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Determinants of International Reserve Currency Shares and Their Implications for the Internationalization of Emerging Market Currencies

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Abstract

Against the backdrop of the international monetary system entering a landscape of multi-currency competition, this paper conducts an empirical analysis of the factors influencing the shares of major international reserve currencies, using data from seven such currencies spanning the fourth quarter of 2016 through the fourth quarter of 2024. The study finds that currency usage inertia is the most central and robust determinant of international reserve currency shares. Specifically, there is a significant negative relationship between economic size and reserve currency shares, while trade volume exerts a significant positive impact. The direct effect of financial depth is found to be insignificant, whereas inflation has a negative effect and relative currency appreciation has a significant positive effect on reserve currency shares. Furthermore, the findings suggest that geopolitical conflicts do not affect the share of international reserve currencies in the short term. Finally, based on these conclusions, the following policy recommendations are proposed for the internationalization of emerging market currencies: continue to foster the inertia of domestic currency usage; promote the transformation of economic and trade advantages into currency usage advantages; steadily increase the openness of financial markets and their investment appeal; and maintain currency stability and policy credibility.

1. Introduction

For a long time, global official foreign exchange reserves have been highly concentrated in the currencies of a few developed economies, with the U.S. dollar, the euro, the Japanese yen, and the British pound dominating the international reserve system. In recent years, however, the global economic center of gravity has gradually shifted; fiscal and debt constraints within the United States have intensified; and the share of emerging market economies in global output, trade, and investment has continued to rise. As a result, the world is gradually entering a new era of multi-currency competition, and international reserve allocation is also showing a certain trend toward diversification (Zhu et al., 2026). At the same time, geopolitical conflicts, financial sanctions, and the diversification of cross-border payment systems have further heightened the practical need for countries to diversify their reserve risks. Against this backdrop, some emerging market economies have begun to actively promote the cross-border use of their currencies, hoping to translate their growing economic and trade influence into corresponding international currency status.

However, in reality, there remains a significant gap between the economic and trade strength of emerging market economies and the international status of their currencies. Although the use of many emerging market currencies in regional trade settlement and cross-border payments has increased, they have not yet attained a status in international reserves commensurate with the size of their economies. Taking the renminbi (RMB) as an example, its inclusion in the International Monetary Fund's Special Drawing Rights (SDR) currency basket in October 2016 marked its official recognition within the international monetary system and represented a significant step in the participation of emerging market currencies in that system (Jiang, 2024). From the perspective of economic fundamentals, China's total economic output accounts for approximately 17% of the global total, its volume of goods trade has

consistently ranked among the world's highest for many years, and it makes a significant contribution to global economic growth. However, as of the end of 2025, the renminbi's share of global official foreign exchange reserves was less than 2%—a figure not only significantly lower than that of the U.S. dollar and the euro but also below that of the Japanese yen and the British pound. This situation is clearly not commensurate with China's economic and trade scale. This characteristic of the renminbi—where "economic and trade strength is relatively strong, yet its status in international reserves is relatively limited"—reflects a common challenge faced by emerging market economies as they transition from economic influence to monetary influence.

The share of a currency in international reserves is a key indicator of a country's currency internationalization status and its level of international recognition, and it is also a concentrated reflection of the degree of currency internationalization (Jiang & Sun, 2015). Compared to functions such as trade settlement, cross-border payments, and international financing, serving as an international reserve currency represents the highest level that a country's currency can attain within the global monetary system. It not only reflects the long-term confidence of monetary authorities in the currency's value stability, liquidity, and security but also embodies the international financial markets' recognition of the currency's comprehensive competitiveness. Therefore, a systematic analysis of the factors influencing the share of international reserve currencies is of great significance for understanding the current competitive landscape of international reserve currencies and the mechanisms underlying the formation of a currency's international status.

For emerging market economies, identifying the key factors influencing the share of international reserve currencies helps explain why their economic and trade strength has not yet been fully translated into international currency status. This provides a policy basis for promoting the expansion of the domestic currency's role from cross-border payment and a medium of exchange to that of a reserve currency, thereby advancing the internationalization of the currency.

The potential contributions of this paper are as follows: First, taking the inclusion of the renminbi in the International Monetary Fund's Special Drawing Rights (SDR) currency basket in the fourth quarter of 2016 as the starting point, the study extends the sample period to the fourth quarter of 2024, covering recent contexts such as the post-pandemic era and frequent global geopolitical conflicts, thereby enhancing the practical explanatory power of the research conclusions. Second, while traditional research has largely focused on the U.S. dollar, the euro, the Japanese yen, and the British pound, this paper incorporates the renminbi, the Canadian dollar, and the Australian dollar into a unified analytical framework, thereby broadening the range of currencies examined in studies on the determinants of international reserve currency shares. Third, based on the results of the empirical analysis, this paper offers insights for promoting the internationalization and expansion of reserve functions for emerging market currencies—including the renminbi—that possess a solid economic and trade foundation, thereby bridging the gap between theoretical analysis and policy application.

2. Literature Review and Research Hypotheses

2.1 Literature Review

The literature relevant to this paper focuses on two areas: first, research on the factors influencing the share of international reserve currencies; and second, the internationalization of emerging market currencies and representative practices involving the renminbi.

2.1.1 Research on Factors Influencing the Share of International Reserve Currencies

The current international reserve currency system is undergoing profound structural evolution. Since the collapse of the Bretton Woods system, the U.S. dollar has long maintained its status as the world's primary reserve currency. In recent years, however, the rising share of non-traditional reserve currencies, the emergence of digital currencies, and shifts in the geopolitical landscape have been reshaping the competitive landscape of reserve currencies (Arslanalp et al., 2022). Existing research has extensively discussed the factors influencing reserve currency shares. A review of the literature identifies the following determinants:

First, the inertia of currency use. Existing studies, both theoretical and empirical, have demonstrated that currency usage inertia is an important factor shaping the status of international reserve currencies (Chen & Peng, 2010; Wu et al., 2015). Triffin (1960) observed that a country's historical share of a particular reserve currency tends to predict its future reserve ratio for that currency. Zhu et al. (2026) define usage inertia as the historical path support underpinning a currency, arguing that it embodies the dual attributes of both "cause" and "effect" and constitutes the core foundation for the incumbency stickiness of reserve currencies. Li & Zhang (2017) found that, in addition to economic size and financial conditions, inertia is a key determinant of a currency's reserve status. Since currency use is characterized by a positive feedback loop—the more entities that use it, the greater its transactional convenience and liquidity—consider the U.S. dollar as an example: when a large number of countries use the dollar for trade settlement and financial transactions, the convenience of holding dollar reserves increases, which in turn attracts even more countries to hold dollars (Liu et al., 2024).

