Global Economy

Russia sanctions threaten to erode dominance of US dollar, says IMF

Ukraine war could cause more 'fragmentation' in global financial system, warns top official

Gita Gopinath, the IMF's first deputy managing director, says that currencies other than the US dollar may start to make up a greater share of countries' foreign reserves © AFP via Getty Images

Jonathan Wheatley in London and **Colby Smith** in Washington YESTERDAY

The unprecedented financial sanctions imposed on Russia after its invasion of Ukraine threaten to gradually dilute the dominance of the US dollar and result in a more fragmented international monetary system, a top official at the IMF has warned.

Gita Gopinath, the IMF's first deputy managing director, said the sweeping measures imposed by western countries following Russia's invasion, including restrictions on its central bank, could encourage the emergence of small currency blocs based on trade between separate groups of countries.

"The dollar would remain the major global currency even in that landscape but fragmentation at a smaller level is certainly quite possible," she said in an interview with the Financial Times. "We are already seeing that with some countries renegotiating the currency in which they get paid for trade."

Russia has sought for years to reduce its dependence on the dollar, a campaign that accelerated in earnest after the US imposed sanctions in retaliation to its annexation of Crimea in 2014.

Despite those efforts, Russia still had roughly a fifth of its foreign reserves in dollar-denominated assets just before the invasion, with a notable chunk held overseas in Germany, France, the UK and Japan. Those countries have now banded together to isolate Moscow from the global financial system.

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Gopinath said the greater use of other currencies in global trade would lead to further diversification of the reserve assets held by national central banks.

"Countries tend to accumulate reserves in the currencies with which they trade with the rest of the world, and in which they borrow from the rest of the world, so you might see some slow-moving trends towards other currencies playing a bigger role [in reserve assets]," she said.

The dominance of the dollar — backed by strong and highly credible institutions, deep markets and the fact that it is freely convertible — was unlikely to be challenged in the medium term, she added.

Gopinath noted that the dollar's share of international reserves had fallen from 70 per cent to 60 per cent over the past two decades, with the emergence of other trading currencies, led by the Australian dollar.

About a quarter of the decline in the dollar's share can be accounted for by greater use of the Chinese renminbi. But less than 3 per cent of global central bank reserves are denominated in Beijing's currency, IMF data show.

Beijing was in the process of internationalising the renminbi before the current crisis and was already ahead of other nations in adopting a central bank digital currency, said Gopinath. But she added that the renminbi was unlikely to replace the dollar as the dominant reserve currency.

"That would require having full convertibility of the currency, having open capital markets and the institutions that can back [them]. That is the slow-moving process that takes time, and the dollar's dominance will stay for a while," she said.

The war would also spur the adoption of digital finance, from cryptocurrencies to stablecoins and central bank digital currencies, she added.

"All of these will get even greater attention following the recent episodes, which draws us to the question of international regulation," said Gopinath. "There is a gap to be filled there."