The Dominant Reserve Currency Role of the Dollar: Challenges Ahead

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- Currency dominance has historically been the product of:
  1. geopolitical (military) power
  2. financial dominance (international money market and lending)
  3. capital account openness

- Only UK & US met these criteria. Japan, Germany/EU, Switzerland missed 1 and somewhat 2. China misses 3 and somewhat 2.

- Yet, possible to be 2nd or a regional dominant currency without meeting all these criteria (Germany-France end of 19th, Sterling post 1945, euro)
- Several important reserves currency are possible

- Are current shifts in geopolitics, international financial markets and digital money going to change the balance of reserves currency?
- Is the domination of the dollar threatened?
- Responses can only be highly prospective…

- 3 main arguments:

- Some features of early 21st century (1998-2010) has been exceptionally supportive for the dollar as a reserve currency. This might change.

  [ongoing work with CEPII]

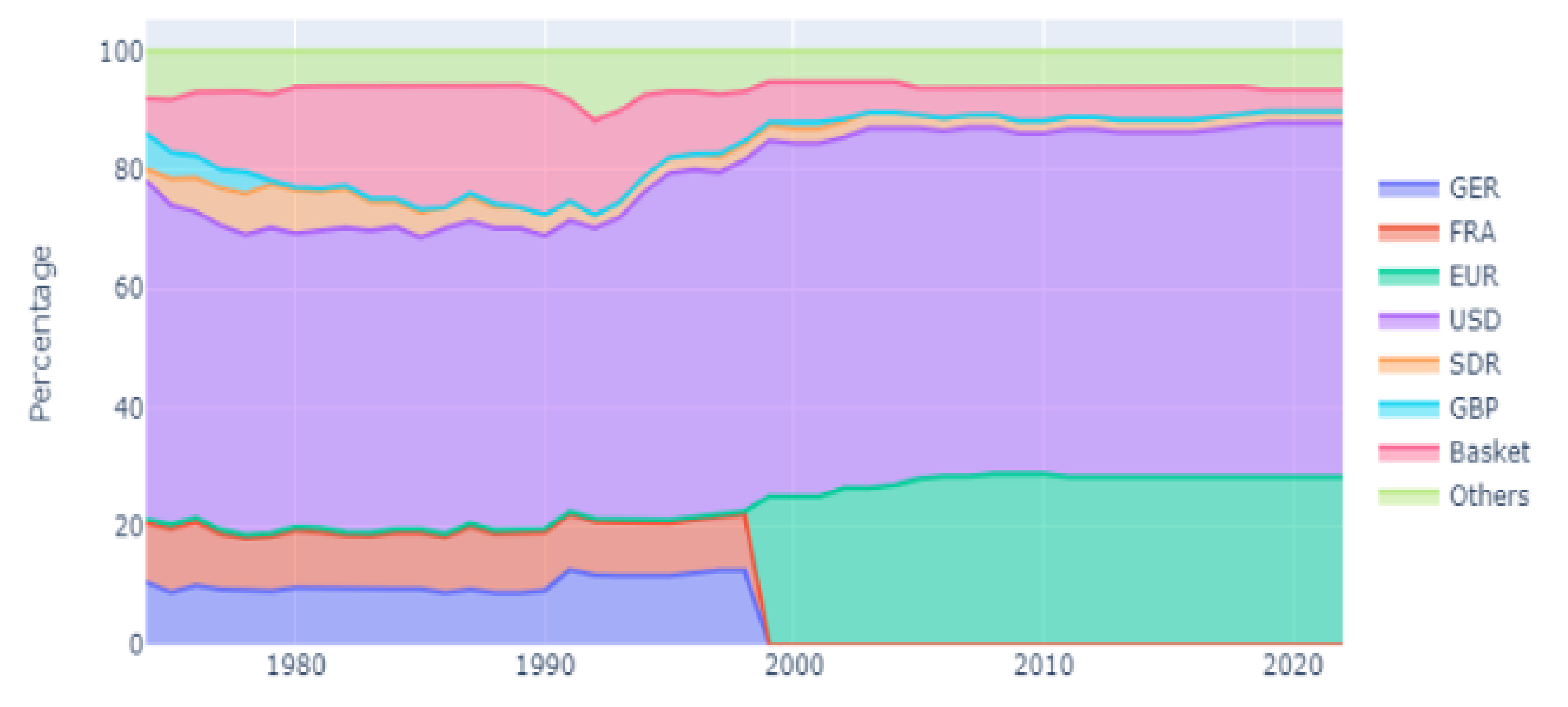
- Possible to become a substantial reserve currency without full current convertibility but requires reserves in dominant currency

  Eichengreen, B., Macaire, C., Mehl, A., Monnet, E., & Naef, A. (2024). "Currency internationalization with Chinese characteristics: Is capital-account convertibility required for the renminbi to acquire reserve-currency status?" *International Finance*, 27(2), 102-128.

