POLSKI INSTYTUT SPRAW MIĘDZYNARODOWYCH
THE POLISH INSTITUTE OF INTERNATIONAL AFFAIRS

NO. 23 (2331), 14 FEBRUARY 2024 © PISM

BULLETIN

U.S. Dollar to Maintain Position as the Leading Global Currency

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The dollar's role in the world's economy has been slowly diminishing but it will still be the most important global currency in the coming decades. Recent difficulties related to its use, including high financing costs for foreign borrowers resulting from U.S. interest rate increases, and sanctions imposed by the administration, may open up opportunities for other currencies, though this will not lead to fundamental changes. It is beneficial for Poland that the dollar's strong position is maintained, which it can support by emphasising in contacts with the American administration the negative consequences of U.S. monetary policy for developing countries and suggesting measures to offset them.

The Dollar as a Global Currency. Discussion about the future of the dollar often focuses on the difficulties associated with its use. Unsubstantiated predictions of the demise of the dollar as a global currency frequently appear in the public debate. These fit into the "decline of the West" narrative exploited by Russian and Chinese disinformation. These claims tend to overlook the U.S. dollar's (USD) actual position in the world and the factors supporting it. While disadvantages do exist, the dollar remains by far the most important currency in international economic relations.

According to data from August 2023, transactions settled in USD accounted for about 48% of the total value of transactions concluded using the SWIFT system for international interbank communications. The euro was second with around 23%, followed by the Japanese yen and the Chinese renminbi, with around 3.5% each. The dollar was also on one side of around 90% of foreign exchange transactions in 2022. It remains the most important invoicing currency in international trade, with a share of around 54%. Also, prices for the most important commodities (e.g., oil) are set in dollars. According to International Monetary Fund data for Q3 2023, the USD is also the world's main reserve currency and accounts for almost 60% of allocated reserves, with a large lead over the euro (around 19.5%), the yen, and the British pound (around 5% each), as well as the renminbi, the Australian dollar, and the Canadian dollar (around 2.5% each). These figures unambiguously confirm that the U.S. dollar remains the most important currency in international economic relations, with most of the other major currencies being issued by U.S. allies.

Structural Reasons. The dollar's role in the global economy surpasses that of the U.S. itself; there are factors strengthening the dollar that are not directly dependent on the state of the U.S. economy. These include the network effect, due to which it makes sense for a market participant to use the dollar because everyone else uses it. As a result, it can be exchanged for virtually any good, regardless of the good's characteristics or origin. The long-standing reliance of international trade on the dollar also means that the infrastructure best suited to it is developed. This applies above all to clearing banks, without which safe and stable international trade would be impossible. The dollar, due to its strong position in international transactions, is also the most important currency in the sovereign debt market. Although the role of China's state-owned banks is growing, private financial institutions still denominate loans (sovereign bonds included) mainly in USD. According to the latest data from Eurodad (a network of European NGOs working on foreign debt and development finance) as of May 2021, among the bonds considered in the study, the dollar accounted for 85.8% of the value, the euro for 11.9%, and the yen for 2.4%. Given that it is common practice to repay maturing obligations with new loans, potential changes in the currencies dominating the sovereign debt market cannot occur suddenly. In addition, many countries have pegged their currency to the dollar (e.g., Saudi Arabia, Jordan, Oman) or use it as their domestic currency (e.g., Ecuador, Panama). Any departure from these arrangements would be costly or raise political difficulties, so these countries will be reluctant to do it, strengthening the USD's position on the global market.

The dollar's strong position is also due to factors unrelated to the financial market itself. The USD is an attractive store of value (which is one of the basic functions of money) because the U.S. political and economic system is stable—despite the problems it encounters, the general perception is that it is not in danger of a sudden collapse. The U.S. authorities do not aggressively manipulate the exchange rate, so the value of the USD is less dependent on domestic current political needs than many other currencies. The U.S. also strongly protects property rights, especially compared to China, which is the only economy of a similar scale in the world. This means that assets in the U.S., such as real estate or securities, are safe and will be attractive to businesses and citizens from other countries, especially those with weaker protection of private property. Ultimately, although the U.S. economy is no longer relatively as powerful as it was after World War II (in 1945, the U.S. accounted for about 50% of world GDP, dropping to about 40% in 1960 until about 25% today), it is still the largest in the world, and GDP *per capita* is by far the highest among large countries. In the long term, therefore, the United States will remain a rich country with a developed economy, even if its relative position declines and storing savings in the U.S. is safer than in most other places in the world.

Difficulties with the Dollar. A series of economic and political crises in recent years has highlighted the difficulties of using the dollar, especially for developing countries. Rising inflation in the U.S. made it necessary to raise interest rates. As a result, the cost of debt service for countries that borrowed in USD increased. Their incomes, due to the global economic turbulence, fell, while import costs rose, especially due to the increase in energy and food commodity prices. This raises the risk of debt crises, which can take the form of defaults on maturing obligations or an inability to spend adequate resources on public services.

The dollar is also sometimes used by the U.S. to meet foreign policy objectives. In order to enforce compliance with sanctions, the US imposes so-called secondary sanctions, which threaten entities doing business with sanctioned persons or companies. It can be particularly problematic for foreign banks that cannot afford to lose their ability to handle USD transactions with American financial institutions. In practice, this means that third-country banks can be forced by the United States to enforce its sanctions.

Conclusions. Any changes in the position of the dollar will occur gradually and a sudden collapse is highly unlikely. Structural factors will not change in the coming years, and deeper changes in the long term may result from developments in the global economy, which cannot be forecast at this point. In addition, it is mainly the currencies with similar characteristics—high liquidity, issued by a country with a stable economy and institutions, and adequate financial infrastructure—that will benefit from a possible erosion of the dollar's position. Currently, only currencies of U.S.-friendly countries (e.g., the euro, British pound, yen, Swiss franc) have all these characteristics. If a possible de-dollarisation would lead to an increase in their role, it will therefore not be politically groundbreaking.

If the U.S. is to continue to benefit from the dollar's global lead, it must take into greater account the negative phenomena, above all the problems of developing countries resulting from interest rate hikes. In addition, it will be necessary to adequately communicate to partners the reasons for imposing and enforcing sanctions. While it is necessary to apply restrictions on countries that do not comply with international law, the perception that these are arbitrary will harm the position of the U.S. and the dollar.

As an ally of the United States, Poland is interested in maintaining the USD's strong position. With the threat of rapid de-dollarisation nearly nil, some actions in the coming years (concerning, e.g., reserve policy) are feasible without changing the country's foreign policy orientation. Poland may address the difficulties of rising debt service costs for developing countries and suggest measures to offset them, for example by raising the aid budget or facilitating loan refinancing, in its contacts with the U.S. administration. In effect, this will promote the maintenance of the USD's position and may also have positive implications for Poland's relations with developing countries.