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Commentary

By Jamie McGeever

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Column: In global FX reserve battle, dollar to remain above the fray

By [Jamie McGeever](#)

ORLANDO, Fla., June 8 (Reuters) - A recomposition of the \$13 trillion pile of global currency reserves would only tee up a battle for the euro's second place in the rankings rather than threaten the dollar's central role.

That's the view of two of the world's leading experts on FX reserves and global capital flows, Barry Eichengreen and Eswar Prasad, who appeared on a Brookings Institution panel discussion this week entitled: "The future of the U.S. dollar: Are its days as the world's dominant currency numbered?"

The panel agreed that the dollar's FX reserve status is better shielded from the tectonic shifts in global technology, trade, and geopolitics than its leading role as an invoicing currency, medium of exchange, or unit of account.

In short, there is still no viable alternative to U.S. capital markets for reserve managers wanting a safe and liquid home for their country's rainy day funds while scraping a steady and relatively decent rate of return at the same time.

"What we are seeing is the battle for second-place status possibly intensifying while the dollar's role remains dominant," said Cornell University professor Prasad.

"That would be exactly my view," University of California, Berkeley professor Eichengreen told Reuters after the panel, adding that he still expects the dollar's dominance to gradually erode over time. "But change has occurred more slowly than I anticipated."

According to the International Monetary Fund, global FX reserves totaled \$12.9 trillion at the end of last year, of which the currency composition of \$12 trillion was known.

Some 58.8% was in dollars, the lowest share in 20 years and down from around 70% two decades earlier. The euro's share was around 20%, little changed from two decades ago.

10% NON-TRADITIONAL

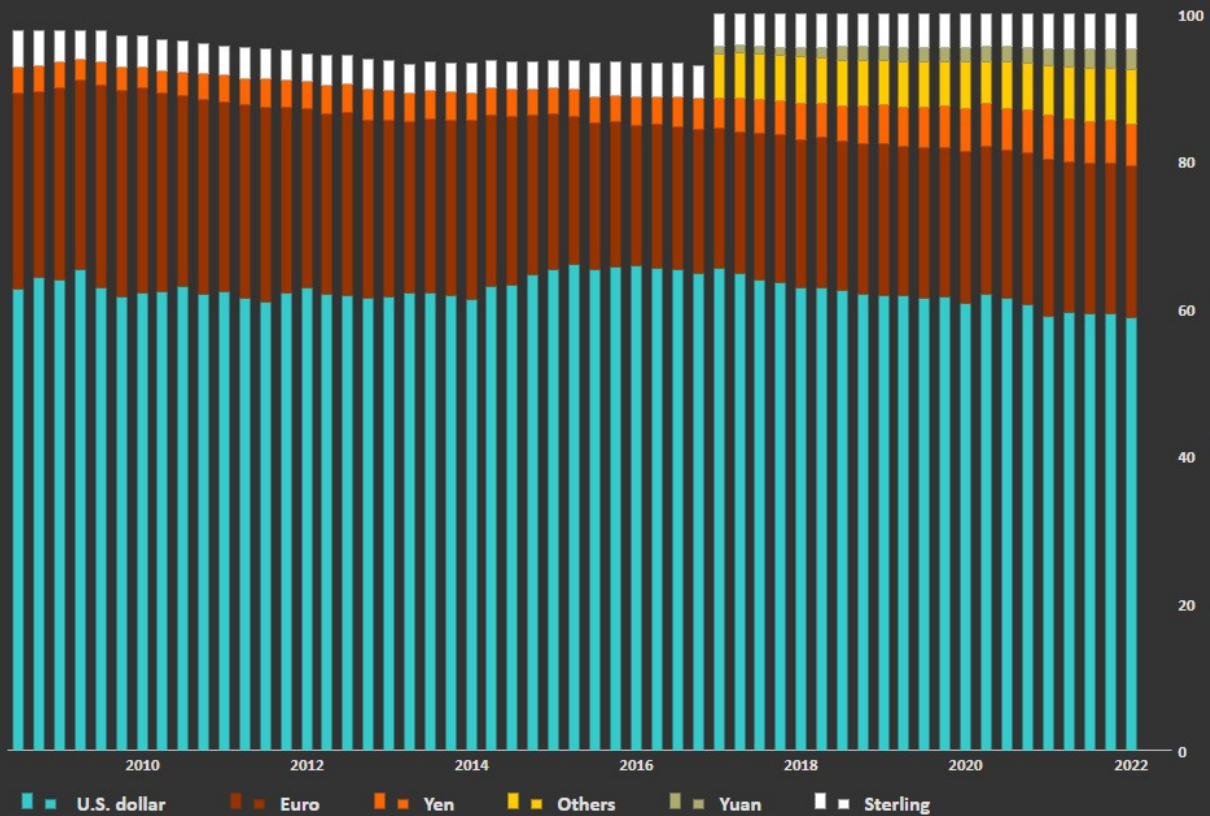
In a co-authored paper in March titled "The Stealth Erosion of Dollar Dominance: Active Diversifiers and the Rise of Nontraditional Reserve Currencies," Eichengreen found that a quarter of the dollar's decline over the past 20 years was to the Chinese renminbi, and three quarters to 'nontraditional' reserve currencies like the Swiss franc, Canadian and Australian dollars, and South Korean won.