- Current US strategy to promote dollar-pegged stablecoins is a potential game changer (without historical equivalent). Other countries might respond by organizing payment multilateralim

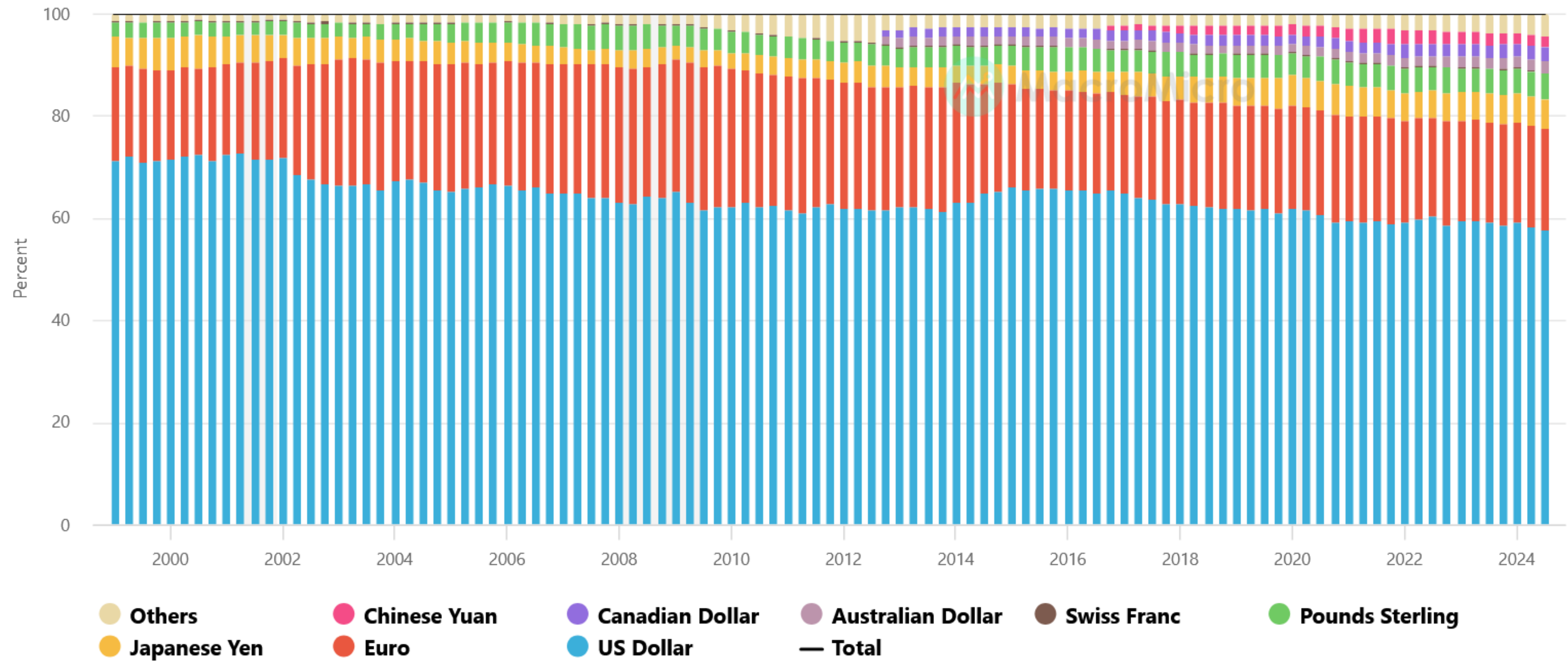
  Klooster van 't, J. , Martino, E., Monnet, E. Cryptomercantilism vs. Monetary Sovereignty. Dealing with the Challenge of US Stablecoins for the EU, European Parliament, 17 June 2025

