The US dollar as a safe haven and reserve currency: status under pressure and implications for currency hedging policy

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INTRODUCTION

For decades, the US dollar (USD) has held a unique position in the global financial system. The currency functions not only as the dominant reserve currency but also as a safe haven during periods of financial stress. This dual role has a major influence on the currency risk policy of institutional investors, particularly in the Netherlands, where investment portfolios often have significant exposure to the USD. In recent years, however, there have been clear signals that both functions of the dollar are under pressure. In 2025, it became apparent during various high-risk periods that the USD no longer automatically acts as a safe haven. At the same time, the dollar's share of global foreign exchange reserves is steadily declining, as shown by recent IMF COFER data (IMF, 2025). This article examines the structural forces driving this decline.

cause shifts, how investors can monitor these developments, and what implications this has for currency hedging policy.

THE UNIQUE POSITION OF THE USD

The USD distinguishes itself from other currencies because it is both

a safe haven if the main reserve currency is (Acharya & Laarits, 2025a; Castro et al., 2025). In times of market stress

investors traditionally sought refuge in the dollar, causing it to rise against other currencies. At the same time, the USD is the dominant currency for international trade and is

the reserve held by central banks worldwide.

This combination of features is unique and underscores the structural demand for USD assets. Other currencies, such as the Japanese yen (JPY) and the Swiss franc (CHF), often rise during crises but do not play a major role as reserve currencies. The euro (EUR) is the largest reserve currency after the USD but does not function as a consistent safe haven. The USD combines both characteristics, which historically led to a positive carry and a natural hedge for international portfolios (Castro et al., 2025).

The attractiveness of the USD as a safe haven and reserve currency is reflected in the so-called convenience yield, the implicit benefit that investors attribute to the exceptional security and immediate tradability of liquid USD assets. This is the extra return that investors are willing to give up for the security and liquidity of US dollars.

The convenience yield is typically positive and reflects the structural demand for USD assets (see Figure 1). This effect was empirically demonstrated early on in price relations in financial markets (Fama & French, 1987) and later further elaborated in

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Figure 1
Illustration of the historical convenience yield on American Dollar

Source: Own calculation based on LSEG Datastream

research into the special demand for USD safe assets (Krishnamurthy & VissingÿJorgensen, 2012; Acharya & Laarits, 2025a).

It is precisely over the five-year maturity that this mechanism becomes most visible. This maturity forms the intersection where expectations regarding future monetary policy converge with binding balance sheet and leverage restrictions on banks and primary dealers, which limit their capacity to hold Treasuries on their balance sheets (Duffie et al., 2023; Kashyap, Stein, Wallen & Younger, 2025). Consequently, an increase in demand for USD safety translates relatively quickly into additional downward pressure on five-year yields and a temporary peak in the convenience yield (see Figure 1).

BREAK IN THE SAFE HAVEN MECHANISM

In recent years, there have been clear signals that the USD's safe haven mechanism no longer functions automatically. During the trade tariff crisis of April 2025, the USD declined, while equities and other risky assets also fell sharply. This differs from previous crises, in which the USD actually rose (Acharya & Laarits, 2025b). The correlation between USD and Treasuries has decreased, and the convenience yield on Treasuries is falling. This is visible in Figure 1, where the downward trend in the convenience yield becomes evident. This undermines the traditional hedging mechanism.

The weakening of the USD's safe-haven status is linked to tensions in the US Treasury market.
Stricter capital rules, such as the Supplementary Leverage Ratio (SLR), high government debt, and concentrated leverage in hedge funds restrict the balance sheet space of banks and dealers (Duffie, 2025; Federal Reserve, 2025). As a result, the market functions less effectively as a safe haven during stress. In the past, banks and dealers were able to draw large amounts of Treasuries onto their balance sheets during times of stress, keeping the market liquid and allowing the USD to fulfill its role as a safe haven. The transport could fulfill. Due to stricter regulations and a historically high national debt, this absorption capacity is now limited.

