



Trends in the global use of major currencies

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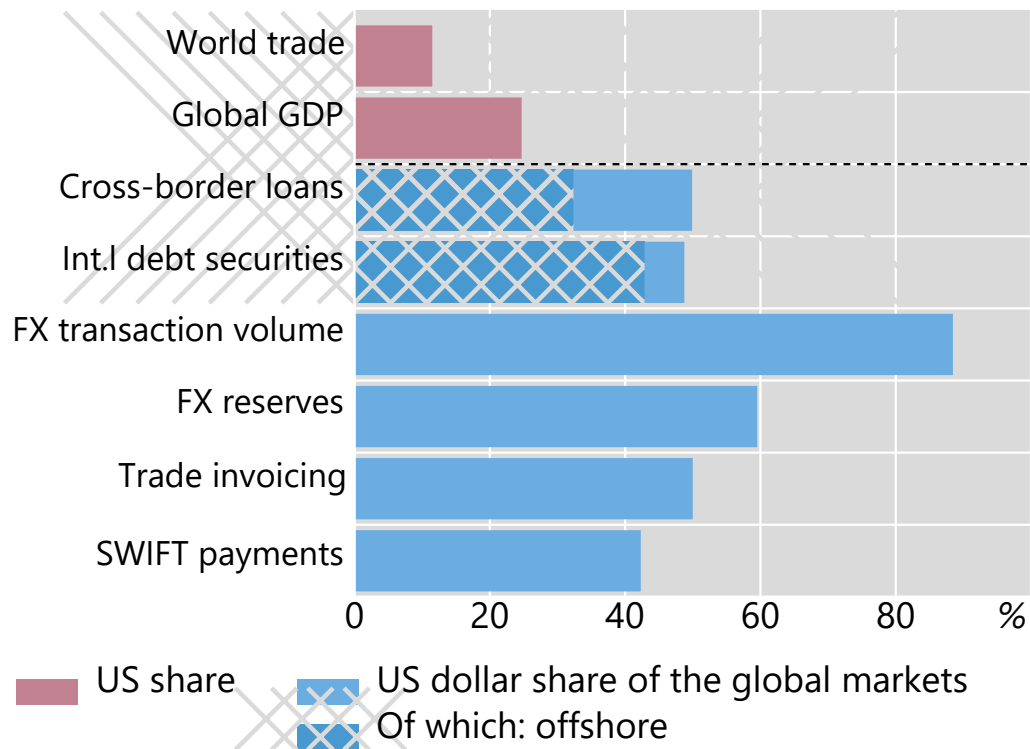
Outline

- **Trends in the global use of currencies: some facts**
- **Deep dive into 3 issues with financial stability & macro implications**
 1. US dollar dominance – a nuanced perspective
 2. Financial channel of exchange rates and weakness in global trade
 3. USD as the major funding currency: FX swaps & financial stability risks

- Trends in the global use of currencies: some facts -

The international role of the US dollar

International role of the US dollar

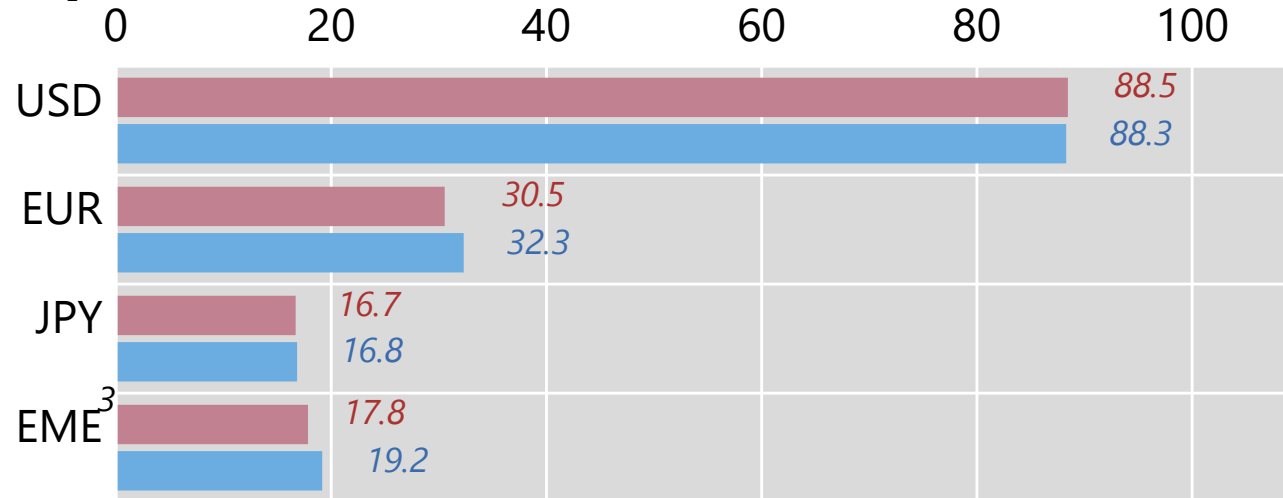


- The USD commands an outsized role in the financial system, **exceeding** the real economy share of US economy by a significant margin ...
- The dollar's dominant role also persisted despite the collapse of the Bretton Woods system
- In FX trades the share of USD is especially elevated
 - USD as the major **vehicle currency**

Sources: G Gopinath, "The international price system", NBER Working Papers, no 2164, 2015; IMF; Bloomberg; CPB World Trade Monitor; SWIFT; BIS debt securities statistics; BIS locational banking statistics; BIS Triennial Central Bank Survey.