Pegs to key currencies



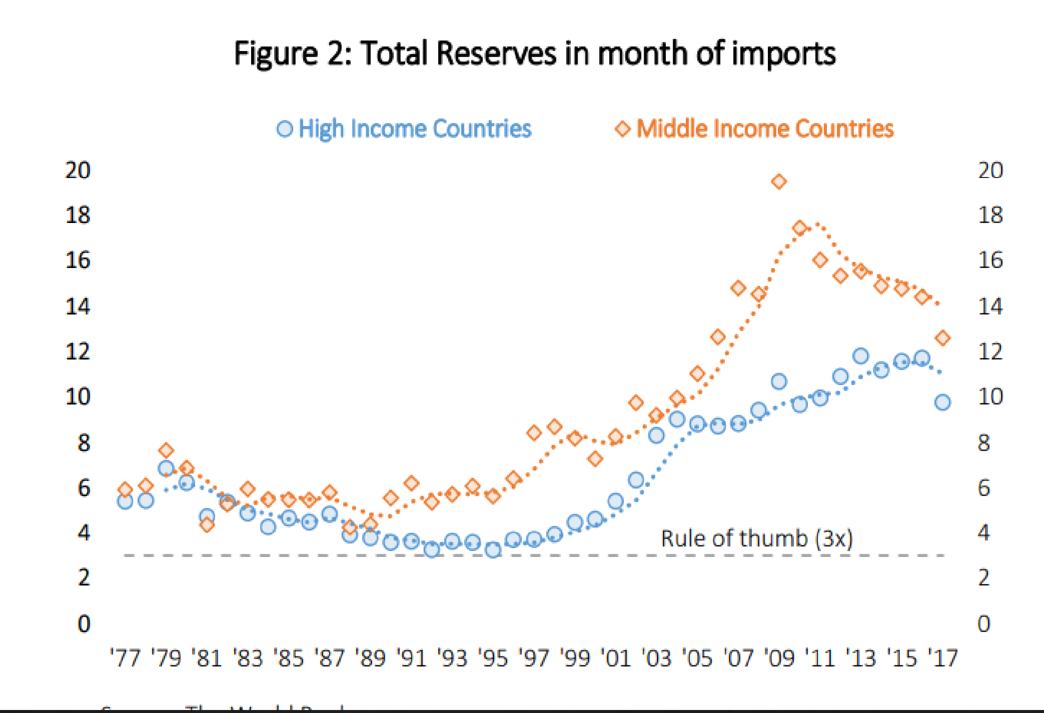
Source: Grekou, Mignon 2025

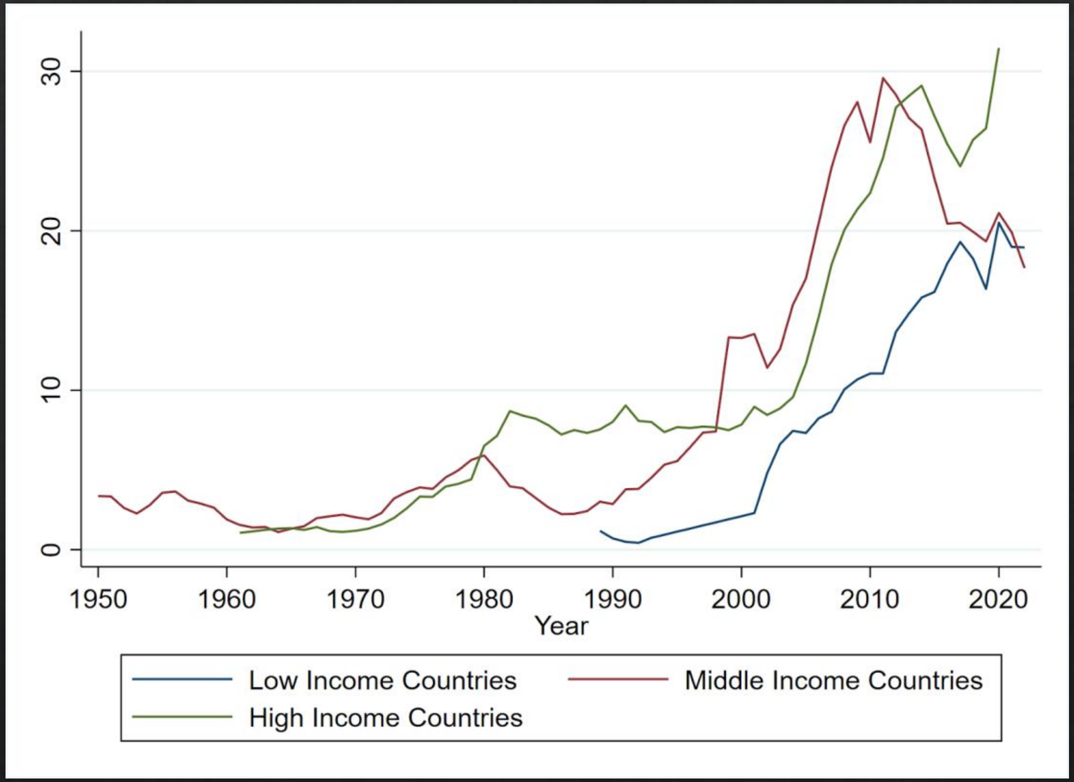
Official Reserves. Currency denomination



