



# THE DOLLAR AS A WORD CURRENCY

HISTORY, CURRENT STATUS, FUTURE ISSUES



# DOLLAR AS A WORLD CURRENCY – WHAT DOES IT MEAN?

- Hardly a week passes without some \$ doomsaying
  - E.g.: “The U.S. dollar conquered the world. Is it at risk of losing its top spot?” (NPR 6/6/2023); Jeffrey Sachs article
- Before asking if the US dollar may be replaced as the “world currency” let’s start with what that means.
- For most of us it means that our currency – the \$ - is always accepted by currency exchanges anywhere
  - “What is that in real money?” asks a US tourist
- The globe actually has very little experience with “world currencies” – only the UK pound and the US \$ can truly said to have achieved that status
  - UK pound from mid to late 19<sup>th</sup> century until WWII
  - US \$ since WWII
    - Other currencies were universally accepted within certain trading systems, e.g. Roman denarii, Venetian ducat, Dutch guilder, etc. but not across the globe
- Currencies, to be accepted, must:
  - Store of value
  - Unit of account
  - Medium of exchange
- To be a “world currency” requires the designated currency to serve these functions across the globe without regard to the issuer

# US \$ BECOMES THE WORLD CURRENCY

- Eight decades ago the dollar emerged from Bretton Woods' International Monetary Conference (1944) as the new world currency
  - Keynes had proposed a new currency to be used for international trade: bancor (Fr: banque)
    - Global trade was relatively small compared to global GDP and across-border capital flows were limited
      - Less than \$50b world trade and less than \$1 trillion global GDP
    - International capital flows were limited and frequently subject to regulation
  - US, led by Harry Dexter White, opposed Keynes idea
    - Most other major industrial powers lay in ruins from WWII
    - US had the largest store of gold, still thought by many to be the ultimate store of value and revered as the basis for economic "stability"
    - US was the largest economy by GDP
- The dollar carried the day – and has largely fulfilled the requirements of a world currency for the last 8 decades

# DOLLAR AS THE WORLD CURRENCY: STORE OF VALUE AND UNIT OF ACCOUNT

- Most common indicator of \$ as a world currency is a store of value measure: central bank allocation of reserves by currency
  - \$ denominated securities about 60% of all central bank holdings
    - Not the result of US Fed reserves: less than \$250 billion of \$12 trillion globally
    - Down from about 70% of “allocated reserves” in 2000
    - Most central bank dollar reserves are in the form of T-bills, notes or bonds
    - Fluctuations – but \$ % loss since 2000 has not been to major currencies (euro, pound, or yen) – some diversification into minor currencies
      - 2008 article predicted euro to replace \$ by 2021
      - RMB is 3% of central bank reserves
  - Equally important: international debt issuances
    - 60% of corp debt issued in non-home currency is in \$\$
- Unit of account: global GDP and world trade is measured in \$\$ as is most national GDPs; also asset values, e.g. oil reserves, financial holdings, etc.

# DOLLAR AS THE WORLD CURRENCY: MEDIUM OF EXCHANGE

- Within a country most transactions are in the national currency
  - There are 180 recognized currencies circulating in 197 countries
- This is not true for cross-border trade
  - Although SWIFT can handle almost all of the 180 currencies, most have minimal presence in SWIFT facilitated transactions
    - US \$ is involved in about 60% of all SWIFT telecommunications, euro another 12%
  - Trading my Chilean copper for your Egyptian cotton is not done in either Chilean pesos or Egyptian pounds – \$\$ are the lingua franca for cross-border trade invoicing
    - \$\$ are the currency of invoice for over 70% (by value) of cross-border trading
    - Exception is the EU area where euro is the invoicing currency for about 70% of all cross border trade (\$ in about 20%)
      - However about 1/3<sup>rd</sup> of EU exports and imports are invoiced in \$\$
      - True even for the most important commodity in global trade: petroleum and petroleum products
- Back to these last two points later

# DOLLAR AS THE WORLD CURRENCY: FINANCE

- An often overlooked aspect of \$ as world currency: role in finance
- \$ is involved on buy or sell side of almost 90% of all global FX trading
  - Daily FX trading = \$7.5 trillion of which \$ trading represents \$6.6 trillion (2022)
- \$ as an anchor currency for countries producing half of all global GDP (ex-US)
  - \$ dominates international banking
    - About 60% of international liabilities (mostly deposits) and claims (mostly loans) are dollar-denominated with no change since 2000
- \$ dominance illustrated during financial and other crises
  - Fed's opened swap lines with other central banks during the GFC and the COVID downturn - \$\$ needed by other central banks swapped for equal value in their home currencies
- The world currency role of the \$ is not linked to the strength of the \$ against other currencies – whether “strong” or “weak” \$
  - See next two slides
- Remember: US does not dominate world trade (unlike UK in 1800s)
  - US share of world GDP about 20%; of world trade about 8%
    - US trade/GDP = 25%, much lower than France, Germany, UK, Canada, China, etc.

