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Why Is the U.S. Dollar the World's Dominant Reserve Currency?

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What do you think of when you hear "U.S. dollar"? Is it the cash in your wallet, the balance in your bank account, or the price of a gallon of gas? In these and other examples, the dollar performs the basic functions of money. This is true in the U.S. and in countries around the world, whose governments, central banks, businesses, and investors use dollars to buy, sell, borrow, and lend. The dollar is integral to the financial "plumbing" of the global economy and is the world's dominant reserve currency.

What Is a Reserve Currency?

A **reserve currency** is a widely accepted currency that governments and central banks hold as part of their official **foreign exchange reserves**. These reserves ensure that a country has reliable access to foreign currency to make international payments, manage its exchange rate, and respond to financial stress.

For example, when a country, business, or individual wants to buy goods, services, or financial assets in an international transaction, the buyer must obtain the seller's currency through the foreign exchange market. This is where currencies are bought and sold and where exchange rates are determined.

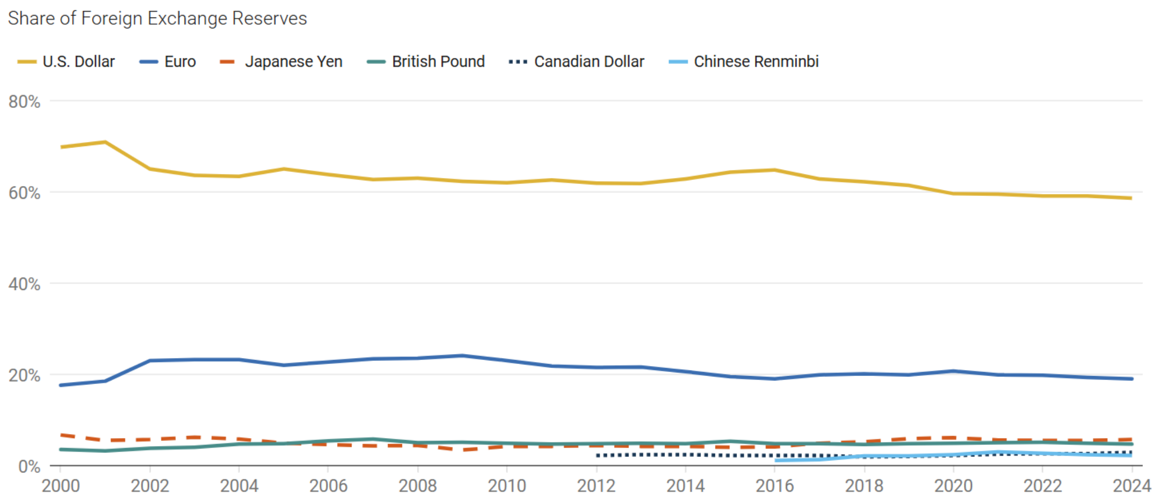
Businesses and individuals normally rely on banks and financial markets to get the foreign currency they need for international transactions. But in a financial crisis, foreign currency can become difficult for a business to obtain. This is when a country's central bank can step in to sell dollar assets from its foreign exchange reserves.

Countries do not hold most of their dollars as stacks of paper currency. Instead, they hold dollar-denominated financial assets, especially **U.S. Treasury securities**, which are debt issued by the U.S. government. When investors buy Treasury securities, they are in effect lending money to the U.S. government in exchange for repayment with interest. When investors sell or redeem Treasury securities, they get dollars in exchange, which they may use to make other dollar-denominated transactions.

These assets are considered both safe and **liquid**: Investors generally trust the U.S. government to repay its debts, and Treasury securities can be quickly and easily converted into cash. So, central banks are able to hold dollars in a form that preserves value and that can be accessed quickly in a financial crisis. In this way, the dollar's roles as a reserve currency and as an **international currency** come together, but each role reflects a different function of money. Consider the following:

- As a **store of value**, the dollar is held through assets such as Treasury securities, which are stable, trusted, and easily converted into cash.
- As a **medium of exchange**, the dollar is widely accepted in international trade and finance, allowing businesses to use it to pay for imports, to settle contracts, and to conduct financial transactions across borders.
- As a **unit of account**, the dollar is quoted in many global prices and financial contracts, giving buyers and sellers a common way to measure value.