Source: IMF

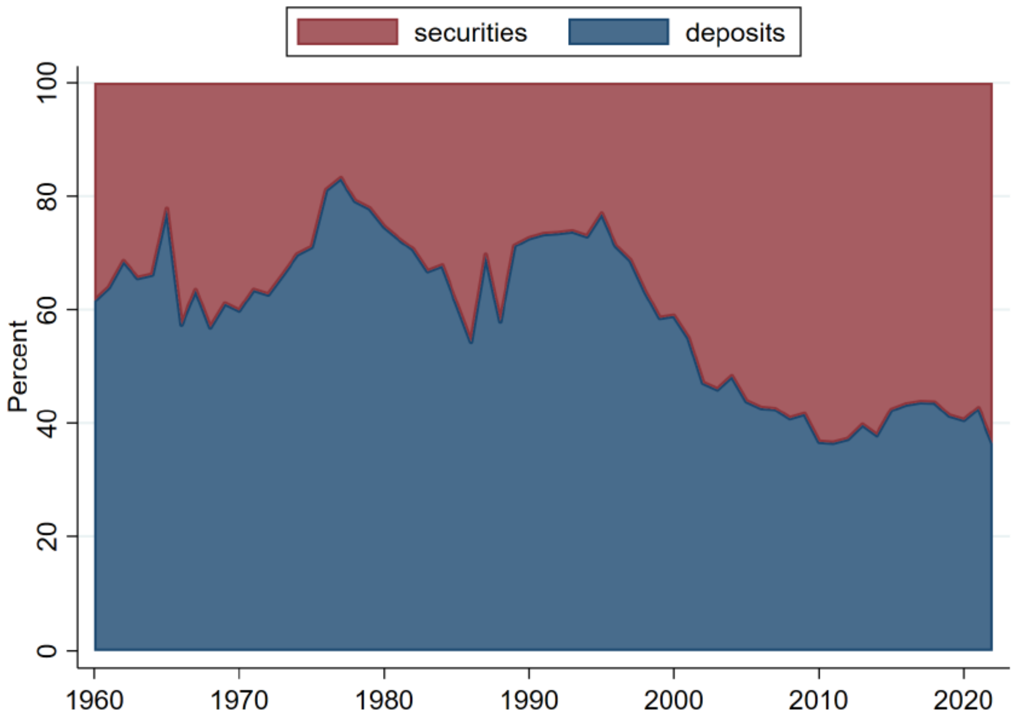
2000-2010: The exceptional rise in demand for official reserves



