

# MARKET SIGHT LINES



## The U.S. Dollar as the World's Reserve Currency: Secure in the Near Term, But...

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In our work on geopolitical risks, we've discussed the idea that we may well be transitioning from a unipolar world, anchored on the global economic power of the U.S., to a multipolar world, with China methodically implementing a strategy to become even more relevant over the coming decades. In this week's Sight|Lines, we discuss the U.S. dollar's (USD) position as the world's reserve currency and the risks, both near and longer term, to the USD's reserve currency status.

### **THE TAKEAWAY: OUR RESERVE CURRENCY STATUS IS OK FOR NOW, BUT ...**

The USD remains in a relatively strong position as the world's primary reserve currency, but its status isn't guaranteed longer term. In summary:

- The USD is the most widely used currency for trade, foreign exchange transactions, and foreign exchange reserves, suggesting confidence in the USD as a store of value.
- In recent years, the BRICS (Brazil, Russia, India, China, and South Africa) and other nations have been promoting the use of national or other currencies, particularly the Chinese yuan (CNY), in trade and transactions.
- Many observers say any shift to the CNY as an alternative currency will take decades, citing structural issues and USD dominance.
- Others see the threat as more immediate, emphasizing China's strategic efforts to promote its currency and the development of central bank digital currencies (CBDCs).
- The risk of fiscal and monetary policy error in the U.S. may erode trust and confidence in the USD, especially as it relates to continued deficit spending and increasing debt.
- If the USD were to lose its reserve currency status, this could reshape the global balance of power and potentially impact financial markets.
- Going forward, it will be important to monitor USD dominance in reserves, trade, and transactions, as well as geopolitical developments, innovation, and economic policies.

## IN-DEPTH: THE U.S. DOLLAR'S RESERVE CURRENCY STATUS IS STABLE FOR NOW, BUT AT RISK LONGER TERM

The USD remains in a relatively strong position as the world's primary reserve currency, but its status isn't guaranteed longer term. Going deeper:

- The USD remains the world's most widely used currency, as evidenced by its share of:
  - Foreign exchange transactions: USD 88%, euro 31%, pound 13%, yen 17%, CNY 7%
  - Global foreign exchange reserves: USD 59%, euro 20%, yen, 5.5%, pound 4.9%, CNY 2.6%.
  - Foreign currency debt issuance: USD 69.7%, euro 20.7%, pound 3.2%, CNY 2.2%
- In the wake of Russia's invasion of Ukraine, the G7 nations (Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States) have increased their use of financial sanctions. In response:
  - The BRICS nations have been promoting the use of national currencies in trade and transactions.
  - China has been expanding its alternative payment system to its trading partners, seeking to increase the international use of the CNY.
- Some observers see the risk of an imminent shift to CNY as a reserve currency, based upon:
  - China's development and expansion of its alternative payment system.
  - Increased use of CNY in oil transactions.
  - The potential development of CBDCs, especially in China.
- Others downplay the immediate threat of the CNY, citing:
  - China's capital controls that restrict money movement into and out of the country.
  - The established USD dominance in global transactions and other currencies like the euro.
- If the USD loses its reserve currency status, the demand for and value of the USD would likely fall.
  - Interest rates could rise, and financial assets could underperform relative to other countries.
- Going forward, it will be important to monitor the USD's reserve currency status and related trends:
  - The Atlantic Council, a D.C.-based nonpartisan think tank, offers a [Dollar Dominance Monitor](#), which analyzes the USD as the world's dominant reserve currency but monitors China's progress.
  - Geopolitical developments, like G7 trade sanctions/BRICS responses and BRICS bilateral agreements promoting the use of the CNY.
  - Innovation, like the development and adoption of CBDCs or other financial infrastructure facilitating non-USD transactions.
  - Global economic and policy trends that increase the confidence and trust in the U.S. compared to China, and vice versa.

### CONCLUSION

The USD has been the world's reserve currency since World War II. In our work on geopolitical risks, we've discussed we've discussed the transition from a U.S.-dominated unipolar world to a multipolar one, with China seeking to become more relevant over the coming decades. We believe the USD remains in a strong position as the world's reserve currency in the near term, but technological innovation, trends among BRICS countries, and China's strategic approach are all threats to the USD's dominance over the medium to long term.

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