

Macro + FX Strategy

De-dollarization: A Reality Check

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- Chatters on “de-dollarization” have increased in recent months with a series of news that some countries have opted or are in the process of opting a non-USD currency to settle some of their (actual or potential) trade activities and/or investments.
- In a post-pandemic world of risk management, diversification and resilience amidst heightened US-China tensions, it is no surprise there is a shift towards diversifying from the USD in some countries’ trade settlement/transactions/reserves, especially in light of US’ sanctions on Russia after the Russia-Ukraine conflict erupted in Feb 2022.
- **Outlook** – After several decades of globalization and trade liberalization, the pendulum is swinging the other way with the evolving US-China tensions, Russia-Ukraine conflict and a post-pandemic world of risk management. The reality is that the USD with the entrenched global financial infrastructure and linkages around it and the lack of a credible challenger mean that it will remain dominant at least for the next decade, if not longer. However, with a lengthened horizon of one to two decades out, it is in businesses’ interest to understand and prepare early for greater usage of a non-dollar alternative in their business operations, which should be an important part of their risk management/diversification/hedging strategy, and also to avail themselves to any business opportunities arising from such a systemic shift.
- **Catalyst** – If the US government do not handle the current US debt ceiling issue properly, a default (even for a brief period of time) or another credit rating downgrade could trigger a paradigm shift on the USD. It would not be unconceivable for central banks, businesses and investors to reduce their reliance on the USD, hence potentially accelerating the pace of de-dollarization globally.

US Dollar (USD) - “Reports of my death are greatly exaggerated”

The quote is widely attributed to author Samuel Clemens (better known by his pen name, Mark Twain) who responded to a reporter’s query that he was dying.¹ Similarly for the USD, its (premature) demise is greatly exaggerated in the recent rounds of media hype around this topic (see table). This was also reflected in the Google trends for the search term “de-dollarization” which surged 4 to 5 times by late Apr compared to just beginning of Apr or the past 12 months.

The interests in “de-dollarization” – here referring to the reduced usage of or dependence on USD for trade, investment or transactions purposes – are likely to be sparked off by a series of news that some countries have opted, or in the process of opting, to use a non-USD currency to settle some of their (actual or potential) trade activities and/or investments. Several currencies have been quoted as alternative to the USD, including the Indian rupee (INR) and the Chinese currency (CNY).

¹ <https://www.dictionary.com/browse/the-reports-of-my-death-are-greatly-exaggerated>

Reality Check On The Global Financial System

In a post-pandemic world of risk management and heightened US-China tensions, it is no surprise there is a movement to diversify away from the USD in some countries' trade settlement/transactions/reserves, especially in light of US' sanctions on Russia after the Russia-Ukraine conflict erupted in Feb 2022.

To recap, among the highest profile US-led financial sanctions against Russia were the freezing by Western governments of nearly half (USD300 bn) of Russia's foreign currency reserves and the removal of major Russian banks from SWIFT (Society for Worldwide Interbank Financial Telecommunication), an interbank messaging service that facilitates international payments.

The list of news articles (see appendix) shows how some of the countries are adopting an alternative currency to the USD, as a means of risk diversification in response to the "weaponization" of the USD.

However, will these moves dethrone the "King Dollar"? Even in the next decade, that is unlikely the case given the dollar's dominance in a variety of settings in global trade, investment and financial transactions as well as growing demand for safe haven assets. An alternative currency would require the similar liquidity, market breadth and depth, and credibility that is the hallmark of the USD today. At this point, there is no credible challenger that possesses such a set of characteristics, be it the EUR, CNY, INR or digital alternatives such as bitcoin and the like.

When Europe's single currency, the EUR, was launched in Jan 1999, it was widely regarded as a challenger to the USD's dominance. More than two decades later, the single currency had made some inroads (accounting for 33% share of SWIFT payments and just about 1/5 of international reserves) but did not gain much adoption outside of Europe.

Alternatives To USD Emerging, But Will Take Time

However, as markets evolve, an alternative to the USD could emerge and it will be an interesting development beyond the next one to two decades as the moves away from the USD continue apace.

Other than the EUR, another potential alternative to the USD would be the Chinese currency, CNY.