Second is the economic and trade scale of the reserve currency-issuing economy. Theoretically, the larger the economic and trade scale of the reserve currency-issuing economy, the greater its role in international trade and financial networks, and the more likely its currency is to be used in these international transactions and as a reserve asset. Chinn & Frankel (2005) argue that countries with a large share of global output, trade, and finance possess a significant natural advantage for their currencies. Chinn et al. (2024) argue that the economic scale of a reserve currency-issuing economy is a significant determinant of its reserve currency share. However, He et al. (2018) found that the relationship between economic scale and reserve currency share is not a simple linear one. Their study suggests that while a country's economic growth increases foreign demand for its currency as a reserve asset, it simultaneously boosts the country's own demand for foreign currencies as reserves, thereby limiting the rise in its currency's share of global reserves.

Third, the level of financial market development in the reserve currency-issuing economy. With the acceleration of global capital flows since the beginning of the 21st century, the influence of financial variables on reserve currency status has attracted growing attention. Empirical studies have shown that the depth and breadth of the issuer's financial markets, together with the supply of highly liquid safe assets, constitute fundamental conditions for a currency to attain international reserve currency status (Papaioannou et al., 2006; Galati & Wooldridge, 2009). Chinn & Frankel (2005) and subsequent IMF research frameworks point out that reserve currency-issuing economies need to possess deep and sufficiently liquid financial markets to enable global investors to allocate and reallocate reserve assets safely and at low cost. Wang & Zhang (2019) examined the impact of factors such as financial market size, financial market depth, and the degree of capital account openness on a country's reserve currency status. Their results indicate that financial market size and depth have a positive, significant, and robust impact on reserve currency status. Research by Shi & Ren (2022) also confirmed that a long-term equilibrium exists between a currency's status as an international reserve asset and the level of financial development in the issuing economy, which helps increase the size of foreign exchange reserves denominated in that currency.

Fourth is the stability of a reserve currency's value. Currency value stability directly affects the wealth security of holding countries; currencies included in the official reserves of central banks worldwide are precisely those that can effectively preserve value (Pittaluga & Seghezza, 2021). Currency stability is generally measured in terms of both domestic and external stability. Domestic stability is typically proxied by inflation, while external stability is measured using exchange rate volatility. Iancu et al. (2022) argue that a currency's appreciation trend is essentially a quantitative indicator of its stability; sustained appreciation is generally viewed as a signal of policy reliability and currency stability.

In addition, geopolitical factors have received increased attention in recent years as influences on reserve currency selection (Eichengreen et al., 2015, 2017; Laser & Weidner, 2020; Gopinath & Stein, 2021). However, existing research offers differing perspectives on the impact of these factors. McDowell (2021) argues that financial sanctions weaken sanctioned countries' preference for the U.S. dollar by raising the expected political risk costs associated with its use, and uses the cases of Russia, Venezuela, and Turkey to demonstrate that sanctions prompt target countries to accelerate their de-dollarization policies. Xu & Xiong (2022) also note that the financial sanctions imposed by the U.S. and Europe on Russia following the Russia-Ukraine conflict have intensified emerging markets' and developing economies' distrust of the U.S. dollar system, undermining the credibility of the U.S. dollar and the SWIFT system as international financial infrastructure. However, some scholars hold opposing views. Dooley et al. (2022) argue that sanctions have actually deepened global structural dependence on the U.S. dollar settlement system, thereby strengthening rather than weakening the dollar's hegemonic status. Weiss (2022) also contends that, although the freezing of Russian reserves in 2022 heightened global concerns about sanctions risks, geopolitical factors alone are insufficient to end the U.S. dollar's dominance as a reserve currency.

2.1.2 The Internationalization of Emerging Market Currencies and the Renminbi as a Representative Case

As emerging market economies have grown in importance in global output, trade, and investment, the internationalization of their currencies has gradually attracted attention. Ma & Villar (2014) point out that the degree of internationalization of emerging market currencies depends on the issuing economy's economic and trade scale, financial market development, institutional quality, and currency usage network; offshore markets and public sector reserve allocation can also play a catalytic role. However, constrained by factors such as limited financial market depth, incomplete capital account liberalization, and the network effects of dominant currencies, the international use of emerging market currencies remains relatively limited overall and typically manifests first as regionalization.

The internationalization of the renminbi is one of the most representative examples of emerging market currency internationalization. From a regional perspective, the internationalization of the renminbi has primarily advanced gradually through trade links, cross-border settlements, and exchange rate linkages. Subramanian & Kessler (2013) argue that trade integration has propelled the renminbi to become an important reference currency in East Asia; however, McCauley & Shu (2018) found that the linkage between the renminbi and emerging market currencies exhibits distinct phases, and existing evidence is insufficient to confirm that a stable renminbi currency area has been formed. Regarding the renminbi's regional influence, domestic research has reached similar conclusions: Liu et al. (2022) find that the renminbi occupies a dominant position within the ASEAN+3 region and has emerged as an influential regional currency.Nevertheless, it still has a long way to go before attaining the status of a truly global currency with international prominence.

The renminbi's potential to attain international reserve currency status has attracted considerable scholarly attention. By comparing the internationalization trajectories of the U.S. dollar, the German mark, and the Japanese yen, Frankel (2012) argues that economic scale, currency confidence, and financial market depth are key conditions for the renminbi to achieve international currency status. Eichengreen & Kawai (2014) point out that while the renminbi has made progress in cross-border trade settlement and offshore bond markets, its further development into a major reserve currency still depends on capital account liberalization, greater exchange rate flexibility, and institutional reforms. Chinese scholars have also systematically examined the fundamental conditions and constraints shaping the renminbi's reserve currency potential from the perspectives of economic fundamentals, exchange rate expectations, the supply of renminbi-denominated safe assets, political stability, and network externalities (Lin & Wang, 2015; Tan et al., 2018). Among the preconditions for renminbi internationalization, capital account liberalization has attracted particular attention. Lu (2021) finds that, provided that the economy is sufficiently large and the currency remains stable, capital account liberalization can advance the internationalization of the renminbi. Related studies, however, stress the need to properly coordinate capital account liberalization with trade invoicing and onshore market development, and to proceed with the opening in a sequenced and orderly manner (Deng & Xie, 2021; Wang & Chen, 2024). In addition, Yu (2026) argues in a recent study that enhancing the renminbi's

international status is a protracted process that will not be achieved overnight: on the one hand, conditions must be created for its further rise; on the other, every available opportunity should be seized. He further suggests that the US–Iran conflict and a potential oil crisis may present an important window of opportunity for the internationalization of the renminbi.

