

Role of the Dollar in the International Monetary System: Some Updates

Barry Eichengreen

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Nice!!!! 🌞 Great Videos! Great Information! Ty

In a [tweet](#) on Tuesday, he responded to a video post by economist Peter St Onge, in which the latter highlighted that "de-dollarization is real and is happening fast."

"Dollar share went from 73% (2001) to 55% in (2020). Went from 55% to 47% since sanction launched on Russia, now de-dollarizing at 10x faster than the previous two decades," Onge said.

Musk responded: "If you weaponize currency enough times, other countries will stop using it."

8:04 AM · May 1, 2023 · 92 Views



A more accurate picture

De-Dollarisation Is Happening at a 'Stunning' Pace, Jen Says



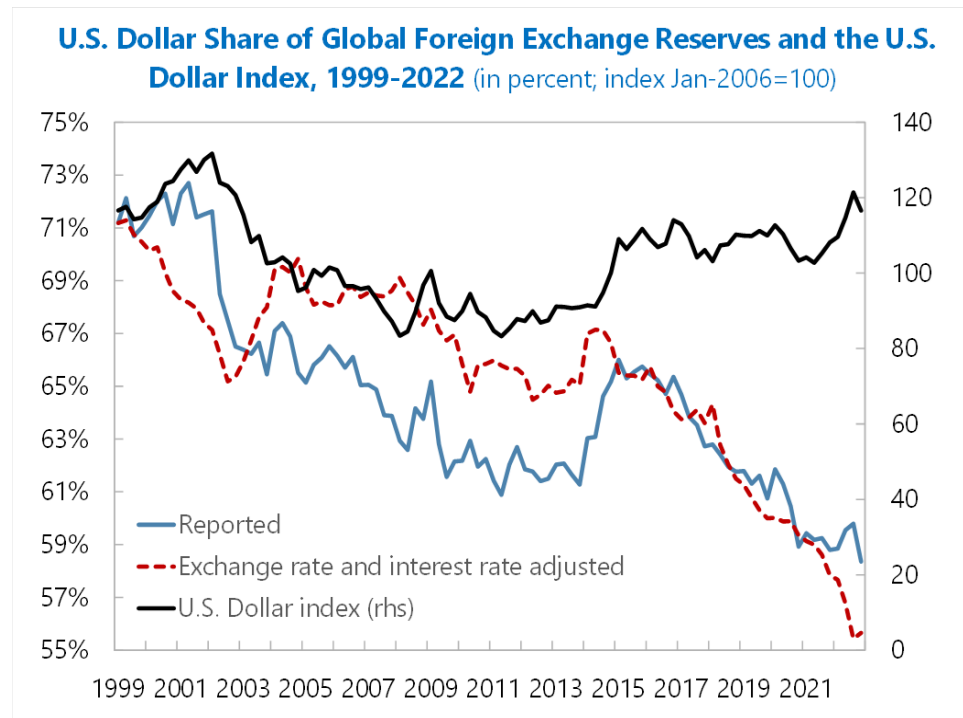
The dollar is losing its reserve status at a faster pace than generally accepted as many analysts have failed to account for last year's wild exchange rate moves, according to Stephen Jen.

The greenback's share in global reserves slid last year at 10 times the average speed of the past two decades as a number of countries looked for alternatives after Russia's invasion of Ukraine triggered sanctions, Jen and his Eurizon SLJ Capital Ltd. colleague Joana Freire wrote in a note. Adjusting for exchange rate movements, the dollar has lost about 11% of its market share since 2016 and double that amount since 2008, they said.

"The dollar suffered a stunning collapse in 2022 in its market share as a reserve currency, presumably due to its muscular use of sanctions," Jen and Freire wrote. "Exceptional actions taken by the US and its allies against Russia have startled large reserve-holding countries," most of which are emerging economies from the so-called Global South, they said.

But “Stunning collapse”?

- Dollar share has fallen by $\frac{1}{2}$ percentage point a year over the last quarter century.
- OK, it fell at about 4 times that rate in 2022.
- Still, “stunning collapse?”



“Muscular use of sanctions” meaning what?