Currency composition of FX trading according to the 2022 BIS Triennial Survey

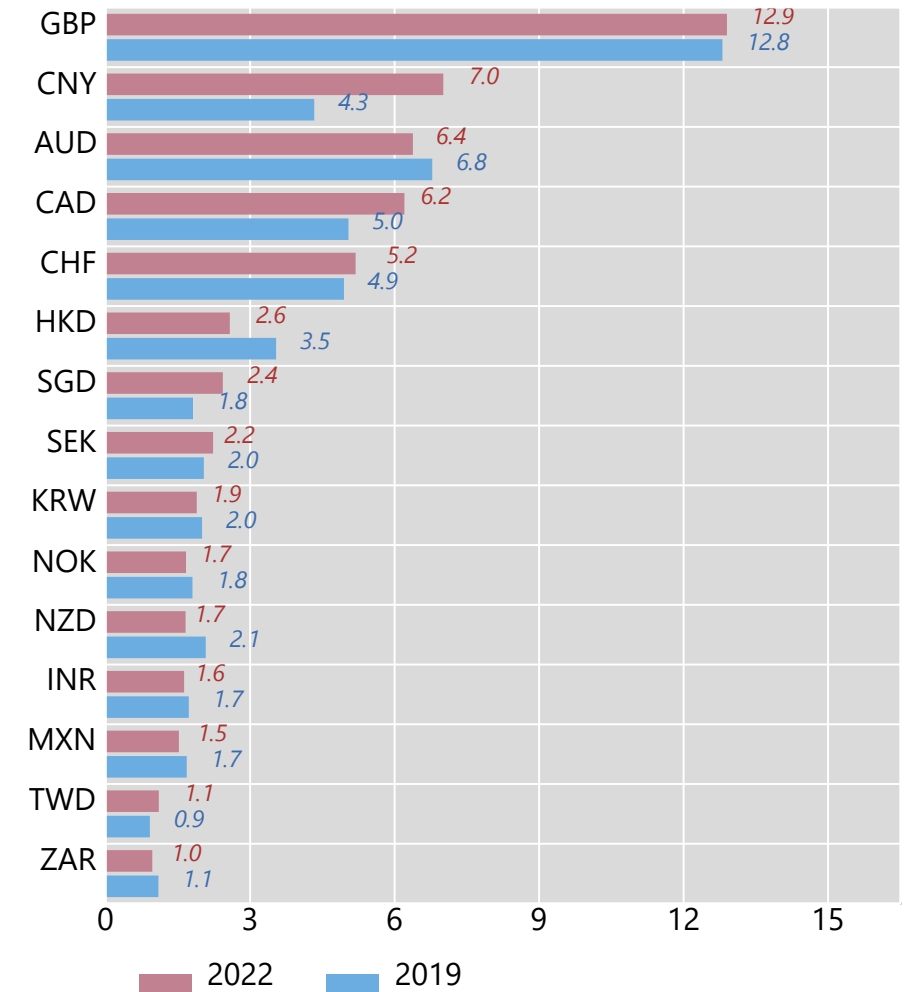
Major currencies and EMEs



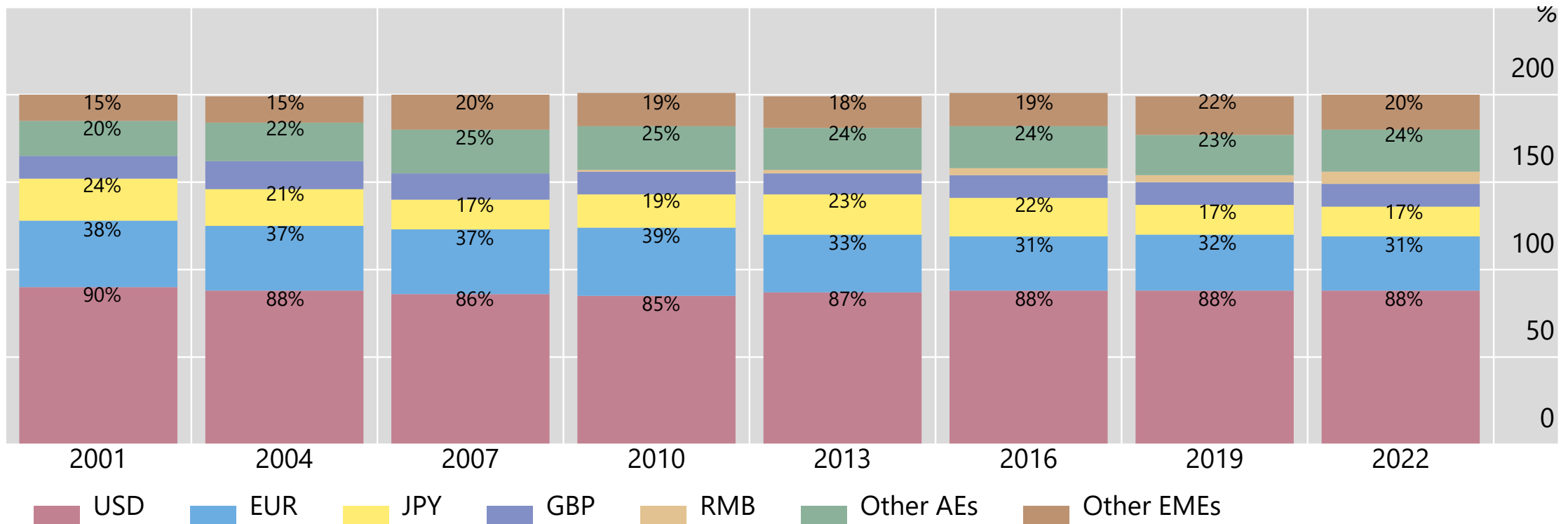
Source: BIS Triennial Survey, 2022; Net-net basis, daily averages in April, as a percentage of total turnover

- **USD** on one side of no less than 88% of global FX trades
- Other major currencies are a long way back, with the **euro** at 31%, the **yen** at 17%
- **Renminbi**, despite rapid ascent, so far only reaches 7%

Selected other currencies



USD dominance in FX markets has remained **stable** over the past two decades ...

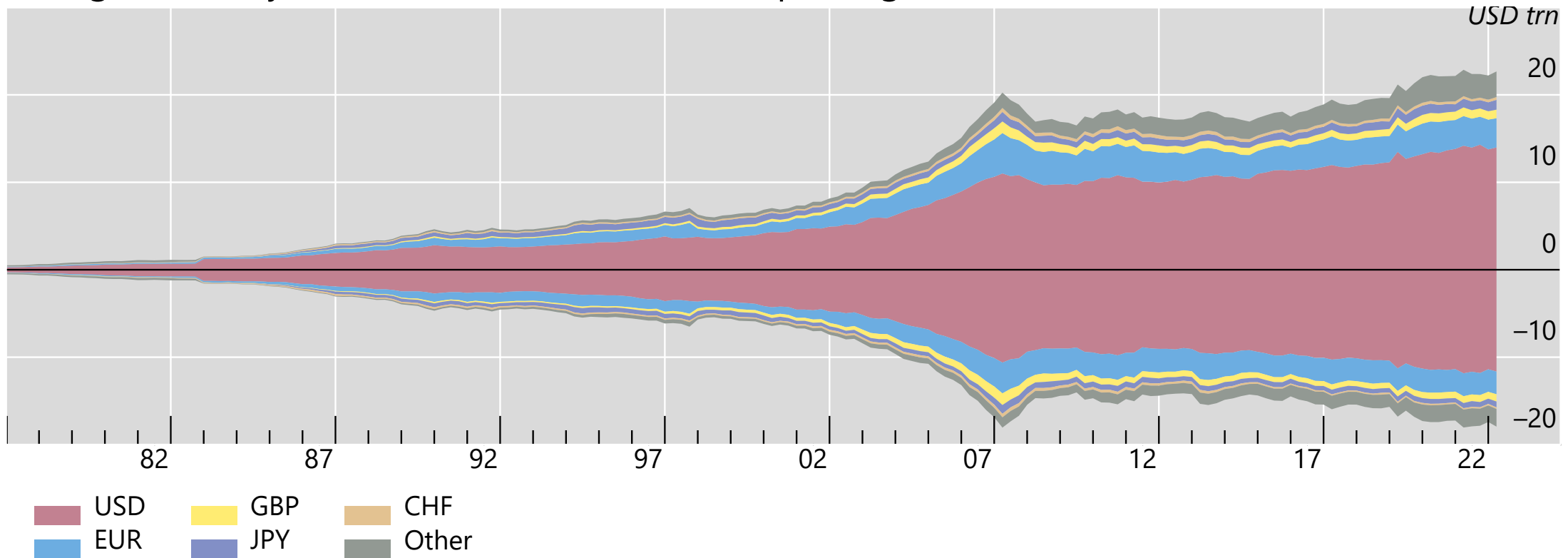


Source: BIS Triennial Central Bank Survey 2022

- The euro's and the yen's heft has declined but both remain significant international currencies
- The global footprint of EME currencies has risen, notably that of Chinese renminbi

The **USD** also dominates **international banking** ...

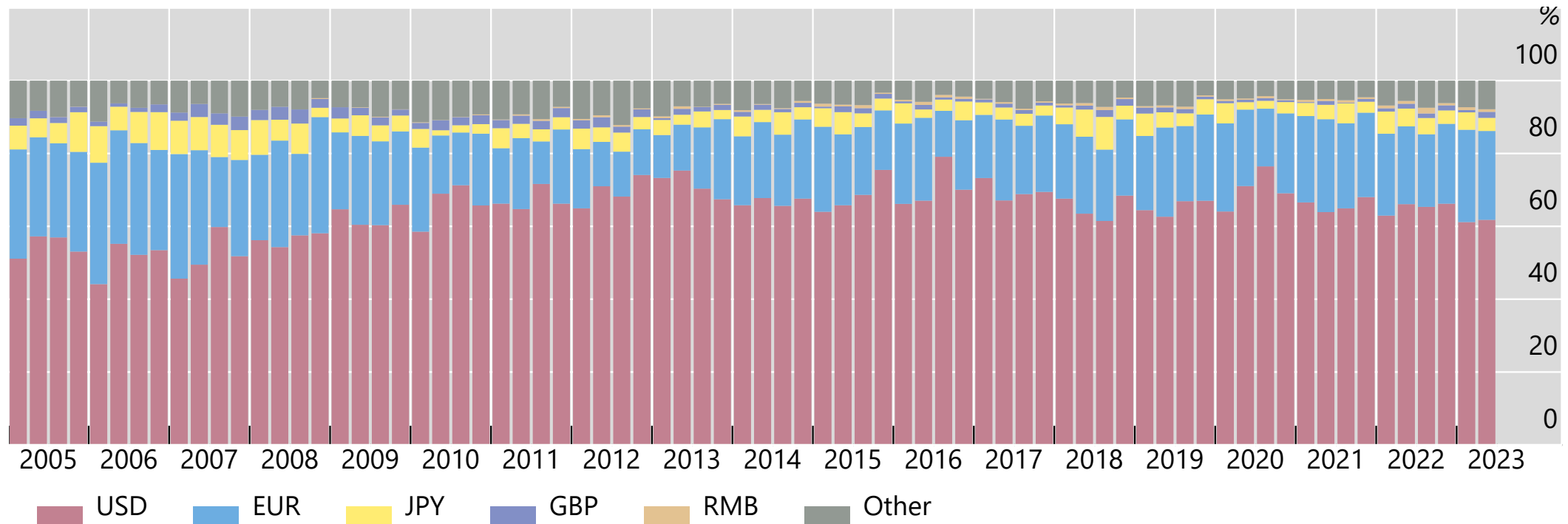
Foreign currency assets and liabilities of BIS reporting banks



Source: BIS Locational Banking Statistics.

