

IS THE US DOLLAR LIKELY to lose its dominance?

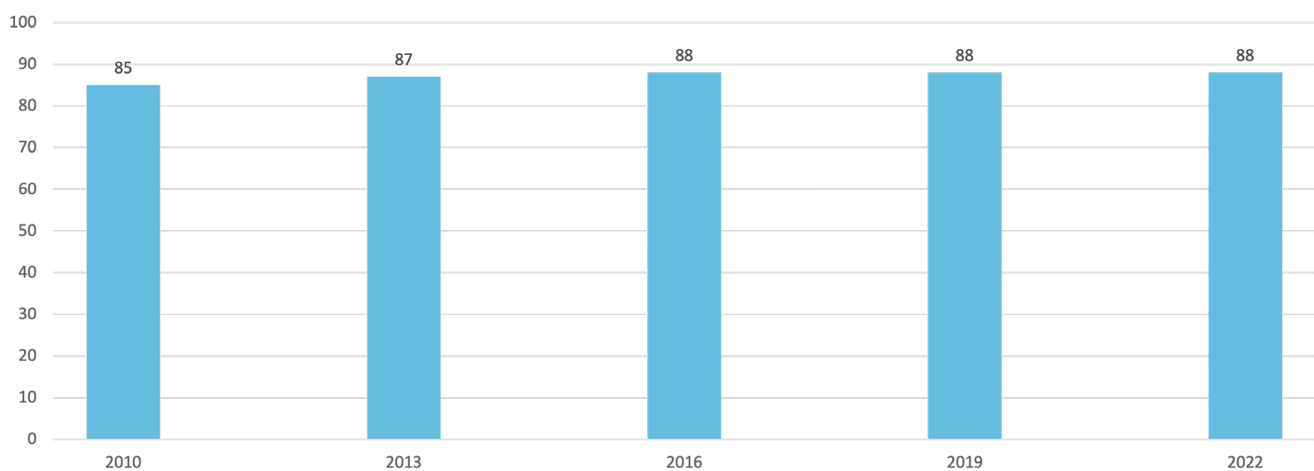
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It is fair to argue that over the past 20 years the role of the dollar should have weakened, allowing other currencies to gain significantly more traction – yet this has not occurred. Is this about to change?

During 2022 the average daily turnover of the US dollar in foreign exchange markets amounted to an incredible \$6.638 trillion, representing 88% of the global foreign exchange market. This is according to data provided by the Bank for International Settlements (BIS). Moreover, the role of the dollar has remained largely unchanged over the past 20 years, despite the US economy declining as a share of world GDP from 31% in 2002 to 25% in 2022.

US dollar share of world currency market

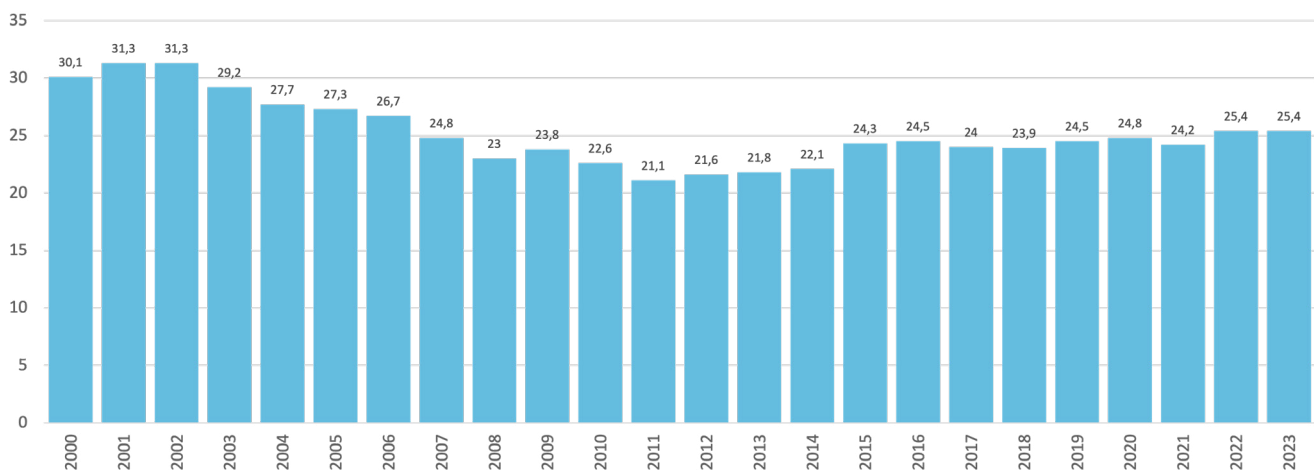
% of currency market (dollar on one-side of each currency transaction)



