftermath of the tariff announcements on April 2, 2025, and the global financial crisis 2008-09, in which flight to safety played an important role (Kekre and Lenel, 2024). For both episodes, we simulate a global flight-to-safety shock (Bodenstein et al., 2023), which combines a symmetric demand contraction in both blocks with an international flight into assets from the safe haven. The shock is calibrated to match the observed appreciation of the euro against the US dollar and the changes in sovereign yields in both regions during the two episodes.

Safe haven status cushions shocks with a relatively large international flight to safety

For both the shock on April 2, 2025, and the financial crisis, we consider two scenarios: one in which the EA, rather than the US, takes the role of a safe haven, and one in which US assets retain their traditional safe haven role. We then consider the role of a safe haven status on the shock transmission on European macro-financial variables.

Our simulations yield two central insights. First, a safe haven status mitigates the effects of global flight-to-safety shocks on aggregate demand and financial conditions. However, it amplifies the negative repercussions on production (in line with the empirical evidence in Georgiadis et al. 2024). The reason is that capital inflows into the safe haven lead to a terms of trade appreciation and lower interest rates. This stabilizes financial conditions and shields aggregate demand in the safe haven

(consumption and investment). However, the appreciation of the safe-haven currency makes exports more expensive and thereby reduces production and employment.

Second, the impact of a safe haven status is considerable when the international flight to safety is relatively large (as was the case after the US trade announcements in April 2025). If, in contrast, the symmetric demand contraction dominates (as during the financial crisis of 2008-09), a safe haven status does not have a big effect. In 2008/09, a safe haven status of the EA would not have significantly mitigated the deterioration in consumption, investment, and financial conditions.

Policy implications for the euro area and beyond

The ability of a safe haven status to cushion the effects of international shocks suggests that maintaining and enhancing the euro area's perception as a safe haven could be beneficial for economic and financial stability. However, there are two important caveats. First, our analysis indicates that one needs to be aware of the limitations of safe haven status during crises like the global financial crisis. In such a scenario a safe haven status may only provide limited protection. Second, while the safe haven status of the EA would mitigate the impact of flight-to-safety shocks on aggregate demand and financing conditions, it would likely exacerbate their impact on production as net exports suffer from the exchange rate appreciation. This could prove particularly detrimental to export-oriented economies like Germany.

References

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