- **USD share** in assets/liabilities roughly **constant** over past 2 decades at about 61%
- Mild drop in the share of the **euro** (now around 15%), while drop in share of the **yen** has been more notable
- **Other** currencies' share has expanded notably, roughly doubling over past two decades

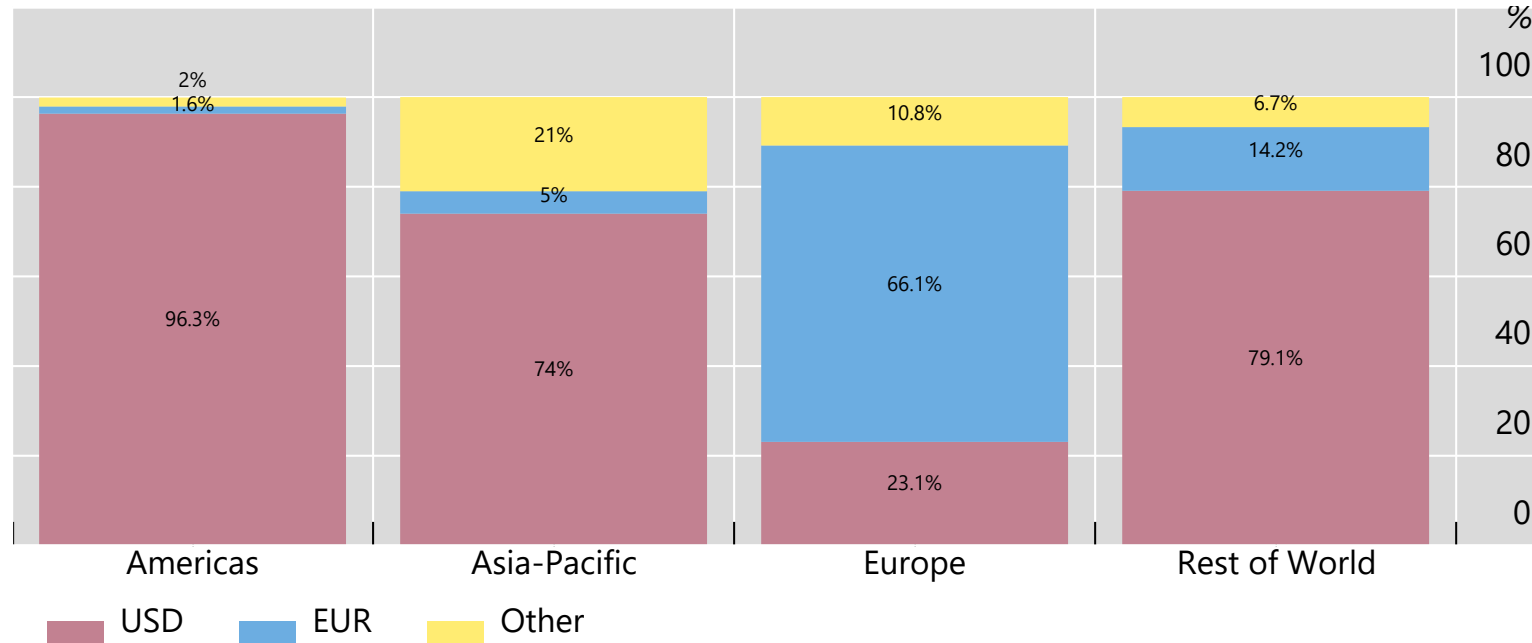
... and the dollar is also the **funding currency** of choice (here: debt security issuance)



Source: Dealogic.

- If firms issue debt in another currency than their home currency, the **dollar** is the primary choice
- Indicates the role of the dollar as the world's primary **funding currency**

The dollar dominates in **trade invoicing** but there are differences across regions



Sources: Bertaut, von Beschwitz, Curcuro (2021): Average annual currency composition of export invoicing (1999-2009); IMF direction of trade data

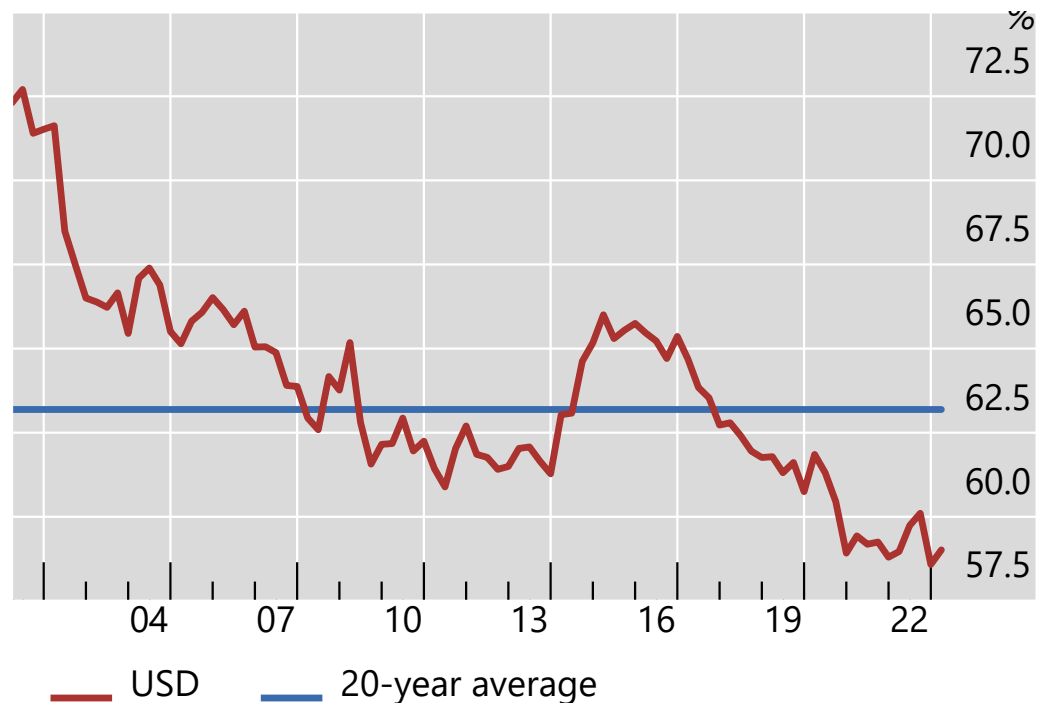
- International role of a currency shows in **its use as a unit of account**
- USD share in trade invoicing exceeds the US economy's role as exporter / importer by a significant margin

- **Complementarities** between use of the currency in trade invoicing and use as a safe asset (Gopinath & Stein (2021))
 - Creates a **link with banking** (hold dollar deposits as safe assets)
 - Gives rise to **demand for USD in financial transactions**

- USD dominance: a nuanced view -

The dominance of the USD in **official reserves** has been slowly declining

US dollar share of official foreign exchange reserves

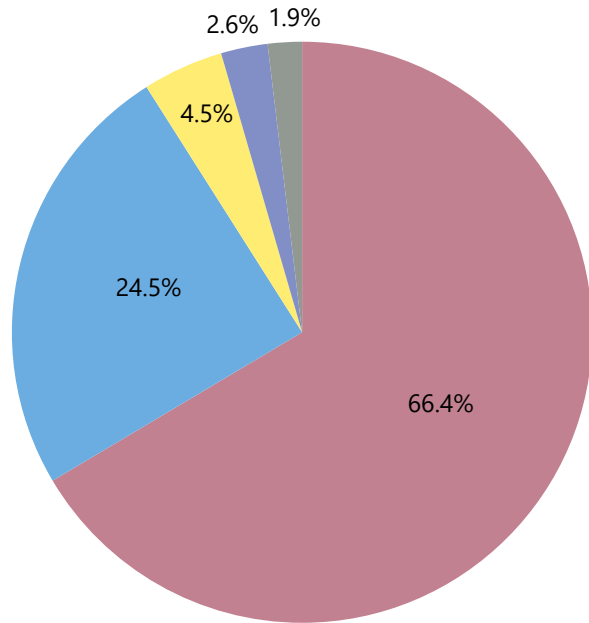


Source: IMF COFER.

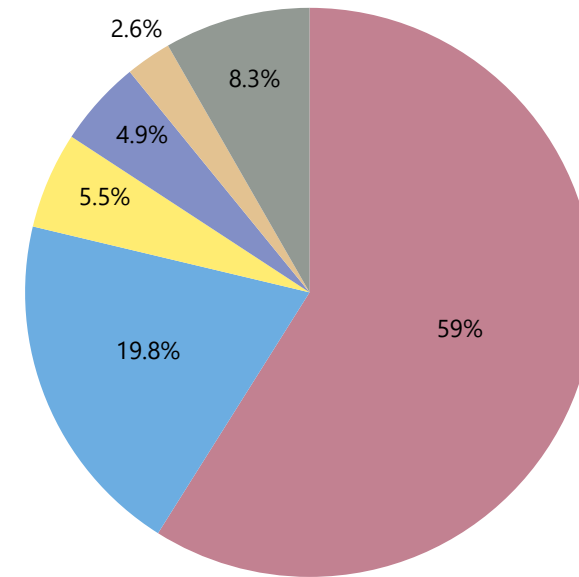
- The US dollar's share in official reserves has been falling over the past two decades
- Main driver: **portfolio diversification** by reserve managers (Arslanalp, Eichengreen, Simpson-Bell, 2022)
- Decline in dollar owes to ...
 - 1/4 rise of renminbi holdings
 - **3/4 rise in non-traditional reserve currencies (search for yield)**
- But this shift has its limits: **dollar liquidity** continues to be at a premium at times of stress ...

FX reserve composition: what difference two decades make ...

