October 5, 2023

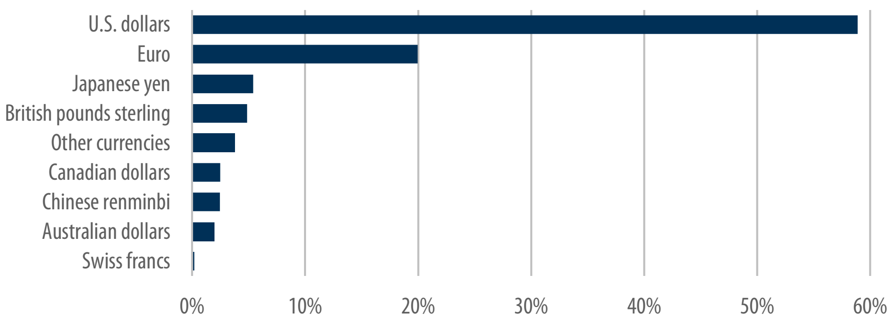
In this week's installment of "Three on Thursday," let's explore some of the dynamics surrounding the United States dollar. In an era of inflation and large deficits, there are persistent rumors circulating that the dollar is at risk of losing its reserve currency status. These rumors are stoked by the desire of China (and others) to see this happen. We think these fears are vastly overblown. The U.S. is not strong because the dollar is the reserve currency, the dollar is the reserve currency because the U.S. is strong. Not just in economic might, but in its governance. The Constitution still stands, along with its protections of private property rights and the rule of law, which have created honest, deep and liquid financial markets. The U.S. remains one of the few places where people risk their lives daily to get *into*, not *out of*. To provide further insight, we've included three informative charts below.

U.S. Dollar Spot Index

Source: ICE Futures, First Trust Advisors. Weekly data from 1/4/2013 - 9/29/2023.

Contrary to prevailing assumptions, the dollar has been strengthening not weakening against a broad basket of currencies over the past several years. In fact, the dollar has risen now for 11 consecutive weeks —a remarkable feat that ranks as the second-longest winning streak in the history of the U.S. Dollar Index. If it maintains its positive performance this week, it will equal the record for the longest weekly streak, previously set in 2014. During periods of distress and uncertainty, the dollar continues to be sought after as a trusted store of value and a symbol of safety on a global scale.

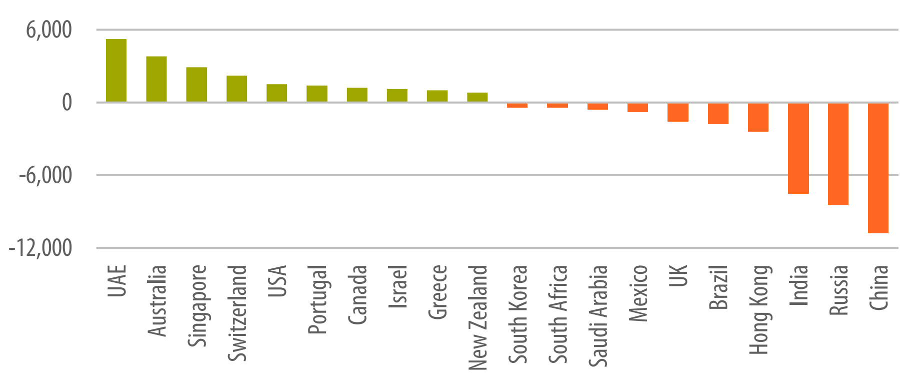
Share of Allocated Foreign Exchange Reserves | Q2 2023



Source: IMF, First Trust Advisors. Data as of Q2 2023.

Examining the most recent IMF data through the second quarter of 2023, we observe that the U.S. dollar comprised 58.9% of official foreign exchange reserves. This was followed by the Euro at 20.0%, the Yen at 5.4%, the British Pound at 4.9%, and the Yuan at a modest 2.5%. It's worth noting that the USD's share of foreign exchange reserves has declined over time; for instance, in 1999, it constituted 71.2% of the total reserves. This decrease can be attributed, in part, to foreign reserve managers diversifying their portfolios by including various smaller currencies. Nevertheless, it's evident that the dollar continues to maintain a significant lead as the world's primary reserve currency.

Top Countries with Net Inflows/Outflows of HNWIs



Source: Henley & Partners, First Trust Advisors. Annual data for 2022. High Net Worth Individuals (HNWI) defined as those with investable wealth of USD 1 million or more.

There is a common belief that China's yuan could potentially replace the U.S. dollar as a new reserve currency, or that the BRICS nations (Brazil, Russia, India, China, South Africa) might create a common currency for trade that could challenge the dollar's dominance. However you cannot replace a stronger currency with a weaker one. It just doesn't work. Looking at the countries who are seeing the largest outflows of high-net-worth individuals, China leads the list, with a net outflow of 10,800 people, followed by Russia, then India. Interestingly, among the top five countries experiencing the largest outflows of wealthy individuals, four are BRIC nations. In contrast, the United States has seen the fifth-largest increase (+1,500) in high-net-worth individuals. Can a country that can't keep their most productive citizens gain the confidence of other nations to adopt their currency? We think not. The current economic and geopolitical realities suggest that the U.S. dollar's dominance remains robust.