The role of hedge funds has also changed in this context. They often finance their positions in Treasuries with short-term loans via the repo market. If banks are less willing to provide these loans, the leverage capacity of hedge funds decreases. Figure 2 shows the net positions of hedge funds in Treasury futures. This shows that leveraged positions remain high, making the system vulnerable. This makes them vulnerable to margin calls and forced sales during market turmoil (Kashyap et al., 2025).

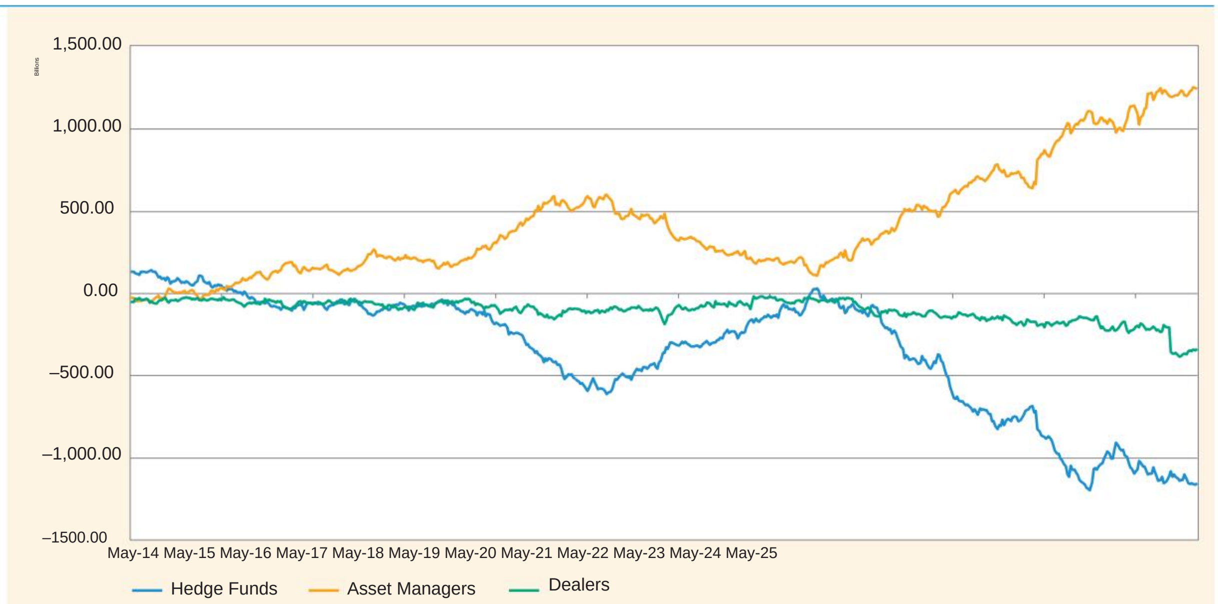
The impact of stricter capital rules on banks' balance sheet space is visible in Figure 3.

THE DOLLAR REMAINS CENTRAL, BUT THE SAFE HAVEN EFFECT IS STRONGER TOGETHER WITH THE OPERATION OF THE TREASURY-- MARKET

Although regulators adopted an adjustment to the eSLR rules in December 2025 to alleviate pressure on bank balance sheets, this change was not yet noticeable in market practice. As a result, banks' limited absorption capacity during recent stress moments largely persisted (OCC, Federal Reserve System & FDIC, 2025).