In summary, existing research has provided a relatively systematic analysis of the determinants of international reserve currency shares, including currency usage inertia, the issuing economy's economic and trade scale, financial market development, currency stability, and geopolitics. However, much of the literature focuses on major reserve currencies such as the U.S. dollar and the euro, with insufficient attention to the combined effects and interactions among various factors; the impact of geopolitics remains controversial. Research on emerging market currencies has largely centered on trade settlement, exchange rate pegs, and regional integration, lacking in-depth analysis of the constraints on their transition from trade and economic strength to reserve currency status. Therefore, it is necessary to examine the primary determinants of international reserve currency shares within a unified analytical framework and, on that basis, identify the practical conditions and constraints for emerging market currencies to expand their reserve functions.

2.2 Research Hypotheses

2.2.1 Usage Inertia and International Reserve Currency Share

According to Krugman's (1980) analysis of the mediating function of money, once a currency occupies a dominant position in the international trading and reserve system, its use becomes self-reinforcing due to economies of scale: transaction costs decrease as the scale of use expands, and liquidity increases as the number of participants grows, thereby attracting more entities to choose that currency. This path-dependence characteristic implies that even if a country's economic fundamentals undergo relative changes, the international status of its currency often lags in adjusting, exhibiting strong inertia. Based on this, this paper proposes:

H1: The inertia of currency use has a positive effect on the share of an international reserve currency.

2.2.2 Economic Scale, Trade Volume, and International Reserve Currency Share

From the perspective of the fundamental conditions for currency internationalization, a country's economic scale and trade volume determine the potential demand for its currency in international settlement and pricing. The larger the economy and the broader the foreign trade network, the more opportunities there are for the country's currency to be held and used by foreign entities, thereby creating endogenous demand and laying the foundation for it to serve as a reserve currency. However, this promotional effect does not increase linearly without limit. A growing body of research indicates that once the economy expands beyond a certain stage, the marginal promotional effect on reserve shares tends to weaken, and diminishing returns may even occur. Based on this, this paper proposes:

H2: The relative economic scale and trade volume of a reserve currency-issuing economy have a positive effect on the growth of its currency's share of international reserves, but this relationship may be nonlinear.

2.2.3 Level of Financial Market Development and the Share of International Reserve Currency

Reserve currencies not only serve as a medium of exchange but, more importantly, must provide foreign holders with safe, liquid, and sufficiently large-scale asset allocation channels. This requires the issuing economy to possess a developed bond market, sound financial infrastructure, and an open capital account to ensure that foreign investors can conveniently hold, trade, and liquidate assets denominated in that currency (Eichengreen, 2011). The higher the level of financial market development—and the greater the market depth and liquidity—the greater the currency's appeal as a store of value. Based on this logic, this paper proposes:

H3: The level of financial market development in the issuing economy of a reserve currency has a positive impact on the currency's share of global reserves.

2.2.4 Currency Stability and the Share of International Reserve Currency

Whether a currency can serve as a reserve asset over the long term depends largely on holders' confidence in the stability of its purchasing power and asset values. On the one hand, persistent inflation erodes the real returns on assets denominated in that currency, increases uncertainty regarding exchange rates and policy, and thereby reduces the willingness of foreign entities to hold the currency, negatively impacting its reserve status (Chinn & Frankel, 2005). On the other hand, a long-term trend of currency appreciation implies expectations of capital gains on assets denominated in that currency, which enhances its appeal as a store of value and, consequently, increases its share in international reserves. Taken together, price stability and long-term currency strength constitute two important aspects of a reserve currency's credibility. Based on this, this paper proposes:

H4: The inflation rate in the economy issuing a reserve currency has a negative effect on its share of international reserves, while a long-term trend of currency appreciation has a positive effect on its share of international reserves.

3. Research Design

3.1 Model Specification

Drawing on the research of Arslanalp et al. (2022), this paper employs a two-way fixed-effects model to test the research hypotheses. The study period spans from Q4 2016 to Q4 2024, and the analysis covers seven major international reserve currencies: the U.S. dollar, euro, Japanese yen, British pound, Canadian dollar, Australian dollar, and Chinese yuan. The baseline regression model is specified as follows:

$$\mathrm{Y}_{\mathrm{i,t}}=\beta_0+\beta_1\mathrm{Y}_{\mathrm{i,t-1}}+\beta_2\mathrm{X}_{\mathrm{i,t}}+\mu_{\mathrm{i}}+\lambda_{\mathrm{t}}+\varepsilon_{\mathrm{i,t}}\#(1)$$

Here, $Y_{i,t}$ is the share of currency i in global official foreign exchange reserves in quarter t; β_0 is the constant term; $Y_{i,t-1}$ is the one-period lag of the dependent variable, with β_1 as its coefficient; $X_{i,t}$ denotes the vector of remaining independent variables, with β_2 as their corresponding coefficients; and μ_i, λ_t, and $\varepsilon_{i,t}$ denote the individual fixed effect, time fixed effect, and error term, respectively.

3.2 Explanation of Variable Selection

3.2.1 Dependent Variable: Share of International Reserves (Reserve_share)

This study uses the shares of seven major international currencies—the U.S. dollar, euro, Japanese yen, British pound, Canadian dollar, Australian dollar, and Chinese yuan—in global official foreign exchange reserves as the dependent variable. For robustness tests, the total volume of global official reserves denominated in these seven currencies is employed as a proxy for total international reserves (Reserve_amount). All data are obtained from quarterly IMF COFER publications. In terms of data processing, because the reserve share is a proportional variable, we apply a logit transformation to Reserve_share and a logarithmic transformation to Reserve_amount.

3.2.2 Explanatory Variables

3.2.2.1 Currency Inertia (L1_Reserve_share, L1_Reserve_amount)

Following existing studies, this study employs the one-period-lagged values of both the reserve share and reserve amount as proxy variables for currency usage inertia.

3.2.2.2 Economic Size (GDP_share)

A reserve currency is typically associated with a large economy. This study measures the relative economic size of each issuing economy using its GDP share of global GDP, with data sourced from Tonghuashun Finance. Since the original data are annual, we follow Li & Li (2025) in converting the data frequency from annual to quarterly using the quadratic-match method.

3.2.2.3 Trade Volume (Trade)

In theory, the larger the trade volume of a currency-issuing economy, the more frequently its currency is used in international transactions. To meet transaction demands, other countries will accordingly increase their holdings of that currency as foreign exchange reserves. This paper measures trade volume using each issuing economy's share of global goods trade (exports plus imports). Similarly, the data frequency was converted from annual to quarterly using the quadratic-match method. All data are sourced from the United Nations Conference on Trade and Development (UNCTAD).

