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RESERVE CURRENCY RELATIONSHIPS, MYTHS, AND REALITIES

The Euro and the Dollar and the Crisis Beyond
Federal Reserve Bank of Dallas
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ROLE OF RESERVE CURRENCIES

Foreign official claims on the United States at $3.9 trillion at the end of 2008 were only 19 % of total US external liabilities of $20.8 trillion. (At least 10% of official claims are **not** reserve holdings.)

A conservative estimate is that 15 % of total international dollar-denominated assets consist of foreign exchange reserves.

The same is probably true of the euro.

Conclusion: The international financial system is not the same as the international monetary system.

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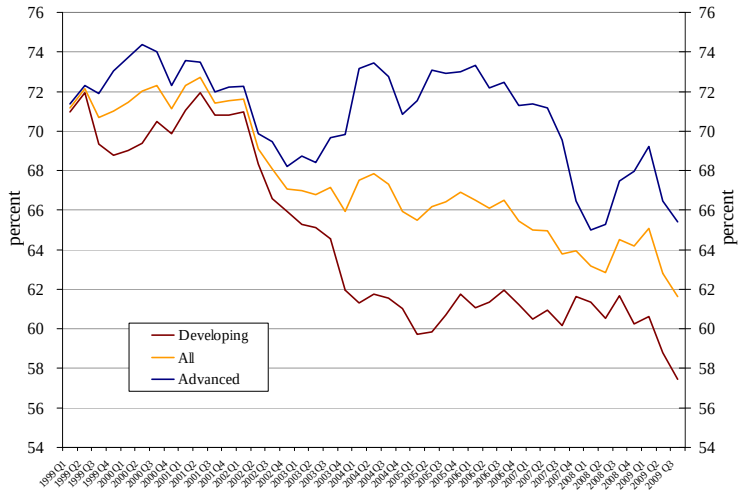
DOLLAR VALUE SHARE OF RESERVES



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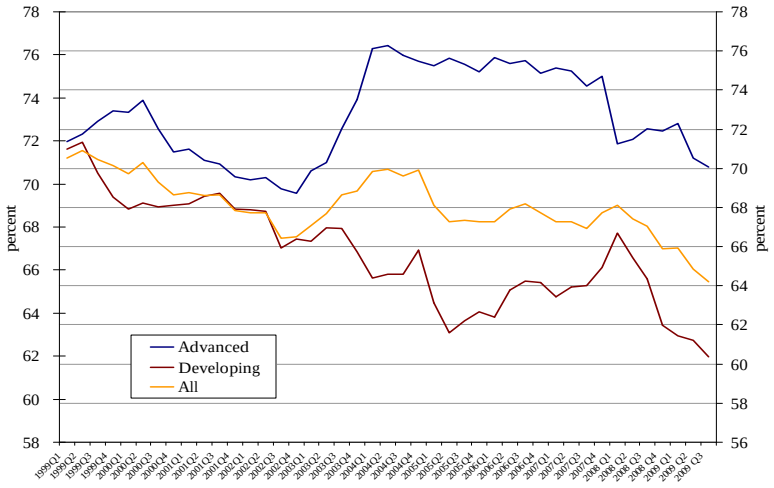
DOLLAR QUANTITY SHARE OF RESERVES



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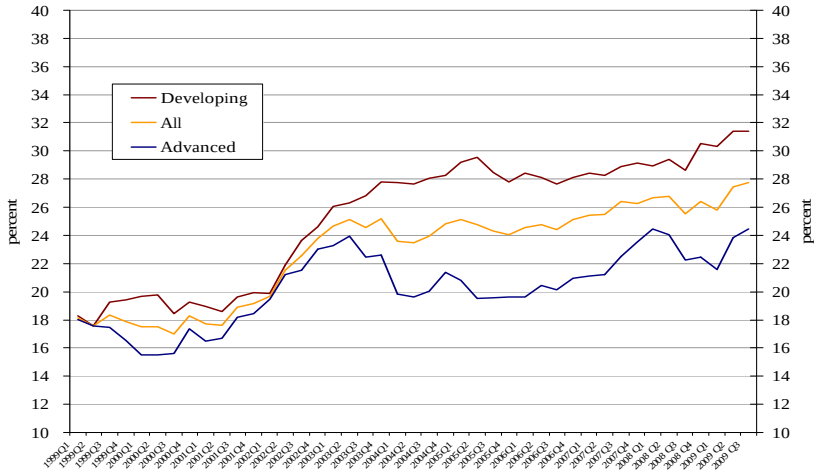
EURO VALUE SHARE OF RESERVES



