**Why the U.S. Dollar Is the Global Currency**

BY KIMBERLY AMADEO

A global currency is one that is accepted for trade throughout the world. Some of the world's currencies are accepted for most international transactions. The most popular are the U.S. dollar, the euro, and the yen. Another name for a global currency is the reserve currency.

According to the International Monetary Fund, the U.S. dollar is the most popular. As of the first quarter of 2019, it makes up 61% of all known central bank foreign exchange reserves. That makes it the de facto global currency, even though it doesn't hold an official title.

The next closest reserve currency is the euro. It makes up 20% of known central bank foreign currency reserves. The chance of the euro becoming a world currency was damaged by the eurozone crisis. It revealed the difficulties of a monetary union that's guided by separate political entities.

The U.S. Dollar Is the Strongest World Currency

The relative strength of the U.S. economy supports the value the dollar. It's the reason the dollar is the most powerful currency. Around $580 billion in U.S. bills are used outside the country. That's 65% of all dollars. That includes 75% of $100 bills, 55% of $50 bills, and 60%of $20 bills. Most of these bills are in the former Soviet Union countries and in Latin America. They are often used as hard currency in day-to-day transactions.

Cash is just one indication of the role of the dollar as a world currency. More than one-third of the world's gross domestic product comes from countries that peg their currencies to the dollar. That includes seven countries that have adopted the U.S. dollar as their own. Another 89 countries keep their currency in a tight trading range relative to the dollar.

In the foreign exchange market, the dollar rules. Around 90% of forex trading involves the U.S. dollar. The dollar is just one of the world's 185 currencies according to the International Standards Organization List, but most of these currencies are only used inside their own countries. Theoretically, any one of them could replace the dollar as the world's currency, but they won't because they aren't as widely traded. The chart below shows a breakdown of the 10 most traded currencies in 2018.

Almost 40% of the world's debt is issued in dollars. As a result, foreign banks need a lot of dollars to conduct business. This became evident during the 2008 financial crisis. Non-American banks had $27 trillion in international liabilities denominated in foreign currencies. Of that, $18 trillion was in U.S. dollars. As a result, the U.S. Federal Reserve had to increase its dollar swap line. That was the only way to keep the world's banks from running out of dollars.

The financial crisis made the dollar even more widely used. In 2017, the banks of Japan, Germany, France, and the United Kingdom held more liabilities denominated in dollars than in their own currencies. Additionally, bank regulations enacted to prevent another crisis have made dollars scarce, and the Federal Reserve has increased the fed funds rate. That decreases the money supply by making dollars more expensive to borrow.

The dollar's strength is the reason governments are willing to hold the dollar in their foreign exchange reserves. Governments acquire currencies from their international transactions. They also receive them from domestic businesses and travelers who redeem them for local currencies.

Some governments invest their reserves in foreign currencies. China and Japan deliberately buy the currencies of their main export partners. The United States is the largest export partner with both countries. They try to keep their currencies cheaper in comparison so their exports are competitively priced.

Why the Dollar Is the Global Currency

The 1944 Bretton Woods agreement kickstarted the dollar into its current position. Before then, most countries were on the gold standard. Their governments promised to redeem their currencies for their value in gold upon demand. The world's developed countries met at Bretton Woods, New Hampshire, to peg the exchange rate for all currencies to the U.S. dollar. At that time, the United States held the largest gold reserves. This agreement allowed other countries to back their currencies with dollars rather than gold.

By the early 1970s, countries began demanding gold for the dollars they held. They needed to combat inflation. Rather than allow Fort Knox to be depleted of all its reserves, President Nixon separated the dollar from gold. By that time, the dollar had already become the world's dominant reserve currency. However, unpegging the dollar from its value in gold created stagflation. That's a combination of inflation and stagnant growth.

<https://www.thebalance.com/world-currency-3305931>