3.2.2.4 Financial Depth

The leverage ratio of the private non-financial sector in reserve currency-issuing economies is used as a proxy for financial depth in this paper. A high leverage ratio reflects the capacity and scale of the financial system to provide credit to the private sector, thereby indirectly reflecting the depth of the financial system in these economies. Data are sourced from the Bank for International Settlements (BIS).

3.2.2.5 Inflation (CPI)

Higher inflation levels indicate poorer currency stability. Drawing on existing research, the year-over-year change in the Consumer Price Index (CPI) for the current quarter is used to measure the stability of the currency's value. Data are sourced from the Organisation for Economic Co-operation and Development (OECD).

3.2.2.6 Currency Appreciation (Exvol)

A long-term appreciation trend comprehensively reflects price stability and policy credibility in the issuing economy. If a currency appreciates against the SDR over the long term, reserve assets denominated in that currency gain in international purchasing power. For reserve managers, this implies a positive real return on holding that currency, which directly enhances its attractiveness as a reserve asset. We measure Exvol by taking the logarithm of each major reserve currency's exchange rate against the SDR and then applying the first difference. The calculation formula is: Exvol = $\ln(e_t) - \ln(e_{t-1})$, with exchange rate data sourced from the International Monetary Fund (IMF).

Table 1
Explanation of Variable Selection

Category	Name	Indicator	Indicator Description	Data Source
Dependent Variable	Reserve_share	Share of International Reserves	The share of this currency in global official foreign exchange reserves	IMF COFER
Alternative Dependent Variable	Reserve_amount	Amount of International Reserves	Total global official foreign exchange reserves denominated in that currency	IMF COFER
Explanatory Variable	L1_Reserve_share	Usage Inertia	International reserve share lagged by one period	IMF COFER
Alternative Explanatory Variable	L1_Reserve_amount	Usage Inertia	International reserve amount lagged by one period	IMF COFER
Explanatory Variable	GDP_share	Economic Size	The share of the issuing economy's GDP in the global total	iFind
Explanatory variable	Trade	Trade Volume	Share of global imports and exports of goods by the economy issuing the currency	UNCTAD
Explanatory Variable	Findeep	Financial Depth	Private non-financial sector leverage ratio	BIS
Explanatory Variable	CPI	Inflation	CPI in the currency-issuing economy, seasonally adjusted, year-over-year	OECD
Explanatory Variable	Exvol	Currency Appreciation	The extent of the currency's appreciation relative to the SDR	IMF

3.3 Descriptive Statistics of Variables

Table 2 presents the descriptive statistics for the main variables. The sample covers seven major international reserve currencies, with a total of 231 quarterly observations. For the dependent variable Reserve_share (international reserve share), the mean is 0.1382, the standard deviation is 0.2014, and the minimum and maximum are 0.0100 and 0.6468, respectively; the median is 0.0463, indicating substantial variation in reserve shares across currencies. The mean of Reserve_amount (logarithm of reserve size) is 13.47, with a standard deviation of 1.22. Among the explanatory variables, Exvol (exchange rate appreciation) has a mean close to 0 but a standard deviation of 0.0229 and a minimum of -0.1025, suggesting considerable fluctuations in appreciation magnitudes and occasional

depreciation episodes. Overall, the variable ranges are reasonable, with no obvious outliers detected, and the sample distribution is consistent with the stylized facts of major reserve currencies, satisfying the requirements for subsequent regression analysis.

Table 2
Descriptive Statistics of Variables

Variable	N	Mean	SD	Min	Median	Max
Reserve_share	231	0.1382	0.2014	0.0100	0.0463	0.6468
Reserve_amount	231	13.4678	1.2248	11.5794	13.2034	15.8538
GDP_share	231	0.0980	0.0841	0.0155	0.0572	0.2612
Trade	231	0.1731	0.1612	0.0250	0.0704	0.4981
Findeep	231	1.7794	0.2359	1.3767	1.7392	2.4500
CPI	231	3.0253	2.7696	-0.8300	2.2000	15.7600
Exvol	231	-0.0032	0.0229	-0.1025	-0.0012	0.0606

4. Empirical Results and Analysis

4.1 Baseline Regression Analysis

Based on the baseline regression model specified above, Table 3 reports the results of the analysis of factors influencing the share of international reserve currencies. Column (1) controls for time effects only, while Column (2) controls for individual effects only.

Table 3
Baseline Regression Results

L1_Reserve_share	**(1)**	**(2)**	**(3)**	**(4)**	**(5)**
	0.9951* **	**0.8220*** **	**0.8245*** **	**0.8198*** **	**0.8146*** **
	(0.0021)	(0.0285)	(0.0282)	(0.0353)	(0.0305)
GDP_share	0.0018	-0.1197	-0.0962	-0.1057	-0.1356*
	(0.0073)	(0.0844)	(0.0693)	(0.0745)	(0.0670)
Trade	0.0002	0.1013	0.0978*	0.0972*	0.0982*
	(0.0033)	(0.0555)	(0.0496)	(0.0492)	(0.0463)
Findeep	-0.0005	-0.0012	-0.0023	-0.0029	-0.0024
	(0.0005)	(0.0017)	(0.0022)	(0.0026)	(0.0024)
CPI	-0.0000	-0.0001		-0.0001	-0.0002
	(0.0001)	(0.0001)		(0.0001)	(0.0001)
Exvol	0.0193*	0.0209***			0.0264**
	(0.0116)	(0.0043)			(0.0084)
ID	NO	YES	YES	YES	YES
QTIME	YES	NO	YES	YES	YES
N	224	224	224	224	224
R-squared	0.9998	0.8385	0.8366	0.8368	0.8414

Note: Standard errors are shown in parentheses; ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively. The same applies below.

The baseline regression results show that the coefficient on L1_Reserve_share (the one-period lagged reserve share) exceeds 0.8 across columns (1) through (5) and is significant at the 1% level. This indicates that currency use inertia exerts a strong positive effect on reserve currency shares, a finding consistent with prior studies and supporting Hypothesis 1 of this paper.

By contrast, the coefficient on GDP_share is generally negative. Even after controlling for individual and time fixed effects, it remains negative and significant at the 10% level. This result deviates somewhat from the positive effect predicted in Hypothesis 2, but it is consistent with the possibility of a nonlinear relationship also noted in that hypothesis.