2003-Q1



2023-Q1

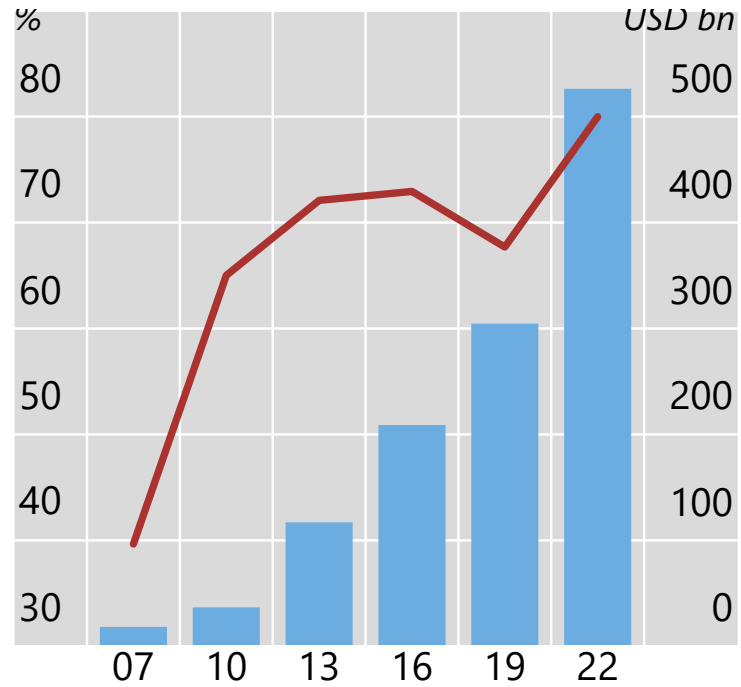


Source: IMF COFER

Non-traditional reserve currencies on the rise: eg Australian Dollar, Canadian Dollar, Chinese Renminbi, Swiss Franc

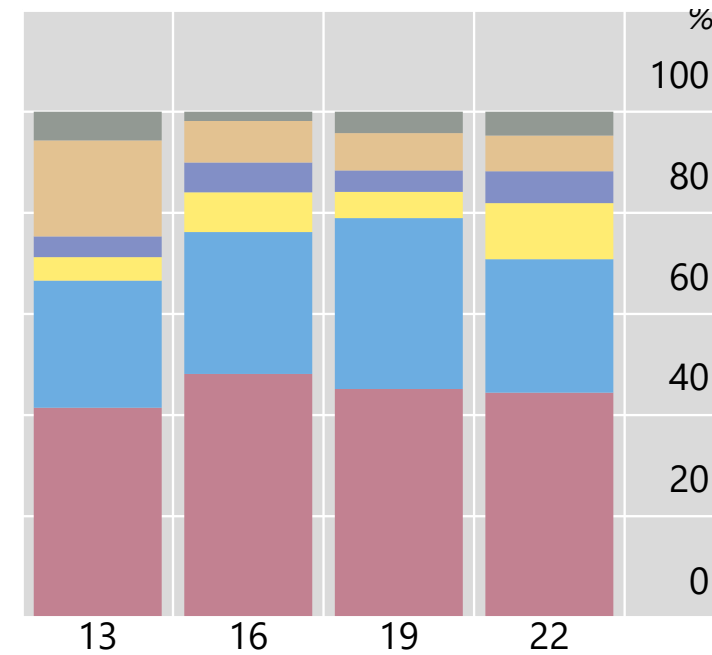
Rising volume & internationalisation of the **Chinese renminbi**

Steep ascent of international trading of RMB



Lhs: — International share
 Rhs: ■ Total turnover (constant USD)

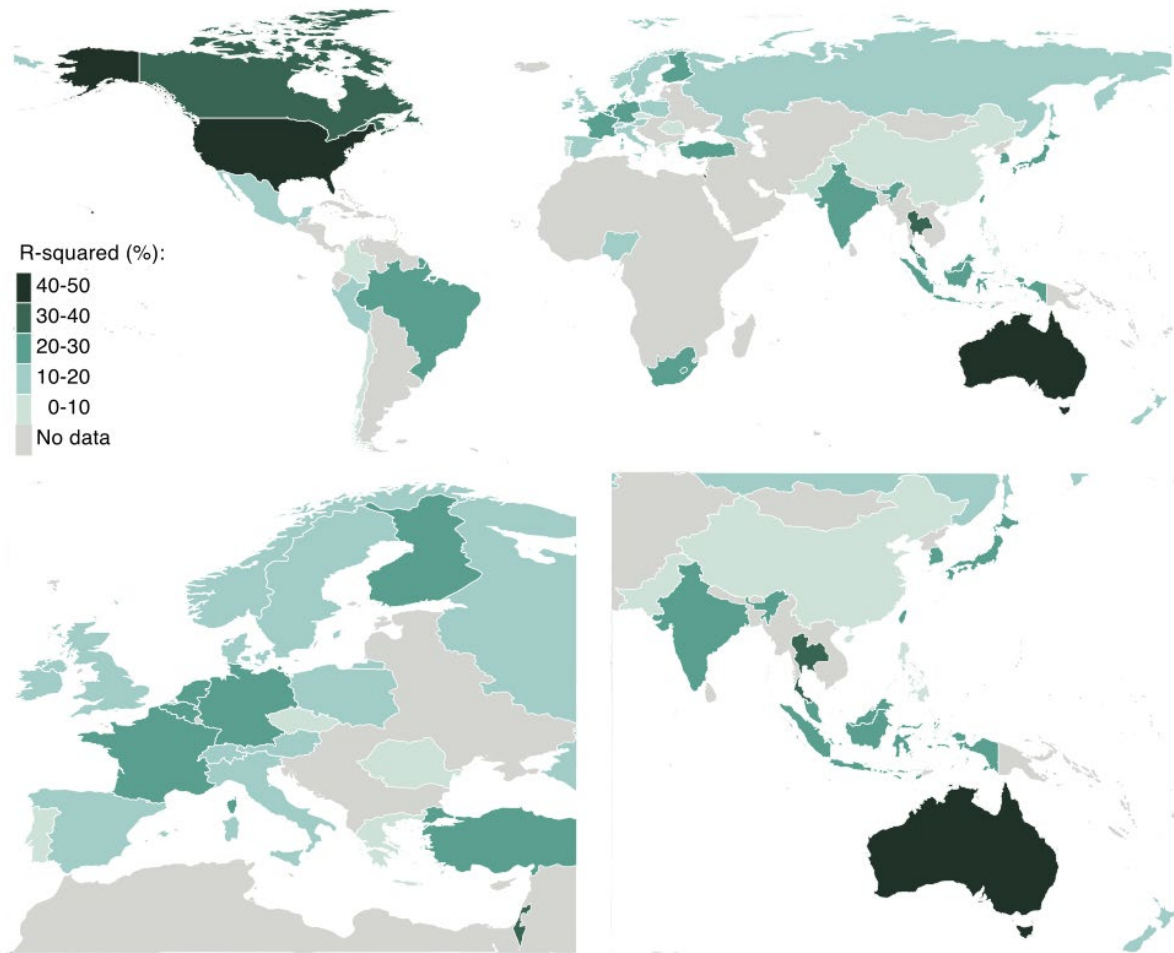
A more diverse set of counterparties



■ Dealers
 ■ Banks
 ■ Institutional
 ■ HF and PTF
 ■ NFC
 ■ Others

Sources: BIS Triennial Central Bank Survey. HF = hedge funds; NFC = non-financial corporations; PFT = proprietary trading firms

It is well-known that **Fed monetary policy spills over** to other country's interest rates