The inclusion of the CNY in the group of currencies that make up the Special Drawing Right (SDR) basket on 1 Oct 2016 is an important milestone in its internationalization process as countries begin to incorporate the currency in their official reserves. CNY's share in the SDR basket has been revised higher from 10.92% in 2016 to 12.28% in 2022. Meanwhile, the shares for the Japanese yen (JPY), sterling pound (GBP) have fallen sharply, to 7.59% and 7.44%, from 14.8% and 11.60% in 2000, respectively.²

China's position as the world's largest trading nation (total exports and imports of USD6.3 tn in 2022, vs USD4.7 tn for the US) will be one leverage for the CNY to increase its usage in the global financial markets, especially on a bilateral basis between one trade partner and China. Going by the news flows, the CNY has indeed gained in prominence in trade and investment on a bilateral basis with China and its trade partners.

² <https://www.imf.org/en/About/Factsheets/Sheets/2023/special-drawing-rights-sdr>

Despite China's relatively closed capital market, there is a sizable offshore CNH market that forms the liquidity pool for the currency as well as offerings of offshore investment products and derivatives for risk management in the currency. CNH deposits in Hong Kong, its largest offshore centre, stood at CNY794.1 bn at the end of Mar 2023. The rapid development of China's Central Bank Digital Currency (CBDC) can also help to accelerate the CNY internationalization.

China's own cross-border payment system (Cross-Border Interbank Payment System or CIPS) processed CNY 96.7 tn in 2022 (USD14 tn), an annual gain of 21.5%, as reported by China Daily³. Notably, this is close to 10% of the value of annual transactions facilitated by SWIFT of about USD150 tn. Currently, the CIPS has not been widely adopted and is used mainly for transactions relating to the CNY.

In terms of China's cross-border payment flows, the latest data from China's State Administration of Foreign Exchange (SAFE) showed an upward trend in the usage of CNY in China's cross-border payments and receipts since data became available from 2010, reaching historic high of 48.4% share of total in Mar 2023, outpacing USD's share (46.7%) for the first time. However, as no other details are available, it is likely that the flows are bilateral basis but do indicate the rising prominence of CNY as a payment currency with China-based entities.

While China has reported increased usage of the CNY within its own financial system, the picture from a global perspective remains very much the same with the USD dominating the scene.

In the global payments/transactions space, data from SWIFT shows that the USD remains the main currency of payments, with more than 40% share. The next closest is the EUR, at about 33%. The CNY's share is only at 2.3%, or about 1/50th of the USD's share. Within the CNY payments space, bulk of it was due to transactions in Hong Kong (>70% share), a Chinese territory itself while other countries' accounted for just small fractions.

The Russia-Ukraine conflict has not led to a reduction in USD's proportion of global payments since Feb 2022. The share for CNY was also largely unchanged on average but increased usage had been observed for currencies including the CAD and CHF since the conflicts, though their respective shares remained small.

Erosion Of Dollar Dominance Is Happening, But Very Slowly

There are clear benefits of having a dominant currency for global transactions such as for efficiency and effectiveness, but concerns are also rising due to the US government's use of financial sanctions as well as the debasing of dollar to finance US' deficits and bank bailouts. The massive Fed interest rate hikes since Mar 2022 also highlighted the monetary policy consequences and potential impact of global dollar shortages in the USD-centric global financial system.

However, the movement away from USD assets is unmistakable as various governments and central banks make conscious efforts to diversify their investment funds and risks. US Treasury's data shows that holdings of US Treasury securities have declined consistently in the past several years among the major holders. Russia started to pare down its holdings to almost zero even before the start of Russia-Ukraine conflict. China lowered its holdings to USD850 bn from the peak of USD1.31 tn in 2011.

³ <https://www.chinadaily.com.cn/a/202303/24/WS641dbebda31057c47ebb6717.html>

In the management of reserves/assets, while global central banks continue to favour the USD as a reserve currency, its decline in weightage is visible. IMF's COFER data show that USD's share in global reserves is at 58%, more than twice the share of the next largest, although there is a decline from 63% share 5 years ago and 73% in 2001. At the current rate of decline, it is possible for the USD's share to drop below the psychological 50% mark in the next 5 - 10 years. Other than risk diversification, this may also reflect dismantling of currency pegs. On the other hand, the CNY's share is still tiny at 2.7%, though it has more than doubled from 5 years ago.