U.S. Dollar is the Dominant Reserve Currency



SOURCE: International Monetary Fund Currency Composition of Official Foreign Exchange Reserves.

The Bank for International Settlements reports that as of April 2025, the dollar was involved in about 89 percent of all foreign exchange trades, making clear its stability and widespread use.

Why Is the Dollar So Widely Used and Held?

Several features of the U.S. economy and its financial system help explain why governments, central banks, and investors around the world choose to hold and use dollar-denominated assets.

First, the U.S. remains one of the world's largest economies, accounting for about 26 percent of global GDP in 2024 (measured in current U.S. dollars). This helps make the dollar central to international trade and finance and encourages other countries to hold dollar-denominated assets as reserves.

Second, U.S. financial markets, especially the market for U.S. Treasury securities, are large, deep, and liquid. U.S. financial markets give foreign central banks and investors access to a wide supply of dollar-denominated assets that can be bought or sold quickly and with relative certainty, which makes the dollar easier to use and more attractive to hold.

Third, the U.S. benefits from long-standing legal, political, and financial institutions that investors generally trust. Confidence that contracts will be enforced, that markets will function, and that the U.S. government will repay its debts increases the appeal of holding dollar assets.

These factors help explain why the dollar dominates global reserve holdings. At the end of 2025, about 57 percent of the world's foreign exchange reserves were held in dollar-denominated assets, compared with about 20 percent for the euro. Other currencies, such as the Japanese yen, British pound, Canadian dollar, and Chinese renminbi, are also reserve currencies, but none comes close to the dollar's share, as shown in the figure above.

The Benefits for the U.S.

There are meaningful advantages for the U.S. in having the dollar serve as the world's dominant reserve currency. The most important benefit is the additional global demand for dollar-denominated assets, especially U.S. Treasury securities. When many investors and foreign central banks want to hold Treasury securities, the U.S. government does not need to offer as high an interest rate to attract buyers, and this helps lower the government's borrowing costs.

The dollar's role as in international currency also supports U.S. businesses. Because the dollar is widely used in global trade and finance, U.S. firms can often borrow, invest, and write contracts in their own currency. Doing so reduces the exchange-rate risks they would face if they had to convert dollars into foreign currencies more frequently. This stability makes it easier for U.S. companies to participate in international markets, influencing borrowing costs, business decisions, and the broader U.S. economy.

The Tradeoffs of a Stronger Dollar

While the dollar's global role brings important benefits, there are tradeoffs: Increased global demand for dollar-denominated assets can make the dollar stronger than it otherwise would be, and this affects Americans in different ways, creating both winners and losers.

For consumers and businesses that import goods or services, a **strong dollar** is a clear advantage. When the dollar rises in value, foreign-made products become cheaper, reducing costs for households and for firms that rely on imported goods.

For exporters, however, a strong dollar makes U.S.-produced goods more expensive for foreign buyers and can make U.S. firms less competitive in global markets. Domestic companies that compete directly with imported goods may also face pressure if cheaper imports gain a larger share of the market.

These contrasting outcomes are an inherent part of how exchange rates work: When a currency strengthens, it becomes easier to purchase goods from other countries but harder to sell goods to them. The dollar's role as the world's dominant reserve currency reinforces this pattern because global demand for dollar assets tends to keep the dollar stronger than it otherwise would be.

Could the Dollar Lose Its Role?

Some countries have taken steps to reduce their reliance on the U.S. dollar, a trend often described as de-dollarization. Their motivations vary. Some want to limit exchange-rate risk, while others aim to avoid potential exposure to U.S. sanctions or promote greater use of their own currencies in trade and finance. Even so, replacing the dollar is challenging because the main alternatives face significant limitations.