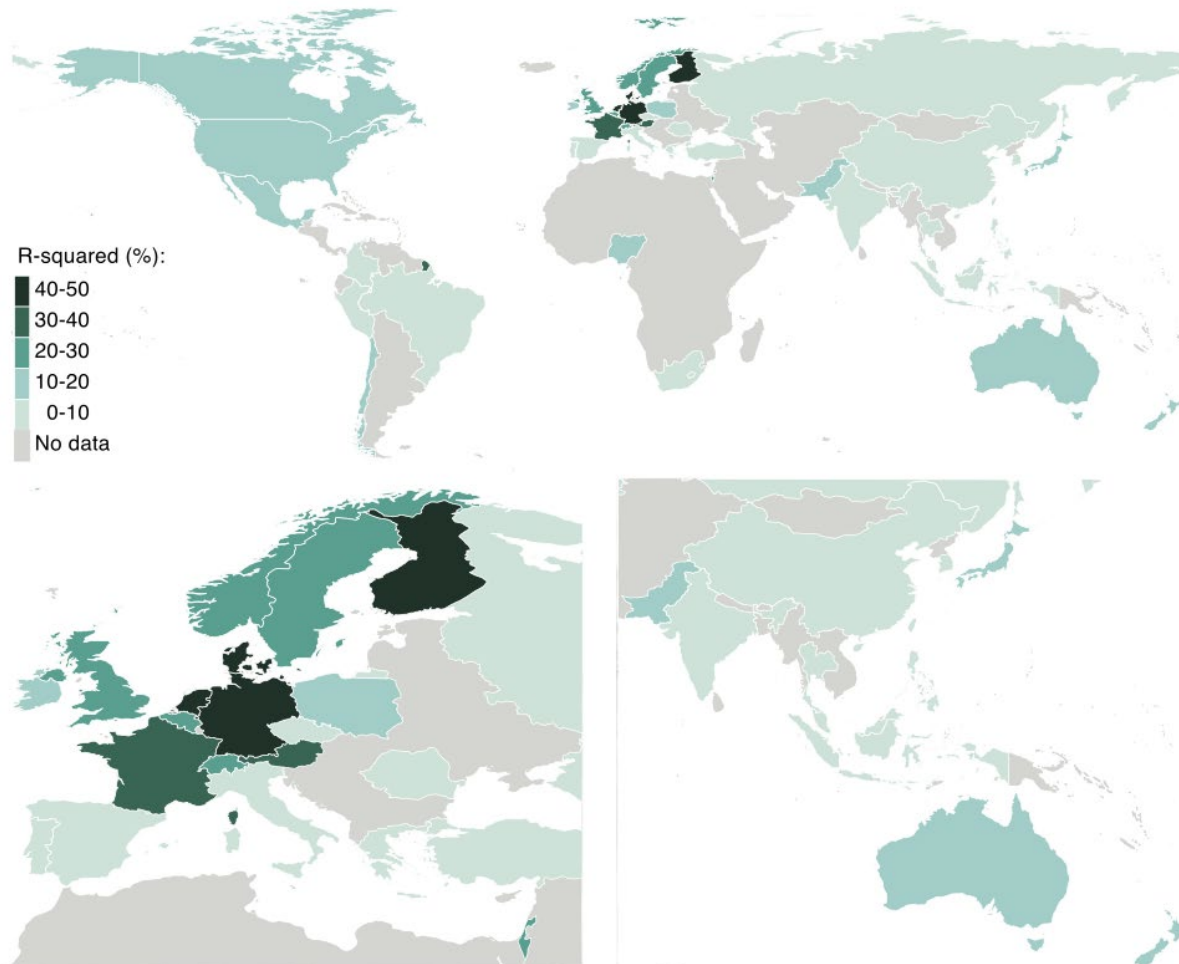
Map depicts **intensity of spillovers** of monetary policy shocks on foreign interest rates

Shocks are measured at high-frequency around monetary policy announcements

The darker the color, the greater the variation in the response of foreign long-term interest rates that can be traced to the monetary policy shock

Source: Kearns, Schrimpf, Xia (2022), Journal of Money Credit and Banking

But the **ECB** is not much behind the Fed in terms of generating spillovers ...



ECB monetary policy shocks have a strong impact in the **region**, but not only there...

... they are also **felt across the globe**, including in many EMEs

And their role has been **rising** over time ...

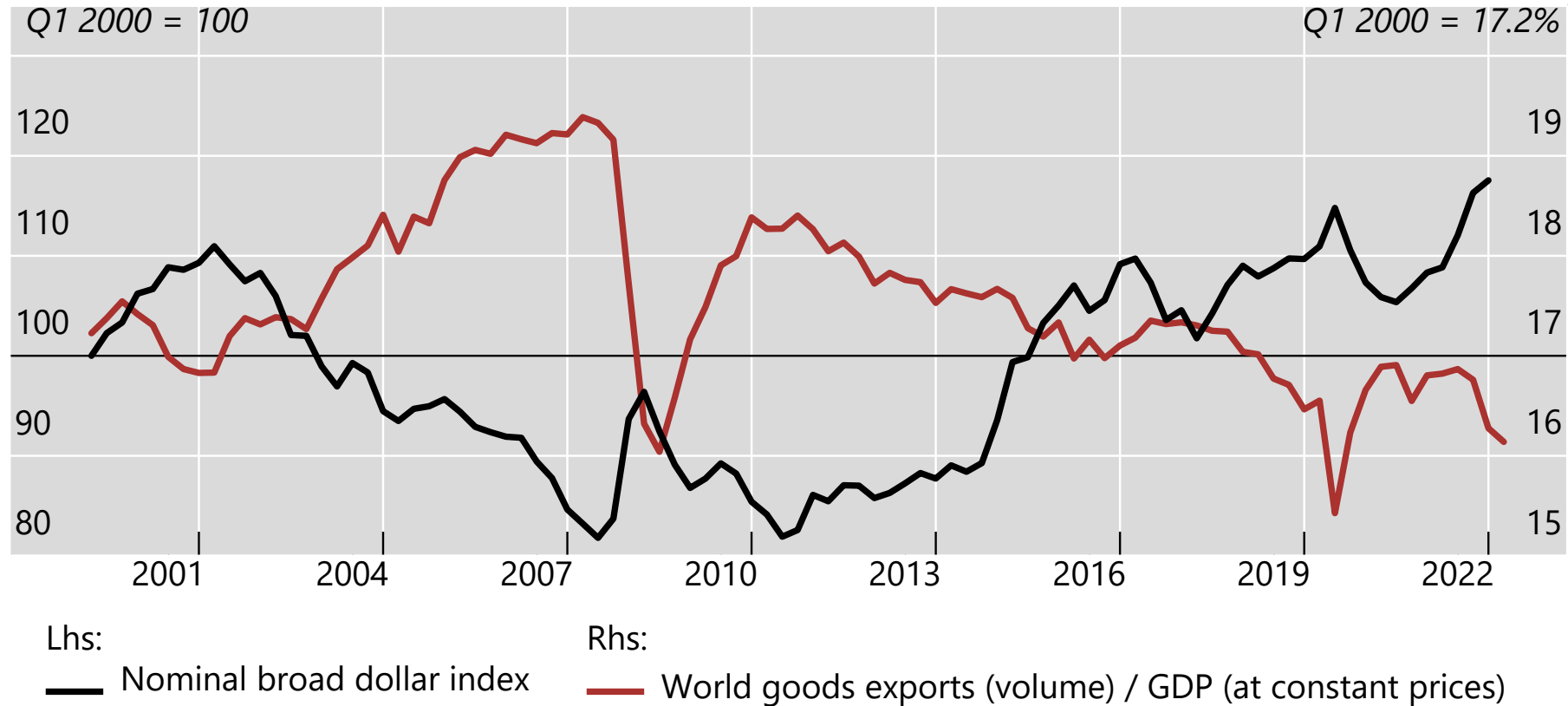
Source: Kearns, Schimpf, Xia (2022), Journal of Money Credit and Banking

- The financial channel of exchange rates -

Financial forces are crucial to understand exchange rates and international trade

- **Macro perspective:** appreciation in the domestic exchange rate leads to a decline in exports
- This effect however may be dominated by the **financial channel**: Bruno and Shin (2015, 2023)
 - Starts from **currency mismatches** on corporate balance sheets (especially EMEs)
 - Borrow in US dollars to finance assets in domestic currency
 - Local currency appreciation leads to a **strengthening of the firm's balance sheet**
 - Lenders (global banks) provide more ample financing
- Suggests a **link between the dollar and key macro variables** (such as exports or investments)

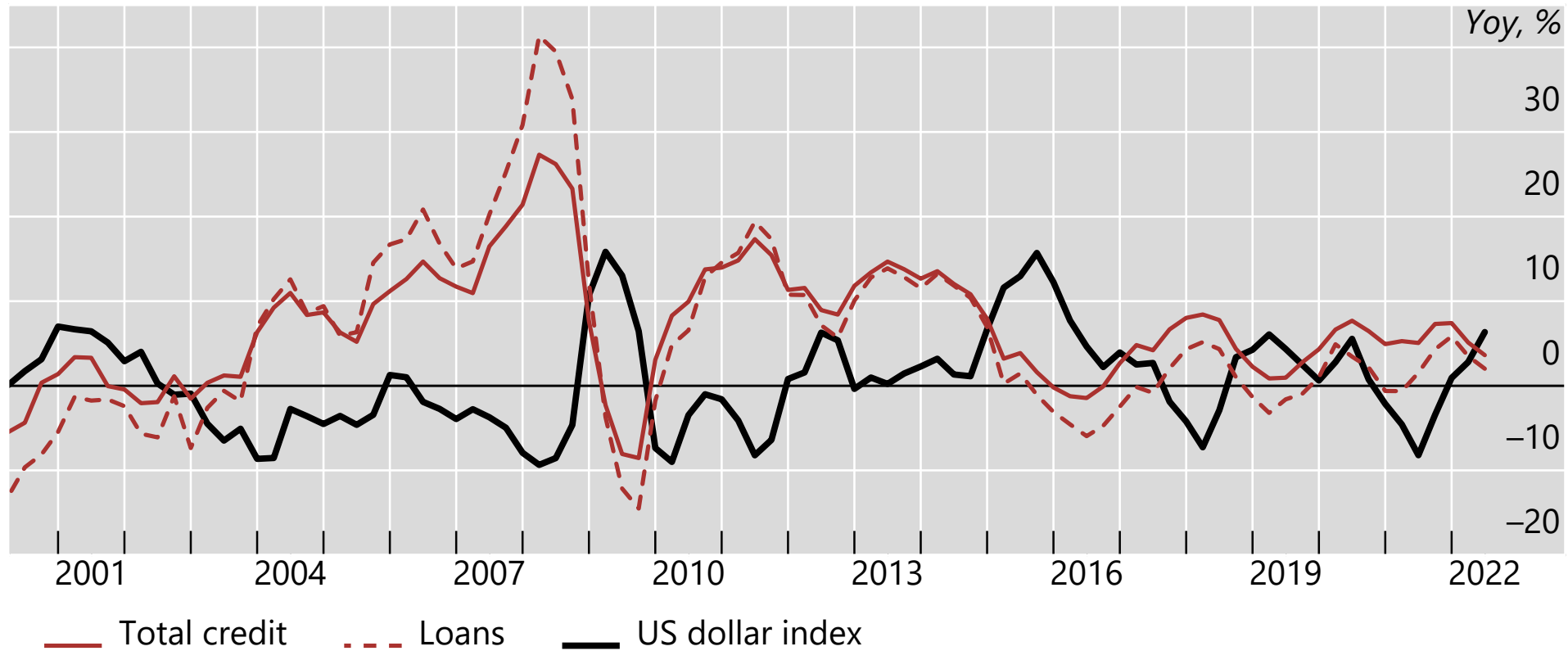
Global trade fluctuates with financial conditions, as measured by the broad dollar index