In nominal terms, global USD holdings in reserve assets is at the lowest since 2017. The decline started in 1Q22 with the onset of the Russia-Ukraine conflict. On the contrary, central banks' gold holdings have surged, particularly in China and Russia which were up 3.5 times and 6.0 times since end-2005, respectively.

The Dollar Is Still King

After several decades of globalization and trade liberalization, the pendulum is swinging the other way with the evolving US-China tensions, Russia-Ukraine conflict and a post-pandemic world of risk diversification, resilience and security (and "just in case"). As such, there is no surprise that the chatter has increased for an alternative to the USD. The reality is that with the entrenched global financial infrastructure and linkages around it such as the SWIFT network that underpins the global financial system, the USD will remain dominant at least for the next decade, if not longer.

Given the USD's reserve currency status, access to USD plays an important role to anchor global financial stability, especially during economic shocks when investors rush into the safe haven assets. In the wake of the recent US banking sector turmoil, the Fed has addressed concerns of USD shortages through its [enhanced daily currency swap arrangements](#) in Mar 2023, with the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank and Swiss National Bank. Currency swap lines provide foreign central banks with USD funding which can be made available to their financial institutions. Temporary liquidity swap lines such as those established during the Covid-19 pandemic (including the Foreign and International Monetary Authorities repo facility) are also used to ease strains in financial markets and mitigate their effects on economic conditions during market stresses. The use of such bilateral currency swap lines with major central banks helped cement the USD's role in global financial system and preserve the USD's status as a safe haven asset with US as the lender of last resort.

That said, we expect to see the share of the USD in international transactions/reserves to decline at the margin, e.g. more countries may opt for CNY in their bilateral transactions with China. With a lengthened horizon of one to two decades out, it will be an interesting development for another currency to emerge as an alternative to, rather than a replacement of, the USD.

While we see more usage of non-traditional currencies in trade deals, these are largely bilateral to facilitate the financial transactions without incurring costs to convert into and out of USD and concurrently reduce reliance on the USD. The increased use of their local currencies in cross-border transactions is not likely to drive the emergence of a single currency to rival the USD, unless the volume of trade is large enough, particularly in the case for China.

Lastly, absent a substantial driver, there is huge inertia to overcome in substituting the USD. Current global payment and trade architecture for businesses has largely been built around the USD. Liquidity in the USD is virtually unmatched compared to its substitutes. For investors, there are no alternatives in terms of depth, liquidity and access when it comes to the US financial markets.

Implication For ASEAN

The ASEAN countries have established arrangements amongst themselves and with major trading partner China for payments in their local currencies in addition to the USD and continues to make inroads on regional payments connectivity as more countries jump on the bandwagon.

For instance, Malaysia, Indonesia, Singapore and Thailand have direct digital payments systems that use local currency for settlement. Meanwhile, China has signed bilateral currency settlement agreements with a number of ASEAN countries including Vietnam, Indonesia and Cambodia separately, as well as currency swap agreements with Indonesia, Malaysia, Singapore and Thailand, worth about CNY800 bn.

Emerging market currencies are particularly vulnerable to capital shifts during market stresses which contribute to significant volatility in the exchange rates with the local currencies prone to sharp depreciation against the USD. Thus, by reducing the reliance on USD, this would provide for a more stable financial system liquidity and lower the economic impact for the region.

Furthermore, given the large amount of trade and investment flows between the China and ASEAN, it is not only feasible, but would also be efficient if transactions are settled in the CNY and local currencies. China has been ASEAN's largest trading partner since 2009, and ASEAN became China's top trading partner since 2020 after surpassing the European Union. On a bilateral basis, China is the top trade partner for Indonesia and Singapore while counting amongst the largest for the rest of the ASEAN nations. China and Hong Kong are also the amongst the largest source of FDI into the region, accounting for 12% share. The Regional Comprehensive Economic Partnership ("RCEP") Agreement that came into force in Jan 2022 is expected to further deepen the trade links between ASEAN and China.

Against this backdrop of financial infrastructure, management of FX volatility and increased trade/investment flows and opportunities, companies in ASEAN could be in a favorable position to consider adopting an alternative currency in settling their trade and investment transactions with counterparts in China.

Outlook –Towards A More “Multi-Polar” International Monetary System

The lesson from the financial sanctions on Russia suggests that in the extreme, the shift to a new way of doing business could take place abruptly and suddenly. At the same time, central banks will continue to experiment with alternatives to reduce their reliance on the USD.