**FRED**

— Nominal Broad U.S. Dollar Index



Source: Board of Governors of the Federal Reserve System (US)

[myf.red/g/15tXc](https://myf.red/g/15tXc)

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Real Broad Dollar Index



Source: Board of Governors of the Federal Reserve System (US)

myf.red/g/15tXi



# BENEFITS TO US WITH DOLLAR AS WORLD CURRENCY

- A manifestation of “soft power”
- US government can finance borrowing at a lower rate because of demand for \$\$
- US businesses and individuals do not face currency exchange transaction costs when importing or exporting to other countries
  - A kind of “home court” advantage for US businesses
- Can be used as a sanction weapon: Iran and Russia.

# WILL THE DOLLAR BE REPLACED AS THE WORLD CURRENCY?

- The dollar's future as the world currency has been questioned, pronounced over, etc. frequently
  - For example: Jeffrey Sachs - Increased use of digital currency and declining US share of global GDP will challenge the \$ world currency position
  - 2008 paper argued that the euro would replace the \$ by about 2020/21
  - 2009 China and Russia issued a call for a new world currency
- There are two obvious potential currencies that might displace the \$: RMB and euro
- Both the PRC and the EU have economies similar in size to that of the US
- Both are major participants in the global trading system

# REPLACING THE DOLLAR? RMB?

- The issuer of the world currency does not have to be the largest economy
  - UK from 1900 was not the largest economy – pound remained world currency
- Nor does it have to be the largest global trading nation
  - US is largest importer by value and second largest exporter by value – PRC is 2<sup>nd</sup> and 1<sup>st</sup>
- With PRC as the largest (PPP) or 2<sup>nd</sup> largest economy, will the RMB replace the \$?
- RMB has very small share of central bank reserves – about 3%
  - RMB not fully convertible
  - PRC state wants to control credit creation and manage the capital account
  - There is limited trust in PRC banks transparency and reliability of their financial reporting
  - Result: no real FX market liquidity for RMB
    - RMB has increased its share of global central bank reserves – to 3%

# REPLACING THE DOLLAR: EURO?

- In mid 2000s there were some that expected the euro to replace the \$
- EU GDP now larger than US GDP
- Euro dominates intra-European trade invoicing
  - About 60% of all intra-EU trading is invoiced in euros
- EU has well developed financial markets
  - However split between non-euro user UK, with the largest FX market and the continent
  - Eurobond market much smaller than US treasury market – but growing
- Euro may be the world currency of the future – but when?

# DOLLAR AS A MEDIUM OF EXCHANGE: CHALLENGES?

- Sachs: Increased use of digital currency and declining US share of global GDP will challenge the \$ world currency position
  - His reference is primarily the \$ as the medium of exchange
- In 2009 Russia and PRC called for creation of a new global currency for trading
- Recently there has been some speculation about a currency created by the BRICs for use in cross border trading
- In 2008 some analysts argued that the euro would replace the \$ as world currency
- There has been some interest – and some action - in pricing oil using another currency
  - E.g. Russian crude exports to PRC
- However, petroleum and petroleum products – while largest single globally traded good – represent only 5% of total global trade
  - And US is the largest exporter of refined products and in the top 5 of crude exports

# WORLD CURRENCY AND GLOBAL TRADE: I

- Does large scale international trade, such as over the past 3 decades, require a world currency?
- Consider Apple
  - iProduct manufacturing is outsourced to companies in Korea, Japan, Germany, US, etc. with final assembly mostly in PRC
  - Use of a world currency greatly reduces the transaction costs to Apple
    - Appears as a large US trade deficit with PRC – but:
      - iPhoneX apparently increased the US trade deficit with PRC by more than \$330/phone; however, only a little over \$100 was from value added in PRC assembly operations
- What is true for Apple is true for other international corporations – the costs of transacting across multiple currencies would:
  - Increase the costs of globally traded goods and services
  - Likely reducing the volume of global trade
    - Biggest impact would be on European countries since most have a much higher global trade/GDP ratio than the US (approx. 25%)

## WORLD CURRENCY AND GLOBAL TRADE: II

- Tooze highlights new correlation between the strength of the \$/commodity prices
  - He suggests this may put pressure on the \$ as the medium of global trade
  - He attributes this new correlation to the shift of the US from an energy importer (oil) to an energy exporter
- I'm not clear on his argument but it may be this?
  - US terms of trade (see next slide – index of export prices compared to an index of import prices) have shifted in US favor over the past few years and US terms of trade correlate with strength of the \$
  - Oil exporters recycled their “petrodollars” into US Treasuries and other US assets – now have fewer dollars to recycle
  - This may reduce the incentive to price oil – and perhaps other commodities – in \$
- Impact on \$ as medium of exchange?

# US Terms of Trade 2000 – 2023



US Bureau of Economic Analysis



## BUT COULD OIL DRIVE A CHANGE?

- US a major exporter of petroleum and the leading exporter of petroleum products
- But US is also a major importer of oil – the type of crude (heavy or light, sweet or sour) needed varies by refinery
- Also, CA imports crude because installed refinery capacity is greater than CA's oil production and there are no oil pipelines connecting CA to the other areas of crude production in the US
- If Saudis etc. decided to price oil in other than \$\$, what would it be?
  - World's largest oil importer in PRC – petro RMBs??
  - Next largest is US, then India – petro rupees?
- John Connolly: “The dollar is our currency but it's your problem” is still true

FRED

Trade Balance: Goods and Services, Balance of Payments Basis



Sources: U.S. Census Bureau; U.S. Bureau of Economic Analysis

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