May 2025

Unipolar disorder

How the euro can benefit from dollar disillusionment

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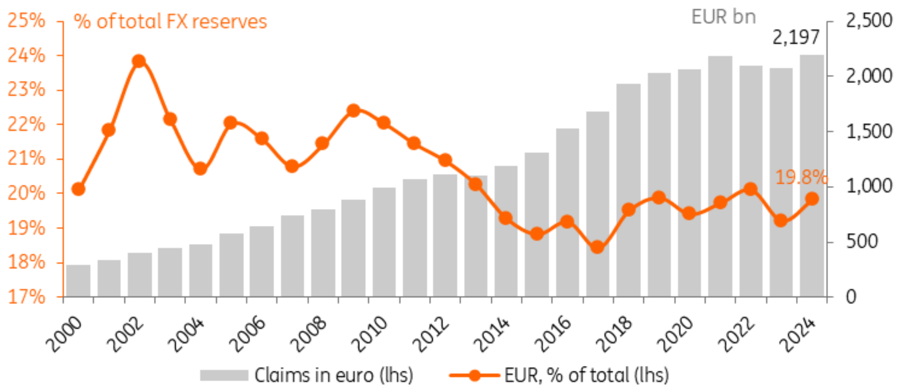
- Donald Trump's unveiling of 'reciprocal' tariffs in April caused considerable volatility and delivered a worrying performance in US Treasuries – an asset class which is normally considered 'safe'. Questions are being asked about whether his administration's geo-economic policy set will expedite the transition from the unipolar financial order, at the centre of which has stood the dollar since the Second World War.
- The transition to a new multipolar world will be a long process, but de-dollarisation in FX reserves (US$11.5trn) continued in 2024. What was new was that the euro was the key beneficiary last year. While data on private sector currency preferences is hard to come by, FX reserve holders' choices will be watched carefully. Should central banks' appetite for euros return to what it was in the early 2000s, euro-denominated FX reserves could increase by as much as around EUR450bn.
- De-dollarisation is helped by the 'domestication' of the UST market, including the exit of key Asian investors. But what does Europe need to do to attract these flows? There will be push-and-pull factors at play here, but at the heart of the story is the need for Europe to provide a high-quality, liquid pool of assets to compete with US Treasuries. Here, more German issuance would help, but it is hard to see how Europe could become a viable alternative to the USD without a European safe asset.
- There is more work to do to increase the attractiveness of euro-denominated assets. Think of an EU bond futures market to help them into sovereign indices, a stronger role for the euro in global trade by, for example, euro invoicing of green energy or a wholesale e-€ CBCD. In short, a fully-fledged savings and investments union, formerly known as Capital Markets Union, would be a good sign to ratings agencies and international investors, and could increase international acceptance of the euro.
- Official investors are also interested in credit. But the IG EUR market is only one-third the size of the USD market and needs to catch up. We're going to be keeping a close watch on flows related to USD and EUR-based credit funds for any signs that investors and issuers are redirecting their interest to euro credit product. We also note that the euro remains a strong second in international debt securities market.
- What does this all mean for EUR/USD? While not our base case, we note peak pessimism on US policy could drive EUR/USD into the over-valued region of 1.20/25. But a more sustainable advance, to 1.30+, is going to require some big changes for the eurozone in areas like energy costs or productivity. We're not there yet.

Role* of euro in the global allocated FX reserves of the central banks



*Pre-2024 shares recalculated using exchange rates of year-end 2024
Source: ING, IMF COFER;

Chris Turner
Global Head of Markets and Regional Head of Research, UK & CEE
chris.turner@ing.com

Dmitry Dolgin
Chief Economist, Russia and CIS
dmitry.dolgin@ing.de

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroder@ing.com

James Wilson
Emerging Markets Sovereign Debt Strategist
james.wilson@ing.com

Michiel Tukker
Senior European Rates Strategist
michiel.tukker@ing.com

Timothy Rahill
Credit Strategist
timothy.rahill@ing.com

Inga Fechner
Senior Economist, Germany, Austria
nga.fechner@ing.de

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

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The transition from a unipolar world

Not to be confused with other purported neurological afflictions affecting global financial markets, such as the so-called 'Trump Derangement Syndrome' (TDS), our term, 'unipolar disorder', references the transition from the dollar as the centre of the financial universe.

We've covered the topic of a transition to a bipolar or multipolar currency universe in some of our prior pieces on de-dollarisation. But the unedifying performance of US financial markets this April certainly raises the question of whether this transition will be expedited and orderly. At the heart of April's story was the performance of US Treasuries and how they failed to provide any offset to the sharp fall in global risk assets.

This volatility comes amid much uncertainty about President Trump's policy. For example, does he fully buy into Stephen Miran's Mar-a-Lago recommendations that an over-valued dollar has hollowed out the manufacturing sector and that trading partners should be encouraged or coerced into delivering stronger currencies by potentially seeing their US Treasury holdings taxed?

Let's not forget that the dollar is still a fiat currency. It's not backed by gold as it was before 1971, and is only worth as much as the global community is prepared to pay. It was no surprise that the dollar's low point in April was reached on speculation over the future of Federal Reserve Chairman Jerome Powell. An attack on the independence of the Fed - the single most important institution in our global financial architecture – clearly exposed the concentration risk in US asset markets.

While the BRICS+ grouping has long had incentives to operate outside the sphere of dollar influence, geo-economic policy from the new Trump administration, primarily in the trade and security space, questions whether the de-dollarisation project broadens.

In a recent presentation, Professor Helene Rey of the London Business School put it nicely when she referenced a 'New Kindelberger's Gap'. In the 1930s, the UK, a fading hegemon in the global financial system, lacked the ability to provide the world with vital public goods, including a stable pound, while the ascendant US lacked the will to take over. The question is whether the current hegemon, the US, lacks the will to provide a stable dollar to the financial system, while an ascendant one, the EU, lacks the ability.

While China also has a keen interest in breaking the dollar's stranglehold on the financial system, the focus of this article is on the euro – and specifically the euro as an investment currency. This is a narrower topic than the full internationalisation of the euro, which the European Central Bank covers in detail annually. However, the topic of the euro challenging the dollar's pre-eminent reserve status does implicitly reference the exceptional opportunity for the eurozone to boost the international status of its currency.

There are roughly US$128trn in assets under management (AUM) as of 2024, according to BCG. Given the lack of data on currency preferences, we focus on areas with higher disclosure, such as central banks' FX reserves (US$11.5tr in allocated FX reserves). We'll look at shares allocated to the euro and the availability of high-quality EUR-denominated fixed income assets as an alternative to US Treasuries. Given heavy weightings in reserve portfolios to government bonds, we'll primarily be examining opportunities for Europe here. But we'll also take a quick look at the corporate bond market, too. And we take a look at the sovereign wealth funds (SWF) with a combined AUM of US$13.7tr, though their asset structure is less transparent. The more progressive central banks with larger reserves and SWFs also have equity. Europe's opportunity to compete with US equity markets is outside the scope of this article.