Therefore, it is in businesses' interest to understand and prepare early for greater usage of a non-USD alternative in their business operations, which should be an important part of their risk management/diversification/hedging strategy, and also to avail themselves to any business opportunities arising from such a systemic shift.

While the status quo could remain for now, it will be important for companies to constantly engage with professionals in the banking, accounting, legal and other sectors to keep abreast of the latest developments in the de-dollarization trend and understand the implications to their businesses and financial positions.

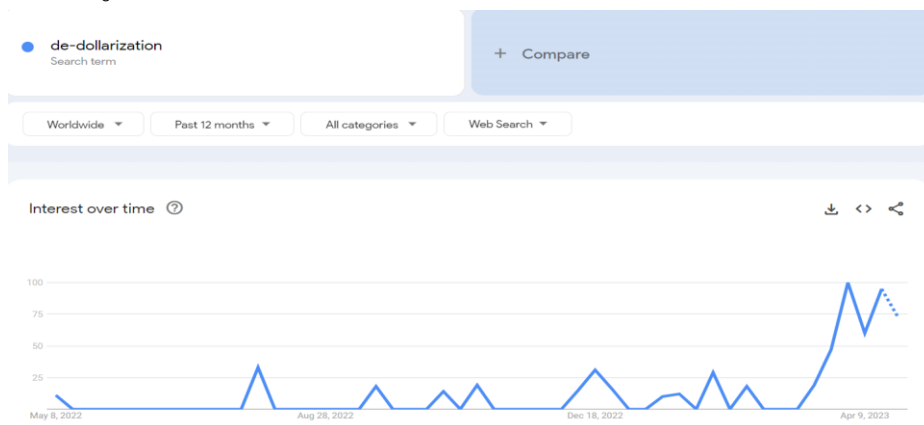
Could US Debt Ceiling Crisis Be A Catalyst To Faster De-Dollarization?

One of the key reasons of the USD's dominant role as a global reserve currency is the trust placed upon it which include the assumptions on stability of the government and the USD, amongst others and that rule of law will prevail. There is thus an implicit faith that the US government has never and will never default on its debt obligations. If the US government cannot agree to extend the US debt ceiling by early Jun, the US government may run out of cash soon after and may be forced to default on some of its maturing debt. To recap, in Aug 2011, the S&P Ratings had downgraded to US sovereign debt rating by one notch to "AA+" from "AAA" in the wake of the debt ceiling brawl then.

Now, if the US government does not handle the current US debt ceiling issue properly, a default (even for a brief period of time) or another credit rating downgrade could trigger a paradigm shift on the USD. It would not be unconceivable for central banks, businesses and investors to reduce their reliance on the USD, hence potentially accelerating the pace of de-dollarization globally.

Google Trends Show Increased Searches For "De-Dollarization" From Apr 2023

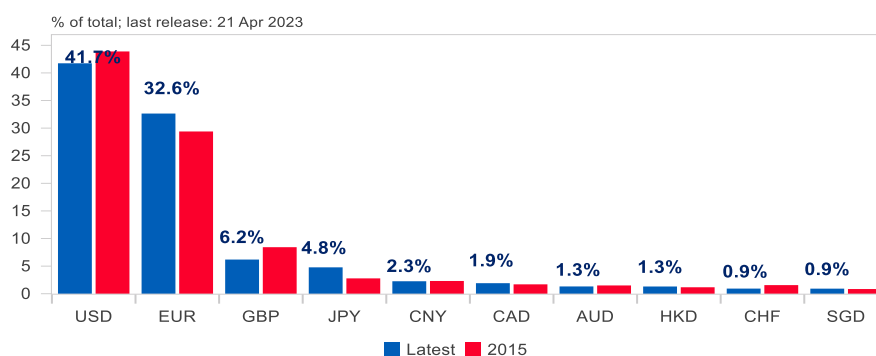
Source: Google, UOB Global Economics & Markets Research