- “Unprecedented” US and G7 sanctions on the Bank of Russia and other Russian financial entities.
 - These sanctions were a shock because the 2004 United Nations Convention on Jurisdictional Immunities of States and their Property, holds that central bank reserves are covered by sovereign immunity.
 - The only times such immunity has been waived by courts in the United States was when the president declared that the target was responsible for state-sponsored terrorism that posed an immediate threat to the United States (the cases of Iran and Afghanistan). No such declaration was made in 2022.
- There are also third countries (“nonaligned” emerging markets) with reason to worry that they might also be subject to secondary financial sanctions in the future.
- Prompting further movement away from the dollar, in favor of currencies and investments that are more sanction proof.

Historical evidence

- My coauthors and I have looked at historical cases of sanctions.
- No evidence that past sanctions imposed by the US caused target countries to move away from the dollar in favor of other currencies.
 - Although Russia has moved in this direction in recent years, essentially liquidating its holdings of US Treasury bonds.
 - And maybe “next time will be different,” given the shock of Russian sanctions.
- But moving away from the dollar means moving toward something else. What something else?

INTERNATIONAL MONETARY FUND

The Stealth Erosion of Dollar Dominance:

Active Diversifiers and the Rise of Nontraditional Reserve Currencies

Serkan Arslanalp, Barry Eichengreen, and Chima Simpson-Bell

WP/22/58

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**2022
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What something else?

- Many of the potential alternatives (issuers of the euro, yen and sterling) are on board with US sanctions.
- China?
 - Perhaps, although Russia's invasion of Ukraine is a reminder of the danger of putting all your eggs in the basket of an authoritarian leader.
 - And its cross-border payments system is underdeveloped.
- Gold?
 - Safe from garnishment if repatriated.
 - But clunky to use.
- Crypto?
 - I will come back to this inevitable question (which looks a bit different in light of recent events...).

What about gold?

- Insulated from sanctions if vaulted at home.
- Although then not especially useful for transactions.
- Case-study evidence points to past movement in this direction. (Five out of top ten increases.)

Table 11. Top 10 Annual Increases in the Share of Gold in Reserves, 2000-21

Country	Year	Increase in gold share (in ppt of reserves)	Increase in gold volume (in percent)	Key events in the concurrent or preceding two years
Turkey	2020	21%	29%	Sanctions by the US (2018) and EU (2019); COVID-19 pandemic (2020)
Belarus	2010	17%	57%	Sanctions by Russia in 2010
Lao PDR	2001	10%	328%	A series of bomb blasts in 2000 before presidential elections in 2001
Turkey	2017	9%	50%	Coup attempt in 2016; Constitutional referendum in 2017
Sri Lanka	2009	8%	299%	Purchase of gold from IMF following the global financial crisis
Paraguay	2012	8%	1141%	Sanctions by Mercosur and Unasur in 2012
Hungary	2021	8%	200%	COVID-19 pandemic in 2020; Disputes with the EU (ongoing)
Belarus	2006	8%	25%	Sanctions by the EU and US in 2006
Sri Lanka	2000	7%	437%	1997-98 Asian crisis; Assassination attempts before elections in 2000
Belarus	2008	7%	33%	Sanctions by the EU and US in 2006

Sources: IMF, International Financial Statistics; Global Sanctions Database (GSDB).

Note: Excludes countries with central bank gold purchase programs from domestic producers.

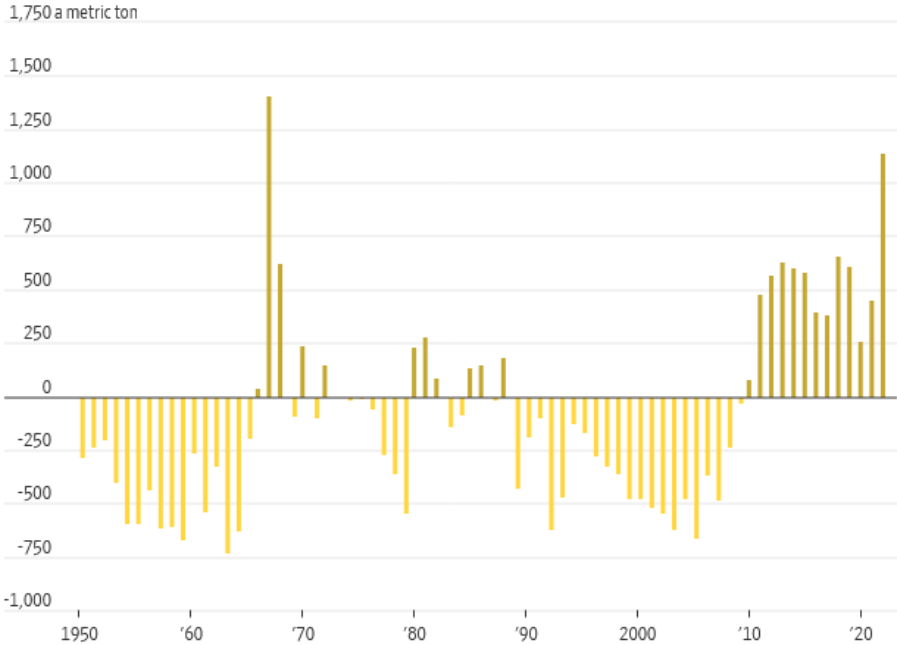
What about gold?