Let's start with a look at the data and the most recent trends in de-dollarisation.

De-dollarisation of FX reserves: euro gained share in 2024

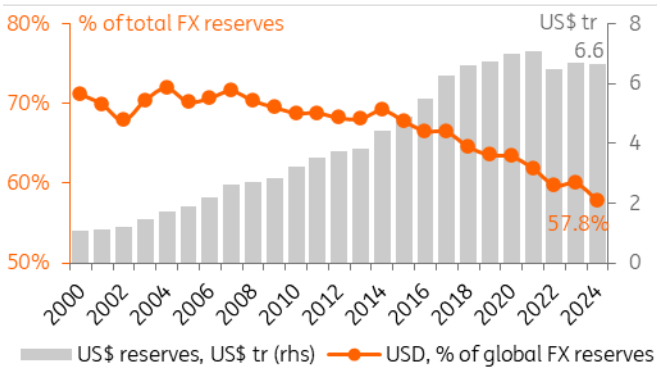
The de-dollarisation of foreign exchange reserves has been a persistent trend, which continued through 2024. According to the latest IMF COFER, the share of the US dollar in allocated central bank FX reserves stood at 57.8% as of year-end 2024. This headline figure shows only a slight change from 57.3% in the third quarter of 2024 and 58.4% at the end of 2023. However, when adjusting for a significant 7% appreciation[1] of the US dollar against key currencies in 4Q24 it suggests a 2.0 percentage point (pp) drop in the US dollar share for the entire year of 2024, including a 1.3pp decline in the fourth quarter alone.

Part of this de-dollarisation can be directly attributed to the US dollar's appreciation in 4Q24, which prompted other central banks such as Brazil and India to actively intervene in the FX market. Nevertheless, when taking a broader view, the data aligns with the long-term trend: after adjusting for exchange rate movements, the share of the US dollar in FX reserves has gradually declined by 13pp since 2000.

Importantly, the key beneficiary of de-dollarisation in 2024 was the euro – central bank holdings in this currency increased by EUR128bn (US$132bn equivalent), representing 40% of the global annual increase in allocated FX reserves last year. This represents a change from the previous dynamic, when de-dollarisation had primarily resulted in a redistribution of reserves in favour of other developed market and non-traditional reserve currencies.

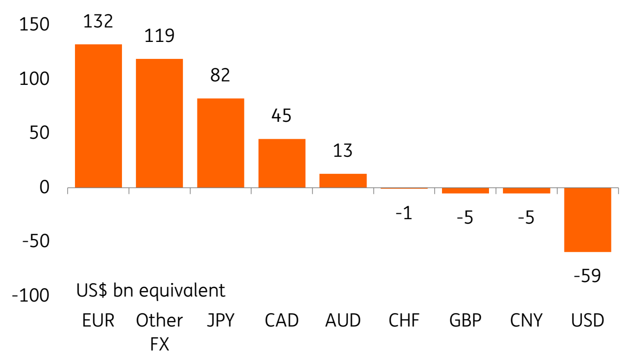
Still, despite some recovery in preferences towards the euro since the 2017 lows to which it dropped following a number of challenges, including the eurozone crisis of the early 2010s, it still currently accounts for a little under 20% of allocated FX reserves. This is 4pp below its peak of 24% in the early 2000s, adjusted for the exchange rates effects. Given today's total allocated FX reserves equivalent of US$11.5 trillion and euro holdings of EUR2.2trn, this 4pp gap corresponds to an "under-allocation" of approximately EUR450bn.

Share* of USD in global FX reserves



*Pre-2024 shares recalculated for FX rates as of YE24
Source: IMF, ING

Global FX reserves increase in 2024 by currencies



*Assuming fixed exchange rates of year-end 2024
Source: IMF, ING

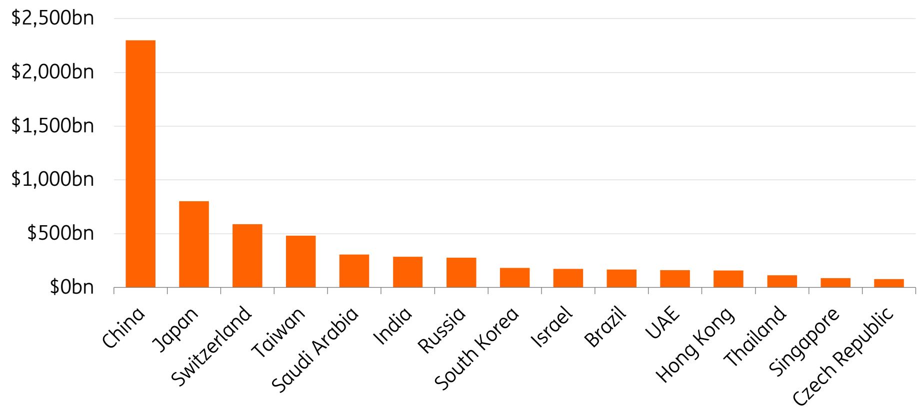
According to a NY Fed study by Goldberg and Hannaoui, the decline in the share of the US dollar in global FX reserves is historically driven by the largest reserve holders with an

[1] The appreciation of the USD exchange rate to major currencies tends to overstate the reported share dynamic of the US dollar in the overall currency mix, as the value of assets in all currencies is reported in USD. To eliminate this distortion, we recalculate the historical dollar equivalents of non-USD assets using the exchange rates from the latest reporting date.

'investment tranche'. Smaller central banks, on the other hand, maintain a high US dollar share for liquidity purposes. If we assume most central bank reserve managers want to hold a minimum of three months' worth of import coverage in terms of FX reserves for liquidity purposes, the generally accepted benchmark, then FX reserve holdings above this level can likely be deployed more flexibly and viewed as 'excess' reserves. For our calculations, we use foreign exchange reserves excluding gold, versus the broadest definition of imports (current account payments, which include goods, services, income payments and transfers). By this measure, the 15 largest pools of 'excess' FX reserves within a potential 'investment tranche' across EM and G10 central banks total over US$6tn, over one half of the world total.

Unsurprisingly, China's PBoC is the key player here, with US$2.3trn in 'excess reserves', followed by Japan and Switzerland in the G10 space at US$800bn and US$590bn, respectively. In terms of EM regions, Asia and the Middle East dominate, with Russia, Brazil, and the Czech Republic the only three EM central banks outside of these regions within the top 15. The importance of the BRICS grouping is also clear here, with Brazil, Russia, India, China and the UAE among the top 15[2].

'Excess' FX reserves above 3-month import coverage benchmark



Source: IMF, National sources, Macrobond, ING

The benchmark of three months' imports is not a concrete rule, with developed market central banks, in particular, often holding smaller reserve portfolios, while countries with pegged exchange rates may want to hold larger stocks of FX reserves purely for liquidity purposes. Finally, outside of pure foreign currency reserves, allocations to gold have also become a more significant consideration for some central banks and could be seen as part of this 'investment tranche'.