Zoom in a little further though, and the data suggests these currencies are now taking share away from the euro more than the dollar.

Consider this. A decade ago the dollar's share of reserves was around 60%, basically the same as last year. The euro's share in 2009 - before the euro crisis and the ECB's negative interest rates and bond-buying stimulus - was a record high 28%

Currency composition of FX reserves

Dollar share of FX reserves fairly steady over last decade ... euro share notably lower



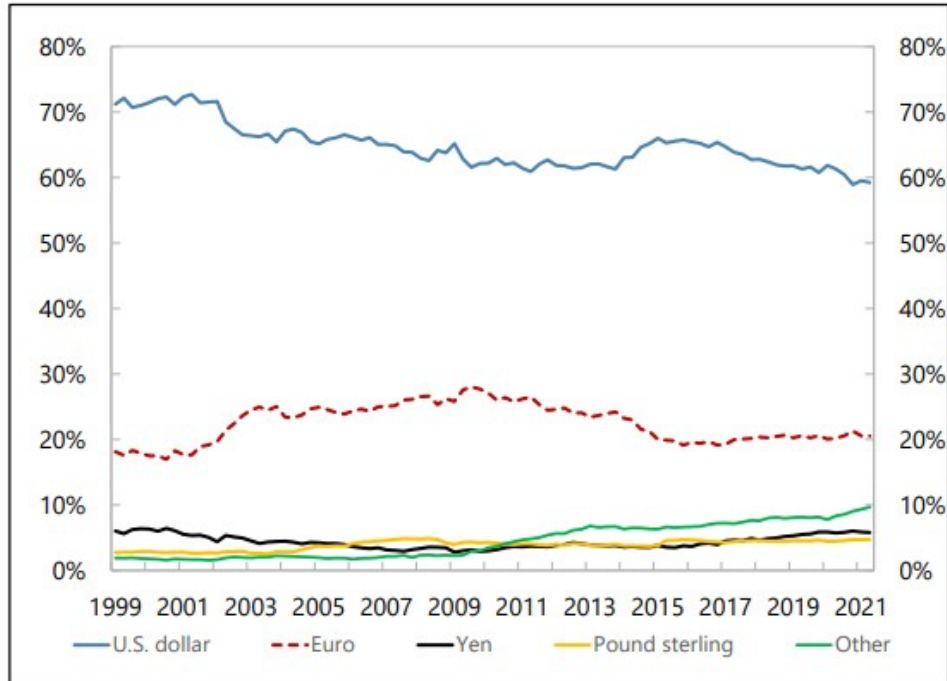
Source: Refinitiv Datastream

Reuters graphic/Saqib Ahmed 08/06/2022 @SaqibReports

The overall share held by 'nontraditional' currencies last year, including the renminbi, was around 10% of global reserves, or \$1.2 trillion. But most that was accumulated over the last decade, a period in which the euro's share fell markedly.

Eichengreen said the rise of these currencies in overall holdings reflects "intelligent portfolio management." Aside from the renminbi, they are attractive from a risk-reward point of view, easily tradable with each other, and their central banks are recipients of dollar swap lines from the U.S. Federal Reserve in times of crisis or emergency.

Figure 1. Currency Composition of Global Foreign Exchange Reserves 1999–2021 (in percent)



Sources: IMF Currency Composition of Official Foreign Exchange Reserves (COFER).

Note: The "other" category contains the Australian dollar, the Canadian dollar, the Chinese renminbi, the Swiss franc and other currencies not separately identified in the COFER survey. China became a COFER reporter between 2015 and 2018.

CHINA – NOWHERE TO RUN

The panel discussion also covered Washington and its allies' freeze on Russia's international reserves, reasons why countries may be wary of increasing their renminbi holdings, and why China may not want the exchange rate appreciation such an inflow would bring.

As ever, what Beijing does or doesn't do with its \$3.2 trillion stash of reserves, an estimated 60% of which is in dollar-denominated assets, sparked intense debate.

Although China and the United States are going through a "slow motion economic divorce," according to panelist Zach Pandl from Goldman Sachs, China is essentially trapped when it comes to its reserves.

Prasad notes that even if China wants to diversify even a fraction of its dollar holdings into the euro, yen, or Swiss franc, the flow would be so big as to prompt an export-damaging appreciation in these currencies.

As the euro zone, Japan, and Switzerland are more open economies than the United States, these central banks would be inclined to buy dollar-denominated FX reserves to ease the upward pressure on their currencies. This would offset China's diversification and dollar reserves could end up rising anyway.

Again, the source of plentiful and liquid safe assets comes back to the United States.

"If you want to look for a place where you can stash away hundreds of billions or trillions of your rainy day reserves, there really isn't much other place to go," Prasad said.