Jan 31, 2023 at 1:00 pm ET ★

Central Banks Pile Into Gold

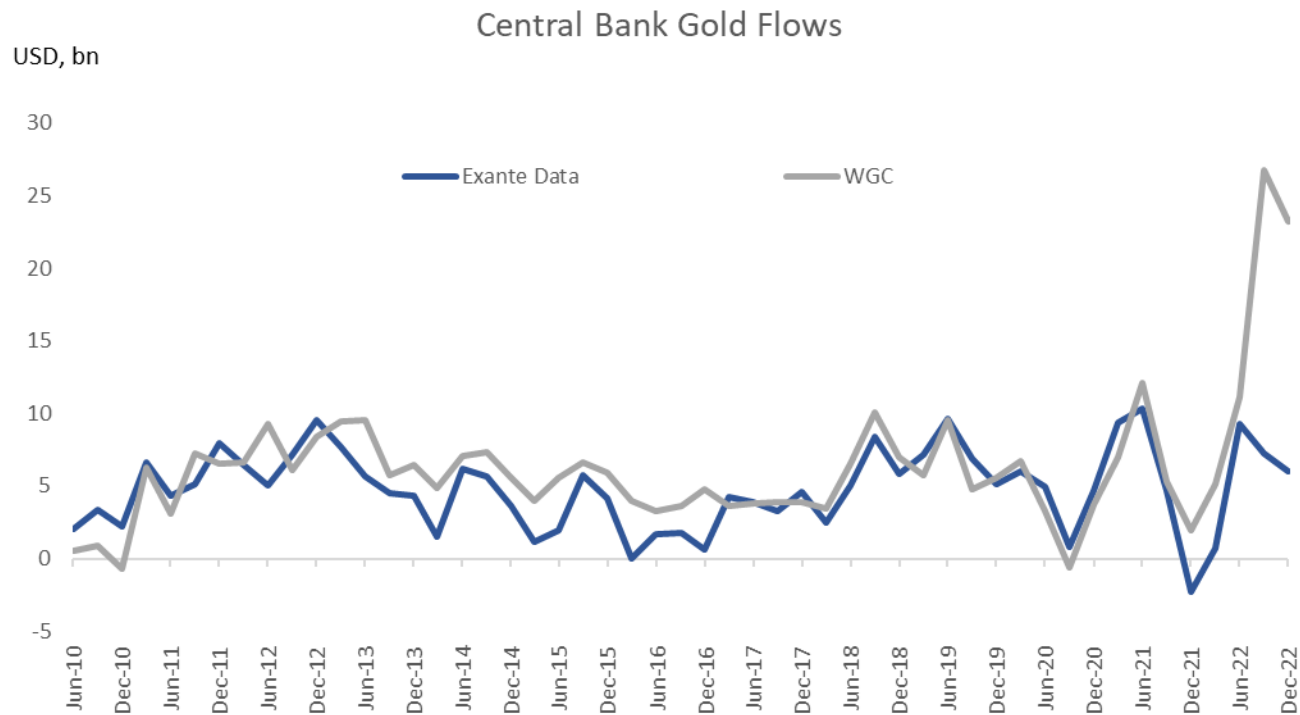
By [Hardika Singh](#)