Source: BIS, STANLIB

US share of world GDP

% of GDP (market exchange rate, dollar)



Source: IMF, STANLIB

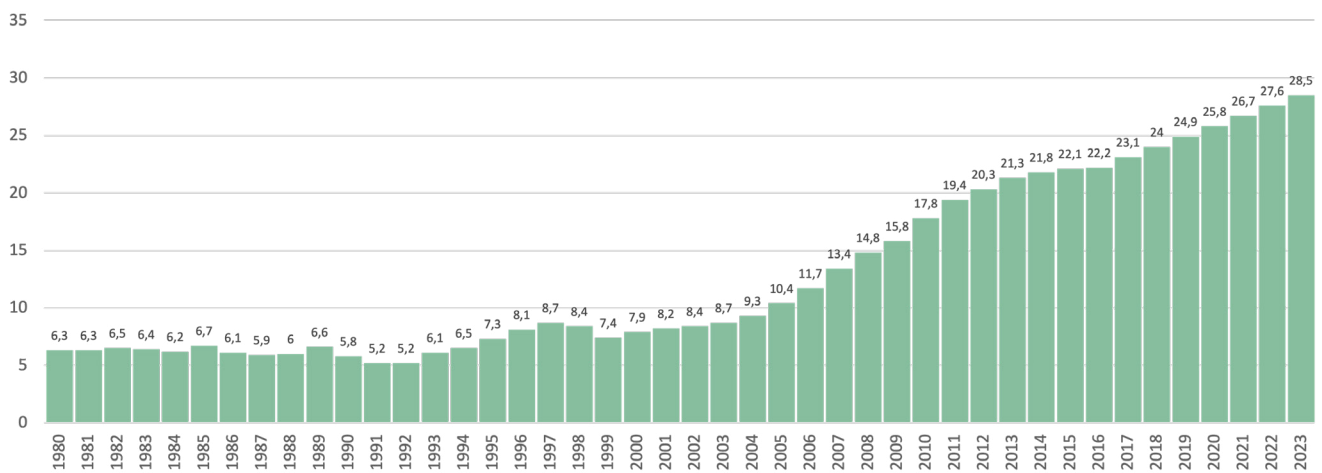
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In contrast, China's share of world GDP has increased dramatically over the past 20 years, rising from 4.2% in 2002 to 18.4% in 2023 (at market exchange rate), yet the Yuan's role in global currency markets has increased to only 7%. If the other BRICS countries are included, the share of the world currency market increases to only 10%, yet the BRICS represent 29% of world economic activity.

