Flash Economics

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What possible substitute is there for the US Dollar as the dominant reserve currency?

The US Dollar may lose its status as the dominant reserve currency as a result of:

- The US Dollar depreciation policy that the United States is likely to implement ;
- A reduction in the flow of US Dollars into Europe as a result of increased investment needs and public spending in Europe;
- The reaction to the aggressive policies of the Trump administration;
- The fall in US stock prices.

If the US Dollar loses its status as the dominant reserve currency, how might the international monetary system be organised in the future?

- A proliferation of reserve currencies (US Dollar, Euro, Chinese RMB, etc.)?
- The return of gold or a growing role for crypto currencies?

These developments would pose a number of difficulties.

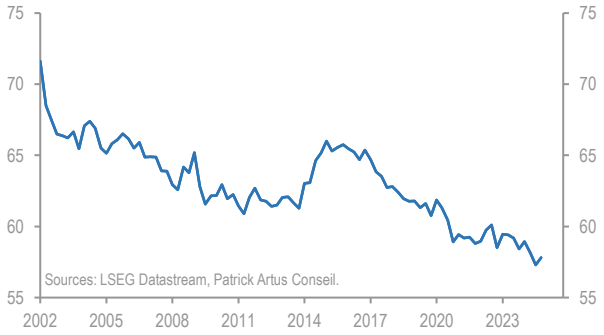
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Risk of the US Dollar losing its status as the dominant reserve currency

Although the US dollar's share of global foreign exchange reserves has fallen slightly (Chart 1), it is still the dominant reserve currency.

Chart 1
World: Weight of US dollar in the global foreign exchange reserves (as %)



But we think there is a risk that the US Dollar will lose its status as the dominant reserve currency, for several reasons.

1- The US Dollar depreciation policy that is likely to be implemented by the United States

The consensus in the Trump administration is that the US Dollar needs to be encouraged to depreciate to improve US competitiveness and re-industrialise the United States (Chart 2).

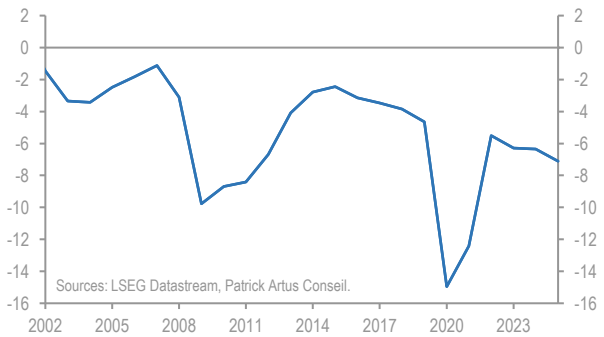
Chart 2
United States : US dollar Index DXY



This depreciation of the US Dollar may occur:

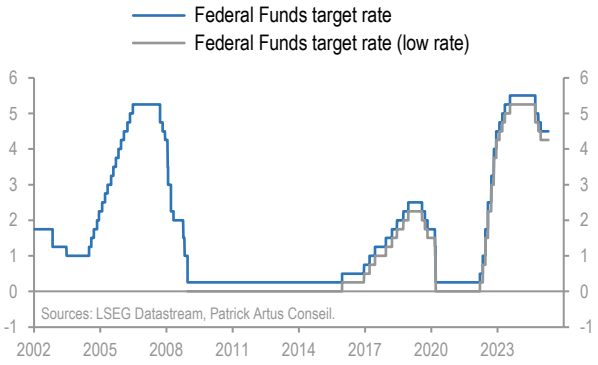
- Spontaneously, due to the depreciation in the perceived quality of US public debt, with the sharp rise in the public deficit (if we extrapolate the US public deficit figures observed from October 2024 to February 2025, we arrive at a deficit of around 7% of GDP for fiscal year 2025, Chart 3);

Chart 3
United States: Budget deficit (as % of nominal GDP)



- As a result of **the shift to a much more expansionary monetary policy** following Jerome Powell's departure from the Federal Reserve (**Chart 4**);

Chart 4
United States: Federal Funds target rate (as %)

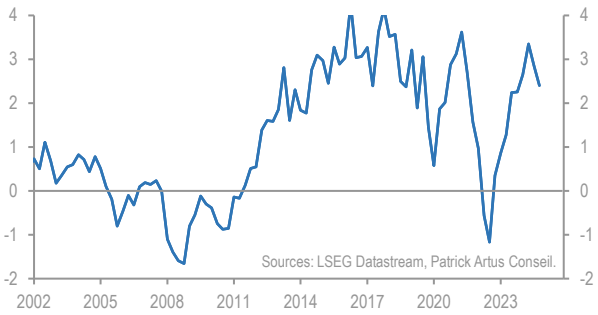


- Perhaps because of **the implementation of Stephen Miran's plan** (the chairman of the Council of Economic Advisors at the White House), which wants to provoke massive sales of US Dollars by the central banks of other countries, mainly to enable the US Dollar's depreciation and reindustrialise. Today, European countries and Middle Eastern oil producers are still net buyers of Treasuries.