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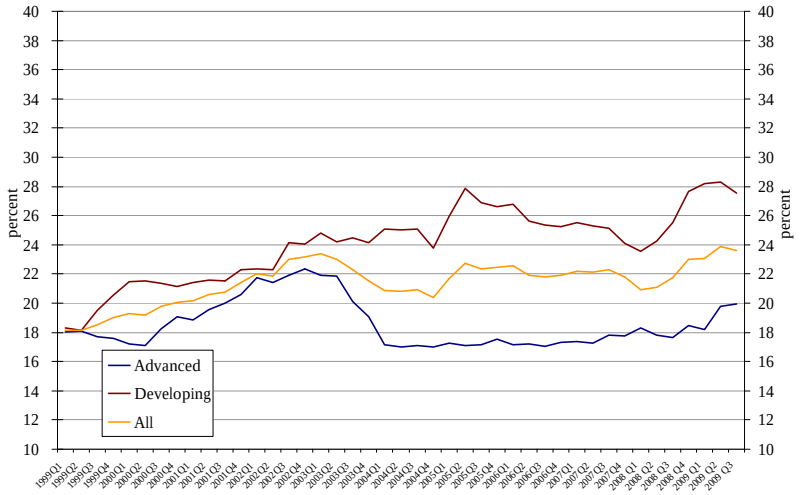
EURO QUANTITY SHARE OF RESERVES



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CHANGES IN VALUE SHARES

Currency	1999 Q1	2009 Q3	1999Q1-2009Q3 Change
Dollar	71.2	61.6	-9.5
Euro	18.1	27.7	9.6
Japanese Yen	6.0	3.2	-2.8
Pound Sterling	2.7	4.3	1.6
Swiss Franc	0.3	0.1	-0.2
Others	1.6	2.9	1.3

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CHANGES IN QUANTITY SHARES

Currency	1999 Q1	2009 Q3	1999Q1-2009Q3 Change
Dollar	71.2	65.4	-5.7
Euro	18.1	23.6	5.4
Japanese Yen	6.0	2.7	-3.4
Pound Sterling	2.7	5.1	2.4
Swiss Franc	0.3	0.1	-0.2
Others	1.6	3.1	1.5

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PREFERENCES IN CURRENCY COMPOSITION

- More than two dozen countries release data on the currency composition of their reserves. Those data show no single pattern and considerable changes (Truman and Wong 2006)
- ECB research (*International Role of the Euro* 2009) confirms this diversity.
  - Transactions motivations dominate: debt denomination, direction of trade, nature and strength of any currency peg
  - Relative returns have some but much smaller explanatory power

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Reserve Currencies and Current Account Balances: 1999-2008

(US dollars, billions)

Currency/Country	Currency Composition of Reserves		Sum of Current Account 1999 to 2008
	End of 2008	Change in Holdings From 1999 Q1	
US dollar	4,436	3,293	-5,712
Euro	1,825	1,534	235
UK sterling	280	236	-471
Japanese yen	216	119	1,447
Swiss franc	9	4	354
Other	143	118	N.A.
Total	6,909	5,303	N.A.

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HOW CAN THIS HAPPEN?

There is no, simple, logical relationship between the currency denomination of reserve holdings and current account positions

Official foreign inflows are but one component of the financial/capital account

At the same time as there are official inflows there may be more than offsetting net, private (possibly official) outflows

The United States during the Bretton Woods period!

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CONCLUSIONS

1. Mistake to identify the international **financial** system with the international monetary system
2. We live today (already) in a **multicurrency reserve system**
3. The reduced role of the US dollar in international reserves has **not accelerated** over the past five years
4. There **is no, simple, logical link** between the performance of the US current account and the reserve role of the US dollar

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