SWIFT: USD Is The Dominant Currency For Payments

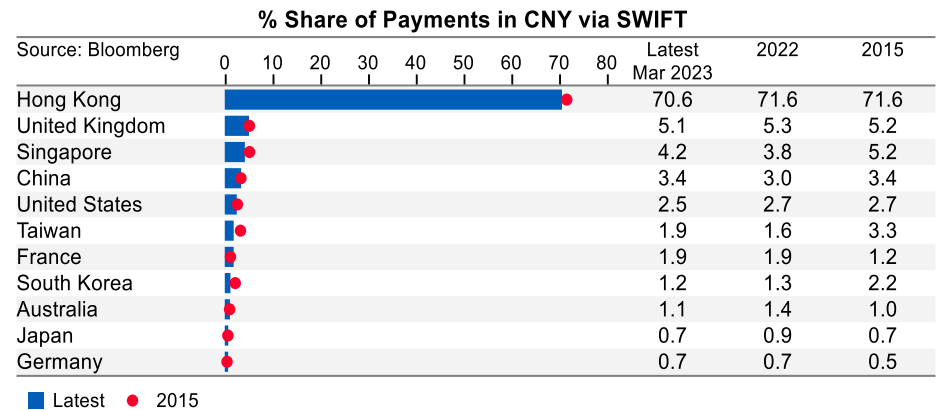
Source: Macrobond, UOB Global Economics & Markets Research

SWIFT: Top 10 Payment Currencies



SWIFT: Majority of CNY Payments Is Centered In Hong Kong

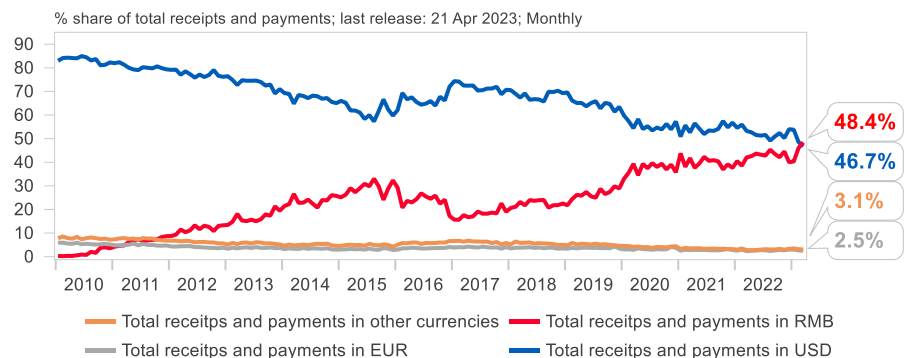
Source: Macrobond, UOB Global Economics & Markets Research



China: Cross-Border Payments And Receipts

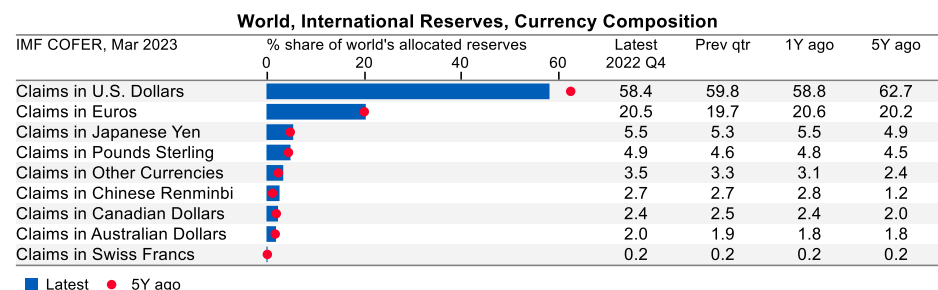
Source: Macrobond, UOB Global Economics & Markets Research

China: Remittance & Overseas Transfer, By Currency (latest: Mar 2023)



