Opinion **US Dollar**

Dollar doomsters have got it all wrong

Global demand for the US currency remains extremely robust while appetite for the renminbi has soured

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An OMFIF survey of 73 central banks, with a combined stash of $5.4tn, found a net 18 per cent expect to increase not decrease their allocation to the dollar © Andrew Harrer/Bloomberg

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As every connoisseur of the more excitable bits of the financial blogosphere can tell you, the dollar is on an unstoppable trajectory to disaster.

One recent post argued that the US has, like the Roman empire before it, weakened itself relative to other world powers. The dollar's central role in the global financial system is in decline as "the people in charge never seem to miss an opportunity to dismantle capitalism brick by brick".

That's the argument. We've all heard it for more than two decades and we'll hear it again, now with the added spice of dark geopolitical trends; the move in 2022 to punish Russia for its full-scale invasion of Ukraine by freezing its dollar reserves held abroad means lots of countries might now look to stash their rainy day funds in other currencies.

A global effort — co-ordinated or otherwise — to demote the dollar could happen. If executed at serious scale it would remove the exorbitant privilege from the US of executed at serious scale it would remove the exorbitant privilege from the US of issuing debt on its own terms safe in the knowledge that other national authorities will lap it up. This would change the game in markets and trade. But evidence to suggest it is already happening is limited at best.

The share of global central bank reserves held in dollars has declined in recent decades. Back in 2016, the currency made up more than 65 per cent of official reserves, according to data from the IMF. By the end of 2023, that had shrunk to 58.4 per cent. The amount held in Chinese renminbi at the start of 2016 was zero. Between the end of that year and 2023 it jumped 188 per cent. But while that sounds huge, it is still just a 2.3 per cent slice of the total.

However, a recent blog from the New York Fed argues that the apparent pullback away from the dollar is not down to a global cooling on the buck. Instead, the shift is attributable to a small number of countries, including Switzerland, where a long-running effort to hold down the franc just over a decade ago led to a huge accumulation of euros. “Indeed, increasing US dollar shares from 2015 to 2021 were a feature of 31 of the 55 countries for which there are estimates,” economists at the New York Fed wrote in late May. “The decline in the dollar preferences of a small group of countries — notably China, India, Russia, and Turkey — and the large increase in the quantity of reserves held by Switzerland explain most of the decline in the aggregate dollar share of reserves.”

Meanwhile, central banks globally have ramped up purchases of gold, in an apparent effort to avoid the risk of sanctions, since gold is not controlled by any national authority. Yet, as the New York Fed stresses, even after a rapid accumulation of gold in 2022 and 2023, the precious metal still accounts for a relatively modest 10 per cent of the global reserve total. Narratives about declining dollar shares and increasing roles for gold “inappropriately generalise the actions of a small group of countries”, it says.

In fairness to the dollar doomsters (who tend to overlap significantly with gold enthusiasts and the crypto curious), gold holdings do appear poised to rise further. A survey of reserve managers by the Official Monetary and Financial Institutions Forum think-tank said despite record high gold prices and a taming in global inflation, for which gold is often seen as a hedge, reserve managers are keen to build up holdings of the metal.

However, demand for the dollar remains extremely robust. This survey does not capture every country, but it does cover 73 central banks, with a combined stash of $5.4tn. Of them, OMFIF said a net 18 per cent expect to increase not decrease their allocation to the dollar, lured in by higher interest rates and a robust US economy. The euro is the next most popular currency on the wish list, suggesting reserve managers are keen to stick to the bigger, more liquid currencies.

Appetite for the renminbi, meanwhile, “has soured”, OMFIF’s researchers said, and 12 per cent of managers are looking to cut back on holdings in the Chinese currency. This is quite a change of heart. In 2021 and 2022, nearly one-third were looking to raise their renminbi holdings.

“This is partly due to relative pessimism on the near-term economic outlook in China, but the vast majority also mentioned market transparency and geopolitics as deterrents . . . ” the think-tank’s report stated.

Nothing lasts for ever. It is not impossible to imagine, in the current political climate, a deterioration in US institutional resilience that ends up posing a serious threat to the dollar’s long-term standing. But it felt premature to call time on the dollar’s primacy in the global financial system two decades ago and it still feels premature now.

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