This SLR headroom of large banks has decreased significantly in recent years, which limits the absorption capacity of banks.
The combination of limited balance sheet space at banks, high leverage among hedge funds, and a growing supply of Treasuries

Figure 2
Hedge Fund net positions in Treasury Futures



Source: Own calculation based on the OFR Hedge Fund Monitor

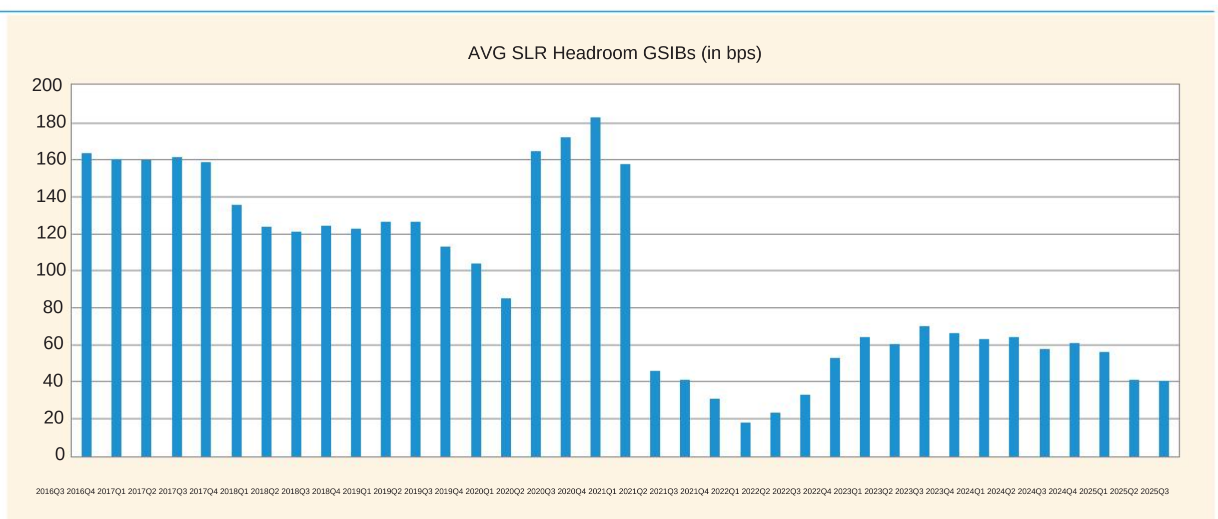
causes the USD's safe haven mechanism to become fragile.

During recent moments of stress, it appears that capital flows still partially flow towards USD assets, but that this inflow is less uniform than during previous crises: in 2025, the USD no longer automatically functioned as a safe haven, while central banks simultaneously shifted a larger share of their safe-haven allocations to gold and other alternatives (Duffie, 2020). Furthermore, global foreign exchange reserve figures show that part of the flight flows spread across other currencies such as the euro, which is consistent with structural currency reserve diversification (Arslanalp, Eichengreen & SimpsonÿBell, 2022). This suggests that investors are still utilizing the USD for lack of a better alternative, but no longer with the same self-evidence as before.

THE USD RESERVE STATUS UNDER PRESSURE

In addition to the safe haven mechanism, the status of the USD is also a factor. under pressure as a reserve currency. Globally, there has been a gradual shift away from the dollar for more than twenty years. The share of the USD in official foreign exchange reserves fell. from over 70% in 2001 to approximately 56% by the end of 2025 (IMF COFER, 2025). Central banks are diversifying their reserves, partly due to geopolitical risks and sanctions (Arslanalp, Eichengreen & Simpson-Bell, 2022). The freeze on Russian reserves in 2022 was a major catalyst that reinforced de-dollarization. Central banks have since realized that dollar reserves not be immune to geopolitical sanctions. Nevertheless, the dollar remains dominant, primarily because central banks need liquid and safe assets that can be deployed quickly in times of crisis. US government bonds still meet those conditions best (Boocker & Wessel, 2024).

Figure 3
Balance sheet absorption capacity weighted average of large banks in bps (SLR headroom)



Source: Own calculation based on the OFR Bank Systemic Risk Monitor

The decline in the dollar's share has not been offset by a rise in traditional alternatives such as the euro, yen, or pound. Instead, an increase is visible in the use of smaller currencies such as the Canadian and Australian dollars, and the Swiss franc. These offer diversification and have become easier to trade thanks to digital technologies. Nevertheless, their role remains limited by scale and liquidity.
Moreover, IMF research shows that this shift is not only taking place among geopolitical rivals of the US, but that at least 49 countries, including the majority of the G20, are gradually diversifying their reserves away from the dollar (Arslanalp et al., 2024).