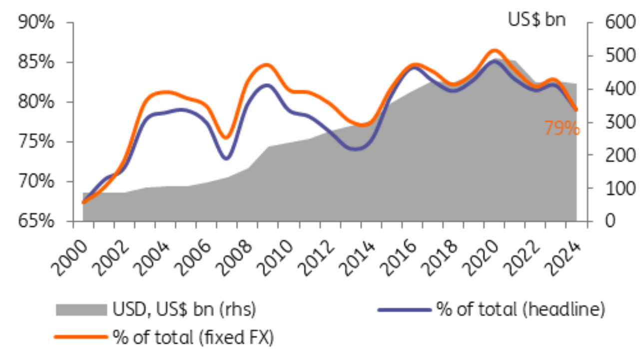
On the use of this 'investment tranche' by reserve managers, 3.9 percentage points (pp) out of the nominal 7.0pp de-dollarisation observed between 2015 and 2021 was driven by the largest 16 central banks, including China, India, and Turkey, according to the abovementioned study NY Fed. This trend is likely to have continued in recent years. According to our estimates, BRICS+, which account for 43% of the world's total FX reserves, stopped actively accumulating currency reserves around 2014, and in a more recent development, their overall foreign currency holdings were virtually flat in 2024 after posting the equivalent of a US$253bn increase in 2023. China, Hong Kong and Macau, jointly accounting for 69% of BRICS+ FX reserves, played a big role in this dynamic, showing a combined drop of FX reserves of US$38bn equivalent in 2024 vs. a US$114bn increase in 2023. While the overall FX structure of the China-related reserves is not

[2] The Bank of Russia had reduced the US dollar holdings to US$69 bn, or 14% of its foreign currency reserves (ex. gold) by the beginning of 2022, the latest official disclosure date, and is unlikely to have contributed to the global dedollarization process recently.

disclosed, the HKMA reserves management report suggests a 3pp decline in the US dollar share to 79% in 2024.

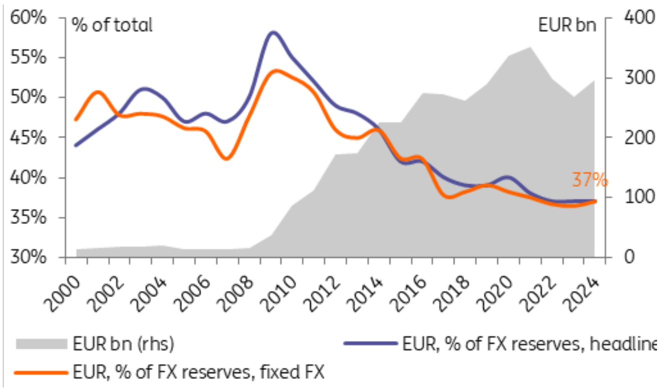
A direct example of how large reserve holders play an important role in the shift of FX preferences is the Swiss National Bank (SNB), which discloses the full FX structure of its reserves. With US$0.8trn equivalent of foreign exchange reserves as of YE2024, it accounts for 7% of global total FX reserves while its EUR0.3trn holdings account for 12% of the world's euro reserves. The SNB accounted for about 21% of the rise in global euro holdings in 2024, contributing EUR27bn out of the EUR128bn total increase. From 2008 to 2024, it supplied EUR0.3trn of the EUR1.4trn cumulative growth. Yet despite this growth, the share of EUR in the SNB's reserves is only 37% currently, vs. a peak of 53% (adjusted for exchange rate movements) seen in 2009-2010.

Role* of USD in HKMA's FX reserves



*Pre-2024 shares recalculated for FX rates as of YE24
Source: HKMA, Refinitiv, ING

Role* of euro in SNB's FX reserves



*Pre-2024 shares recalculated for FX rates as of YE24
Source: SNB, Refinitiv, ING

With a number of large FX holders being highly sensitive to US actions and signals on trade and overall economic policy, the trend for de-dollarisation of FX reserves will probably continue, intensifying the search for suitable alternatives.

There is also the small issue of 'returns' – the third component of the 'Safety, Liquidity and Return' mandate for FX reserve managers. Here, both the Swiss National Bank and Czech National Bank suffered large net losses on their FX reserves in 2022. Both have some of the more diversified holdings when it comes to equities (20%+). And both could be some of the more sensitive to any secular decline in the dollar.

Before turning to the availability of high-quality fixed-income assets in Europe, we'll take a quick look at what the ever-expanding stockpile of US debt has meant for the USD share in reserve manager holdings.

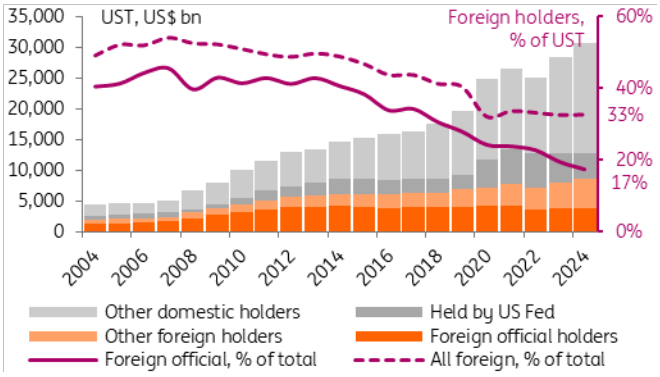
Growing US debt does not prevent de-internationalisation of USD

An important contributor to the de-dollarisation of reserves, which might be creating opportunities for assets in other currencies, is the 'domestication' of the US Treasury market. The share of foreign holders of UST seems to have gradually declined from 54% before 2008 to 33% currently. The share of foreign official holders, such as central banks and sovereign wealth funds (discussed later in the article), has dropped more rapidly, from 46% to 17%. In absolute terms, official holders have ceased accumulating UST positions since 2012 – their UST portfolio has been fluctuating in the US$3.7-4.2trn since then. This indicates that the continued increase in US public debt supply is not translating into higher preference for dollar assets by central banks and sovereign funds.

Rather, the net issuance in the US Treasuries market in recent years has been absorbed mainly by domestic private investors. They bought as much as 95% of net issuance in 2024 vs. 74% in the last 10 years and 61% in 20 years, suggesting an increased level of 'domestication'. Interestingly, the contribution of the Federal Reserve to the de-internationalisation of the US Treasuries market has been much more modest. Over the last 20 years, the Fed's holdings of US government debt – through several rounds of quantitative easing (QE) – increased by US$3.6tr, or just 14% of the market growth, with only a few periods of significant contributions (50% of the market growth or higher) in 2006, 2013, and 2020-21.

