

USD: Hegemonic headaches

IMF data shows another decline in the US dollar's share of global FX reserves. Here's why it matters



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➔ USD: Not everyone's in love with the dollar

We rarely talk about the dollar's hegemony – but it often comes onto our radar when the IMF releases their quarterly COFER data on global central bank reserve holdings. The latest release for 2Q18 showed another decline in the USD's share of global FX reserves to 62.25% – the lowest share since the end of 2013. This is the sixth consecutive decline since the USD's share hit 65.35% in 2016 – which is by no coincidence the dawn of the current Trump administration (more on this shortly). To be clear, it's not that reserve managers are 'dumping dollars' – but more a case of marginal additional allocation and a preference to increase holdings of other non-USD currencies. Indeed, we prefer to define this trend as a 'diversification' away from excess USD holdings. What's of particular interest is the currencies that are steadily gaining favour – namely the Chinese renminbi and Japanese yen (sure the EUR's share is up by more than one percentage point since 4Q16 – though it did fall back a bit to 20.25% in 2Q18). The key point is that real money investors may be subtly looking to shift away from the USD – a trend which, as renowned economist Jeffrey Sachs points out, could accelerate on the back of President Trump's antagonistic trade and foreign policy. Russia's central bank provides anecdotal evidence of this. We may be talking fine margins and subtle shifts – but for an \$11.5 trillion market, trends in global central bank FX reserves tell a long-run story that not everyone in the market is currently in love with the USD.

➔ EUR: Fading risks of Italy-EU budget clash help ease political woes

Media reports that the Italian government will now look to tighten the budget in 2020 and 2021 – by running a lower fiscal deficit than previously stated in these years (2.0% versus 2.4%) – has helped lift euro sentiment. We feel that a lot of bad news is already priced into Italian assets (including a Moody's downgrade) and hence see the balance of risks tilted towards the euro moving higher from here as some of the markets' worst fears are shelved. EUR/USD to drift above 1.16.

➔ GBP: May surviving Tory conference may mark a peak in UK political risks

With GBP markets breathing a sigh of relief after Boris Johnson made no official leadership bid and told delegates to 'back Theresa May' yesterday, the focus at the Tory Party conference today turns to the Prime Minister's keynote speech. The pound is trading a bit soggy going into the event – which somewhat raises the bar for any sharp negative sterling reaction to May's speech. Indeed, the negatives surrounding deadlocked Brexit negotiations and the UK government's Chequers plan are largely priced into the currency. We doubt the PM's hopes for a post-Brexit future 'full of promise' will invoke much Churchillian confidence in UK assets – but with the PM set to survive the conference politically unscathed, then today may mark a peak in short-term UK political risks that GBP investors will look to move positively forward from. GBP/USD to sustainably break 1.30.

➔ PLN: Same neutral tone from the MPC to have limited impact on zloty

Our economists look for the MPC to reiterate that interest rates should remain flat through till the end of 2019 today. The National Bank of Poland's President Adam Glapiński will likely play down the recent rise in oil given the supply-side character of the shock – thus remaining out of the MPC's control (note that the September CPI also dipped from 2.0% YoY to 1.8%). As this should be largely in line with market expectations, we look for a very limited impact on EUR/PLN (in the 4.28-4.30 range) – with the cross staying largely driven by the external environment.

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