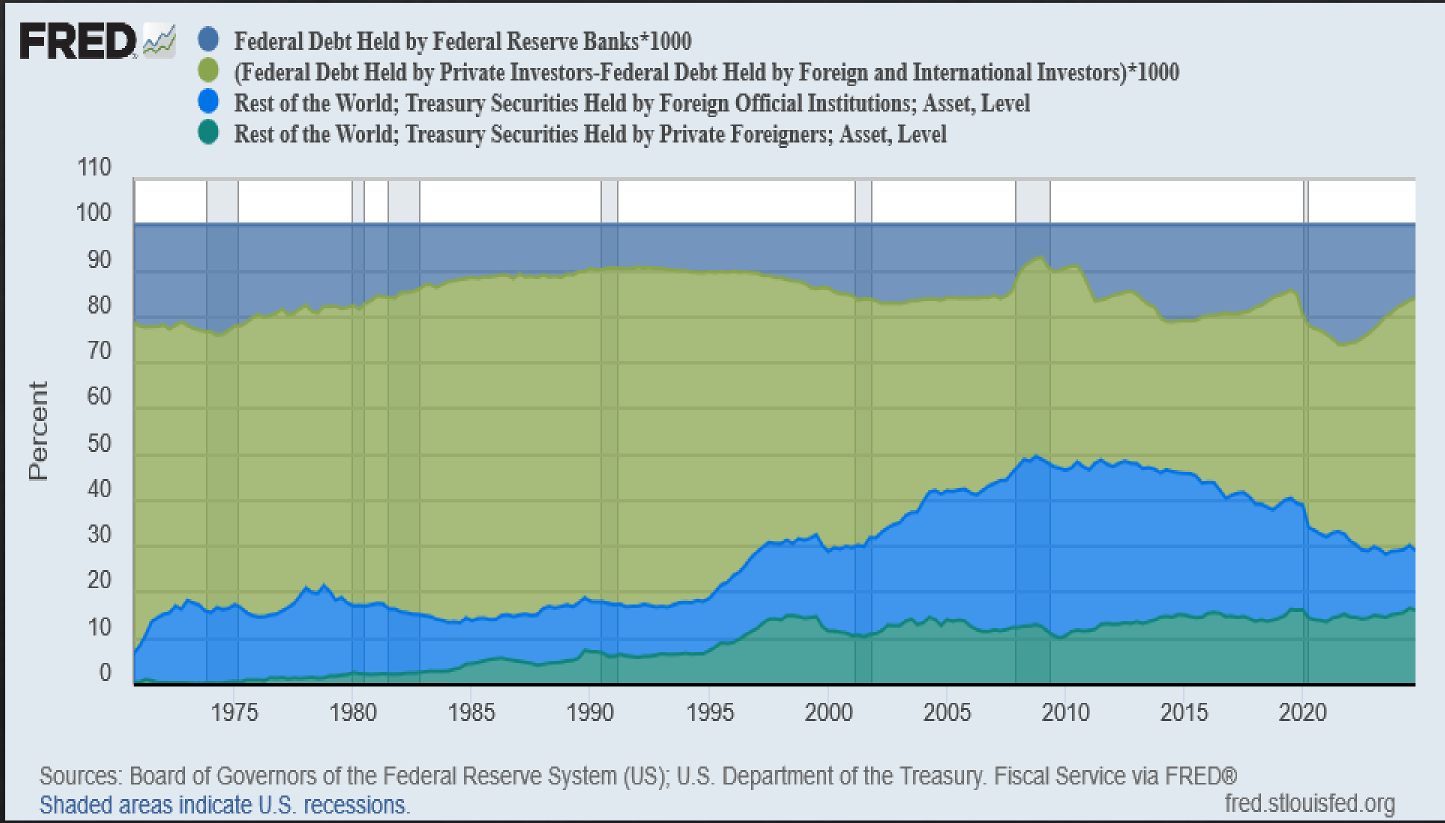


2000-2010: The exceptional rise in official demand for FX securities

Figure 2: Composition of foreign exchange reserves (1960-2022)



2000-2010: The exceptional share of foreign holding of US public debt



Foreign Portfolio Holdings of U.S. Debt Securities as of June 30, 2024 (in millions of USD)

Type	Category	Total	Treasury	Agency	Corporate
Long-Term	Total	12,981,891	7,099,652	1,326,966	4,555,273
	Official	4,362,248	3,557,744	592,113	212,391
Short-Term	Total	1,318,890	1,099,813	6,611	212,466
	Official	274,441	265,665	–	849

Table – Major Foreign Holders of Treasury Securities (Jan. 2025)

Country/Region	Amount (in billion USD)
China (mainland + Hong Kong)	1016.7
Japan	1079.3
Asia (largest holders)	2981.9
EU	1558.2
EU + UK + Switzerland + Norway	2772.6
Total	**8526.4**
of which official FX reserves	*3810.6*

- Current context (last 10 years) less favorable to rely on FX reserves for financing of large US debt
  - Might explain some recent US positions
- But might not imply a fall in share of USD as reserve currency
- Competitors?
- US policy to counteract this trend?

International Finance

ORIGINAL ARTICLE

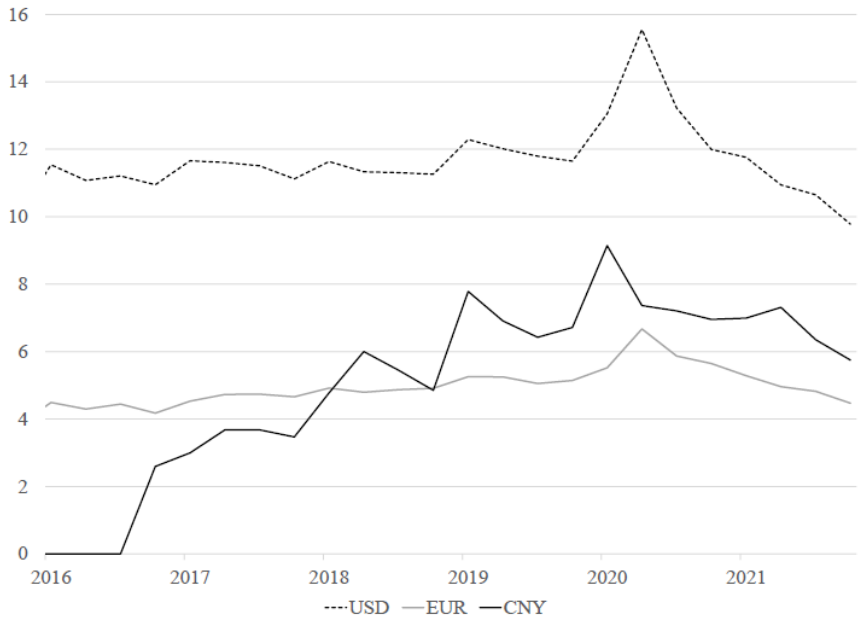
Currency internationalization with Chinese characteristics: Is capital-account convertibility required for the renminbi to acquire reserve-currency status?

