

non-US dollar holdings of official reserves are held within Europe by European countries themselves. With EMU, these holdings will become domestic funds, so that the ECB will have to hold mainly US dollars for its own foreign exchange reserves.

Reserve holdings by currency and country are provided below in Table 2.

Table 2
G-7 Countries' Holdings of Official Reserves

	<u>US dollars</u>	<u>Ecu</u>	<u>other currencies</u>
	(millions of US dollars equivalent, end-1995)		
Canada	12,127	-	502
France	12,259	4,674	6,233
Germany	50,127	27,520	147
Italy	15,017	6,257	6,531
UK	9,787	11,198	13,623
Japan	65,707	-	6,016
US	-	-	49,096

Source: BIS. Unallocated reserves of Asian industrializing countries total US \$246 billion, mostly in US dollars, including large holdings by Taiwan and China.

There are considerable holdings of ECU by the European countries which will become euros on a one-for-one exchange; these will then become domestic assets with EMU (except the considerable UK holdings, if the UK stays out of EMU.) Other countries' reserve holdings of deutschemarks and other European currencies will become redeemable in euros at the locked exchange rates. At least initially, EMU will probably result in a *decreased* share of European currencies in global reserve portfolios as intra-European official foreign exchange claims become domestic assets. The growth of euros as a reserve currency will therefore depend on the willingness of other large reserve holders (US, Japan, Taiwan, and China) to hold them.

The euro will probably come to occupy a significant part of international reserve portfolios after several years as euro capital markets mature and reserve holders become convinced of the prudence of Europe's monetary and fiscal policies. Potential reserve flows occasioned by adjustments of official portfolios, while large in absolute terms, will be dwarfed by the size, liquidity, and elasticity of global money markets. What will be most important for the euro interest rate and exchange rate is the policy stance of the ECB vis a vis