Text: <u>Climbing Greenback Mountain</u>
1) Why is China troubled because of its large $ reserves?
China does not like to rely on the dollar. Officials are troubled by the Federal Reserve's notably loose monetary policy and by America's rapidly rising public debt. They fear that stimulus measures put in place to revive America's flagging economy will sooner or later generate a burst of high inflation and weaken the dollar. That would hurt holders of US government bonds, including China. Around $2 trillion of its currency reserves of $3.2 trillion are in dollars, mostly in bonds.

2) Why does it make sense for countries to hold large $ reserves?
Currencies fulfill the function of money in their home country. The won fulfils these roles in South Korea and the yuan does the job in China. However, the dollar provides these services in international markets as well as in America. It is the unit of account for commodities such as crude oil that are traded globally. Most trade that is invoiced in a currency other than those of the trading partners is quoted in dollars. And because the dollar is the benchmark for world prices and is used to settle cross-border trades, it makes sense for countries to keep stores of dollar reserves, both as a float and to bolster confidence in their own currencies.

3) Which advantages do countries that issue reserve currencies enjoy?
- Seigniorage extends beyond border
- Ressources factured in $ ➔ domestic traders do not experience large price swings due to changing exchange rates and can buy the commodity with their own money
- protection from currency volatility
- no need to acquire and hold reserves
- lower yield in countries which issue reserve currencies because most central banks invest in issuing countries Government bonds. This pushes down the yield which stimulates investment.

2) What is meant with 'original sin'?
Countries which borrow in foreign currency. If the exchange rate changes this can cause huge increases in the debt (might also be the case for Greece).

5) What is the 'Triffin Dilemma'?
Under the Bretton Woods arrangement currencies were pegged to the dollar at fixed exchange rates. The dollar in turn was tied to gold at a fixed price. Triffin spotted a dilemma. A rising stock of dollars was needed to finance world trade. The more dollars were supplied, the more the currency's link to gold would be questioned since America's gold stocks would support an ever larger pile of banknotes. This came to a head in August 1971 when heavy selling forced President Nixon to suspend the conversion of dollars into gold.

6) Why would a reserve currency regime in which the dollar, euro and yuan share privileges and responsibilities make the world a safer place according to Mr. Eichengreen?
Mr Eichengreen argues that a reserve-currency system will emerge in which the dollar, the euro and the yuan share the privileges and the responsibilities. That would make the world a safer place, he reckons, because each issuer would nudge the others towards financial and fiscal discipline.

7) What are 'dim-sum bonds'?
By the end of July yuan deposits in Hong Kong had swollen to 572 billion. The IMF said in July that 155 billion of yuan-denominated bonds (so-called "dim sum" bonds) had been issued in Hong Kong since the market was set up, many by branches of mainland banks.

8) What are the three gauges of economic dominance reserve currency status depends upon?
-size of economy,
-exports and
-net foreign assets