

FX Reserves Dip Modestly in Q1

The IMF's Q1 data on the composition of official foreign exchange reserves (COFER) reflects a marginal decline in overall FX reserve holdings in the period. The USD's proportion of allocated reserves increased slightly to just under 62% in the period but the change was marginal; other currency holdings were largely steady and seem likely to remain so.

Global FX reserve holdings were largely steady in Q1, according to the IMF's latest COFER data. Total reserve holdings fell in the period (to USD11.73tn, down from USD11.82tn) but the change was relatively minor considering the period reflected significant market volatility and some sizeable FX declines for currencies such as the BRL (-23% in Q1 versus the USD), the ZAR (-21.5%) and the RUB (-21%) etc. as the impact of the coronavirus outbreak spread.

The general trend in reserve accumulation that began in 2017 following a roughly 10% decline in total reserve holdings between 2014-16 remains intact. But total FX reserves have yet to regain the 2014 peak of just over USD12tn. Allocated reserve holdings (reserves held in specified currencies) remain stable at around 93% of total reserves, meanwhile.

The composition of FX reserves reflects the USD's continued dominance in reserve holdings. Reserves held in USD amounted to USD6.795tn in Q1, a small increase over Q4 and a new record high. Reserves held in EUR—the next largest holding—dipped slightly to USD2.197tn (from USD2.279tn); all other currencies saw small declines in allocated holdings in the period, except the CNY which increased to USD221.5bn, from USD215.8bn. Valuation changes perhaps account for some—though not all—of these relatively small moves. The USD strengthened broadly in Q1 but the EUR lost about 1.6% in the period against the USD, almost exactly the same as the CNY.

The proportion of FX reserves allocated in USD rose to 61.98% in Q1, the highest since mid-2018, while the proportion of EUR reserves dipped slightly to 20.04%. This compares to an average holding of 64.85% for the USD over the past 20 years and 22.85% for the EUR. While total holdings of other, small currencies continues to rise, the relative share of JPY (5.7%), GBP (4.43%), (CNY 2.02%), CAD (1.78%), AUD (1.55%) and CHF (0.15%) in allocated FX reserves remains little changed over the past few quarters. Indeed, the CAD's proportion of FX reserves is precisely where it stood in 2013.

This is understandable. USD-denominated asset markets are deep and liquid and while Eurozone asset markets are competitive in size and scale, the EUR has been beset with doubts about the longevity of the single currency project as the EU grapples with recession, regional economic disparity and a reluctance by some members to consider Eurozone debt mutualisation. Moreover, the driving forces behind reserve diversification 10-15 years ago—higher relative returns, strong credit ratings, perceived safety relative to the US—are much less compelling now following global recessions, credit downgrades and a move to zero interest rate policy (or near to it) around the globe. Central bank asset purchase programs also mean that reserve managers compete with home central banks in some less liquid markets.

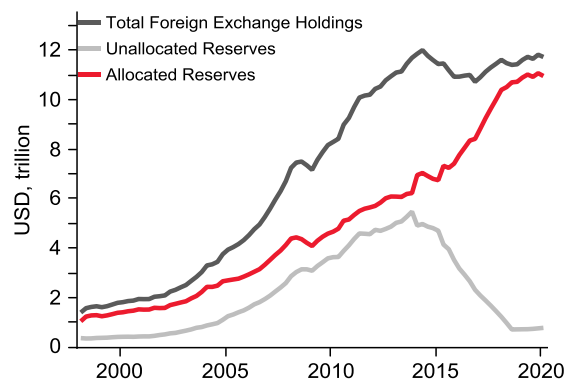
It seems likely then that the status quo in FX reserve management defined by a preference for the USD and holding strategies for allocations to other currencies is likely to persist. Holdings of—and demand for the assets denominated in—the “smaller” currencies are likely to remain proportionate to overall reserve holding for now.

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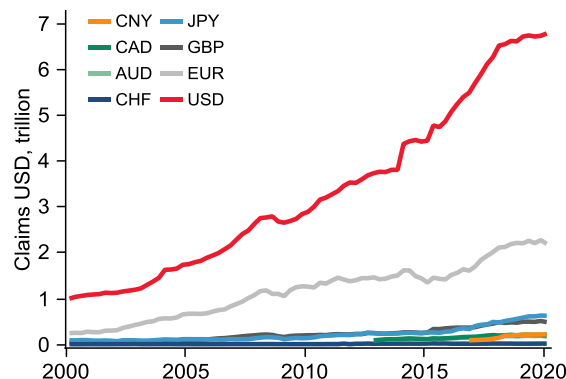
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Official FX Reserves



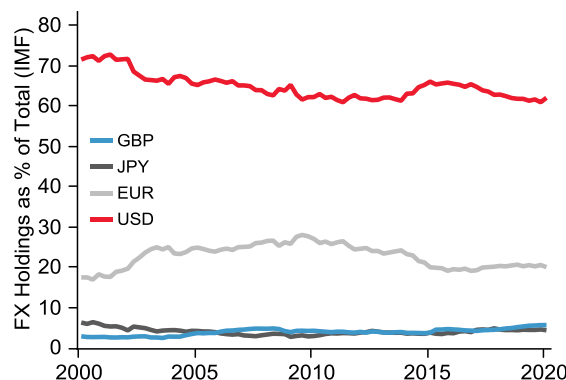
Source: Macrobond, Scotiabank FICC Strategy

Composition of Allocated Reserves



Source: Macrobond, Scotiabank FICC Strategy

USD Share of Reserves Nudges Higher



Sources: Macrobond, Scotiabank FICC Strategy

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