Sources: Federal Reserve Bank of St Louis, FRED; IMF; World Trade Organization; national data.

- In phases of **dollar strength**, **global trade tends to weaken** ...
- Mechanism operates through **balance sheets** of borrowers and global intermediaries

Broad **dollar index** is a barometer of **global credit conditions** in dollars



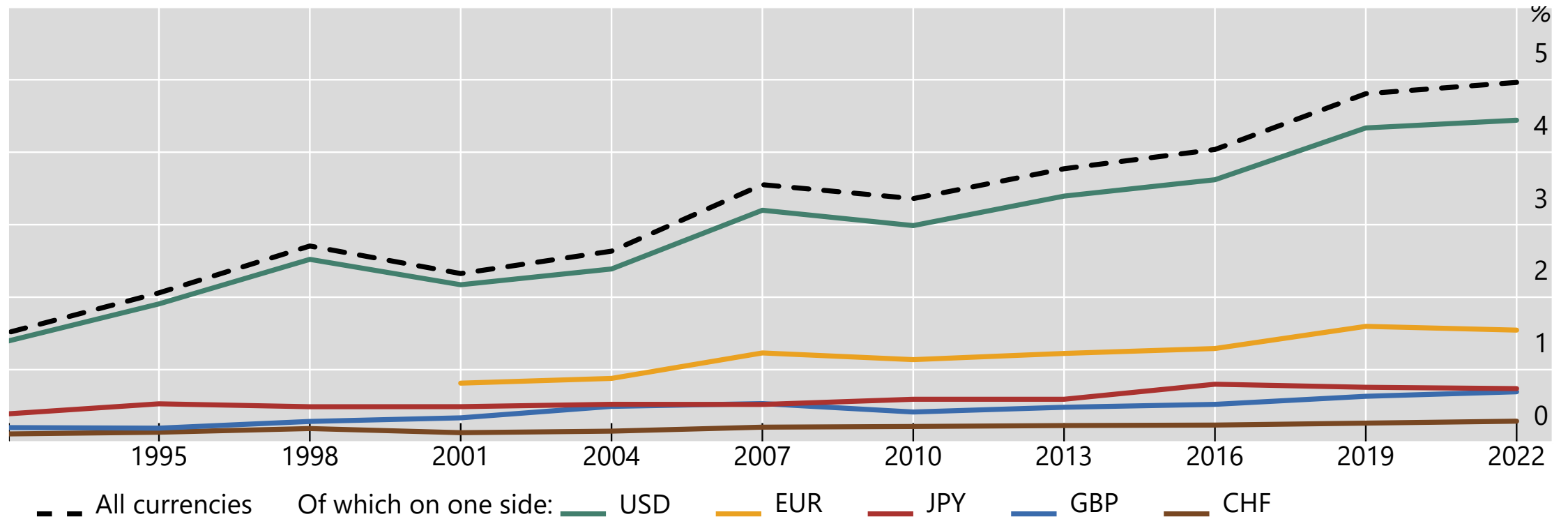
Sources: Federal Reserve Bank of St Louis, FRED.

A **stronger dollar** goes hand in hand with more **subdued credit conditions** ...

- USD as the major funding currency: FX swaps & financial stability risks

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Turnover of FX swaps and forwards, scaled by world GDP



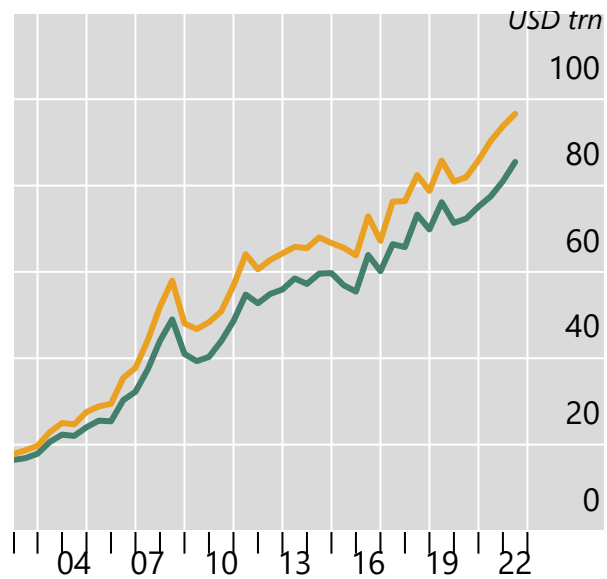
Sources: IMF, BIS Triennial Survey.

FX swaps (and other FX derivatives) as **missing debt** ...

- FX derivatives create **debt-like obligations** (Borio, McCauley, McGuire (2019, 2022))
- An FX swap is in effect a secured loan with principal to be paid in full at maturity
 - Two parties agree **exchange two currencies spot** (say USD and EUR) and **reverse the exchange at a future date** (with the forward price determined already today)
 - The respective other currency serves as the collateral for the transactions
 - Source of **USD funding** when other forms less attractive or not available
- Debt obligations through FX swaps are not recorded on balance sheets (just on a net basis)
- Borio et al (2019, 2022) put the **dollar debt** from FX swaps/forwards of **non-banks outside the US** at \$25 trillion in mid-2022, double their \$13 trillion in on-balance sheet dollar debt

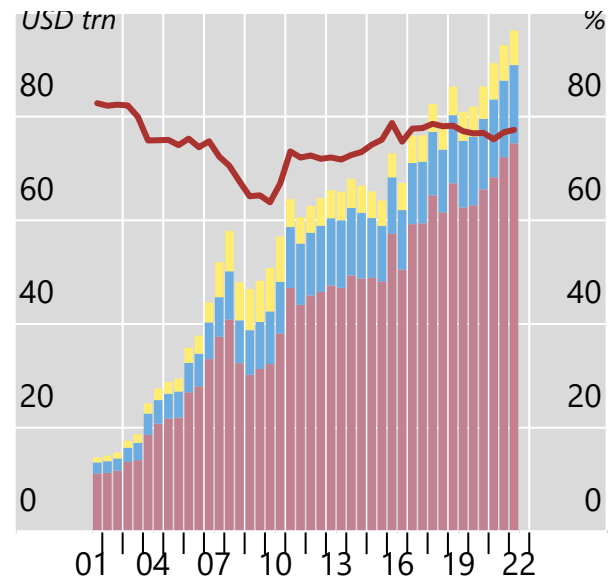
The markets for FX swaps and forwards provide a window on this global role of the dollar as the main **funding currency** for both banks and non-banks

By currency



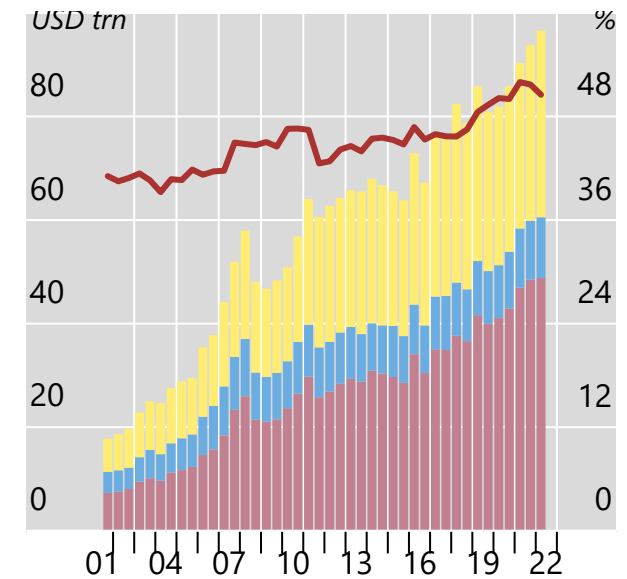
— All currency pairs, total
— US dollar on one side