Net purchases by central banks and other institutions



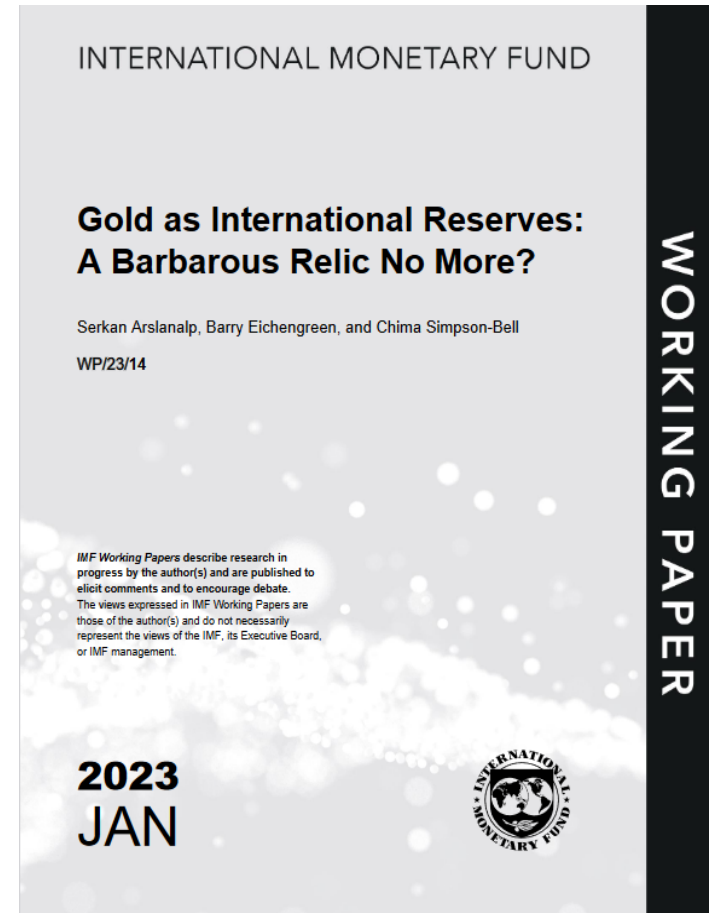
Source: World Gold Council

Although there's disagreement about how much (IMF vs. WGC)



Source: Exante Data, IMF, WGC

- But my coauthors and I looked at this one as well.
- We found a significant positive effect of current or past sanctions on the share of CB reserves held in gold.
- But that effect was quite small.



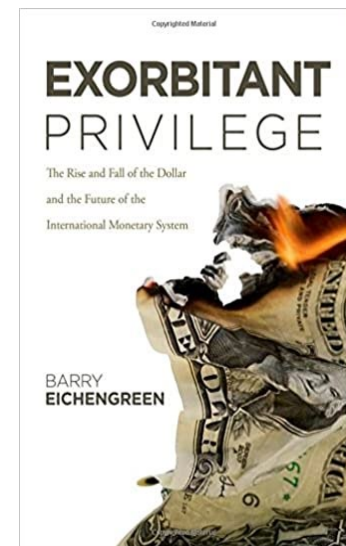
So on balance there is limited evidence of changes in reserve composition due to sanctions

- Because of limited alternatives.
- And because changes in the structure of the international monetary and financial system tend to proceed gradually, even glacially, reflecting network effects and complementarities.
- Since the turn of the century, for example, the dollar's share of global foreign exchange reserves has fallen by roughly $\frac{1}{2}$ percentage point a year.
- I would expect this trend to continue, everything else equal, since the US is likely to account for a shrinking share of global GDP, trade and finance as emerging markets continue to emerge.



This is the trend I predicted in my book “Exorbitant Privilege” (12 years ago...)

- That we would move to a more diverse, better diversified international monetary and financial system that better matched our more diverse, better diversified global economy.
- I predicted movement toward the euro and the RMB.
- But that is *not*, in the main, what we have seen.



Instead, the share of “nontraditional” currencies has risen (updated to end 2021)

- Where nontraditional means other than the long-standing members of the SDR basket (euro, yen, pound)
- In fact, the share of “nontraditional reserve currencies” has risen from zero at the turn of the century to 10% today.
 - Exactly matching the 10% decline in the dollar’s share.
- This is only $\frac{1}{4}$ a shift into RMB and $\frac{3}{4}$ a shift into other currencies (Canadian dollar, Aussie dollar, Swedish krona, Norwegian krone, South Korean won).
- This shift is broad-based: my coauthors and I have identified 46 “active diversifiers” now with a share of reserves in nontraditional currencies of at least 5%.

Nontraditional currencies in allocated reserves, end-2021		
	in bil US\$	as % of Total
Total	1239	100%
Australian dollar	221	18%
Canadian dollar	287	23%
Chinese renminbi	337	27%
Swiss franc	21	2%
Other	372	30%
Korean won	127	10%
Swedish krona	50	4%
Singapore dollar	84	7%
Norwegian krone	51	4%
Danish krone	30	2%
New Zealand dollar	13	1%
Hong Kong dollar	18	1%

Sources: IMF, COFER and CPIS.