IMF: USD Remains The Dominant Reserve Assets

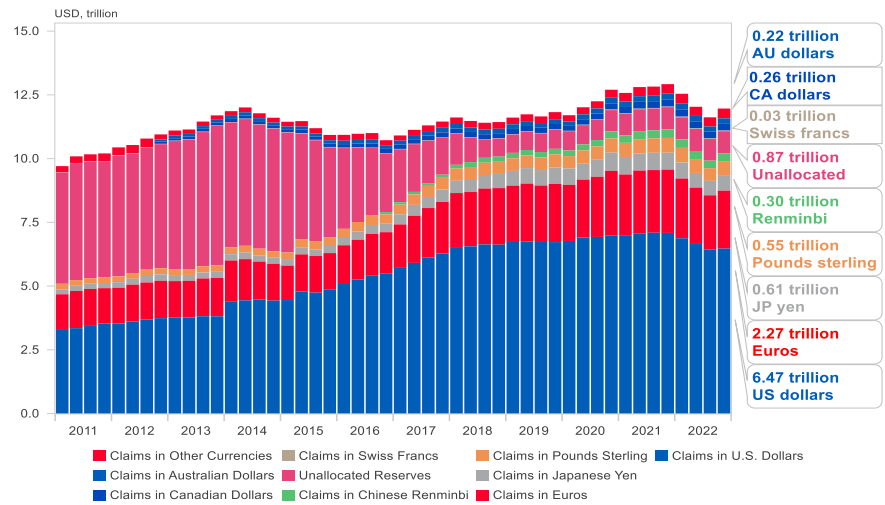
Source: Macrobond, UOB Global Economics & Markets Research



IMF: In Nominal Terms, USD Holdings In Reserves Assets Have Fallen Since The Ukraine Invasion

Source: Macrobond, UOB Global Economics & Markets Research

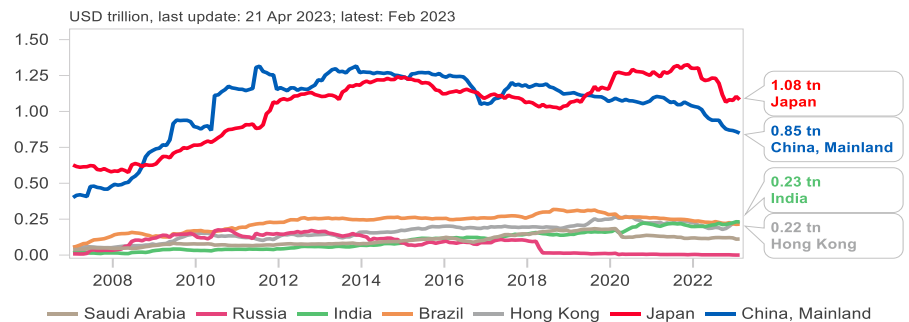
World, International Reserves, Currency Composition (IMF COFER), USD



US: Major Foreign Holders Are Paring Down Treasury Securities

Source: Macrobond, UOB Global Economics & Markets Research

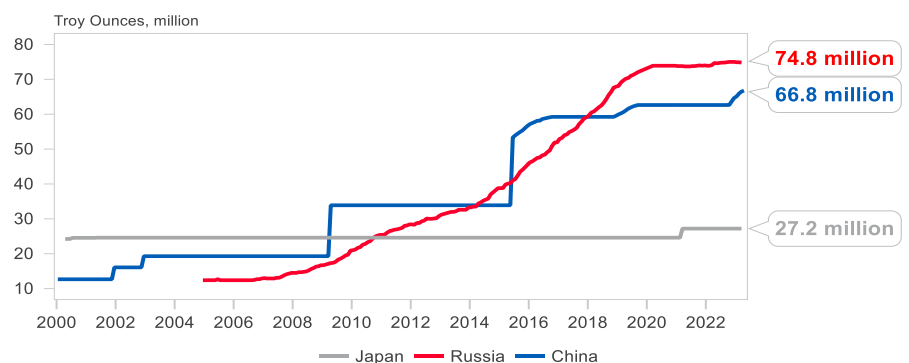
US: TIC Selected Foreign Holders of Treasury Securities



Gold: Gold Reserves Increasing As Part Of Diversification Out Of Dollar Assets

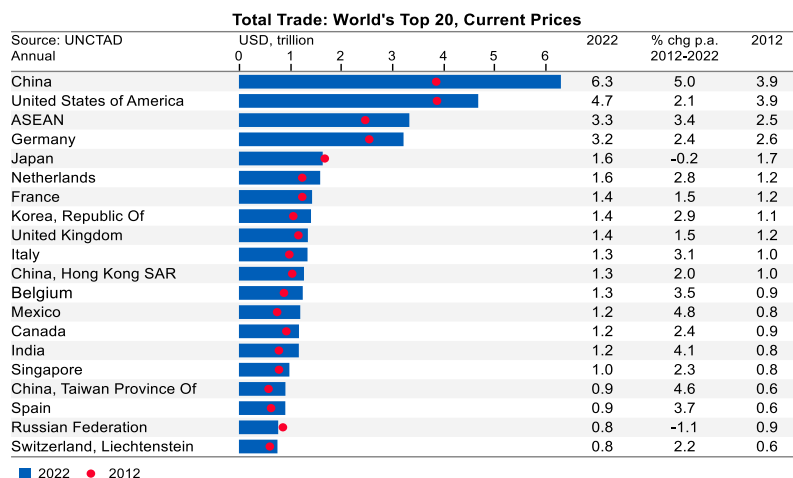
Source: Macrobond, UOB Global Economics & Markets Research