By maturity



Lhs: — ≤1 year
— >1 year and ≤5 years
— >5 years
— Share of ≤1 year maturity (rhs)

By counterparty sector



Lhs: — Other financial institutions
— Non-financial customers
— Reporting dealers
— Share of other financial institutions (rhs)

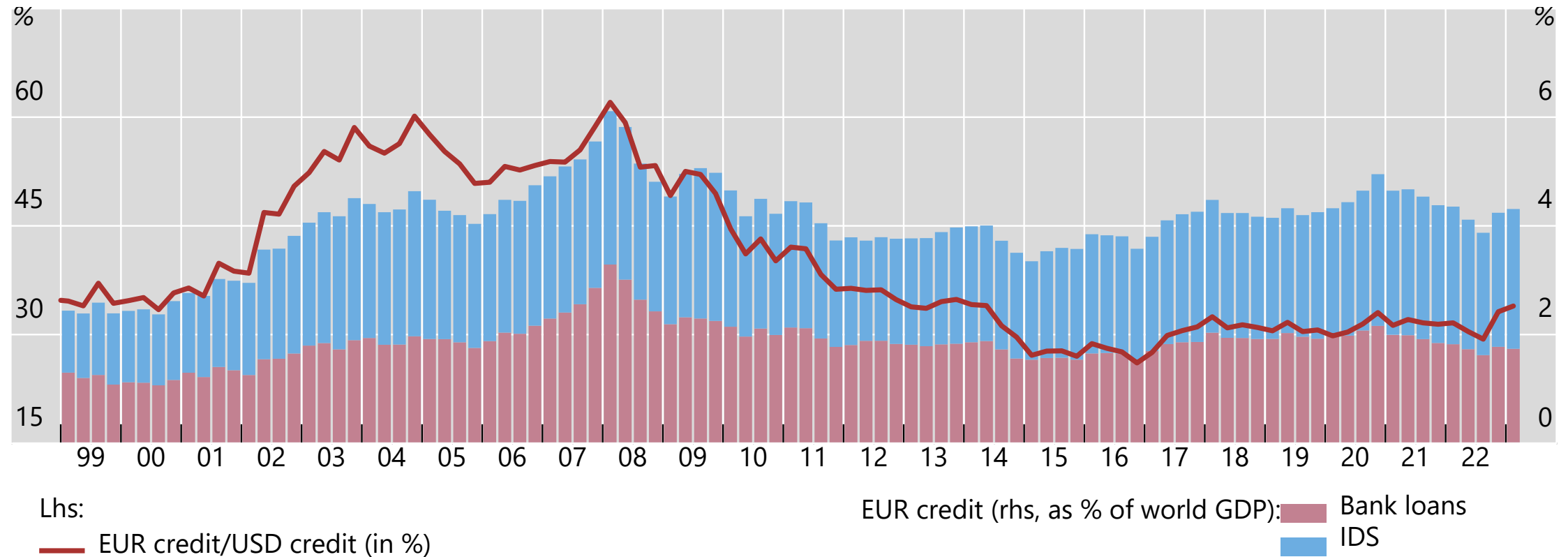
Source: BIS OTC derivatives statistics.

Summary

- The **US dollar remains in a dominant position** in the global financial system
 - Major uses as means of payment (FX vehicle currency), unit of account, and store of value
 - **Interlinkages between real and financial considerations** – USD as primary currency for investments (safe assets) & funding (debt securities, banking and FX swaps)
- A nuanced view however suggests a more **diverse** system than often portrayed ...
- **Financial forces** key in understanding developments in the global use of currencies
 - The **financial channel** is powerful and explains eg recent weakness in global trade
 - USD liabilities recorded on the balance sheet are just a tip of the iceberg
 - Non-US banks and corporates face **rollover risks** in **FX swaps and other derivatives**
 - Granular analysis of **currency & maturity mismatches** needed to gauge financial stability risks

- Appendix -

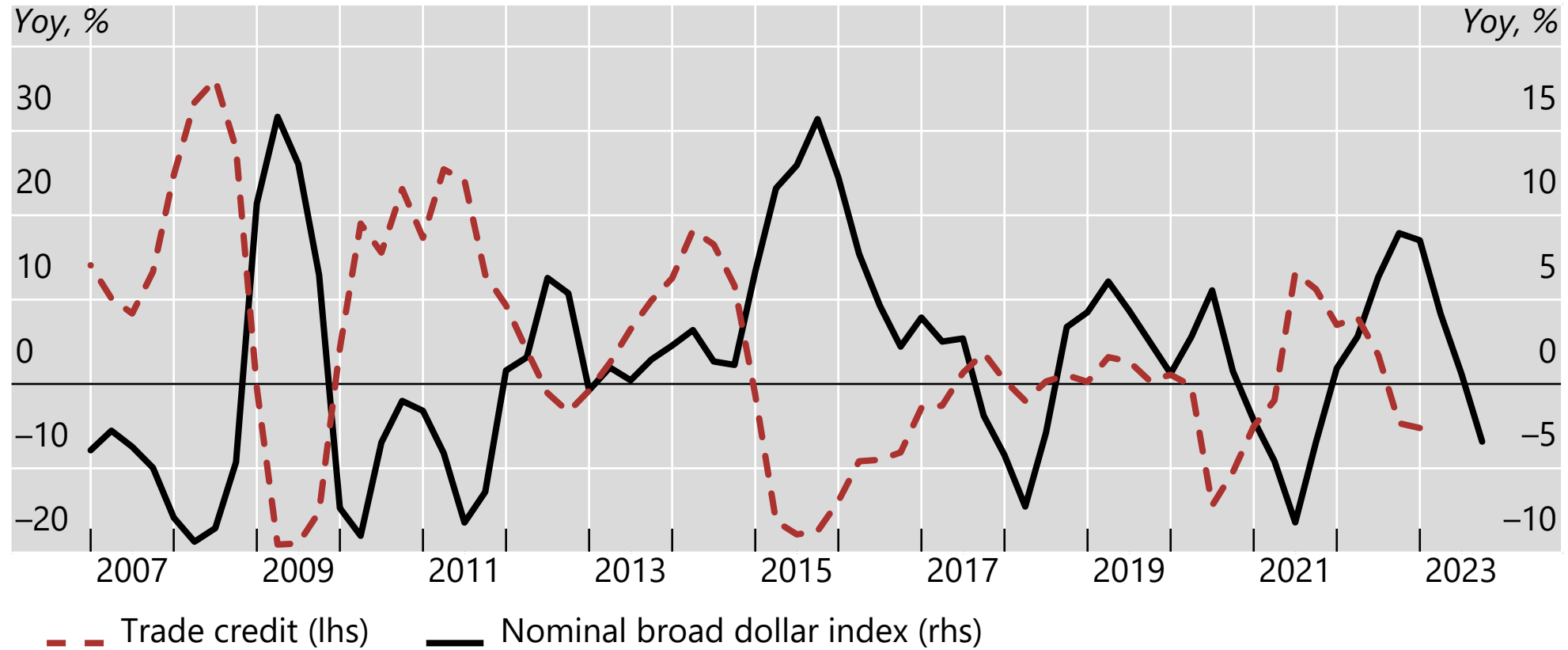
The ups and downs in the euro's role as an international funding currency



Sources: IMF World Economic Outlook; BIS locational banking statistics; BIS international debt securities statistics; BIS global liquidity indicators.

- The euro has suffered well-known setbacks and its realm may be less global than that of the USD
- But still the euro retains an important international footprint ...