Note: The size of “other” currencies is estimated based on Arslanalp and Tsuda (2014).

Several contributing factors

- First, improvements in technology (electronic trading platforms, automated market making, automated liquidity management) making for more forex market liquidity in nontraditional currencies and facilitating direct trades.
 - Example: Mexican peso/Canadian dollar pair.
- Second, central bank reserve managers with larger portfolios more actively managing and chasing returns.
 - Liquidity tranche vs. investment tranche.
- Third, low yields and high volatility of traditional reserve currencies.
 - Literature emphasizes policy initiatives of govts and central banks to internationalize their currencies. My analysis suggests that market forces, structures and incentives are at least as important.

Why doesn't the euro play a more important role?

- Shortage of AAA-rated government securities to be held as reserves by corporate treasurers and central bank reserve managers.
 - Because European finance is bank based.
 - Because only a handful of European sovereigns are AAA rated.
 - Because most of those securities are held to meet capital requirements by European banks or have been hoovered up by the ECB.
 - Although a greatly scaled up European Recovery Fund could change this, the existing ERF is peanuts.
 - Will it in fact be scaled up, or is it a one-off?

Why doesn't the RMB play a more important role?

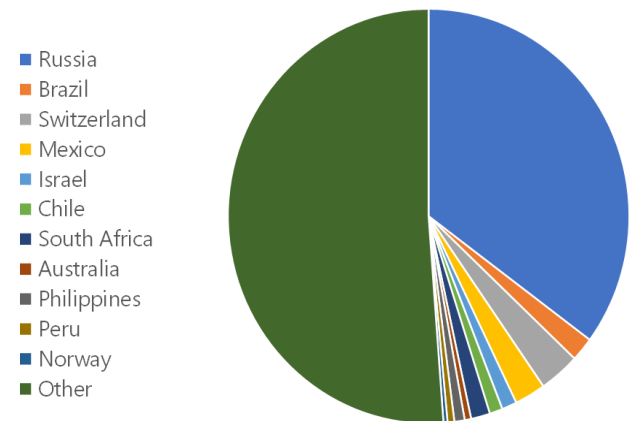
- Lack of infrastructure.
 - CIPS is still only a shadow of CHIPS, and relies on SWIFT for most of its messaging.
- Continued capital controls.
 - Due to prioritizing domestic growth).
- China's governance.



Much of the demand for RMB reserves in fact comes from Russia (updated)

- Which sees China as a geopolitical safe haven.
- And which doesn't see the Aussie dollar, Canadian dollar, Swedish krone or the Korean won, as any safer from this point of view.
- But other countries have been moving in a different direction.
- The other three quarters of the shift, into other “nontraditional reserve currencies” other than the RMB, is coming from other countries.

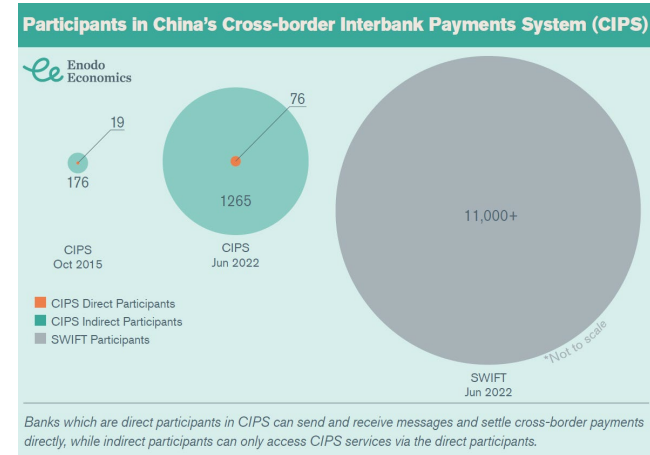
Countries Holdings Chinese Renminbi in Reserve Assets
(as a share of total RMB holdings, end-2022)



Sources: IMF COFER, IMF Reserve Data Teample, and central bank annual reports.
Note: The chart shows identified countries that hold more than US\$1 billion of RMB in reserve assets. Data for the Philippines, Russia, and South Africa are for Dec 2021, Dec 2021, and Mar 2022, respectively.

What can China do?