Barry Eichengreen, Camille Macaire, Arnaud Mehl, Eric Monnet, Alain Naef

First published: 07 July 2024 | https://doi.org/10.1111/infi.12447 |

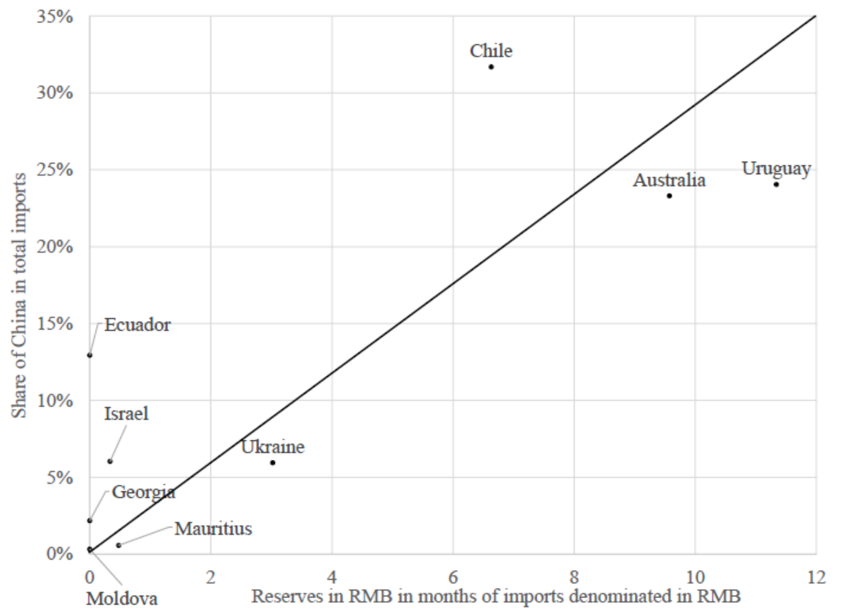
Relative to trade invoicing, RMB performs not so bad as a reserve currency

Figure 10. Reserves to imports ratio – Global estimates by currency
(as a percentage)



Sources: IMF, national sources, and authors' calculations

Figure 11. Reserve to imports coverage – Country-level evidence
(y-axis: as a percentage; x-axis: months)

