Flash Economics

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Could there be a sharp depreciation of the dollar?

The dollar-euro exchange rate rose from 1.03 at the beginning of January 2025 to 1.18 at the end of February 2026. For now, the dollar's depreciation has been limited: the euro-dollar exchange rate fluctuated around 1.10 from the beginning of 2023 to October 2024.

Should we fear a much sharper decline in the dollar, which would be welcome news for Donald Trump, who wants a weak dollar to boost US exports?

A very sharp depreciation of the dollar would occur:

- If US domestic or foreign policy became even more aggressive (towards opponents or other countries);
- If the Federal Reserve adopted a strategy of sharply lowering short-term interest rates and effectively abandoned its inflation target;
- If countries holding large amounts of US Treasury debt (Japan, the United Kingdom, China, the European Union, Canada, Taiwan, the Cayman Islands, Switzerland, Singapore and Norway) decided to reduce their exposure to US debt.

On the other hand, it is unlikely that the dollar's role in international bond issues, international credit or trade invoicing will diminish, which has a stabilising effect on the dollar exchange rate.

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Depreciation of the dollar since the beginning of 2025

The exchange rate of the dollar against the euro rose from 1.03 at the beginning of January 2025 to 1.18 at the end of February 2026. **For the time being, the depreciation of the dollar is limited**, as the euro fluctuated around 1.10 dollars in 2023 and 2024 (**Chart 1**).

Chart 1
Euro/dollar exchange rate (EUR 1 = USD...)



But we know that Donald Trump wants the dollar to depreciate in order to boost US competitiveness, so it is logical to wonder whether there is a **risk of a sharp depreciation of the dollar**.

Possible factors weakening the dollar

Recently, we have seen the dollar depreciate in response to:

- **The Trump administration's aggressive domestic policies** towards opponents (Democrats) and minorities (ICE actions against immigrants);
- **The implementation of an aggressive foreign policy** (towards European countries on the subject of Greenland, towards Iran);
- **The possibility that the Federal Reserve will move to a much more expansionary monetary policy**, with lower interest rates and the de facto abandonment of its inflation target. **Kevin Warsh is believed to be in favour of lowering short-term interest rates but reducing the size of the Federal Reserve's balance sheet**. This would result in lower short-term interest rates and higher long-term interest rates (**Charts 2 and 3**), with an overall ambiguous effect on the dollar.

Chart 2
United States: Eurodollar contracts (3-month)

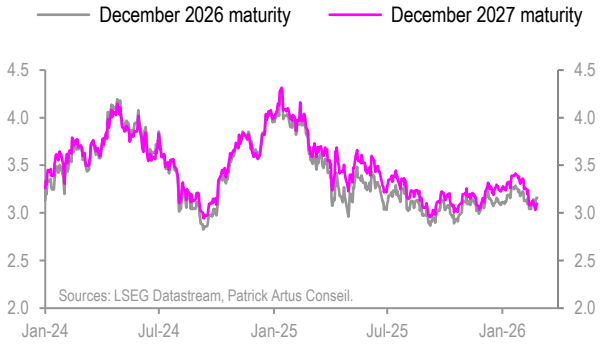
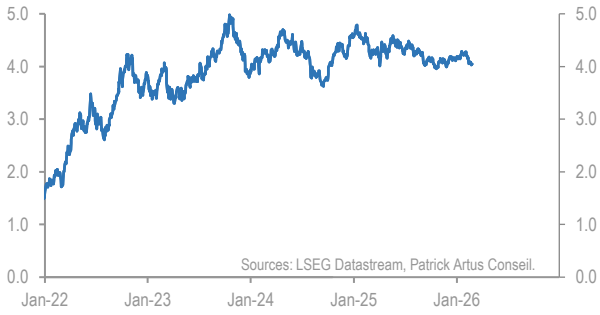


Chart 3
United States: Interest rate on 10-year government bonds (as %)



One risk is that holders of US Treasury securities may sell part of their holdings. The largest holders of US Treasury securities are Japan, the United Kingdom, Canada, China and Hong Kong, the Euro zone countries, the Cayman Islands, Taiwan, Switzerland, Singapore and Norway (**Charts 4A/B**).