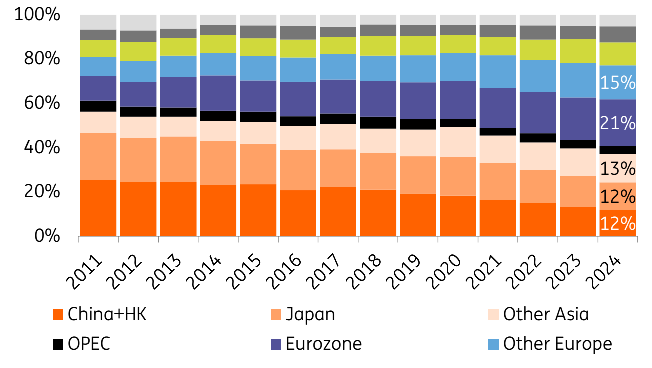
The geographic structure of foreign holders of UST (combining public and private holders) indirectly confirms that countries with the largest balance of payments surpluses, such as China and Japan, are significant drivers of de-dollarisation. Another noteworthy observation is that Europe is poised to overtake Asia as the largest foreign UST holder, with shares of 36% and 37%, respectively, as of 2024.

Holders of US Treasuries outstanding



Source: US Treasury, ING

Foreign holders (official and private) of US Treasuries



Source: US Treasury, ING

The issues related to the US fiscal and debt trajectory, combined with direct actions and signals from the US administration, including proposals related to foreign ownership of UST, could further hamper foreign interest in Treasuries, particularly from investors in Asia, which used to be traditional holders of US public debt. While USTs are not the only USD-denominated assets held by FX reserves managers, they have long been regarded as the most liquid and secure. This raises the question of potential alternatives should current trends persist or accelerate.

And given April's events, scrutiny will intensify over whether foreign investors—both public and private—are reducing their presence in the Treasury market. Despite messy Treasury auctions in April, US Treasury data did not show a material drop-off in foreign demand. And equally, the US Treasury International Capital System (TIC) data has yet to show a foreign exodus from the US Treasury market. TIC data for March is released in mid-May, but the key April data does not emerge until mid-June.

We'll also be keeping close watch of the Fed H.4.1 weekly releases, which show the amount of US Treasuries held in custody for foreign central banks. Any sharp decline here will invariably fire up the de-dollarisation discussion. Also of interest are remarks by the co-head of Germany's debt management agency, speculating that investors will switch to overseas bond markets as US Treasury bond holdings mature.

But enough of Treasuries. Does Europe have a sufficient amount of high-quality and liquid fixed-income assets to compete?

What does Europe need to do now?

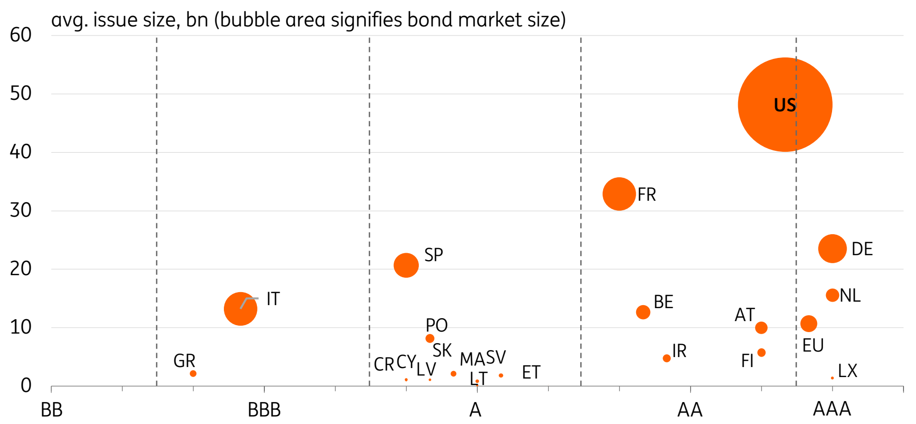
Government bonds: Size matters

The [2024 ECB report on the international role of the euro] implies sluggish issuance of euro-denominated debt as a factor limiting the internationalisation of the euro. To what degree can euro reserve assets really replace US assets? While the behaviour of US Treasury bonds over the past weeks has raised concern over a loss of confidence in the quality of US debt, the reality is that there is still little alternative in terms of market depth and liquidity.

In terms of scale, the euro government bond market—including EU-issued bonds—stands at nearly €11 trillion, roughly half the size of the US Treasury market. Crucially, though, the euro debt market is not homogeneous. It is divided across the 20 member states of various economic sizes, credit quality, and perceived political stability. Considering that central banks and sovereign funds currently prefer sovereign bonds with at least a single-A rating as their primary asset, one would have to set aside the significant portion presented by the Italian market.

However, the ability to trade large amounts, especially in times of stress, is at least equally important. If we use average issue size as a proxy for liquidity, the fractured nature of the eurozone government bond market appears even more striking relative to the US market. Only a few individual country bond markets come anywhere close to competing with the US.

Sovereign and EU-bond markets relative size and ratings



Source: national debt agencies, Big-3 rating agencies, ING

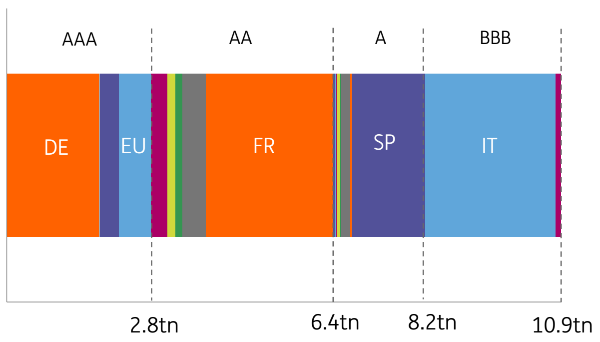
In theory, the current situation poses an opportunity for the euro to build out its share in FX reserves. A key factor limiting the euro's potential in past years was, among other things, the lack of supply in high-quality, liquid euro assets.

Part of the reason was that these assets had been bought up by the ECB itself. It currently still holds more than €3tn in public sector euro debt. The estimated investor structure of German government debt assets provided by the finance agency shows how the ECB's quantitative easing also "ate" into foreign official holdings.

That supply picture is turning now, not just with the ECB rolling off its bond portfolio, but also with prospects of more issuance to finance a ramp-up in defence spending and – in Germany – in infrastructure investments. However, there is not yet any commitment or clarity on the exact spending plans. Don't forget that the €150bn in additional EU debt to fund national defence spending still depends on individual member states requesting such a loan. The European Commission would then have to agree and issue EU bonds for the funding. If all the money were to be used, it would push the EU bond market to €1trn by the end of 2026. Germany could look at additional net issuance of more than €100bn per year starting in 2026 as part of its defence plans and €500bn infrastructure package.

