CHAPTER EIGHT

World Reserve Currency

Reserve Currency

The Gold Standard

Reserve Currency

Reserve currency
A currency that is held in large quantities by other central banks of the world as a part of their holdings of foreign exchange reserves.

Reserve currencies are accepted as a medium for settlement of international debts.

To be a reserve currency it must follow two rules:

1. The reserve currency must have a stable long-term value
2. The reserve currency must be readily available as a supply of money and securities in that currency

The U.S. Dollar - An Accepted form of Reserve Currency

- U.S. currency is seen as strong, stable, and confidence inspiring (particularly after WW2)

Reserve Currency

Advantages of the U.S Dollar Being A Reserve Currency

- Reduced concern about the inherent exchange rate risk faced by other countries in the currency conversion process
- Ability to make policy decisions from purely domestic perspectives

Disadvantages of the U.S Dollar Being A Reserve Currency

- Lowers bond yields
- Continual running of the trade deficit is a downside because imports into the U.S. are outpacing exports

Reserve Currency

The U.S. Dollar should remain the reserve currency if:

- The dollar maintains availability
- The dollar continues to grow and/or remains stable
- The U.S. remains a net importer, running a trade deficit

The Gold Standard

The gold standard
A global system where countries fix their currency values to the price of gold.

Bretton Woods Agreement:

- A collective global foreign exchange regime that lasted from 1945-1973
- Countries defined their currency values to the U.S. Dollar
- A gold exchange standard, which is a hybrid of the reserve currency system and a gold standard