We offer several possible explanations. First, the strong inertia of currency usage may delay adjustments: for instance, a relative decline in the U.S. GDP share does not immediately reduce the dollar’s reserve share, nor does a relative rise in China’s GDP share quickly boost the renminbi’s reserve

share. Second, after controlling for trade volume (Trade) and financial depth (Findeep), GDP_share may primarily capture the component of economic size that is not transmitted through these channels, and its marginal effect on reserve shares could be weak or even negative. Third, the dollar's dominant status as the global reserve currency means its share far exceeds what economic size alone would predict, which may also drive down the estimated coefficient on GDP_share.

The positive and statistically significant (at the 10% level) coefficient on trade volume suggests that a greater share of global trade by the issuing economy facilitates broader use of its currency in international settlement, pricing, and financing. This in turn bolsters transaction demand and network externality, generating a self-reinforcing dynamic whereby trade networks underpin the formation of reserve currency status.

Furthermore, trade expansion often goes hand in hand with deeper financial markets and greater liquidity, which reinforce the currency's reserve attractiveness. Hence, the positive effect of Trade on Reserve_share—even after accounting for economic scale—implies that reserve currency status is not merely a function of the issuer's GDP, but also reflects the actual extent to which its currency is utilized in international trade.

The estimated coefficient on Findeep (financial depth) is negative and small in magnitude, and fails to reach statistical significance—a result at odds with Hypothesis 3. This finding, however, should not be interpreted as evidence that financial depth is inconsequential for reserve currency status. The lack of a significant direct effect may be attributable to the pronounced path dependence of reserve shares: after the lagged dependent variable accounts for the bulk of historical persistence, the marginal explanatory power of contemporaneous financial depth is likely to be obscured. Furthermore, given the inherent collinearity among financial depth, economic size, and trade volume, the model may struggle to isolate their respective contributions.

The estimated coefficient on CPI is negative, implying that inflationary pressures in the issuing economy tend to diminish its currency's reserve share. This result is qualitatively consistent with theoretical priors, although it does not attain statistical significance. In contrast, Exvol—which captures exchange rate stability—exhibits a positive and statistically significant relationship with Reserve_share, and this effect remains robust at the 5% level after controlling for both individual and time fixed effects. Such a result suggests that currency appreciation serves as a positive signal of the issuing economy's macroeconomic stability and institutional credibility, enhancing the relative valuation of its reserve assets and reinforcing the willingness of foreign central banks to hold them. These empirical findings are generally supportive of Hypothesis 4.

4.2 Robustness Tests

4.2.1 Replacing the Dependent Variable

As a robustness check, we re-estimate the model using alternative variable definitions. Column (6) of Table 4 presents the results when the reserve share (Reserve_share) is replaced by the reserve amount (Reserve_amount) as the dependent variable, and the lagged reserve amount (L1_Reserve_amount) is used in place of the lagged reserve share to capture inertia. The findings for inertia and exchange rate appreciation are largely unchanged. Trade volume continues to exhibit economic significance, though its statistical significance is no longer retained.

4.2.2 Substitution of Explanatory Variables

Column (7) reports the results when the short-term appreciation measure (Exvol) is replaced by a long-term trend indicator (Extrend), constructed as the four-quarter cumulative deviation: Extrend = $\ln(e_t) - [\ln(e_{t-1}) + \ln(e_{t-2}) + \ln(e_{t-3}) + \ln(e_{t-4})]$. The estimated coefficient on Extrend is positive and statistically significant, suggesting that the attainment of reserve currency status is influenced by both short-run exchange rate dynamics and long-run currency stability. These results are broadly consistent with the baseline specification, and our main inferences remain intact.

4.2.3 Excluding the U.S. Dollar from the Sample

Given the U.S. dollar's dominant position in global foreign exchange reserves, its reserve share may be disproportionately large relative to other currencies, potentially exerting undue influence on the regression results. To rule out this concern, we re-estimate the model after excluding the U.S. dollar from the sample. As shown in Column (8) of Table 4, the coefficients on most explanatory variables retain their original signs, suggesting that our baseline findings are not driven by the U.S. dollar and are therefore reasonably robust.

After excluding the U.S. dollar, the coefficient on L1_Reserve_share declines from 0.8146 to 0.7019 but remains highly significant, indicating that inertia in reserve shares persists among non-dollar currencies, although the exceptionally strong inertia associated with the dollar had previously inflated the overall estimate.

The coefficient on GDP_share turns from negative to positive. This reversal suggests that the negative coefficient in the full sample reflects the dollar's outsized reserve share relative to its economic size; once the dollar is removed, economic size exhibits a positive relationship with reserve shares. The coefficient on Trade loses significance, implying that the positive effect of trade volume on reserve shares is also largely driven by the U.S. dollar. As the primary settlement currency for international trade, the dollar's trade volume and reserve status are closely linked, whereas this relationship does not hold for other currencies.

By contrast, the coefficients on CPI and Exvol remain stable across both samples, making them the most robust explanatory variables. This suggests that the impact of currency stability on reserve shares is not specific to the dollar but is equally relevant for other reserve currencies.

Table 4
Robustness Test Results

L1_Reserve_amount	**(6)**	**(7)**	**(8)**
	0.8529* **		
	(0.0260)		
L1_Reserve_share		0.8087***	0.7019***
		(0.0342)	(0.0909)
GDP_share	-0.2011	-0.1454	0.0196
	(0.6091)	(0.0843)	(0.0580)
Trade	0.7071	0.1037*	0.0247
	(0.4684)	(0.0516)	(0.0229)
Findeep	-0.0436	-0.0021	0.0007
	(0.0636)	(0.0023)	(0.0022)
CPI	0.0003	-0.0002	-0.0002
	(0.0020)	(0.0001)	(0.0002)
Exvol	0.4510***		0.0288**
	(0.1082)		(0.0107)
Extrend		0.0204***	
		(0.0052)	
ID	YES	YES	YES
QTIME	YES	YES	YES
N	224	224	192
R-squared	0.9500	0.8412	0.8115

4.3 Endogeneity Analysis

To address potential concerns about reverse causality, omitted variables, and dynamic panel bias, we further employ the LSDVC (Least Squares Dummy Variable Corrected) estimator and the FE-IV (Fixed Effects with Instrumental Variables) approach to test for endogeneity. Specifically, LSDVC is used to correct for Nickell bias that arises in dynamic panel models with lagged dependent variables and individual fixed effects.

Given that economic size and trade volume may be endogenous, we use their lagged terms as instrumental variables to mitigate this concern. As reported in Table 5, our core findings—regarding the effects of inertia, trade volume, and currency appreciation—remain qualitatively unchanged after accounting for potential endogeneity.

