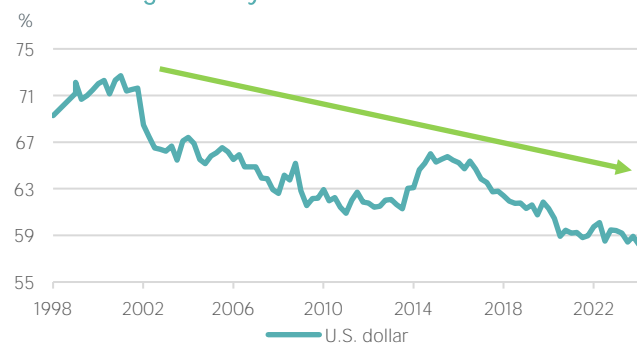


De-dollarization - vision or reality?

The eighth topic in the series analyzes efforts to break the dollar's global dominance

The world is highly dependent on the U.S. dollar. At the same time, however, there is a fundamental asymmetry between the shrinking importance of the U.S. economy globally, as China and other emerging economies grow faster, and the global role of the U.S. dollar in trade flows and as an issuing currency, which has tended to grow. In this context, and also for geopolitical reasons, there have been increasing attempts in recent years to break the dollar's dominance and establish an equivalent alternative. There are several ideas, but a single currency for the BRICS countries or the use of cryptocurrencies seem out of the question as dollar alternatives in the short to medium term. Nevertheless, the push towards de-dollarization cannot be ignored, and the question is over what period of time a replacement for the dollar is realistic – if at all.

Share of U.S. dollars in international currency reserves has fallen significantly



Sources: International Monetary Fund, DWS Investment GmbH as of 06/30/24.

It is not only since the Russian attack on Ukraine that there has been growing resentment, particularly in Emerging Markets, about the dominant position of the West and, by extension, the dollar. The first signs of de-dollarization can be seen in commodities. In energy trading, transactions are increasingly being settled in alternative currencies. An even clearer trend can be seen in international currency reserves of central banks. According to the International Monetary Fund (IMF), in the first quarter of this year, the U.S. currency accounted for around 59% of international currency reserves;¹ this is significantly less than in 2000, for example,

when the dollar accounted for just over 70%. However, as experts at J.P. Morgan point out, foreign exchange reserves provide an incomplete picture. A significant increase in dollar-denominated bank deposits, sovereign wealth funds and private foreign assets in Emerging Markets has more than offset the decline in reserves.²

Other numbers also speak in favor of the dollar. For example, around 47% of all payments processed by the Society for Worldwide Interbank Financial Telecommunication (SWIFT) system are still settled in U.S. dollars. The euro, in second place, accounts for just under 23%, while the Chinese yuan – also seen as a possible alternative to the dollar – is a distant fourth with 4.6%.³

The reality is that discussion of a viable alternative to the dollar among the BRICS countries has so far not gone beyond words. In our view, the countries involved are too heterogeneous for a new currency to emerge in the short or medium term; to be not only a leading reserve currency but also a store of value and global means of payment is a big ask. However, this does not mean that the dollar cannot be undermined.

In principle, de-dollarization implies a shift in the balance of power between countries, which in an extreme case could lead to a new world order. The effects would probably be felt most strongly in the U.S., although the focus would probably be less on the economic consequences and more on the impact on the capital market.

Diversification away from the dollar is taking place. Yet the U.S. currency's dominance still seems firmly entrenched. It is not only in finance that the dollar offers diverse benefits, such as liquidity and legal certainty when it comes to financial transactions. Donald Trump's election victory is also likely to further underpin the US currency's claim to international leadership. It will probably be decades before the dollar's dominance begins to crumble noticeably.

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Footnotes

¹ Dollar Dominance in the International Reserve System: An Update, IMF as of 6/11/24.

² De-dollarization: Is the US dollar losing its dominance?, J.P. Morgan as of 10/8/24.

³ Share of major currencies in international payments in 06/24, statista as of 07/24.

Glossary

BRICS is the abbreviation for the five large emerging economies Brazil, Russia, India, China and South Africa.

The **Chinese yuan (CNY)** is legal tender on the Chinese mainland and the unit of account of the currency, Renminbi (RMB).

Emerging markets (EM) are economies not yet fully developed in terms of, amongst others, market efficiency and liquidity.

The **euro (EUR)** is the common currency of states participating in the Economic and Monetary Union and is the second most held reserve currency in the world after the dollar.

The **International Monetary Fund (IMF)**, created in 1945 and headquartered in Washington, D.C., is an organization of 188 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world.

Liquidity refers to the degree to which an asset or security can be bought or sold in the market without affecting the asset's price and to the ability to convert an asset to cash quickly.

SWIFT (Society for Worldwide Interbank Financial Telecommunications) is a vast messaging network used by financial institutions to quickly, accurately, and securely send and receive information, such as money transfer instructions.

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