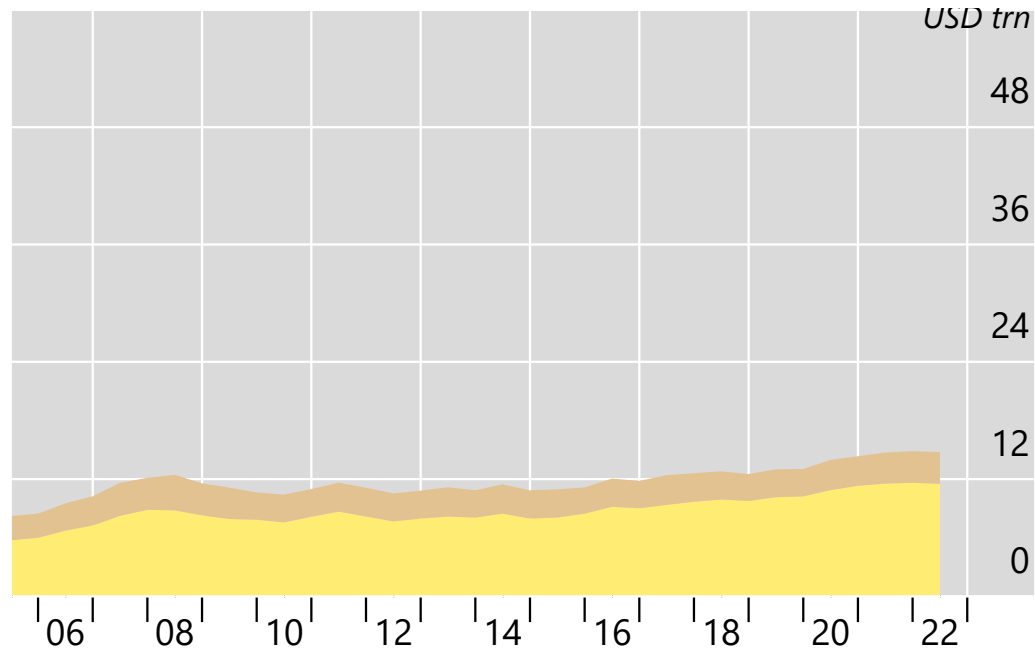
And **growth of trade finance** closely follows movements in the broad dollar index too



Sources: Federal Reserve Bank of St Louis, FRED; BIS.

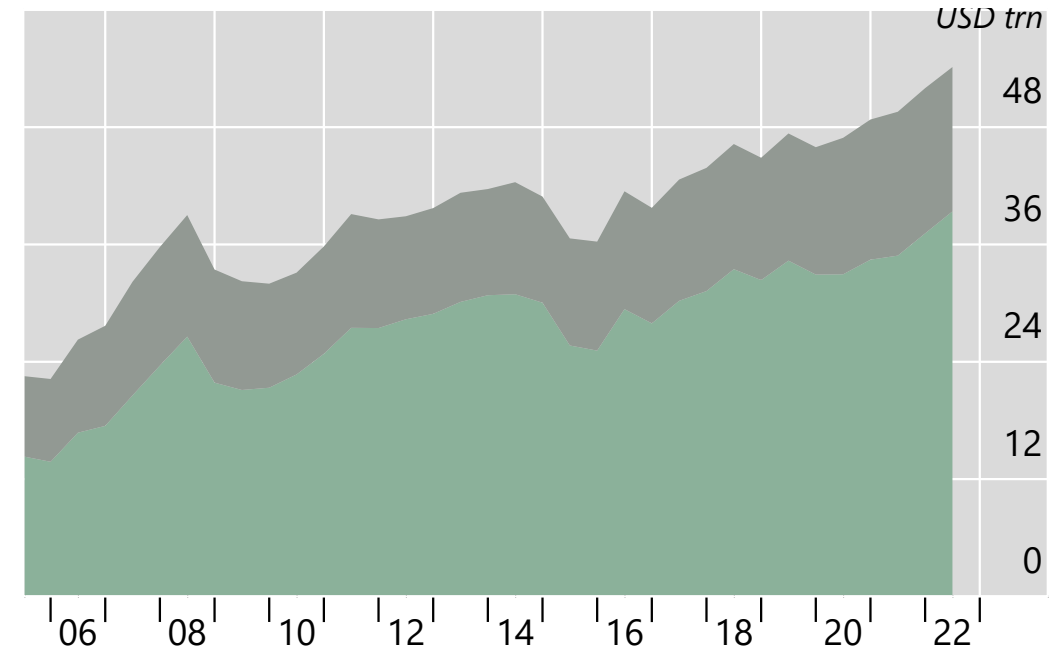
US dollar-denominated debt - Non-US banks

On-balance sheet debt



■ Booked outside the US
■ Booked inside the US

On- and off-balance sheet debt

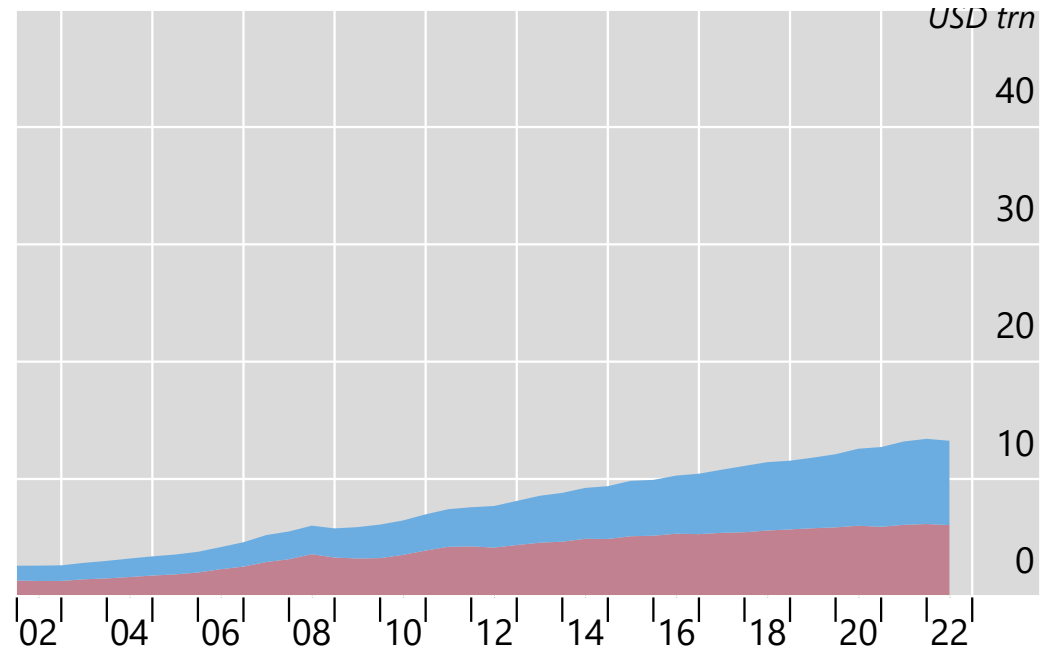


■ On-balance sheet debt
■ Estimated off-balance sheet debt

Sources: Sources: US Office of the Comptroller of the Currency (OCC); Dealogic; Euroclear; Thomson Reuters; Xtrakter; national data; BIS consolidated banking statistics (CBS); BIS locational banking statistics (LBS); BIS OTC derivatives statistics (OTCD).

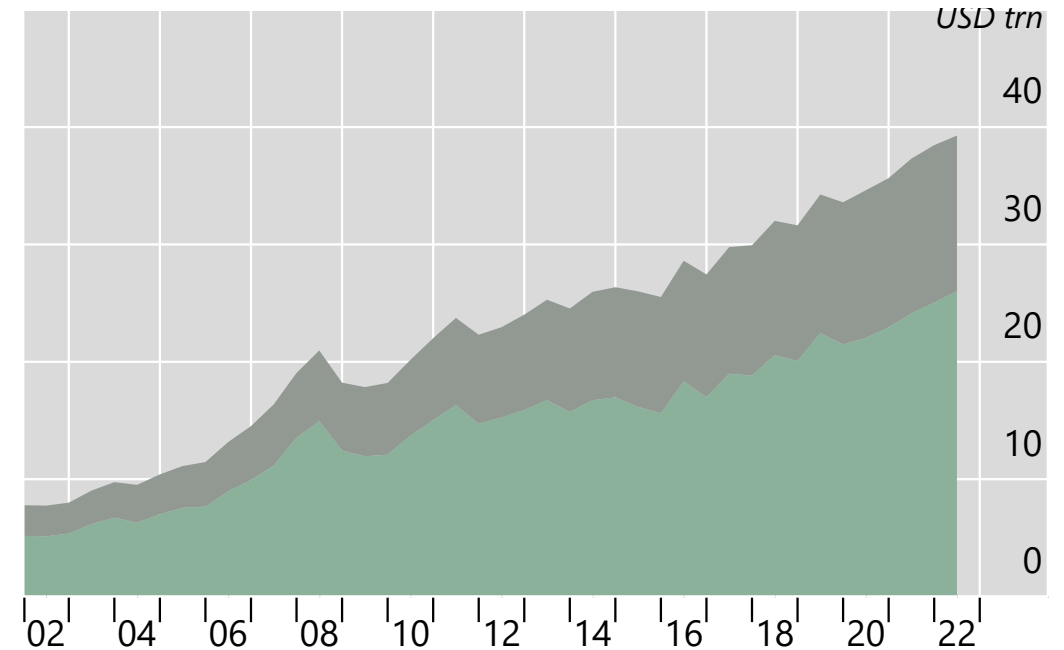
US dollar-denominated debt - Non-banks outside the United States

On-balance sheet debt



- Bank loans to non-banks
- Bonds issued by non-banks

On- and off-balance sheet debt



- On-balance sheet debt
- Estimated off-balance sheet debt

Sources: Sources: US Office of the Comptroller of the Currency (OCC); Dealogic; Euroclear; Thomson Reuters; Xtrakter; national data; BIS consolidated banking statistics (CBS); BIS locational banking statistics (LBS); BIS OTC derivatives statistics (OTCD).