Table 5
Results of Endogeneity Analysis

L.Reserve_share	**(9)** **LSDVC**	**(10)** **LSDVC**	**(11)** **LSDVC**	**(12)** **FE-IV**
	0.8608* **	**0.8552*** **	**0.8536*** **	**0.8137*** **
	(0.0338)	(0.0345)	(0.0351)	(0.0356)
GDP_share	-0.0678	-0.0783	-0.1012	-0.1254**
	(0.0568)	(0.0621)	(0.0644)	(0.0568)
Trade	0.0764*	0.0770*	0.0814*	0.1000**
	(0.0442)	(0.0440)	(0.0439)	(0.0420)
Findeep	-0.0007	-0.0013	-0.0012	-0.0011
	(0.0020)	(0.0025)	(0.0025)	(0.0025)
CPI		-0.0001	-0.0001	-0.0001
		(0.0001)	(0.0001)	(0.0001)
Exvol			0.0211**	0.0212**
			(0.0092)	(0.0097)
N	224	224	224	217

5. Further Analysis

The onset of the Russia–Ukraine conflict on February 24, 2022, prompted a series of coordinated financial sanctions. The European Union subsequently decided to disconnect selected Russian banks from the SWIFT payment system, and the United States, together with its allies, froze an estimated $300 billion in assets belonging to the Central Bank of Russia. These actions had far-reaching implications for Russia's international financial transactions and, more fundamentally, raised profound questions regarding the security of sovereign reserve assets—issues that have since generated extensive scholarly and policy debate.

The baseline estimates presented above capture the persistent influence of slow-moving determinants such as inertia, but they do not readily speak to the role of acute geopolitical events in reshaping the

reserve currency landscape. Furthermore, the infrequent occurrence of such events and their limited cross-sectional heterogeneity render them ill-suited for inclusion in a standard panel specification—a challenge that has also generated considerable debate in the literature. To explicitly assess the impact of the Russia–Ukraine conflict, we therefore turn to a Regression Discontinuity in Time (RDiT) framework, taking the first quarter of 2022 as the threshold. The empirical model is specified as follows:

$$\mathrm{Y_{it}}=\eta_0+\eta_1\mathrm{Post_t}+\eta_2\mathrm{TimeToCutoff_t}+\eta_3\left(\mathrm{Post_t}\times\mathrm{TimeToCutoff_t}\right)+\eta_4\mathrm{X_{i,t}}+\mu_\mathrm{i}+\lambda_\mathrm{t}+\varepsilon_{\mathrm{i,t}}\#(2)$$

where $Post_t$ is a discontinuity indicator that equals *1* for the first quarter of 2022 and thereafter, and *0* otherwise. $TimeToCutoff_t$ is the running variable, defined as the number of quarters between the observation period and the cutoff point—taking negative values before the discontinuity and positive values after it. The coefficient η_1 captures the treatment effect at the cutoff, indicating whether the outbreak of the conflict caused an immediate shift in the reserve share.

$\mathrm{X_{i,t}}$ denotes the vector of explanatory variables, including the one-period lagged reserve share, economic size, trade volume, financial depth, inflation, and currency appreciation. μ_i, λ_t, and $\varepsilon_{i,t}$ denote the individual fixed effect, time fixed effect, and error term, respectively.

Table 6 displays the results of the breakpoint regression analysis. Column (13) reports the baseline specification, which includes only the discontinuity dummy to capture a potential level shift at 2022Q1. Column (14) presents the full RDiT specification, which simultaneously controls for the level jump at the cutoff and the differential slope on either side. Column (15) reports a local linear regression estimated over a symmetric 8-quarter bandwidth (4 quarters before and after the cutoff) to evaluate the robustness of the estimates to alternative bandwidth choices. All regressions control for both individual and time fixed effects.

The estimation results indicate that the coefficient on the breakpoint indicator *Post* is statistically insignificant across all model specifications, suggesting that the onset of the Russia-Ukraine conflict did not generate an immediate, discernible jump in reserve shares during 2022Q1. In the full RDiT specification, the estimated coefficient on Post is -0.0035 (with a standard error of 0.0245), and the null hypothesis of no level shift at the cutoff cannot be rejected. Similarly, the coefficient on the interaction term (*Post×TimeToCutoff*) is 0.0002 and lacks statistical significance, implying that the pre-and post-breakpoint trends in reserve shares are not materially different.

These findings are consistent with those of Chinn et al. (2024), who report that geopolitical factors do not exert a statistically significant influence on reserve currency shares. Taken together, the evidence points to the possibility that geopolitical effects may manifest primarily through indirect, longer-term channels, rather than by prompting swift portfolio reallocations in reserve holdings.

Table 6
Results of Breakpoint Regression Analysis on the Russia-Ukraine Conflict

L1_Reserve_share	**(13)**	**(14)**	**(15)**
	Level Only	**RDiT Full**	**BW = 8**
	0.8146* **	**0.8146*** **	**0.5593*** **
	(0.0305)	(0.0305)	(0.0627)
GDP_share	-0.1356*	-0.1356*	-0.0425
	(0.0670)	(0.0670)	(0.0702)
Trade	0.0982*	0.0982*	0.1090
	(0.0463)	(0.0463)	(0.1368)
Findeep	-0.0024	-0.0024	-0.0056
	(0.0024)	(0.0024)	(0.0049)
CPI	-0.0002	-0.0002	-0.0003**
	(0.0001)	(0.0001)	(0.0001)
Exvol	0.0264**	0.0264**	0.0218*
	(0.0084)	(0.0084)	(0.0101)
post	-0.0001	-0.0035	-0.0014
	(0.0010)	(0.0245)	(0.0136)
time_to_cutoff		0.0000	0.0000
		(0.0001)	(0.0005)
post_x_time		0.0002	0.0000
		(0.0025)	(0.0025)
ID	YES	YES	YES
QTIME	YES	YES	YES
N	224	224	119
R-squared	0.8414	0.8414	0.4788

6. Conclusions and Implications

6.1 Research Conclusions

Taking the inclusion of the renminbi into the IMF's Special Drawing Rights (SDR) basket as our analytical starting point, we selected seven major international reserve currencies—the US dollar, euro, Japanese yen, British pound, Canadian dollar, Australian dollar, and renminbi—for examination over the period from Q4 2016 to Q4 2024. Employing a two-way fixed-effects model, we conducted robustness checks, endogeneity tests, and structural break regressions to systematically investigate the determinants of international reserve currency shares, with a particular focus on the impact of the Russia-Ukraine conflict's outbreak in Q1 2022 on the reserve currency composition. Our main findings are as follows:

First, currency usage inertia emerges as the most robust and central determinant of international reserve currency shares. Our empirical results show that the lagged reserve share exerts a significant positive effect on the current share, implying that the status of international reserve currencies is subject to strong path dependence, and that short-term economic fluctuations are unlikely to rapidly reshape the existing order.