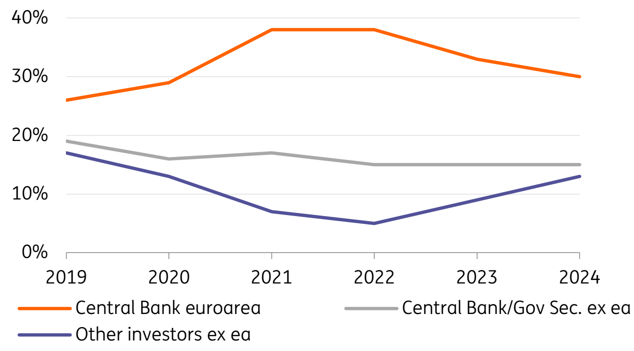
However, these volumes are not likely to change the bigger picture relative to the USD. The steps needed are further EU integration and common debt issuance beyond the time-limited programmes which currently exist. On that subject, we imagine that the progress of the new Savings and Investments Union (SIU), complementing Banking Union (deposit guarantees) and the Capital Markets Union, would be welcomed by ratings agencies and investors alike.

EGB market (+EU bonds) by rating



Source: Debt agencies, ING

German debt holdings by investor type



Source: German debt agency (DFA), ING

Joint EU bonds can be an attractive global safe asset, but this comes with challenges

One could argue that joint EU issuance addresses the problems of a fragmented market and, with an AAA rating, would provide an attractive safe asset to investors. But so far, market players have not been convinced of the potential of EU-issued bonds. Bond programmes have been sporadic in nature, with the Next Generation EU recovery package the latest example. Investors prefer certainty that they can maintain their bond allocation over the long term and not just on an ad-hoc basis.

Meanwhile, market infrastructure players are making attempts to increase the role of EU bonds in markets, but progress has been slow. The adoption of EU bonds in key government benchmark indices such as MSCI and ICE was rejected after consulting investors. One argument raised against the inclusion was the lack of a futures market, which is an important hedging tool to manage interest rate risk. Since then, Eurex has announced it will launch a futures contract on EU-issued bonds in September, while ICE has already launched an EU bond futures contract, though liquidity remains limited so far. Index providers will organise new consultations this year to review whether opinions have changed.

Also, the ECB has taken steps to build confidence in the euro as a reserve asset. The Eurosystem repo facility (EUREP) was called into existence during Covid and offers euro liquidity to central banks outside the eurozone. In exchange for eurozone government bonds, other central banks can obtain euros in times of liquidity stress. Such a repo facility prevents the forced sale of government bonds, thereby addressing the risk of bond yields spiralling up due to market shocks. This facility is in addition to the usual FX swap lines that the ECB has outstanding with all major developed markets, including China.

Even with the technical hurdles overcome, the political dimension cannot be ignored by bond investors. So far, all initiatives for the joint issuance of EU debt had been temporary. Northern European countries, in particular, have opposed joint debt, pointing to the risks of debt mutualisation, moral hazard and the no-bailout clause. Still, the discussion on joint EU debt has changed in Europe, from emphasising the no-bailout clause at the start of the Greek crisis to conditional financial support, project bonds during the pandemic and now, defence-related funding. However, to really convince investors to shift assets into euro, predictable issuances and clarity on the treatment of debt are needed, something a German Bund still offers to a greater extent.

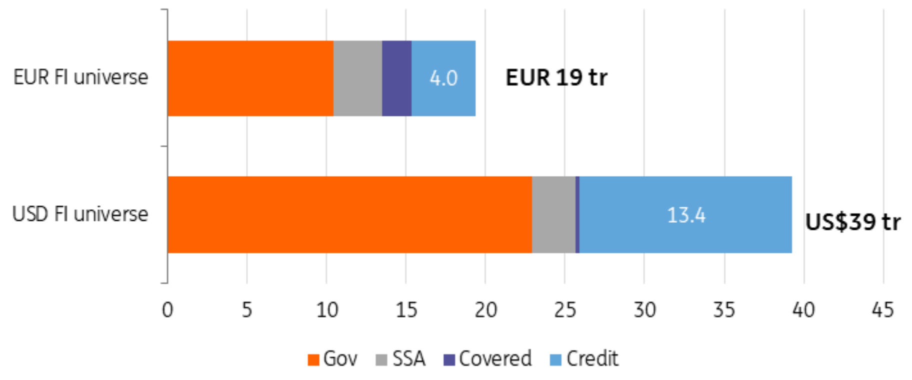
To conclude this section on European government bonds, we would argue that if Europe really wants to challenge the safe asset primacy of the US Treasury market, it is hard to see that happening without a larger and more predictable supply of joint debt.

Credit: More interest in EUR product?

Not many, but some central banks do hold private credit in their FX reserve portfolios, and credit is certainly of more interest for the risk-seeking sovereign wealth fund community. For example, in 2024, government bonds made up 82% of the SNB's total bond holdings, with the rest being comprised of debt holdings in supranational issuers, local authorities, financial institutions, and other companies.

According to our estimates, the investment-grade USD-denominated private sector credit market, valued at US$13.4 trillion, is approximately three times larger than its euro-denominated counterpart (EUR4.0 trillion). This disparity underscores the US dollar market's superior depth and liquidity, particularly in this segment. Overall, when high-grade government, supranational, covered, and private sector credit is combined, the euro-denominated segment is slightly more than half of its USD-denominated counterpart.

Investment-grade* fixed income space composition by currency and issuer type



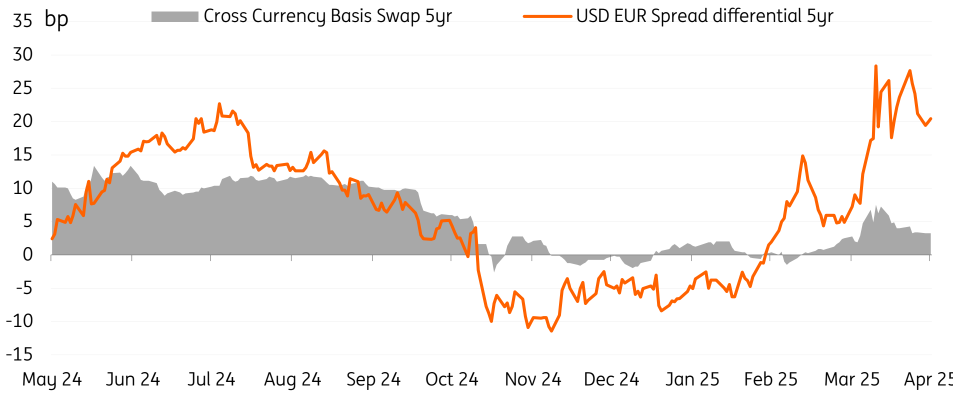
*Includes issues with investment grade ratings assigned by at least one of Big-3 rating agencies
Source: ING

What are the chances of de-dollarisation showing up in the currency preferences of credit market investors?

USD credit has been the underperformer in the recent market volatility as risks on the US side are perceived to be higher for now. Of course, USD credit is coming from a much more expensive place and had more room to swing wider, but even the recent retracement of spreads is minimal relative to euro credit.

Reverse Yankee supply is set to increase as market conditions increasingly favour cost-saving advantages for US issuers. The increased differential between EUR and USD spreads creates a lower cost of issuance in euro, particularly as the cross-currency basis swap remains at historically very low levels. This could be an important watch factor as the higher cost of issuance has been mentioned by a number of investors as an obstacle to higher euro usage.

