



# Could China's yuan replace the dollar as a reserve currency?

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Published: Jan 18, 2018 6:39 a.m. ET



## Trouble in reserve currency paradise



The Chinese yuan, or renminbi, could give the dollar a run for its money one day, at least when it comes to being a major reserve currency, analysts say. Those days may still be far off in 2018, but recent developments show that there's a new kid on the reserve block that's worth noting.

"There's nothing quite like a falling dollar to spur talk of the erosion of the greenback's reserve status," said Marc Chandler, global head of currency strategy for Brown Brothers Harriman.

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The U.S. dollar **DXY, +0.46%** is the world's leading reserve currency, but it isn't the only one. The euro **EURUSD, -0.6591%**, British pound **GBPUSD, -0.5983%**, Japanese yen **USDJPY, +0.03%** and also China's yuan **USDCNY, +0.6735%** are up there with it.

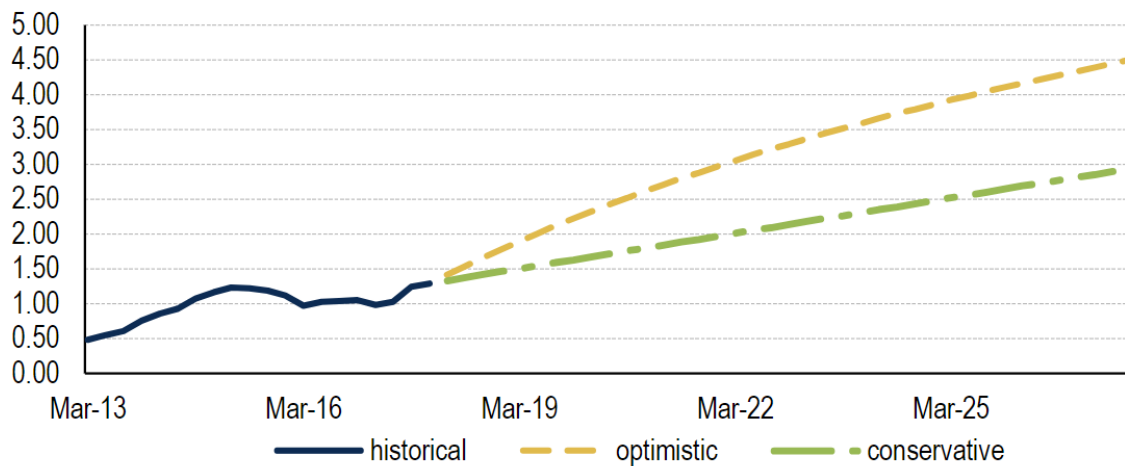
Given the U.S. dollar's poor performance compared to its major rivals in 2017, talk of diversifying into different reserve currencies in the new year has increased.

For example, analysts expect a pickup in euro-buying from the reserve community in 2018 after the shared currency was such a steady outperformer last year. But there has also been more talk about the yuan of late, including a yuan-denominated oil benchmark, another dollar-dominated area.

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This week, the Bank of France confirmed that it held the Chinese currency as part of its reserves, while the German central bank said it will add yuan to its arsenal in the future. Meanwhile, China is also reportedly diversifying its FX reserves.

## Chart of the Day: Potential growth of RMB share in global reserves



Source: BofA Merrill Lynch Global Research estimates, IMF; Note: Optimistic assumption - RMB reaching 4.5% share of reserves (similar to GBP & JPY); Conservative assumption - RMB share rises at the same pace seen since 2013.

“In the long run, over the next decade or so, we expect the share of China in global reserves to increase to similar levels as to British pound and Japanese yen, both of which represent about 4.5% as of September 2017,” wrote FX strategist Adarsh Sinha and rates strategist Yang Chen of Bank of America Merrill Lynch.

Because the “global reserve allocations are a slow moving beast” rapid changes are unlikely, however, making this more important for the dollar in the long term rather than for its 2018 performance, according to Sinha and Chen. The buck’s role as the leading reserve currency “has been trending lower for close to two decades,” they wrote. “The correlation of the ICE U.S. Dollar Index with U.S. rates provides a real-time measure of when diversification is accelerating.”

Still, this shift is rather slow, in part because the dollar remains attractive to reserve buyers given the size and liquidity of the U.S. Treasury market, they said.

“The yuan accounted for a little more than 1% of global reserves whose allocation has been declared, and some of the dollar’s value of yuan reserves is a function of the yuan’s 4.2% appreciation against the dollar in the first three quarters of 2017,” said Chandler.