IMF Can’t End Dollar’s Reign

Ever since Quantitative Easing began, a group of so-called Monetarist/Austrian thinkers have predicted “hyper-inflation” and the demise of the dollar as the world’s “reserve currency.”

In spite of the fact that gold has fallen and inflation remains low, scare stories about other countries dumping their Treasury securities, US interest rates skyrocketing, and a return of the trauma of 2008 proliferate. And, if that’s not enough, according to the pouting pundits of pessimism, the Federal Reserve won’t be able to address the problem because long-term rates will be headed up, rather than down.

Now, these pundits have another flash point of fear because the International Monetary Fund is considering adding the Chinese currency, the yuan, to the basket of currencies it recognizes as “reserve currencies.” The yuan would bring the IMF’s list of key currencies to five, along with the dollar, yen, euro, and British pound. (Notice how no one is worried that the euro, yen, and pound already have that status.)

The idea that the IMF’s decision could trigger a selloff of US dollars and Treasuries makes no sense. The IMF’s “currency,” called Special Drawing Rights (SDRs), is an accounting tool only; it’s not used as a store of value across time. By contrast, the key issues that decide whether the dollar maintains its status are the foreign appetite to own dollar-denominated securities, particularly Treasury debt, and the dollar’s share of international transactions. And in those two areas, the dollar is doing better than ever.

Back in 2005, foreign entities – foreign central banks, foreign companies, foreign individuals – were willing to own $2 trillion of US Treasury securities, equivalent to about 15% of US GDP and 4.5% of global GDP. Today, foreign entities are willing to hold about $6.2 trillion in Treasury debt, 35% of the US GDP and 7.9% of global GDP.

Even with these large holdings, there is likely more growth ahead. Imagine what’s going to happen as India’s economy continues to expand. As the Indian central bank issues more local currency, it must decide how to back it, and will likely choose dollars. Right now, India owns just $100 billion of US Treasuries, while China owns about $1.3 trillion. As India grows, demand for US Treasury securities will rise.

SWIFT – a global transaction settlement platform - tracks the share of global bank activity settling in various currencies. Since early 2012, the share settling in US dollars has risen to 45% from 31%. Meanwhile, the share settling in euros has dropped to 28% from 42%. The share in the Chinese yuan is up, but is still only 2%. This low level for the yuan suggests that it is not yet used enough for the IMF to include it in its SDR basket, but more importantly it means no matter what the IMF does, the Yuan is not a threat to the dollar.

No one should become completely complacent. The dollar “could” eventually lose its reserve currency status. But to lose that status, another country (or region) has to issue a currency that is stronger and safer than the dollar over long periods of time. The Swiss Franc probably passes that test, but the Swiss economy is just too small relative to the world economy for it to be a key reserve currency.

The dollar’s status as the world’s key reserve currency isn’t going away, and neither are the stories about the imminent demise of that special status (see Wesbury 101 on the topic).