The euro is the second-most widely held reserve currency, but it lacks a single, unified Treasury market (PDF) comparable to the large and liquid market for U.S. Treasury securities. China's renminbi has expanded its international presence in recent years. Yet continued exchange rate management and **capital controls** limit how freely funds can move into and out of the country, creating obstacles to becoming a global reserve currency.

The dollar's role is not fixed. Its share of global reserves can rise or fall over time depending on economic conditions, policy decisions, and investor confidence. Still, displacing the dollar entirely would be difficult. Few currencies combine the same scale, safety, liquidity, and trusted institutions that make the dollar so widely used and held.

Conclusion

The dollar's position as the world's dominant reserve currency provides the U.S. with important advantages, but it also brings tradeoffs. Its global role helps lower government borrowing costs and reduces financial frictions for U.S. businesses, but it also contributes to a stronger dollar that creates challenges for exporters and domestic firms.

The dollar serves the basic functions of money in its roles as a reserve currency and an international currency, as it is both stable and widely accepted by sellers, lenders, and investors around the world. And when you hear "U.S. dollar," you now have a better understanding of its integral role in the global economy and why it dominates global reserve holdings.

Glossary

Capital controls: Government rules that restrict investments and other financial flows into or out of a country.

Foreign exchange reserves: Foreign-currency assets held by a country's central bank or treasury to support international payments, manage exchange rates, make payments on foreign debt, or respond to crises.

International currency: A currency widely used in transactions between countries.

Liquid asset: An asset that is easily convertible to cash with relatively little loss of value in the conversion process.

Medium of exchange: Anything that is generally acceptable in exchange for goods and services.

Reserve currency: A currency held by governments or central banks as part of official foreign exchange reserves.

Store of value: The ability to retain worth.

Strong dollar: A situation in which the U.S. dollar rises in value relative to other currencies.

Unit of account: A common measurement used to compare the value of goods and services.

U.S. Treasury securities: The collective name for the bills, bonds, and notes issued by the U.S. Treasury on behalf of the federal government.

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Name____ **Period**________

Reading Q&A

Why Is the U.S. Dollar the World's Dominant Reserve Currency?

After reading the article, complete the following:

1. What is the main reason a country's central bank holds reserve currency?
   a. To increase domestic consumer spending
   b. To support international payments
   c. To eliminate the need for exchange rates
   d. To replace private banks in global trade

2. Why do central banks prefer to hold U.S. Treasury securities as reserves?
   a. They guarantee the highest possible returns.
   b. They reduce the need for international borrowing.
   c. They automatically prevent exchange-rate movements.
   d. They are safe, trusted, and easily converted into cash.

3. Which function of money does the dollar perform when it is used to pay for imports or settle contracts?
   a. Store of value
   b. Unit of account
   c. Medium of exchange
   d. Government subsidy

4. Which function of money does the dollar perform when an international transaction is recorded in dollars?
   a. Store of value
   b. Unit of account
   c. Medium of exchange
   d. Capital control

5. What happens during a financial crisis that makes reserves especially important?
   a. Foreign currency becomes difficult for businesses to obtain.
   b. Exchange rates stay stable without intervention.
   c. Imports grow cheaper in most countries.
   d. Private banks always increase lending.

6. Which factor helps explain why the dollar is the dominant reserve currency?
   a. Limited availability of U.S. currency
   b. Small size of U.S. financial markets
   c. Deep and liquid markets for Treasury securities
   d. Frequent U.S. capital controls on foreign investors

7. What is one benefit the U.S. government receives from having the dollar as the dominant reserve currency?
   a. Reduced trust in U.S. financial institutions
   b. Fewer countries trading with U.S. firms
   c. Higher required interest rates on government debt
   d. Lower borrowing costs due to strong global demand

8. What best describes the tradeoff created by strong global demand for dollar-denominated assets?
   a. It always causes the dollar to fall in value.
   b. It keeps the dollar stronger, helping importers but challenging exporters.
   c. It prevents fluctuations in global interest rates.
   d. It eliminates exchange-rate risks for U.S. businesses.