Cross currency basis swap and USD EUR spread differential - 5yr



Source: ICE, Refinitiv, ING

Already, we have seen a jump in Reverse Yankee supply, with April levels reaching €21bn, the highest monthly Reverse Yankee supply since May of last year. This is significant considering the very low issuance levels seen overall in April, as primary markets were closed on the back of market volatility and holidays. Therefore, whilst windows were limited, US issuers were ready to act swiftly when the opportunity was presented.

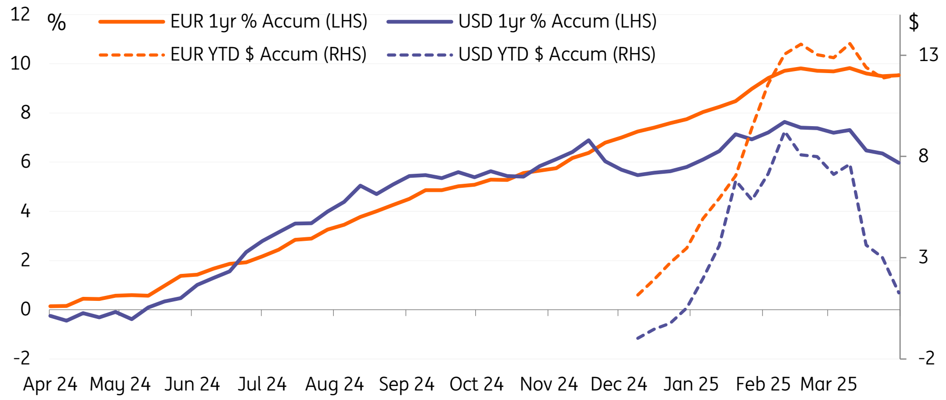
In times of volatility and uncertainty, the general preference is to lean towards the safer, more well-known domestic issuers. But at the moment, there is still so much cash to be put to work from euro investors that US companies bringing Reverse Yankees will be met with strong demand in the form of relatively low New Issue Premia and oversubscribed books.

Outflows have been more drastic in USD, which raises the question as to whether there is any solace to be found in euro credit for investors. There has been a clear slowdown in USD inflows since late last year, with the 1yr accumulation of USD inflows amounting to about 6% of AuM, compared to nearly 10% in euro inflows. Taking a shorter time frame of just the past four months, euro inflows have equated to US$12bn, versus only about US$1bn flowing into USD after much has been wiped out in recent weeks. In our opinion, euro credit is set to see less volatility than USD credit in the coming months, with technicals stronger in euro.

Speaking to our colleagues in Debt Capital Markets, they mostly agree that the appetite to issue in euro credit will largely be commercial at this stage, as per the Reverse Yankee story above. But the issuers will be keeping a close of watch on flows between USD and EUR-denominated credit funds. Any clear preference for euro-dominated debt could see issuers follow, helping to build out the size of the euro Investment Grade credit market.

A larger and more liquid euro-denominated credit market could provide more of an alternative to those FX reserve and SWF managers who invest in private sector credit markets.

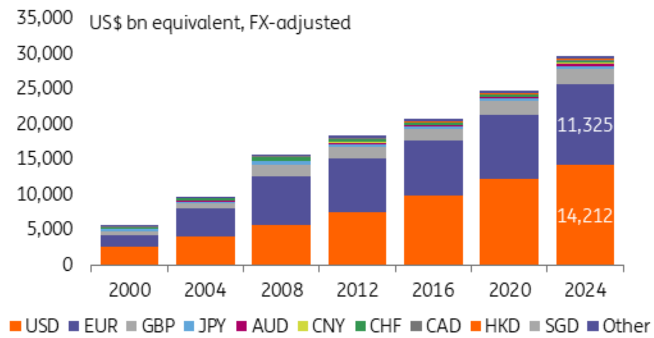
Outflows more drastic in USD credit



Source: ING, EPFR

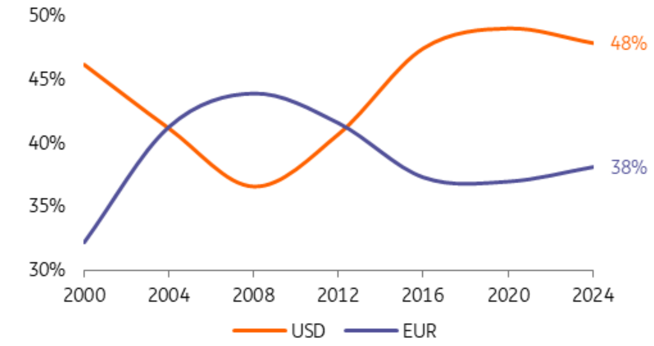
Longer-term trends tend to confirm this, as despite a few challenges, the euro remains a strong and stable runner-up to the US dollar in the growing market of international debt securities. By the end of 2024, non-domestic euro-denominated debt totalled €11 trillion, making up 38% of the global market, significantly ahead of other non-USD currencies. In comparison, GBP accounts for 8%, while JPY, AUD, and CHF each represent just 1%. Interestingly, despite the active efforts related to the internationalisation of CNY, it also holds only 1% of the global Eurobond market so far.

International debt securities (IDS) by currencies*



*Assuming fixed exchange rates of year-end 2024
Source: BIS, Refinitiv, ING

Shares* of USD and EUR in IDS outstanding



*Pre-2024 shares recalculated for FX rates as of YE24
Source: BIS, Refinitiv, ING

Enhancing trade in euro

Another way to increase the euro's share in FX reserves is by enhancing trade ties. The abovementioned NY Fed research shows that countries with significant trade relationships with the EU tend to hold a larger portion of their FX reserves in euro. This is because holding reserves in the currency of major trading partners can reduce exchange rate risk and transaction costs. Also, while the US dollar is a globally dominant currency, the euro is in fact a regionally dominant currency not only in Europe but also in parts of Africa, as ECB and IMF research has shown. Next to geopolitical proximity, countries preparing to adopt the euro or that joined the EU, as well as EU candidate countries and other European nations, have increased their use of the euro for invoicing, often at the expense of the US dollar. This trend is evident in the export data of these countries, showing a rise in euro invoicing alongside a decline in US dollar invoicing.

The long-term trends related to global trade and financial ties seem to confirm opportunities for the euro in this regard. A study of IMF Direction of Trade Statistics (DOTS) by Agrippino, Nenova, and Rey suggests that in the period between 2000 and 2019, the network of global trade has evolved from being centred around the US to being tripolar, with the eurozone, the US, and China in the middle. Additionally, according to the same study, the eurozone seems to have caught up with the US in terms of portfolio investments. Therefore, despite a stable share in the global trade flows over the last 20 years (at close to 30% of world exports), qualitatively, the euro could now be better positioned to take a greater international role as currency of invoicing and reserves.

