**De-dollarization evident in FX reserves, dollar's share declining**

**None 'None** [None; None; None; De-dollarization: The end of dollar dominance? | J.P. Morgan ; None; https://www.jpmorgan.com/insights/global-research/currencies/de-dollarization; Accessed 06-22-2024; cut by AI] \*double quotes converted to single quotes

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Top dollar no more? Find out if the current geopolitical climate is threatening the dominance of the world’s reserve currency.

Overview 'The risk of de-dollarization, which is a periodically recurrent theme throughout post-war history, has returned into focus due to geopolitical and geostrategic shifts.' Alexander Wise Strategic Research, J.P. Morgan In short, de-dollarization entails a significant reduction in the use of dollars in world trade and financial transactions, decreasing national, institutional and corporate demand for the greenback. This would diminish the dominance of the dollar-denominated global capital market, in which borrowers and lenders around the world transact in dollars.  There are two scenarios that could erode the dollar’s status. The first includes adverse events that undermine the perceived safety and stability of the greenback — and the U.S.’s overall standing as the world’s leading economic, political and military power. For instance, increased polarization in the U.S. could jeopardize the perceived stability of its governance, which underpins its role as a global safe haven.  The second factor involves positive developments outside the U.S. that boost the credibility of alternative currencies — economic and political reforms in China, for example. “A candidate reserve currency must be perceived as safe and stable, and must provide a source of liquidity that is sufficient to meet growing global demand,” Wise noted.

Fundamentally, de-dollarization would shift the balance of power among countries, and this could in turn reshape the global economy and markets.

The impact would be most acutely felt in the U.S., where de-dollarization would likely lead to a broad depreciation and underperformance of U.S. financial assets versus the rest of the world. “For U.S. equities, outright and relative returns would be negatively impacted by divestment or reallocation away from U.S. markets and a severe loss in confidence. There would also likely be upward pressure on real yields due to the partial divestment of U.S. fixed income by investors, or the diversification or reduction of international reserve allocations,” Wise said.

However, the effect of de-dollarization on U.S. growth is uncertain. While a structurally depressed dollar could raise U.S. competitiveness, it could also directly lower foreign investment in the U.S. economy. In addition, a weakening dollar could in principle create inflationary pressure in the U.S. by raising the cost of imported goods and services, though benchmark estimates suggest these effects may be relatively small.

“The dollar’s transactional dominance remains top-of-class despite secular declines in U.S. trade shares. On the other hand, de-dollarization is **evident** in **FX** **reserves**, where the dollar’s share has declined to a **record** **low** of 58%.” Meera Chandan Co-Head of Global FX Strategy, J.P. Morgan De-dollarization could reduce institutional, investor and corporate demand for the dollar over time, and in size could cause its value to fall. If there is a specific catalyst for the move, de-dollarization could also result in heightened exchange rate volatility, especially as over 60 currencies are pegged to the greenback.

However, while some signs of de-dollarization are emerging in currency markets, the dollar is thus far still maintaining its dominance. “Overall dollar usage has declined, but it remains within long-run ranges and its share remains elevated compared to other currencies,” said Meera Chandan, Co-Head of the Global FX Strategy research team at J.P. Morgan.

Looking at FX volumes, the dollar’s share stands at 88%, near record highs, while its share of trade invoicing, cross-border liabilities and foreign currency debt issuance has held steady over the last two decades. “The dollar’s transactional dominance remains top-of-class despite secular declines in U.S. trade shares. On the other hand, de-dollarization is evident in FX reserves, where the dollar’s share has declined to a record low of 58%,” Chandan noted.

Which currencies could dethrone the greenback? “In terms of competitors, China has been attempting to internationalize the renminbi. However, the renminbi’s global footprint is still small despite growing every year, and this will be a long process requiring reform,” Chandan said. For instance, the renminbi makes up just 2.3% of SWIFT payments, versus the dollar’s share of 43% and the euro’s share of 32%.

“With China’s growing centrality in global commerce, one might naturally expect the renminbi to assume a greater role in the global economy over time, but this transition would likely occur over the course of decades,” Wise added. “Relaxing capital controls, opening markets, implementing measures to promote market liquidity, bolstering the rule of law, reducing appropriation and regulatory risk, and promoting Chinese government bonds as an alternative safe asset — these could all cement China and the renminbi as a credible alternative to the U.S. and the dollar.”

USD’s share of global FX volumes\*\* and global exports (%)

The dollar has retained its transactional dominance, but its share of global exports has decreased to a record low of 9%.

Some signs of de-dollarization are also playing out in oil markets. “The U.S. dollar, one of the key drivers of global oil prices, appears to be losing its once powerful influence,” said Natasha Kaneva, Head of Global Commodities Strategy at J.P. Morgan.

Traditionally, the dollar is negatively correlated to oil prices. When the dollar appreciates, the imported price of oil rises and demand falls as a result, especially in emerging market (EM) economies. However, more oil sales are now being transacted in non-dollar currencies such as the renminbi. “Crucially, Russian oil is now either sold in the local currencies of the buyers or in the currencies of countries that Russia perceives as friendly,” Kaneva said.

For example, some Indian refiners have begun paying for Russian oil purchased via Dubai-based traders in dirhams, while others are considering doing so in yuan. Saudi Arabia is reportedly exploring the acceptance of payments in other currencies. In addition, major Russian commodity producers have started issuing bonds in yuan. In September 2022, state-owned oil company Rosneft made a public offering of 10 billion yuan in bonds, followed by a second tranche of 15 billion yuan in March 2023.

Is the dollar’s dominance truly waning in oil markets? Data from J.P. Morgan Research shows that between 2005 and 2013, a 1% appreciation of the U.S. trade-weighted dollar (USNEER) reduced the price of Brent crude by about 3%. Between 2014 and 2022 however, this figure declined to a mere 0.2%, with OECD oil inventories now playing a much more dominant role in determining oil prices.

“Overall, we find that the importance of the dollar has **declined** **significantly** from 2014 to 2022,” said Jahangir Aziz, Head of Emerging Market Economics Research at J.P. Morgan. “While it is possible that this shift is overly influenced by the rise in macroeconomic volatility caused by the spike in post-pandemic inflation and geopolitics, it is hard to ignore it altogether.'

Overall, while marginal de-dollarization is expected, rapid de-dollarization is not on the cards. “This is especially given the considerable advantages that accrue to a ubiquitous currency, and the fact that the U.S. has a long-standing global network of alliances and partnerships,” Wise said.

Instead, partial de-dollarization — in which the renminbi assumes some of the current functions of the dollar among non-aligned countries and China’s trading partners — is more plausible, especially against a backdrop of strategic competition. This could over time give rise to regionalism, creating distinct economic and financial spheres of influence in which different currencies and markets assume central roles.

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