Second, the relationship between economic size and reserve currency share is not simply linear or uniformly positive. In the baseline regression, the coefficient on economic size is significantly negative. This counterintuitive result reflects the distinctive structure of the international reserve currency system: the U.S. dollar, as the dominant reserve currency, commands a share far exceeding what its economic size alone would predict, which pulls down the estimated coefficient for the full sample. Regressions excluding the dollar confirm that, among the remaining currencies, economic size is positively associated with reserve share, suggesting that the effect of economic size is substantially moderated by currency inertia and the incumbent advantages of the dominant currency.

Third, trade volume exerts a significant positive effect on international reserve currency shares. The greater a currency-issuing economy's embeddedness in the global trade network, the more extensively its currency is utilized in international settlement, pricing, and financing, thereby generating stronger transactional demand and network externalities. Even after controlling for economic size, trade volume continues to positively influence reserve currency status, suggesting that reserve status is shaped not solely by economic size but also by the actual depth of a currency's usage in international trade.

Fourth, the direct effect of financial market development on reserve shares is not statistically significant, which deviates somewhat from theoretical predictions. This result may be attributable to the fact that the lagged reserve share has already absorbed the cumulative effects of financial market development over time, making it difficult to isolate the marginal contribution of current financial depth. In addition, the strong collinearity between financial depth and both economic and trade scales further dilutes its independent impact.

Fifth, currency stability constitutes a noteworthy factor influencing the share of international reserve currencies. Inflation is found to have a dampening effect on reserve shares, consistent with theoretical predictions, although this effect does not reach statistical significance. In contrast, appreciation against the SDR exerts a significantly positive influence on reserve shares. This pattern suggests that steady

appreciation serves as an indicator of robust macroeconomic conditions and credible policy frameworks in the issuing economy, thereby reinforcing foreign central banks' propensity to hold the currency.

Sixth, the outbreak of the Russia-Ukraine conflict and the subsequent financial sanctions did not produce a discernible immediate upward shift in international reserve currency shares during the first quarter of 2022. The breakpoint regression estimates reveal that the coefficients on the break dummies are not significant under any specification, nor do the pre- and post-break time trends display any significant divergence. These results further corroborate the strong inertial nature of the international reserve currency structure. A single geopolitical episode is unlikely to induce an immediate portfolio rebalancing; rather, its influence is more apt to manifest itself gradually, over a medium-to-long-term horizon and in an incremental manner.

6.2 Implications for the Internationalization of Emerging Market Currencies

Based on the research findings above, the following policy implications are proposed for emerging market economies aiming to advance their currency internationalization:

First, efforts should be made to reinforce the habitual use of the domestic currency. The literature shows that international currency status is characterized by strong path dependence, implying that currency internationalization cannot be accomplished through short-term policy interventions alone. Therefore, emerging market economies should initially leverage their existing economic and trade linkages with neighboring countries to broaden the use of their currencies in cross-border settlements and investment and financing activities. This approach would help cultivate stable and sustained usage scenarios over time, thereby fostering market participants' familiarity and routine reliance on the domestic currency.

Second, it is imperative for these economies to convert their economic and trade prowess into currency usage advantages. While a large economy is a foundational asset, research underscores that the critical factor lies in effectively channeling trade and real-economy linkages into demand for the local currency. By capitalizing on regional cooperation, industrial chain connectivity, and commodity trading, emerging markets can expand the role of their currency in trade invoicing, settlement, and financing. Such efforts would foster a virtuous cycle in which trade, investment, and currency flows reinforce one another.

Third, it is essential to steadily increase the openness of financial markets and strengthen their investment appeal. While the direct impact of financial depth may appear limited, this does not diminish the critical role of well-developed financial markets in supporting currency internationalization. A truly international currency must serve not only as a payment instrument but also as a reliable store of value, providing foreign investors and official reserve managers with safe, liquid, and sufficiently sizable assets denominated in the domestic currency. Accordingly, emerging market economies should persistently bolster their domestic financial infrastructure, enhance policy transparency, and ensure the predictability of market rules.

Fourth, maintaining currency stability and policy credibility is of paramount importance. Empirical evidence indicates that international investors and reserve managers prioritize the value-preserving attributes of a currency. To this end, emerging market economies should adhere to sound fiscal and monetary frameworks, reinforce their inflation management capabilities, and mitigate undue exchange rate fluctuations. Such measures are instrumental in cultivating a stable macroeconomic environment, thereby reinforcing foreign entities' confidence in acquiring and holding domestic currency-denominated assets.

Declarations

Author Contribution

Author ContributionsX.L.: Conceptualization, methodology design, data curation, and manuscript review and revision.J.H.: Drafting of the original manuscript, data analysis, and literature/ data collection and empirical analysis.All authors have read and agreed to the published version of the manuscript.

Data Availability

The data on international reserve currency shares used in this study are publicly available from the International Monetary Fund's Currency Composition of Official Foreign Exchange Reserves (COFER) database . The remaining macroeconomic and financial variables were obtained from the iFinD financial database, which requires a paid institutional subscription for access. Data supporting the findings of this study are available from the corresponding author upon reasonable request.

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46.