CENTRAL BANKS REALIZE THAT DOLLAR RESERVES ARE NOT IMMUNED TO GEOPOLITICAL SANCTIONS

The renminbi initially appeared to benefit from this trend, partly due to Chinese initiatives such as the CIPS payment system and the digital yuan. However, since 2022, the share of the renminbi in reserves has also declined, even after adjusting for exchange rate effects. Limited tradability and capital controls remain a structural impediment to the currency's international role (von Beschwitz, 2024). At the same time, gold is gaining importance as a geopolitical hedge. Emerging markets, in particular, view gold as a sanctions-resistant alternative that can be stored locally. IMF research shows that demand for gold correlates positively with geopolitical tensions and global uncertainty (Arslanalp et al., 2024).
However, gold is not a substitute for currency: it generates no interest, is less liquid, and plays no role in trade invoicing.

We expect structural demand for dollars to persist as long as alternatives do not meet the same liquidity and reliability requirements. This supports convenience.
yield and justifies partial exposure to the USD.
If the hedging properties of Treasuries deteriorate further, as outlined by Acharya and Laarits (2025a), this could undermine the attractiveness of the USD as a reserve currency. Central banks might then be more inclined to diversify their reserves towards assets that perform better in crisis situations.

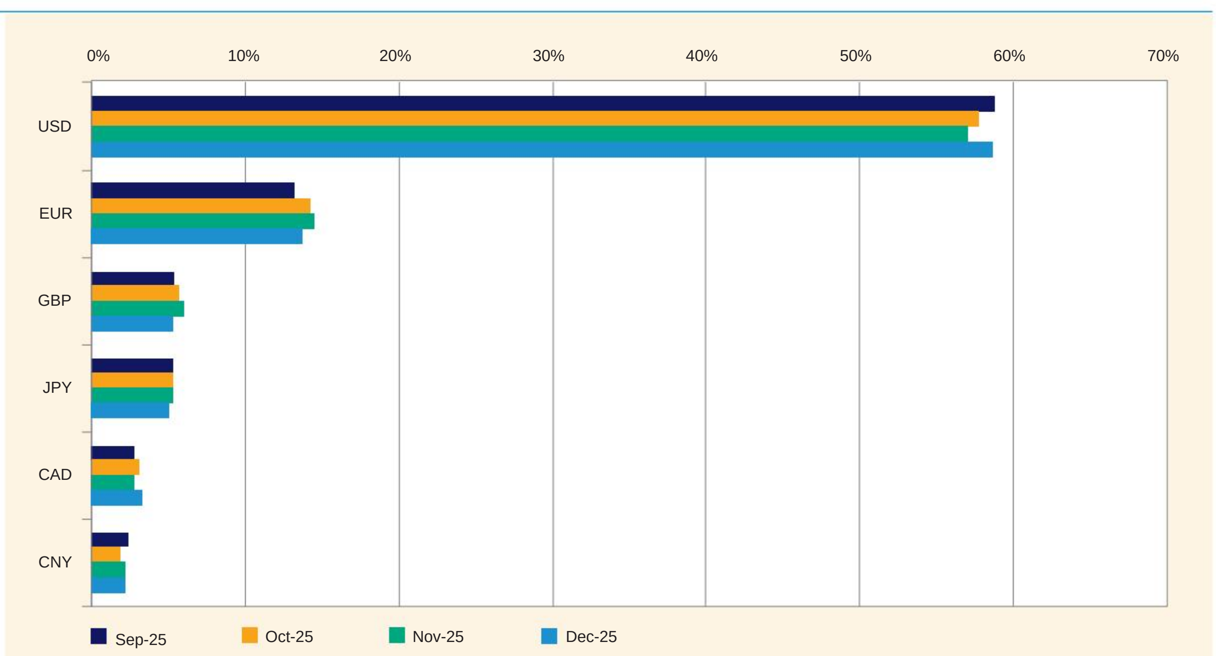
NETWORK EFFECTS AND THE ROLE OF THE USD IN INTERNATIONAL TRADE

The desire for diversification is also growing in world trade, with some economies having reduced their dependence on the dollar in trade invoicing since 2021 (Boz et al., 2025). Nevertheless, more than half of all global trade is still invoiced in dollars (see Figure 4). Moreover, the dollar is involved in almost all currency transactions. This dominance limits the policy space of many countries, particularly emerging economies. Because prices are often fixed in dollars, exchange rate fluctuations have less impact on export prices. As a result, monetary policy outside the US becomes less effective (Gopinath & Itskhoki, 2022).

The continued dominance of the dollar is due to
strong network effects. The more countries use the dollar, the more attractive it becomes for other countries to use it as well. In addition, the infrastructure surrounding the dollar is well developed. Consider the global SWIFT system, the role of the Federal Reserve as a crisis bank via swap lines, and the deep market for Treasuries (Georgiadis & Möslé, 2019).

China is working on alternatives, such as the CIPS network and renminbi swap lines. These are primarily used in Asia.

Figure 4
Share of the USD in international payments



Source: Swift RMB Tracker