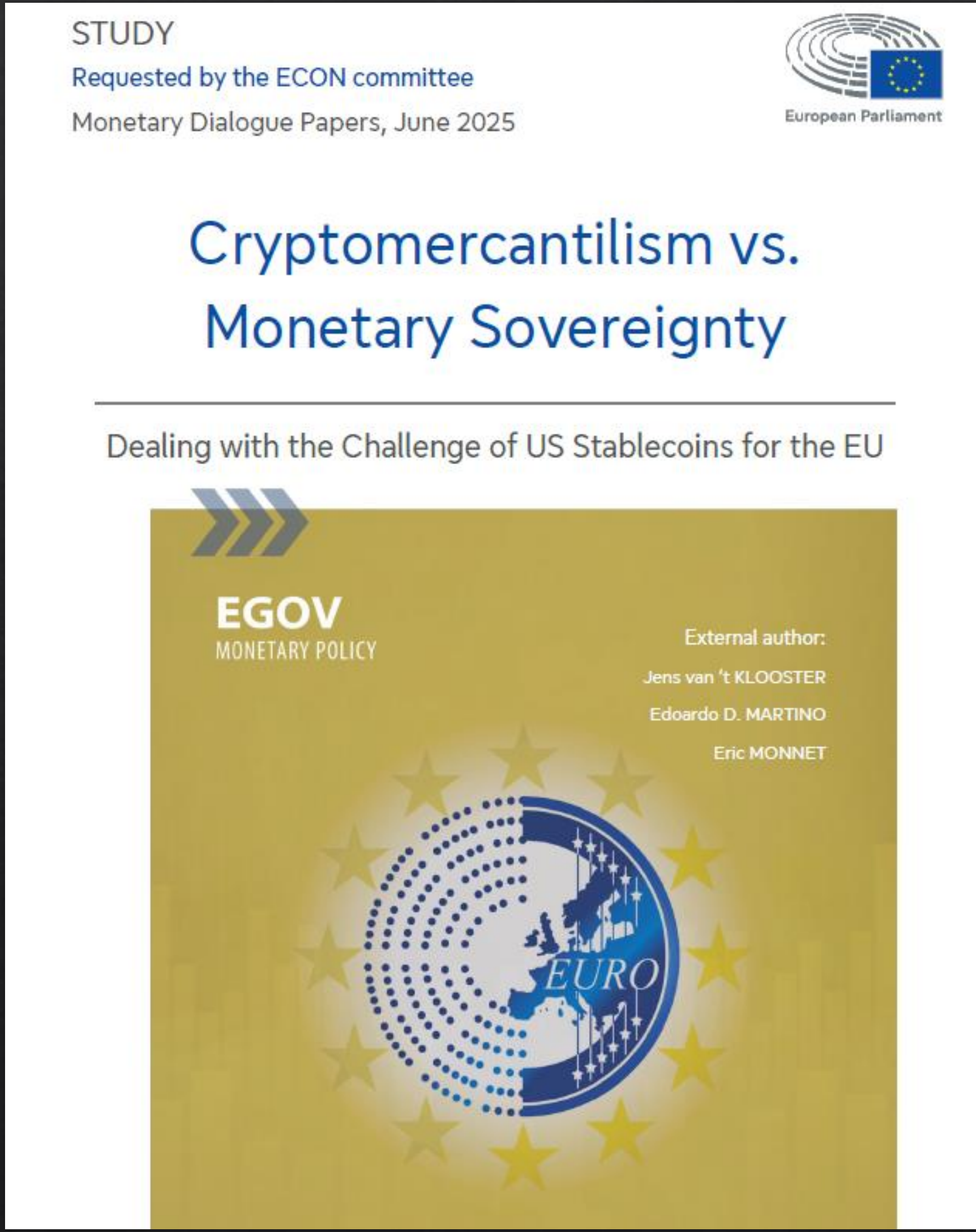


Sources: Boz et al. (2022), IMF DOTS

- Possible to be a reserve currency (not the dominant) without full CA convertibility if
  - Bilateral ways to provide currency to foreign countries (swap lines, loans)
  - Other countries themselves have capital controls (especially FX controls)
  - Hold sufficient reserves to intervene on FX markets or exchange against dominant currency upon request.   USD for RMB today. Gold for USD under Bretton Woods. Gold & USD for Sterling under Bretton Woods

US Policy

- Strengthen official USD holding through bilateral agreements
- Or
- Find an alternative demand for US debt


STUDY
Requested by the ECON committee
Monetary Dialogue Papers, June 2025

European Parliament

Cryptomercantilism vs. Monetary Sovereignty

Dealing with the Challenge of US Stablecoins for the EU

EGOV
MONETARY POLICY

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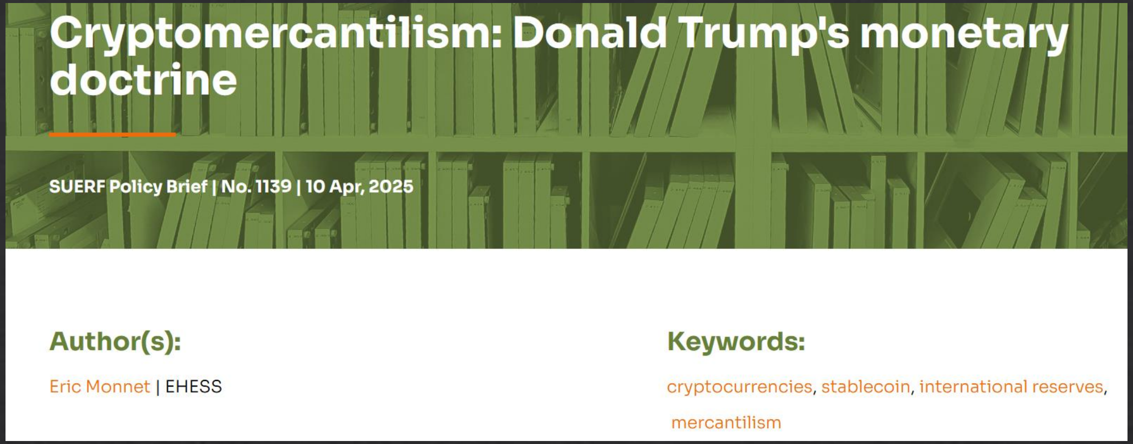
Cryptomercantilism: Donald Trump's monetary doctrine

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Author(s):
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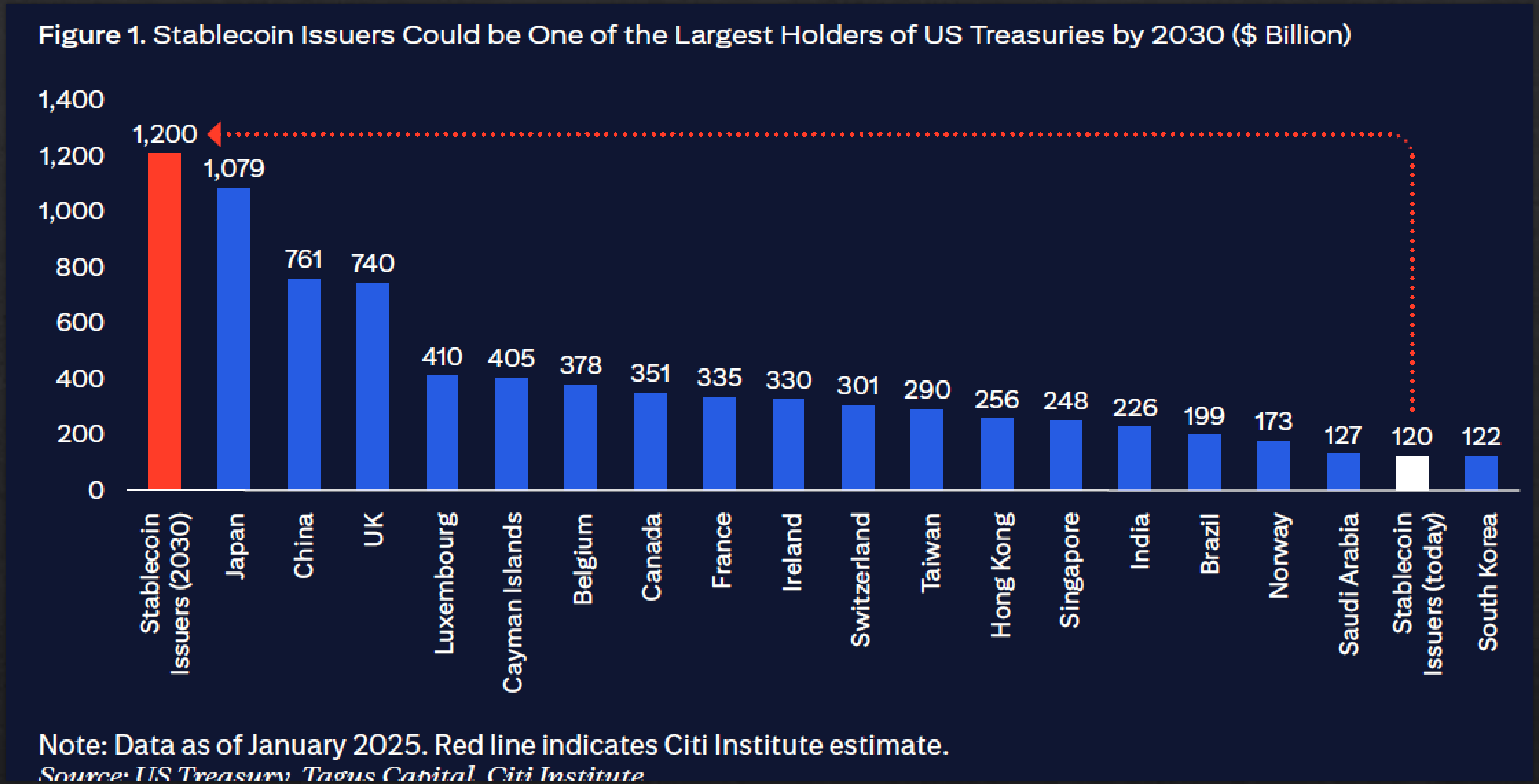
Keywords:
cryptocurrencies, stablecoin, international reserves, mercantilism

