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Ditching the dollar?

In 1944, representatives of forty four countries met in Bretton Woods, New Hampshire, to agree a post-war exchange rate regime that would reduce currency volatility and thereby promote international trade and finance. Although the UK economist JM Keynes argued for a global central bank and an independent reserve currency, his American counterpart carried the day. Whilst the subsequent agreement birthed both the IMF and the World Bank, their remit was more modest than Keynes envisioned. The US dollar was also adopted as the world's reserve currency. International peers were pegged to the greenback which was, in turn, pegged to gold at $35/oz.

The regime dissolved in the early 1970s as the US Federal Reserve printed dollars to help finance the Vietnam War and President Johnson's 'Great Society' programs. As money supply swelled, it became impossible to maintain the peg, leading President Nixon to end dollar/gold convertibility in 1971. Other major countries moved to floating exchange rates.

Despite this, the reserve status endured as dollar pricing of international trade was entrenched and global Central Banks had accumulated vast dollar reserves. The agreement of Middle East oil producers to recycle surpluses into Treasuries served to reinforce. Despite the rise of Japan in the 1980s, the creation of the Euro and China's rapid ascent, over half of global trade is still invoiced in dollars with about 60% of foreign exchange reserves parked in dollar bonds.

However, international business and large importers of oil, food and metals pay a high price for dollar hegemony. They have to sustain destabilising dollar debts to facilitate global trade and hold deep pools of dollar reserves to hedge against both exchange rate and commodity price volatility. This material dollar exposure leaves countries beholden to US monetary and fiscal policy, often to the detriment of domestic imperatives.

This dependence has become unsustainable as developing nations have grown. In 1982 the BRICS nations (Brazil, Russia, India, China and South Africa) accounted for 11% of global GDP; that figure now stands at 32% (source: Statista). Unsurprisingly, they seek greater independence. This is

doubly so given the 'weaponisation' of the dollar. Successive US administrations have used the dollar clearing system (SWIFT) to exert extra-territorial influence, threatening harsh sanctions on any party that uses dollars to settle trade with enemies of the US state. The rapid freeze of $300bn of Russian state assets by America and its allies in 2022 served as a cautionary tale. We note that China still holds $850bn of Treasuries, down from a peak of $1.3trn in 2013.

Finally, the dollar is losing its allure due to ongoing fiat debasement. In the last decade, the value of dollars in circulation has doubled to $2.3trn, with nearly $0.5trn being added since the onset of covid in March 2020 (source: FRED). At the same time, government debt now stands at 117% of GDP and is projected to hit 250% by the middle of the century (source: Congressional Budget Office).

Taken together, it is rational for the BRICS alliance to pursue an alternative. Having created the Shanghai-based New Development Bank (NDB) in 2014, it seeks to use this as a conduit for economic and political coordination especially as the number of members swells; there are currently thirteen applications pending. At a meeting in June, the NDB was tasked with outlining how a shared currency might work, with the explicit aim of increasing influence and challenging the US.

In the meantime, economic ties are deepening and an increasing number of bilateral trade deals are being priced in local currencies. Unsurprisingly, Russia and China are leading the way, with two thirds of trade between the nations now settled in roubles and renminbi. Interestingly, Beijing and Riyadh are also exploring oil sales in renminbi, echoing a wider imperative of the Saudi government.

Further afield, Brazil is launching a joint currency with Argentina. The aim of the "sur" is to facilitate intra-nation trade with the aspiration to become a Latin American common currency. A similar project is under way in South East Asia, as Indonesia, Thailand, Singapore, Malaysia and the Philippines develop a digital payments system to settle trade in their local currencies.

These moves are a very visible extension of a gradual trend in de-dollarisation. The value of trade settled in US dollars has been falling with the share of foreign exchange reserves at major central banks declining from over 70% in 2000 to less than 60% now. In a similar vein, international holders now own 29% of US Federal debt, down from 48% in 2009.