and BRICS countries. Swap lines demonstrably lead to increased renminbi invoicing, particularly in countries with significant trade with China (Georgiadis et al., 2021). Nevertheless, the renminbi remains of limited use due to capital constraints and institutional uncertainty.

Other initiatives, such as a joint BRICS currency or digital trading platforms, are still in an early stage.
They lack scale, trust, and stable governance (Mayer, 2024).
Internal tensions within BRICS countries and concerns about Chinese dominance limit support. There are also signs of de-dollarization in the commodities trade, such as the increase in energy contracts priced in other currencies (JP Morgan, 2025). However, the dollar remains the dominant currency for oil exports, according to recent IMF research (Boz et al., 2025).

RESERVE DIVERSIFICATION RARELY TAKEN VIA ONE SUCCESSOR, BUT VIA DISTRIBUTION, WITH GOLD AND SMALLER CURRENCIES IN THE SPOTLIGHT MORE OFTEN

New technologies, such as digital central bank currencies, can reduce dependence on the dollar in the long term.
Pilots show that cross-border payments can be faster and cheaper without the intervention of the dollar. However, these systems are still in their infancy. A real shift requires more: trust, cooperation, and time.

PRACTICAL IMPLICATIONS FOR CURRENCY HEDGING POLICY

This article shows that the USD's status as a safe haven and reserve currency is no longer a given. Market structure, regulation, and geopolitical trends are putting the traditional mechanism under pressure. For investors, this means: do not cling to old assumptions, but actively monitor the underlying drivers and be prepared to adjust currency policy if structural changes persist.

However, as long as there is no full-fledged alternative, the USD continues to play a central role. At the same time, it is logical for investors to consider possible reactions to a less obvious dollar position. Depending on investment objectives and risk appetite, this may consist of controlled diversification or the careful management of currency risk through a stable and long-term-oriented hedging framework. In the current environment, where temporary dollar movements do not automatically reflect structural trends, a consistent long-term approach remains the most rational.

It is advisable not only to look at short-term volatility or political noise, but above all to focus on the economic fundamentals that underpin the safe haven mechanism of

steer the dollar. This requires attention to the structure and functioning of the Treasury market, how it is influenced by the balance sheet positions of banks and hedge funds, and the international demand for U.S. debt. In addition, shifts in the composition of global reserve portfolios and the use of the USD in international trade and payment infrastructure are of lasting importance.

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