23 January 2025, the United States (US) President signed an executive order calling for "actions to promote the development and growth of lawful and legitimate dollar-backed stablecoins worldwide".

A few weeks later (March 6), Treasury Secretary Scott Bessent stated that "we are going to keep the US the dominant reserve currency in the world, and we will use stablecoins to do that".



Citibank, Digital Dollars

- Dollar-pegged stablecoins raise three types of potential risks for the EU.

1. financial stability risks either through redemption risk if the assets of stablecoin issuers are not properly regulated, or by increasing the risk of bank runs if stablecoins suddenly attract bank deposits. Common to all stablecoins (Gorton et al 2023).

2. digital dollarization of the euro-area > exchange rate risks + constrain monetary policy.

3. if dollar-pegged stablecoins circulate widely in the world, this could limit monetary sovereignty in third countries (economic trade partners to the EU) and conflict with the recently restated objective of a greater international role or the euro (Lagarde 2025).

How to assess these risks?

- Legal analysis. Difference between MiCAR (EU) and proposed GENIUS Act (US)
- Both the EU and US mandate a 1-1 redemption at par in off-chain assets and prohibit stablecoins from being interest bearing
- EU: special regime for significant issuers vs. US: one size fits all
- EU: 30% of the reserve assets are always deposited in a bank account while the rest can only be invested in 'highly liquid financial instruments vs US: wide range of potential reserve assets
- US: the Secretary of the Treasury can take ad hoc decisions to authorise a foreign issuer; can enter into agreements with other jurisdictions to facilitate international transactions and the interoperability with United States dollar-denominated payment stablecoins issued overseas. Vs EU: none
- ECB can ask the EBA (binding opinion) to stop issuance of non-euro denominated stablecoins

- In highly bancarized societies with stable currency, stablecoins are a limited threat:
    - If every euro-area citizen holds EUR 1,000 stablecoins > EUR 382 billion
    - EUR 5,173.6 billion in overnight deposits and EUR 2,304.2 billion in short-term deposits
    - Digital euro might compete
- ECB has the power to avoid circulation of dollar-pegged stablecoins

- Different in countries with
    - Low financial inclusion
    - Unstable currencies (inflation)
    - High level of remittances
    - Easy access to digital payments (phone, social networks)

  >> these countries may bear the financial risk of stablecoin + digital dollarization, while strengthening the dominance of USD through stablecoin reserves

- Either competition of stablecoins (euro vs USD etc.)

- Or promotion of payment multilateralism between CBDC & fast payment systems (Pix)

- Interoperability requires information sharing, consistent communication standards, and regulatory approaches to facilitate cross-border payments (BIS, 2022; Aurazo et al. 2024, Reslow et al. 2024).

Conclusion

- Recent US promotion of stablecoins as a way to (partly) replace falling demand of official reserves held in USD

- Unprecedented potential change for the international monetary system. Usual reasonings don’t apply

- Digital dollarization through private money (stablecoin) or payment multilateralism to safeguard monetary sovereignty