

The Daily Dish

Is the Dollar in Decline?

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The specter of a debt-ceiling meltdown involving some combination of credit downgrades for Treasury securities, missed payments of interest and principal on federal debt, global financial volatility, and declines in real economic growth has prompted many to wonder if the dollar's status as a reserve currency is in danger. (This is not to be confused with a decline in the value of the dollar; that has happened over the past year but valuation is very different than its role as a linchpin of global financial transactions.)

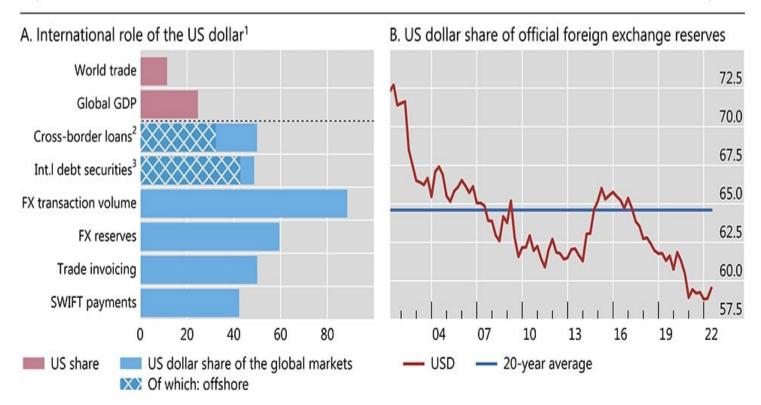
Moreover, some countries are actively seeking to overthrow the dollar. China has been trying to have the yuan replace the dollar for years. Brazil and China took steps to make it easier to settle their foreign trade operations in yuan or reais recently. And Brazil, Russia, India, China, and South Africa (the so-called BRICS countries) have announced their intention to create a common currency as an alternative to the dollar.

Still, fear and a few announcements are a far cry from actually replacing the dollar. There is a lot to replace! The global foreign exchange market is dominated by the dollar and a few other currencies. According to the Bank for International Settlements (BIS), the U.S. dollar (USD) was involved in nearly 90 percent of foreign exchange transactions. The euro came second, but was only involved in 31 percent of transactions. The Japanese yen and British pound all rank higher than the Chinese yuan, which was involved in under 10 percent of transactions.

Some other metrics of the involvement of the dollar in the global economic are captured in the graphic (below), reproduced from the BIS. While there has been decline in the USD share of official foreign exchange reserves and the share of trade invoicing, the involvement of the dollar in the global financial system remains dominant.

The international role of the US dollar

In per cent Graph A2



¹ Data refer to latest available value. ² USD-denominated cross-border loans by banks to counterparties in all countries (excluding inter-office claims but including interbank claims on account of loans and deposits). Offshore refers to cross-border loans excluding loans from United States and on United States. ³ USD-denominated international debt securities by all issuers; these securities are issued outside the local market of the country where the borrower resides (eg eurobonds or foreign bonds). Offshore refers to USD-denominated loans/debt issued outside United States.

Sources: G Gopinath, "The international price system", NBER Working Papers, no 2164, 2015; IMF; Bloomberg; CPB World Trade Monitor; SWIFT; BIS debt securities statistics; BIS locational banking statistics; BIS Triennial Central Bank Survey.

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Having a reserve currency is good for the global economy, as it minimizes the transaction costs of international trades. There is no reason to switch from the dollar unless the dollar is undermined by a failure of the federal government to be a good steward of the federal finances. The future of the dollar is firmly in the government's hands.