- It can continue building CIPS to encourage cross-border payments using the RMB.
 - But it will take 15 years, at CIPS's current rate of growth, before it rivals CHIPS.
- It can encourage use of the e-CNY for cross-border transactions.
 - But how?
 - And would a wider rollout of the e-CNY really make a difference?



What about crypto?

- Plain-vanilla cryptocurrencies (Bitcoin) are too volatile.
- Stable coins are either:
 - ...not stable, if only partially or algorithmically collateralized, or
 - ...or will not scale, if fully or overcollateralized.



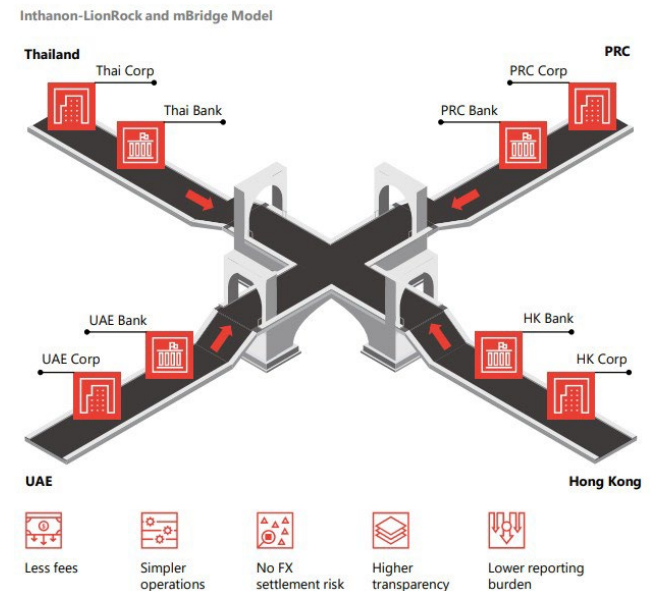
What about CBDCs?

- Currently, CBDCs can't be used cross-border.
- To use China's, for example, you must be resident in China.
- Allowing foreigners to hold significant amounts of eCNY would undermine China's capital controls.
- For other countries, especially in the developing world, cross-border use would create problems of dollarization/currency substitution.
- So it is not clear they will allow this to happen.



Bringing down the cost of cross-border payments

- In principle, multiple central banks could agree on a dedicated corridor (mBridge).
- Experiments are underway along these lines.
- Or multiple CBDCs could run on a single blockchain.
- No strictly technical obstacle to this. But consider the governance problems.
- An order of magnitude more serious than World Trade Organization Governance.



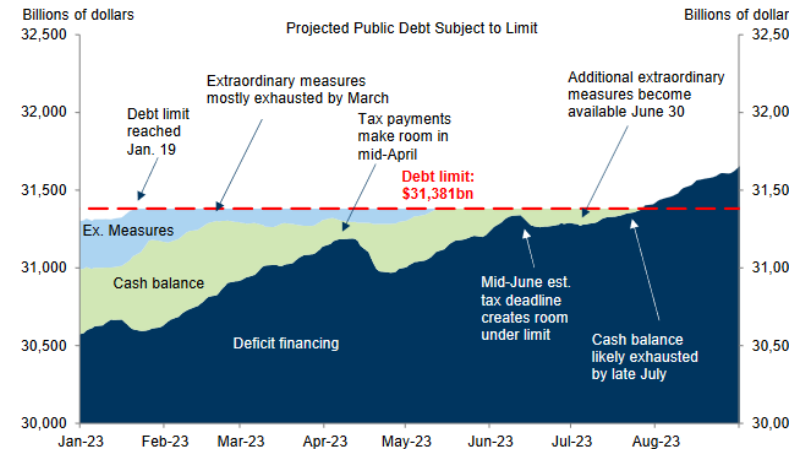
So it remains...

- ... “our currency and your problem.”
- Though the dollar’s dominance is increasingly challenged by “a swarm of midgets.”
- And it is likely to trend weaker going forward due to both US policy risk and geopolitical risk.
- Meaning that we are moving slowly, slowly toward a more diversified international monetary and financial system.
 - Which, in my view, is a good thing.



Though there's also the possibility of our shooting ourselves in the foot

- An extended government shutdown and even a temporary interruption of interest payments on Treasuries would not exactly enhance the allure of the dollar.
- 2% to 3% probability of this, the experts say.
- 2% to 3% is not big, but it is not zero...



- Thank you.