International Reserves, Gold, Volume



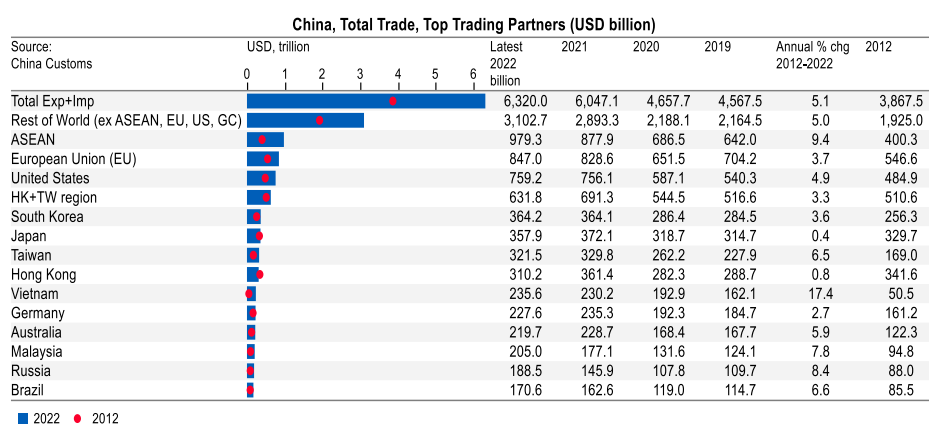
Trade: China Is The Dominant Trading Nation

Source: Macrobond, UOB Global Economics & Markets Research



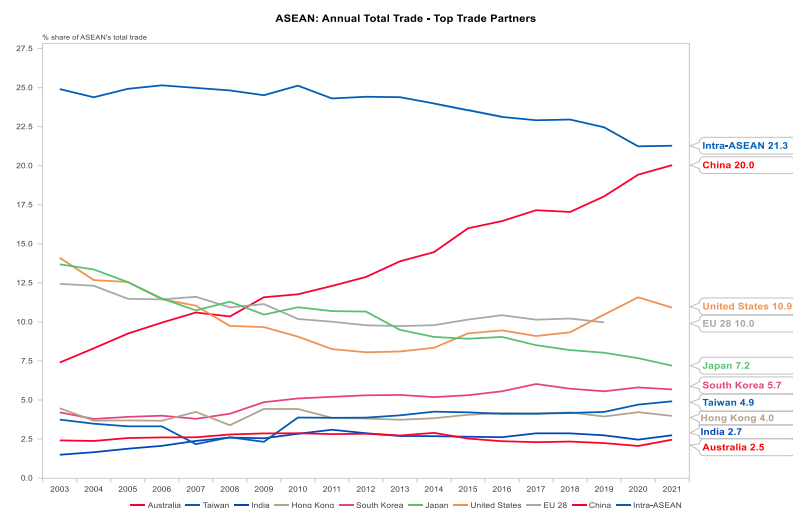
China: ASEAN Is China's Largest Trading Partner Since 2020

Source: Macrobond, UOB Global Economics & Markets Research



ASEAN: China Is ASEAN's Largest Trading Partner With Its Share Rising Rapidly

Source: Macrobond, UOB Global Economics & Markets Research



Appendix: The table below shows news that relate to the adoption of an alternative currency other than the USD in some of their actual/future transactions or trade settlement.