Here, one immediately thinks of the myriad of PBoC swap lines to encourage the use of the renminbi as part of China's Belt and Road Initiative. For reference, the ECB currently has swap lines with 16 countries. Any additions here over future years would be a signal of a more activist ECB in this regard, and certainly the ECB was more activist in 2022 when it extended its repo and swap lines to additional non-euro area central banks.

And while we're on the subject of some blue sky thinking, some believe that expanding the eurozone to include Poland, Sweden, and Denmark would clearly increase the sway of the currency. Yet those three countries typically sit at the bottom of the table when EU members are asked about EMU being a good idea.

Other areas occasionally discussed when it comes to building out the use of the euro in trade – and hence the need for central banks to hold euros – are topics like the pricing of green energy and the financing of the energy transition (where Europe dominates), plus the potential rollout of an e-€ wholesale central bank digital currency.

When it comes to green energy, Europe has a lot of work to do to wean itself off the dollar-denominated LNG market. Equally, Gerben Hieminga, ING's senior sector economist for energy, thinks hydrogen priced in euros may not be a significant story until after 2035 and will initially be grey hydrogen from natural gas (a dollar story).

For wholesale CBDCs, Teunis Brosens, ING's Head of Regulatory analysis, discussed in our last de-dollarisation article that while the technology for wholesale CBDCs is there, the organisation and governance are not. He makes the very fair point that in this space, 'we tend to overestimate short-term changes but underestimate the long-term impact'. Given that the ECB is largely focusing on a retail CBDC at this stage, it seems the ECB has a huge amount of work to do here.

In short, there could be an opportunity for the euro to play a greater role in invoicing, but it seems like policymakers will have to push their agendas even harder.

Potential interest from sovereign wealth funds

When talking about de-dollarisation and opportunities for the euro, the sovereign wealth funds need to be mentioned specifically. Although they are not included in the IMF COFER data, they still matter for the international role of a currency. According to the SWF Institute, the assets under management of the world's top 100 sovereign wealth funds slightly exceed those of central banks, amounting to approximately US$13.7trn equivalent. These assets are reportedly deployed across a much wider set of assets compared to more traditional asset allocations of monetary authorities.

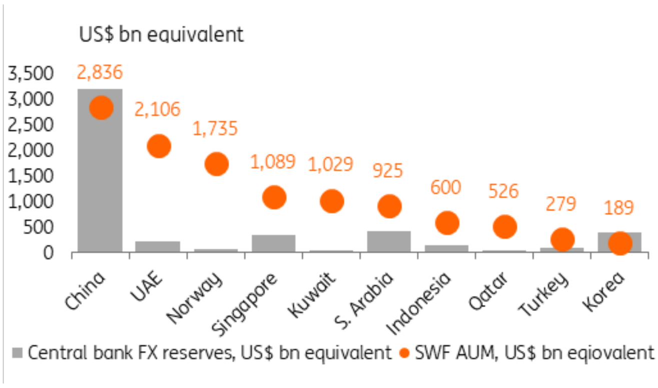
In some cases, the size of sovereign wealth funds can dwarf the reserve holdings of the respective national central banks, which is especially true of the oil-producing countries, including Norway and the Gulf Cooperation Council (GCC) nations in the Middle East.

As an illustration, 83% of the assets under management ($11.3trn out of $13.7trn) of the world's largest sovereign wealth funds are concentrated in 10 countries, and their combined SWF AUM are more than double the size of their national central banks' FX reserves of US$5trn. Meanwhile, in the case of Norway and the oil-producing countries of the GCC region, SWF assets under management are nearly eight times the central bank FX reserves – US$6.3trn vs. US$0.8trn.

The currency disclosure of the SWF asset portfolios is less readily available than that of central bank reserves, but anecdotal evidence from Norway's Government Pension Fund

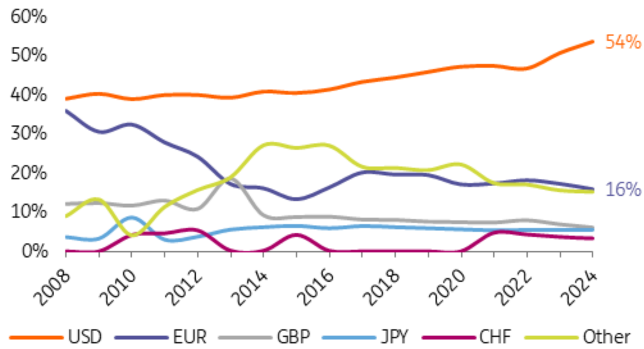
Global, which has assets totalling around US$1.7trn equivalent (12% of top 100 SWFs) suggests that the USD remains a favoured currency for investments, while the euro is the top second choice as a developed market currency but is in close competition with non-traditional currencies. An important caveat here is that bonds account for only 27% of the GPFG's portfolio vs. 71% in equities, serving as an indicator that SWFs' asset allocation could be much closer to the private sector. This makes SWF behaviour an important watch factor for global investment appetite.

Central bank FX reserves vs. sovereign wealth fund AUM* for largest holders



*CB FX reserves as of year-end 2024, SWF – latest available date
Source: IMF, SWF institute, national sources, ING

FX structure* of Norway's sovereign fund AUM



*Pre-2024 shares recalculated for FX rates as of YE24
Source: NBIM GPFG, Refinitiv, ING

Sovereign investors in the Middle East, particularly those in the GCC, tend to prefer the USD due to the invoicing of oil in USD, which leads to USD pegs for their currencies. This consideration seems to outweigh the political distance of those countries from the US. According to the IMF working paper by Arslanalp, Eichengreen, and Simpson-Bell, the USD peg is one of the key determinants of the elevated USD share in FX reserves. This peg ensures that the currencies of these oil-exporting countries remain stable and aligned with the US dollar, further solidifying the USD's dominance in their reserve portfolios.

Whether the shifting nature of the US security umbrella has any major ramifications on the SWF's dollar share remains to be seen. But we would say this community is more akin to those central banks with large investment tranches. And in addition, SWFs have been entrusted with keeping the proceeds of the country's natural resources safe for future generations. Those future generations may not forgive portfolio managers who have overstayed their welcome in US asset markets.

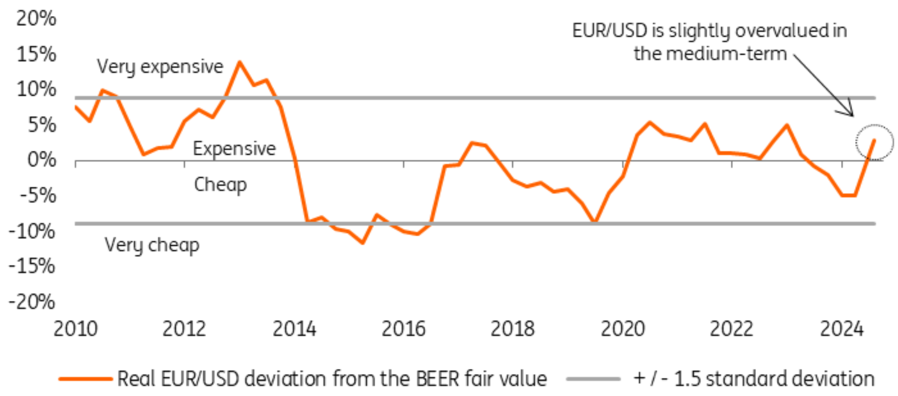
Opportunities for the euro in this regard could potentially arise along with the global energy transition and in cases of greater diversification of commodities trade invoicing. Even if the hydrocarbon trade shifts away from the US dollar, the euro would still face strong competition from other currencies, including non-traditional ones. This challenge is particularly pronounced given Russia's geopolitical aversion - as a major hydrocarbon market player and a holder of substantial central bank reserves - to both the dollar and the euro.

