The Future of the US Dollar as the Global Reserve Currency

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Background and Context

The US dollar has maintained its status as the world's predominant reserve currency since the Bretton Woods Agreement in 1944. This status has afforded the United States significant economic advantages, including lower borrowing costs and a more significant influence over global financial markets. Currently, the US dollar accounts for 59% of global foreign exchange reserves, far surpassing other currencies like the euro (20%), the Japanese yen (5.4%), and the British pound (4.9%).

Stakeholders and Interests

1. United States: The primary stakeholder in maintaining the dollar's reserve currency status. The US benefits from lower interest rates on its debt and substantial geopolitical leverage.
2. China: A key challenger, promoting the internationalization of the Renminbi (RMB). China seeks to reduce its dependency on the US dollar to mitigate the impact of US sanctions and enhance its geopolitical influence.
3. Eurozone: With the euro as the second most held reserve currency, the Eurozone has a vested interest in increasing the euro's share of global reserves.

4. Emerging Markets: Countries like Russia, India, and Brazil have shown interest in diversifying their reserves away from the US dollar to reduce exposure to US economic policies and sanctions.

Capabilities and Resources

- United States: The US dollar's dominance is supported by the size and stability of the US economy, its deep and liquid financial markets, and strong institutional frameworks. Additionally, the dollar is the primary currency used in global trade, particularly in commodities like oil.
- China: Despite efforts to internationalize the RMB, including establishing currency swap lines with 38 countries, the RMB only accounts for 2.5% of global reserves. The limited convertibility of the RMB and China's capital controls hinder its progress as a global reserve currency.

Trends and Dynamics

1. Incremental RMB Internationalization: China is gradually increasing the use of the RMB in international trade and finance. Recent agreements with countries like Brazil and Saudi Arabia to settle trade in RMB are steps in this direction, though their impact remains limited due to the continued dominance of the dollar in global transactions.
2. US Sanctions and Geopolitical Tensions: The US's use of economic sanctions as a geopolitical tool has prompted targeted countries to seek alternatives to the dollar. This trend is evident in the growing use of the RMB by Russia for trade settlements following Western sanctions over the Ukraine conflict.
3. Technological and Financial Innovations: Digital currencies and blockchain technology present potential disruptions to traditional reserve currencies. China's development of a digital RMB (e-CNY) could enhance its currency's international appeal if widely adopted.

Scenarios and Implications

- Best-case scenario: The US dollar retains its dominance, supported by economic stability and effective monetary policy. Efforts by other currencies to challenge the dollar result in only marginal shifts in global reserves.
- Worst-case scenario: A significant loss of confidence in the US dollar due to political instability, economic mismanagement, or a successful challenge by the RMB or another currency. This could lead to increased borrowing costs for the US and reduced global influence.
- Most likely scenario: The dollar remains the primary global reserve currency, but with a gradual decline in its share of global reserves as the RMB and other currencies gain ground incrementally. This scenario would still see the US maintaining considerable influence but facing more competition in global financial markets.

Implications for American Multinational Companies

- Risks of Exposure to China: American companies with significant operations in China face potential regulatory challenges and market access issues due to geopolitical tensions and China's economic policies aimed at reducing dollar dependence.
- Opportunities for Growth in Other Markets: Diversifying investments into other emerging markets, particularly in Southeast Asia, Africa, and Latin America, can mitigate risks associated with overreliance on China. These regions offer robust growth prospects and could become alternative hubs for manufacturing and trade.
- Strategies for Mitigating Risks and Capitalizing on Opportunities: Companies should develop contingency plans for supply chain disruptions, engage in strategic partnerships in emerging markets, and invest in digital technologies to enhance operational flexibility. Monitoring geopolitical developments and adapting quickly to regulatory changes will be crucial for sustained growth.

Core Documents:

[1]
The U.S. Dollar as the World’s Dominant Reserve Currency
A strong US dollar generally makes it harder for US producers to compete in global markets and can lead to persistent trade deficits, although US consumers may benefit from less expensive imports. For example, the dollar has strengthened since mid-2021 as the Fed tightened monetary policy to combat rising inflation.
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[2]
The Stealth Erosion of Dollar Dominance: Active Diversifiers and the Rise of Nontraditional Reserve Currencies, WP/22/58, March 2022
The right panel shows the US share of global trade, alongside the share of global trade invoiced in dollars.The share of global exports destined for the United States moved down over the period, in line with movements in the dollar's share in global reserves.
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[3]
The Fed is falling behind as other central banks leap ahead on digital currencies - Atlantic Council
That is a miscalculation. Instead of thinking about innovation defensively, the US government should drive payment innovation from a position of strength. As the issuer of the world's reserve currency, the Fed has a unique opportunity to set standards and influence constructive developments on the future of payments.
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[4]
Dedollarization is not just geopolitics, economic fundamentals matter - Atlantic Council
In early 2022 the value of a dollar against a basket of global currencies jumped 19.8 percent from right before the start of the invasion to its peak in October 2022. While its value has dropped in the year since, the dollar's value still remains elevated by around 10 percent compared to its pre-invasion average.
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[5]
De-Dollarization Efforts in China and Russia

The Fed has consistently demonstrated its capacity and willingness to bear the costs of backing up the global financial system, particularly during crises. Most recently, the Fed's actions to provide dollar liquidity to the global economy stabilized international markets during the COVID-19 pandemic.
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[6]
The Great Economic Rivalry China vs the U.S.
Central banks around the world continue to hold most of their reserves in US dollars. The dollar accounts for 60% of total foreign exchange reserves, down from 70% at the beginning of the century. While the IMF added China's RMB to the Special Drawing Rights valuation basket in 2016, it has barely cracked 2% in holdings.91 Similarly, US dollar centrality persists in terms of share of forex trading, global payments, and trade.92 Currency Share of Forex Trading (%) Share of Official Forex Reserves (%) Share of Cross-Border Payments (%) US Dollar 88.3 59 38.3 Renminbi 4.3 2.3 2.4 Euro 32.3 21.2 36.6 Yen 16.8 6 3.6 Pound 12.8 4.7 6.8 Source : IMF, Bloomberg, BIS93 The dollar's share of SWIFT-mediated cross-border payments rose 10 percentage points from 2012-2019.
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[7]
War and Currency Statecraft
As the dollar became weaponized, momentum for CBDCs sped up: China obviously has one; India has one too; Brazil and Russia will launch one by 2024; and South Africa is a bit behind but “recognizes the value of having one ”, and one might assume it will get fast -track help from fellow members of the BRICS club.
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[8]
The US, EU, and UK need a shared approach to economic statecraft Here’s where to start Adjusting Sanctions Policy to the Anti-Dollar Era Despite click-baiting predictions of its imminent demise, the dollar remains the world economy's indispensable currency and maintains economic and political advantages over all alternatives.
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[9]
Liquidity, Debt Denomination, and Currency Dominance

Eren and Malamud (2022) presents empirical evidence showing that over longer horizons the dollar depreciates after negative shocks, and this can make it optimal for firms to issues debt in dollars as a hedge against the downturns. 7.
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[10]
Silicon Triangle: The United States, Taiwan, China, and Global Semiconductor Security
The United States and its allies do comfortably well in this future economically, but they are passengers on the bus. They no longer lead in setting standards and norms, including trade rules, and they no longer benefit from the US dollar being the reserve currency and currency.
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