Recent News Reports On "de-dollarization"			
Date of Publication	Headline	Main Contents/Quotes	Source/Access Link
30 Apr 2023	India joins China in De-dollarization Drive	"On March 29th, India unveiled its new foreign trade policy, which allows the use of rupees in trade with countries facing dollar shortages or currency crises. Malaysia is the latest country to join this scheme ..."	https://moderndiplomacy.eu/2023/04/30/india-joins-china-in-de-dollarization-drive/
27 Apr 2023	Thailand and China to encourage businesses to use yuan-baht settlement for bilateral trade	"The Bank of Thailand is in discussions with China's central bank over supporting the use of yuan-baht settlement to mitigate foreign exchange risk amid ongoing US dollar volatility." Both central banks renewed their yuan-baht Bilateral Currency Swap Arrangement (BSA) in 2021.	https://www.bangkokpost.com/business/2558236/banks-eye-yuan-baht-trade-payments
27 Apr 2023	Argentina to pay for Chinese imports in yuan rather than dollars	"Argentina will start to pay for Chinese imports in yuan rather than dollars, the government announced Wednesday, a measure that aims to relieve the country's dwindling dollar reserves. In April, it aims to pay around \$1 billion of Chinese imports in yuan instead of dollars and thereafter around \$790 million of monthly imports will be paid in yuan, a government statement said."	https://www.reuters.com/world/china/argentina-govt-pay-chinese-imports-yuan-rather-than-dollars-2023-04-26/
26 Apr 2023	Yuan overtakes dollar to become most-used currency in China's cross-border transactions	"The yuan became the most widely-used currency for cross-border transactions in China in March, overtaking the dollar for the first time, official data showed, reflecting efforts by Beijing to internationalise use of the yuan. ... The yuan was used in 48.4% of all cross-border transactions, Reuters calculated, while the dollar's share declined to 46.7% from 48.6% a month earlier."	https://www.reuters.com/markets/currencies/yuan-overtakes-dollar-become-most-used-currency-chinas-cross-border-transactions-2023-04-26/#:~:text=The%20yuan%20was%20used%20in,the%20current%20and%20capital%20accounts

04 Apr 2023	Press citation: There is no need to continue depending on US Dollar in investments -- PM Anwar	"He [PM Anwar] said negotiations between Malaysia and other countries should use the currencies of both countries. According to him, Bank Negara Malaysia has also made a proposal to pioneer the said method in matters of trade during visits to China using ringgit and renminbi."	https://www.mof.gov.my/portal/en/news/press-citations/there-is-no-need-to-continue-depending-on-us-dollar-in-investments-pm-anwar
30 Mar 2023	China, Brazil strike deal to ditch dollar for trade	"China and Brazil have reached a deal to trade in their own currencies, ditching the United States dollar as an intermediary, the Brazilian government said on Wednesday."	https://www.straitstimes.com/world/china-brazil-strike-deal-to-ditch-dollar-for-trade
28 Mar 2023	China completes first yuan-settled LNG trade	"Chinese national oil company CNOOC and France's TotalEnergies have completed China's first yuan-settled liquefied natural gas (LNG) trade through the Shanghai Petroleum and Natural Gas Exchange, the exchange said on Tuesday (Mar 28)."	https://www.businesstimes.com.sg/international/china-completes-first-yuan-settled-lng-trade
17 Jan 2023	Saudi Arabia open to trading in currencies besides the US dollar	"Saudi Arabia will consider trading in currencies other than the US dollar, the country's finance minister said on Tuesday, in one of the clearest signs yet that the oil-rich kingdom is open to diversifying away from the greenback."	https://www.middleeasteye.net/news/saudi-arabia-open-trading-currencies-besides-us-dollar
14 Nov 2022	In ASEAN, the MOU on Cooperation in Regional Payment Connectivity (RPC) was signed on 14 November 2022.	Ravi Menon, Managing Director of MAS, stated, "This MOU underscores ASEAN's commitment to achieve regional payments interoperability and connectivity by 2025."	https://www.mas.gov.sg/news/media-releases/2022/central-banks-of-indonesia-malaysia-philippines-singapore-and-thailand-seal-cooperation-in-regional-payment-connectivity
15 Mar 2022	Saudi Arabia Considers Accepting Yuan Instead of Dollars for Chinese Oil Sales	"Saudi Arabia is in active talks with Beijing to price some of its oil sales to China in yuan, people familiar with the matter said, a move that would dent the U.S. dollar's dominance of the global petroleum market and mark another shift by the world's top crude exporter toward Asia."	https://www.wsj.com/articles/saudi-arabia-considers-accepting-yuan-instead-of-dollars-for-chinese-oil-sales-11647351541

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