2- Reduced US Dollar purchases by Europe

The eurozone's current account surplus (**Chart 5**) is mainly invested in the United States. With the investment needs mentioned in the Draghi report (almost 5% of GDP, to finance investment in the energy transition, the digital transition and disruptive innovations) and with the need to increase military spending, **these capital flows from Europe to the United States could cease**, which would of course cause the US Dollar to depreciate sharply.

Chart 5
Euro zone : Current account balance
(as % of nominal GDP)



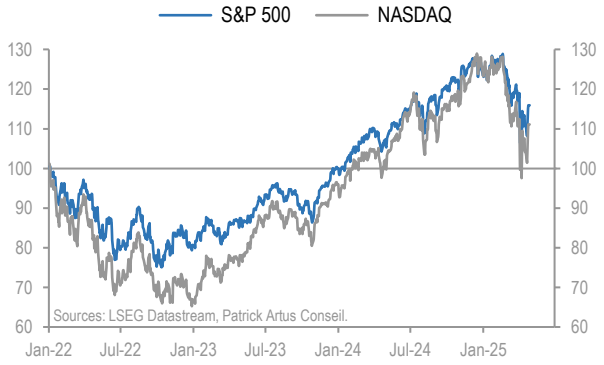
3- Reaction to Donald Trump's aggressive policies

Measures taken by the Trump administration, such as tariffs, US aid to poor countries and military protection for Europe, could discourage investors from buying US assets.

4- The decline in US stock prices

The decline in stock prices since the start of 2025 (Chart 6) will encourage foreign investors to reduce their positions in US equities, especially as the US Dollar has depreciated since the start of the year.

Chart 6
United States: Stock market indices (01.01.2022 = 100)



How would the international monetary system function if the US Dollar lost its dominant role?

We saw above that the US Dollar accounts for 57.5% of the world's foreign exchange reserves (Chart 1).

But we should also bear in mind that:

- 61.6% of international bank loans or loans in foreign currencies are denominated in US Dollars;
- 69.7% of foreign currency debt issues are denominated in US Dollars[1];
- Half of the world's exports are invoiced in US Dollars;
- 88% (out of a possible 200%) of foreign exchange transactions are between the US Dollar and another currency[2];
- By early 2025, half of all transactions recorded in the Swift international payment system will be denominated in US Dollars.

If the international role of the US Dollar were to be greatly reduced, we could imagine:

- **The transition to an international monetary system based on multiple currencies**: Euro, Pound Sterling, Swiss Franc, Yen, Chinese RMB;
- **The return of gold, the price of which has risen considerably in recent times**, demonstrating the high level of demand for gold, to the centre of the international monetary system;
- **The emergence of crypto currencies as a reserve asset**, an asset used to bill for world trade, and an asset used as a basis for bond issues.

[1] Bertaut, Carol, Bastian von Beschwitz, Stephanie Curcuru (2023). "The International Role of the U.S. Dollar" Post-COVID Edition," FEDS Notes. Washington: Board of Governors of the Federal Reserve System, June 23, 2023, https://doi.org/10.17016/2380-7172.3334.

[2] Drehmann, M., & Sushko, V. (2022). The global foreign exchange market in a higher-volatility environment. *BIS Quarterly Review*, *12*, 33-48.

Summary: a major shock

- If the US Dollar's role as an international currency declines (because of the fall in demand for US Dollars, which generates cumulative effects, since the induced depreciation of the US Dollar further reduces demand for US Dollars), how could the international monetary system function?
- With a multiplicity of reference currencies, which would mean constant conversions from one reference currency to another and exchange rate risk;
- With the return of gold as the pivot of the international monetary system, which is materially possible given the value of the world's gold stock (18,800 billion US Dollars);
- With the use of crypto-currencies as reserve assets, for billing exchanges and for financing securities issues, which would be difficult given the low value of crypto-currencies outstanding (e.g. for bitcoin, 1950 billion US Dollars).

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