BRICS share of world GDP

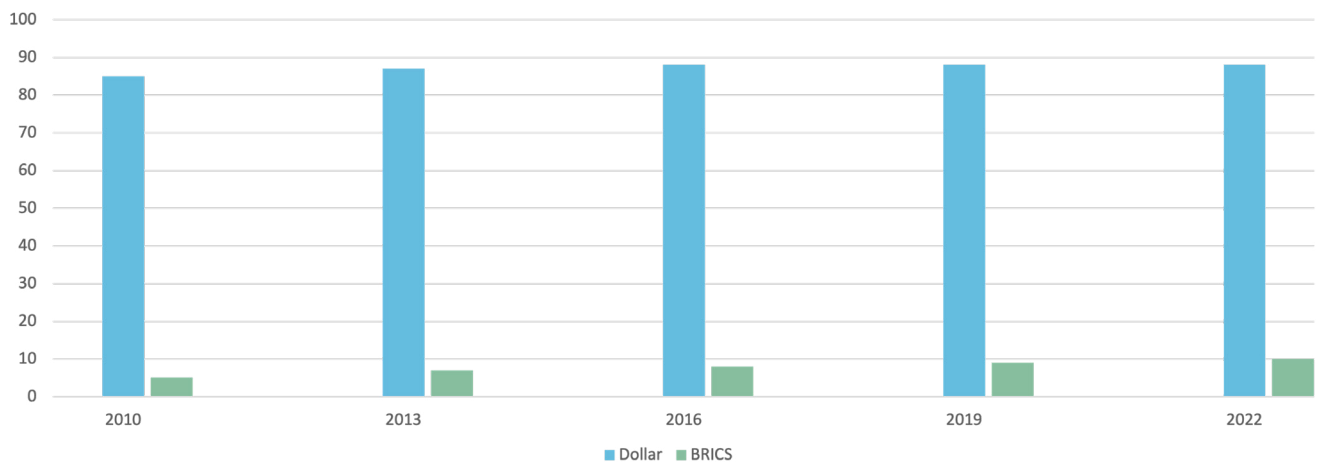
% of GDP (market exchange rate, dollar)



Source: IMF, STANLIB

Dollar and BRICS share of world currency market

% of currency market (Dollar/BRICS on one-side of each currency transaction)



Source: BIS, STANLIB

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This over-whelming dominance of the dollar has occurred for several reasons, including the sheer size and sophistication of the US financial system, the fact that a very large number of companies, households and governments outside of the US choose to hold their assets in dollars, the fact that the dollar remains the preferred means of payment worldwide, and most importantly, the dollar remains the world's most trusted currency and retains its status as the world's most sought-after safe haven currency.

In practice, it is very common for central banks around the world to hold extensive dollar reserves to intervene in foreign exchange markets in order to defend the value of their own currency, particularly during times of crisis. At the same time, private sector participants, such as exporters and importers, regularly hedge their foreign currency transactions in dollar to protect themselves against macroeconomic shocks.

This belief in the dollar has persisted despite a deterioration in the framework of the US economy, including the US Federal Reserve embarking on extensive and prolonged Quantitative Easing (QE), the declining role of the US economy within the world economy, and the lack of compelling leadership within the US executive.

It is also worthwhile highlighting that the unification of Europe, which took a set of fragmented currencies and created one currency, has been unable to dislodge the dominance of the dollar. In fact, during 2022 the Euro represented 31% of the world currency market, down from 32% in 2019 and 33% in 2013.

All of this highlights that the demise of dollar dominance will not be easy, especially given the absence of suitable alternatives. For example, the Euro has a complicated mix of fiscal and monetary unions that make the widespread adoption of the Euro as the world's reserve currency challenging, the Japanese Yen is faced with significant structural impediments and high debt levels, and the Chinese Yuan is plagued by a lack of transparency, exchange control restrictions, and political interference. Investors require investment grade government securities to hold as safe assets and for central banks to accumulate as reserves. Furthermore, most currencies simply lack the liquidity and credibility needed to become a global reserve currency.

While there is, understandably, some willingness to erode the dominance of the US dollar or rather, elevate the role of alternative currencies, it is not clear how this is likely to be achieved, especially by the BRICS's currencies – which has been in the news recently. Furthermore, it is also unclear how such a development would be beneficial, especially if the resulting currency strength systematically undermined the export competitiveness of the challenging countries. Would China really want a significantly stronger currency?

Sources: BIS Triennial report 2022, and IMF Working Paper March 2022

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