Figures

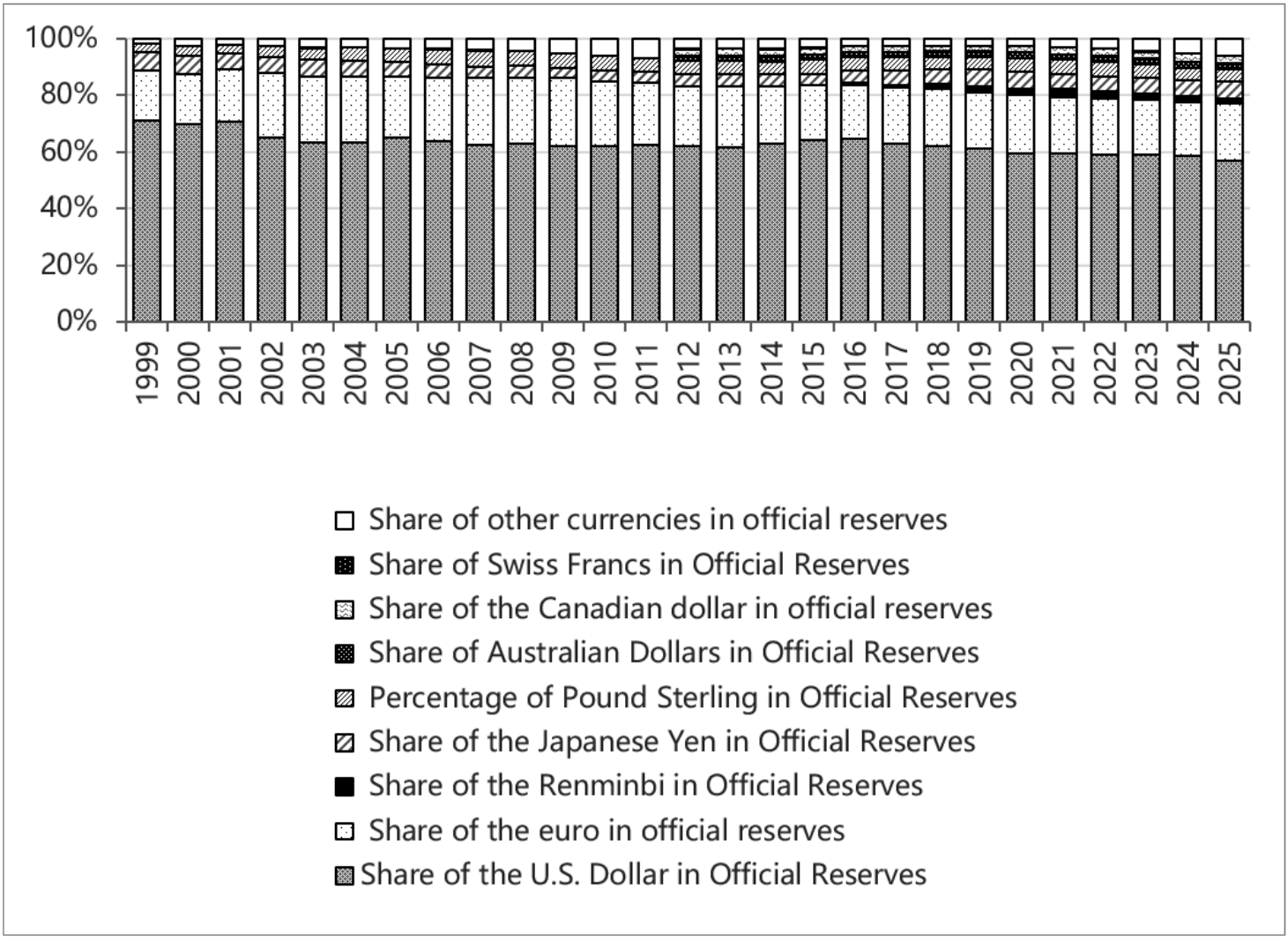


Figure 1

Evolution of Currency Shares in Global Official Foreign Exchange Reserves

Data Source: IMF COFER

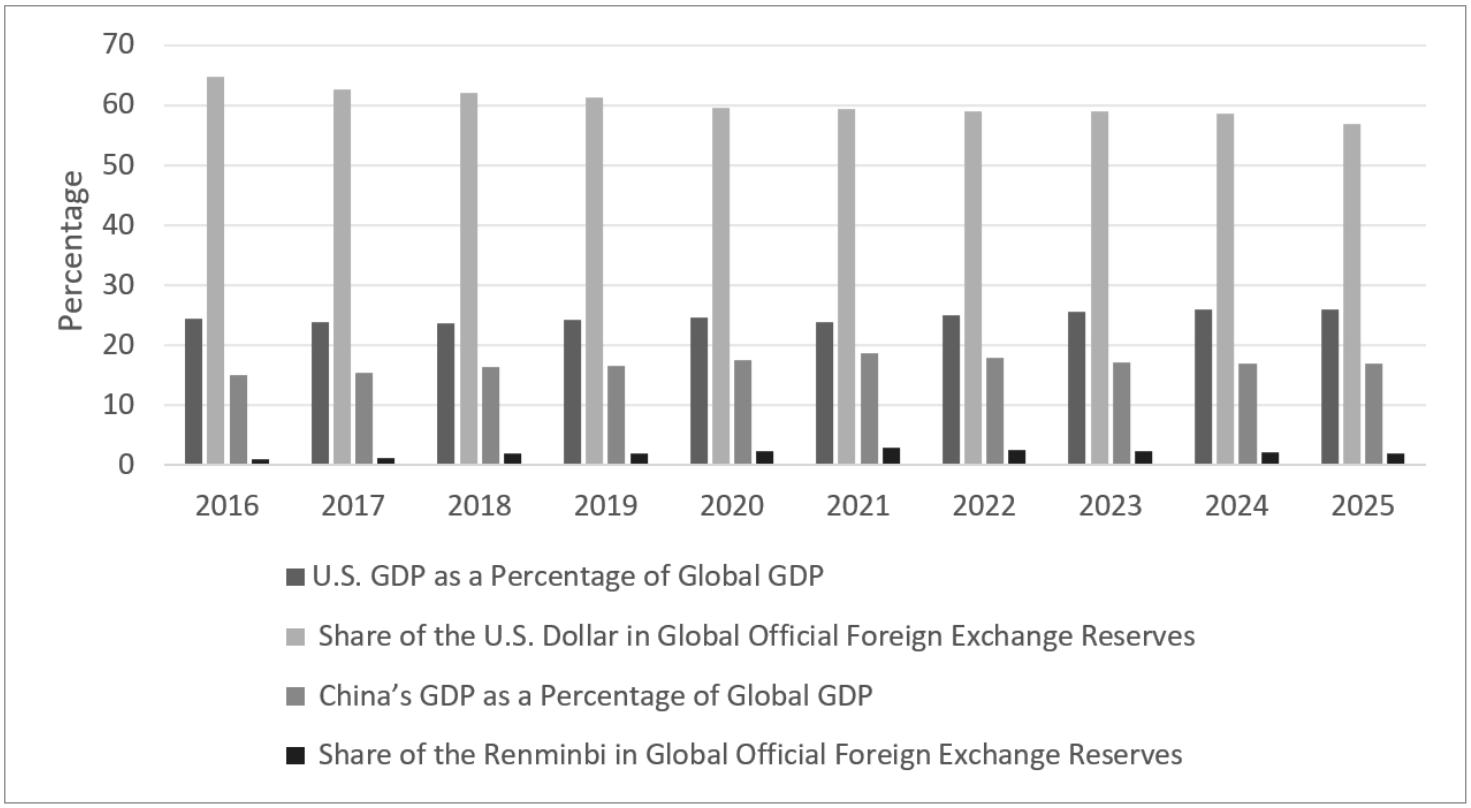


Figure 2

Structural Comparison of Economic Strength and Currency Reserve Status Between China and the U.S. (2016–2025)

Data Sources: IMF COFER, iFind