To be clear, we are not arguing for a precipitous decline in the US dollar and the wholesale rejection of its reserve currency status. First and foremost, there is a lack of viable alternatives. A reserve currency must offer a deep, liquid market where surplus nations can park their assets. At this time, the US treasury market is worth $24trn, more than the euro area and Japanese equivalents combined. As for China, shallow liquidity and capital controls limit appeal whilst political and inflation instability rule out most emerging market debt.

As for a new common currency, participants will need to harmonise fiscal and monetary policies, sacrificing elements of independence for the shared common purpose. A tall order for the disparate BRICS cabal. Indeed, it will take time to move away from the established reality. Non-US entities own over $12trn of dollar debt and, as we noted before, the majority of global trade is still settled in dollars. Any reordering will be measured in years.

For the time being, the greenback remains the ultimate safe haven and, whilst we expect dollar primacy to wane, there will be periods of cyclical strength along the way. Our best guess is that we

are heading for a bifurcated world with a dollar and non-dollar blocs. As regards the latter, it could well be dominated by China but not their currency. For the renminbi to act as the foundation, the authorities would need to open their capital account and sacrifice the related control. A trade weighted basket of relevant currencies seems more likely, backed by gold or similar.

To that end, it is interesting to note the rapid accumulation of gold bullion by Asian, MENA and Chinese Central Banks. Indeed, a 2023 survey by Goldhub revealed that 62% of developing nation Central Banks intend to increase their bullion reserves over the next 12 months. With the ongoing debasement of most major fiat currencies and the possibility of Trump's re-election, this adds weight to our long run conviction in bullion and the related equities.

Policy Matrix Summary

The matrix below is a summary of our current 12-24 month outlook for the various equity, bond and commodity markets that we monitor. It shows areas where we are either positive or negative; for all other asset classes, we have a neutral view. It is not intended as anything other than a high-level guide on where we stand at this time.

12-24 Month view	Equities	Bonds	Alternatives
+	Gold Miners China A Shares UK Small Companies Japan ESG & Impact funds	Inflation-linked US Treasuries Short-dated Paper	Gold, Volatility Strategies
–	European	European Japanese	

All performance numbers show % changes except for bond yields which show yield changes.

	31st May 23	-1 Mth	-3 Mth	-12 Mth
CURRENCIES (VS USD)				
GBP	1.2441	-1.0%	3.5%	-1.3%
CHF	1.0981	-1.8%	3.5%	5.4%
AUD	0.6503	-1.7%	-3.4%	-9.4%
JPY	139.3400	-2.2%	-2.3%	-7.6%
EUR	1.0689	-3.0%	1.1%	-0.4%
BOND YIELDS (10 yr)				
UK	4.18	0.46	0.35	2.08
US	3.65	0.22	-0.28	0.80
Germany	2.28	-0.03	-0.37	1.16
Australia	3.61	0.27	-0.25	0.25
Japan	0.43	0.05	-0.07	0.20
EQUITIES				
US. S&P 500 (USD)	4,179.83	0.2%	5.3%	1.2%
UK. FTSE 100 (GBP)	7,446.14	-5.4%	-5.5%	-2.1%
MSCI Eur ex UK (Local)	1,599.83	-3.1%	-1.0%	4.2%
Japan. Topix (JPY)	2,130.63	3.6%	6.9%	11.4%
China. Shangai Comp (RMB)	3,204.56	-3.6%	-2.3%	0.6%
HK. Hang Seng (HKD)	18,234.27	-8.3%	-7.8%	-14.9%
Australia. All Ords (AUD)	7,273.55	-3.0%	-2.5%	-2.4%
MSCI Pac ex Jap (USD)	1,235.34	-6.6%	-6.8%	-10.9%
MSCI World (USD)	2,800.56	-1.2%	3.2%	0.3%
MSCI World (GBP)	2,260.88	0.3%	0.8%	2.2%
COMMODITIES				
Oil (WTI)	68.09	-11.1%	-11.5%	-25.3%
Gold	1962.73	-1.4%	7.4%	6.8%

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