The global finance system over the dollar's dominance will continue, CIO sees little to credibly threaten its reign. (UBS)

Why the US-dollar-centric world is likely to continue for years to come

16 December 2024, 06:11 am CET, written by UBS Editorial Team US Editorial Team

Incoming US President Donald Trump on Saturday threatened BRICS nations with 100% import tariffs unless they commit to not developing a joint currency and to not backing any alternative to the US dollar for international trade.

De-dollarization efforts have gained momentum following Russia's invasion of Ukraine and subsequent Western governments' seizures of Russian central bank assets. Global central banks have purchased gold at the fastest pace in history over the past couple of years, according to the World Gold Council. The latest BRICS summit declaration in Kazan this October supported the use of local currencies for bilateral trade, and Russian President Vladimir Putin drew headlines after posing at the summit with mock-up BRICS currency notes.

But while international tensions are rising over trade, currency, and sanctions, we see several reasons the US-dollar-centric world is likely to continue for years to come:

Global currency regimes are sticky. The US dollar dominates financial markets and international trade. Historically, it has taken a long time for changes to materialize in the world's dominant currency. Even as great economic powers rise and fall, their currencies' reserve status tends to survive well past the peak of their influence. The latest IMF survey on the currency composition of global foreign exchange reserves reveals that the share of US dollars held by central banks still stands at almost 60%, roughly stable over the past four years. The greenback is also used in over 47% of global payments and dominates 84% of trade finance contracts, according to SWIFT. For comparison, 23% of all global payments are made in euros, with its trade finance share at just 6%. The numbers for the Chinese yuan are less than 5% and 5%, respectively.

Liquidity is king, and the dollar still dominates here. Liquidity ranks near the top of the properties that global reserve managers and those involved in international trade look for in a currency. The US dollar remains the world's dominant currency in this realm: It is on one side of 88% of all trades, according to the latest survey by the Bank for International Settlements (BIS). It also offers deep derivative markets—forwards, swaps, options, etc.—giving market participants the ability to efficiently hedge exposure.

US stability and safety matter. The US political atmosphere and fiscal accounts are no doubt experiencing challenges, yet the situation in competing jurisdictions is also problematic. The US still ranks highly in various gauges of institutional strength, including market openness, regulatory quality and efficiency, and rule of law. In this context, the US continues to attract large flows of foreign investment. The US-centric AI technological revolution is cementing the country's reputation for innovation and acting like a magnet for foreign capital. Of course, the US must treat the privilege of issuing the world's preeminent currency with care. Outsized fiscal deficits, together with recurrent debt-limit sagas, are eroding confidence. Foreign investors will also be eager for assurances that the Fed's independence won't be compromised.

So, while tensions in the global finance system over the dollar's dominance will continue, we see little to credibly threaten its reign. For investors weighing their currency exposure, we anticipate the US dollar may stay well-supported in the near term, with many of Trump's early policies likely to be positive for the dollar.

But we caution that the dollar's valuation appears overstretched at current levels, and we recommend investors use periods of USD strength to reduce US dollar exposure through strategies such as hedging dollar assets, switching from USD cash and fixed income exposure to other currencies, and through structured strategies where suitable. We anticipate central banks (most notably in emerging markets) will continue to accumulate gold going forward, which alongside lower US rates and recovering ETF demand should push spot prices higher. We forecast gold rising to USD 2,900/oz by mid- to late-2025. With cross-asset volatility likely to pick up in the second Trump administration, we also favor diversification into alternatives and other less-correlated assets.

Main contributors: Solita Marcelli, Mark Haefele, Alejo Czerwonko, Jon Gordon, Vincent Heaney, Julian Wee

Original report: **Trump demands BRICS back dominant dollar, 02 December 2024.**