Chart 4A
United States: Holdings of Treasuries by country (USD bn)

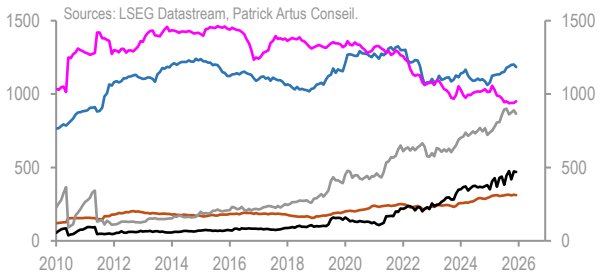
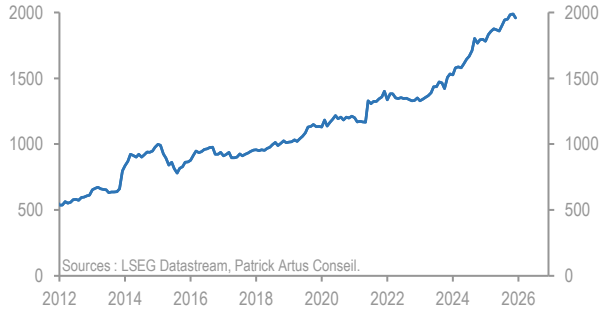


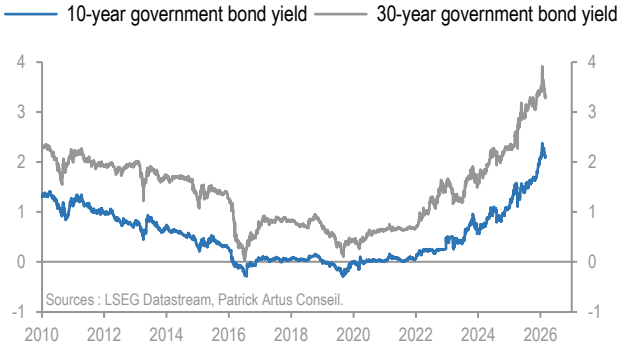
Chart 4B
United States: Holdings of Treasuries by Euro zone (USD bn)



In 2025, Japan, the United Kingdom, Canada, the Euro zone, Taiwan, Singapore and Norway increased their holdings of US Treasury securities, Switzerland and the Cayman Islands stabilised theirs, while China and Hong Kong reduced theirs.

The risk is that, either for political reasons (trade or territorial disputes with the United States) **or economic reasons** (e.g. rising domestic interest rates in Japan, **Chart 5**), **these countries will reduce their holdings of US Treasury securities**.

Chart 5
Japan: 10-year and 30-year government bond yields (%)



This would result in a **further decline in the dollar's weight in global foreign exchange reserves** (**Chart 6**), making it difficult to finance the US public deficit and leading to mistrust of the dollar.

Chart 6
World: Weight of US dollar in the global foreign exchange reserves (as %)



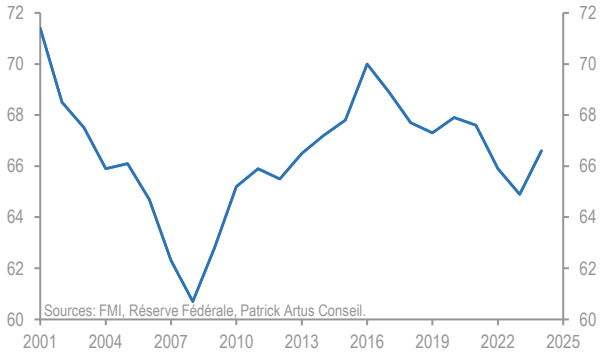
However, it should not be forgotten that dollar holdings are held for reasons other than foreign exchange reserves or US Treasury debt holdings

Non-Americans hold dollars for reasons other than reserve holdings; **the dollar is indeed the dominant currency**:

- **For invoicing global trade** (96% of international trade in the Americas, 74% in Asia-Pacific, and 79% in the world outside the Americas, Asia-Pacific and the European Union is denominated in dollars);
- **For international payments** (46% of international payments are made in dollars, and this percentage is rising);
- **For international debt issues in foreign currencies** (for which the dollar accounts for 62%).

The Federal Reserve is developing a composite index of currency usage (**Chart 7**).

Chart 7
Index of international currency usage of US dollar



The dollar's weighting for all uses of an international currency is currently 67%, and has remained relatively stable since 2002.

Summary: do not expect the dollar to collapse

There may be concern about a possible decline in demand for US Treasury securities by non-residents, or a possible decline in the weight of the dollar in global foreign exchange reserves.

However, there are many other reasons for holding dollars besides holding dollar reserves or Treasuries: invoicing for global trade, international payments, international debt issues and international bank loans.

The dollar's overall international role has not weakened, even though its weight in global foreign exchange reserves has declined.

Demand for dollars will be sustained by these various roles of the US currency. It is therefore difficult to believe that the dollar will collapse.

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