EUR/USD: Sizing the rally

A discussion of the euro benefiting from de-dollarisation, be it in the private or public sector, invariably brings us to EUR/USD. Are we seeing a cyclical or structural rally? While EUR/USD responds primarily to market factors (rate differentials, risk sentiment, commodities) in the short term, economic fundamentals dominate longer-term moves. Our Behavioural Equilibrium Exchange Rate (BEER) model estimates medium-term fair value through economic variables, excluding market factors. Terms of trade show the highest beta in the EUR/USD model, followed by labour productivity and the current account balance.

As of end-April (spot 1.14), using quarterly data through March 2025, EUR/USD sits roughly 2.5-3.0% above its medium-term equilibrium. Historically, moves beyond 1.5 standard deviations (9% from fair value for EUR/USD) signal extreme misvaluation and typically precede reversals in the following quarters.

Deviation of EUR/USD vs. its fair value according to BEER



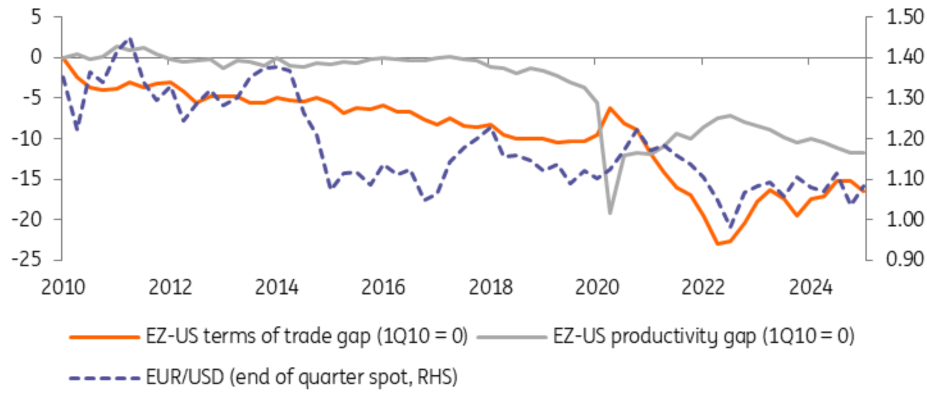
Source: Macrobond, ING

Since our BEER-implied fair value is currently around 1.11, a move to 1.20 would take EUR/USD right to the “very expensive” threshold. That is, however, only if EUR/USD fair value remains unchanged, and we don’t think this will be the case. The first month of the second quarter has seen the terms of trade differential shift notably in the eurozone's favour versus the US, largely due to opposite energy trade positions (the eurozone is a net energy importer and thus benefits from falling energy prices while the US is a significant exporter and experiences the inverse effect). Barring a reversal higher in oil and gas prices, EUR/USD fair value should trend higher from here, perhaps close to 1.15 at the end of 2Q. That would push the 1.5 standard deviation upper-bound to around 1.24, meaning moves up to 1.20/25 would represent overvaluation, but not extreme mispricing. In other words, a EUR/USD move over 1.20 this year is entirely possible

However, sustained moves beyond 1.25-1.30 would require a much more radical improvement in eurozone economic fundamentals relative to the US: a terms of trade recovery beyond the current energy dip, a reversal of the US-EZ productivity gap, and failure of US policies to reduce its current account deficit. For now, this all seems a stretch.

Our baseline view sees a conservative, multi-quarter advance in EUR/USD to the 1.15 area – though risks are skewed to the upside.

Market EUR/USD vs. EZ-US terms of trade and productivity gaps



Source: Macrobond, ING

Conclusion

- The worrying performance of US Treasuries in April should, in theory, present an opportunity for Europe to demonstrate its offering of alternative safe assets.
- When it comes to the world's $128trn in assets under management, a standardised data set for currency breakdown is hard to come by. But insights from central bank FX reserves, representing about 10% of global AUM, suggest this community continues to diversify its dollar holdings: the dollar share in FX reserves has fallen 13 percentage points since 2000.
- 2024 marked a new development: reserve diversification flowed more into euros than to other currencies. If reserve managers restored their euro allocations to 2000 levels, an estimated €450 billion in assets could be purchased. Key actors in this could be China, Switzerland and Japan which have some of the largest investment tranches in their FX reserve portfolios.
- De-dollarisation is helped by 'domestication' of the US Treasury market, as the share of foreign holders is at 33% (and 17% for central banks and sovereign wealth funds). Public and private investors from Asia, especially China, seem to preside over the foreign outflows from the US Treasuries.
- Does the eurozone have sufficient high-grade bonds to offer? The stock of eurozone government bonds is only half that of the US. The ECB scaling down its bond holdings will help, as will more German issuance. If Europe wants to create competitive safe assets, sizable and predictable joint EU issuance is needed. Hurdles to overcome, in addition to politics, include the creation of a liquid futures market allowing inclusion of joint debt into key market indices.
- Credit is also attractive for some public investors. So far, euro IG credit is only one-third the size of the USD market. But this year, we expect commercially driven Reverse Yankee issuance to help the euro. Fund flows in the credit space would be the factor to watch. Any sizable shift from USD to euro – an investor-driven move – could have important implications for issuers and euro holdings.
- Euro already holds a formidable 38% share in the global Eurobond market and will be the go-to currency for issuers with any doubts about dollar product.
- The share of currency in FX reserves is also determined by trade and portfolio ties, and the world, some argue, has recently become tripolar. The transition away from the dollar hegemony could be aided by enhancing the euro's role in trade invoicing. The ECB could take a leaf out of the PBoC's book and more broadly roll out euro swap lines to interested parties. Equally, the euro's role in financing the green transition and green energy pricing could help here.
- Sovereign wealth funds with US$13.7trn in AUM and asset allocation closer to the private sector are important players to watch. Oil-producing GCC countries tend to favour USD due to currency pegs, but the global energy transition and higher diversification of commodities trade invoicing could help.
- What are the long-term implications for EUR/USD from all of this? Real-world fundamentals are going to need to change to drive a sustainable move over 1.30. In our medium-term models, factors like terms of trade or productivity differentials have had a big say in EUR/USD pricing. Unless and until we can see Europe benefiting from much lower energy prices – or Europe's productivity somehow outpaces that of the US – it is still hard to make the case for a much higher EUR/USD over the longer term.

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