



Dollar To Weaken But Retain Reserve Status

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In this note, Strategas Chief Investment Strategist Jason Trennert lays out the case for the U.S. dollar to retain its reserve currency status for the foreseeable future despite the multitude of headwinds. Jason discusses what gives the U.S. dollar such weight in the global arena, as well as the challenges that come from such “exorbitant privilege.”

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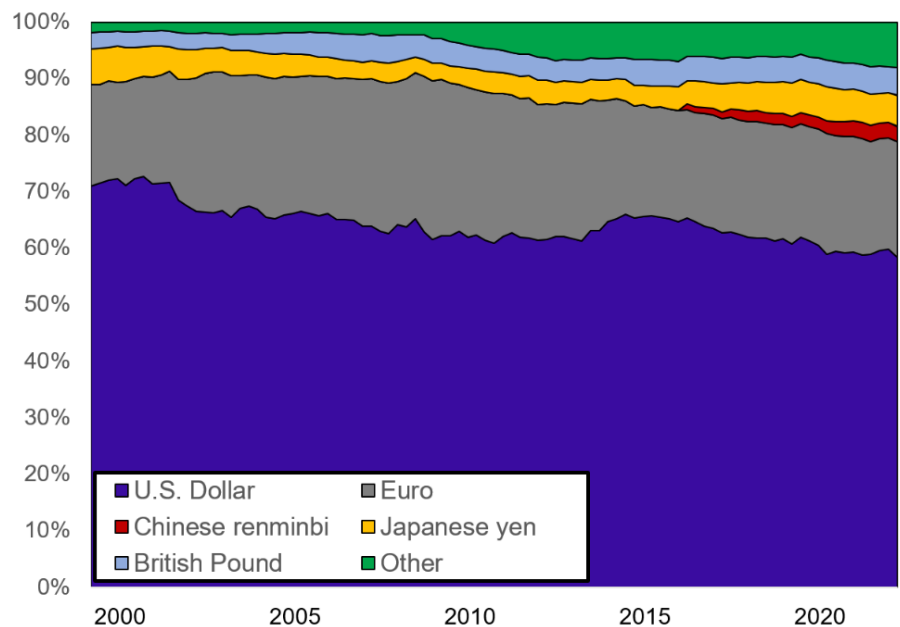
DOLLAR TO REMAIN RESERVE CURRENCY DESPITE INTERNAL AND EXTERNAL CHALLENGES

In a certain brashness that at times seems uniquely American, former Governor of Texas and Secretary of the Treasury John Connally in the Nixon Administration was famous for declaring to the world that the “dollar is our currency and your problem.” Such terms of endearment have had many outside the Lower 48 hoping for an end to the dollar’s special status as the world’s reserve currency ever since. In recent weeks, worries about the ability of the United States to maintain its “exorbitant privilege” have been heightened by Saudi Arabia’s decision to take payment for oil in a currency other than the greenback and the publicly expressed hopes of China, Russia, India, and Brazil to weaken the dollar’s supremacy in global trade. These concerns have been intensified with China’s decision to drop the charade that it is an economic partner of the U.S. – a rival at best, an enemy at worst. **But despite our own fiscal profligacy and monetary incontinence, it is difficult to imagine the dollar losing its special status in global finance for the foreseeable future.**

Of course, possessing the world’s reserve currency is no divine right. There have been many countries and societies throughout time that have had and lost this privilege, but none in an era of true economic globalization and nuclear weapons. **Our own fiscal mismanagement makes it tempting to think that America is living on borrowed time, but the U.S. and the dollar possess certain features that make it difficult to imagine any other currency displacing our currency’s unique role in global finance.** A reserve currency must be deep enough to underwrite global trade while at the same time being administered by a country that can possess an almost permanent current account deficit, that is governed by the rule of law, that respects property rights, and, most importantly, will not whimsically impose capital controls on those who decide to store their wealth in its own unit of exchange. **Having the world’s largest navy to ensure the free flow of goods also helps.**

Currency Share of Foreign Exchange Reserves

(Through Q4 2022, Source: Currency Composition of Official Foreign Exchange Reserves)



This is not to say that the U.S. dollar can and likely will lose value versus other fiat currencies and hard assets or that other countries won't seek to diversify their currency reserves for financial or geopolitical reasons. It simply means that, to coin a phrase, there is no alternative. This is largely because, as Marc Chandler of Bannockburn Global Forex recently put it in Barron's, "the market for money outstrips the market for goods magnitudes." It is estimated that the total value of all global trade last year was roughly \$32 trillion dollars. The Bank of International Settlements estimates that the turnover in the money markets, on the other hand, is \$7.5 trillion a day. **Despite all the talk of the U.S. losing its hegemonic status, the U.S. dollar is one side of 88% of those trades today, down slightly from 90% in 1988.** The dollar is literally and figuratively the coin of the realm when it comes to the international money markets.

As mentioned previously, there appears to be little mystery now that China wishes to displace America as the world's preeminent superpower. And perhaps the serious demographic and economic challenges the country faces might tempt China to seek another land to conquer. **But the chances of the yuan replacing the dollar as the reserve currency are currently about zero.** This is due in large part to the fact that China maintains a floating peg against the dollar. Almost by definition, if you're pegging your currency against another, that "other" is the greater reserve. Any attempt to become the world's reserve currency would require other countries to hold significant reserves in yuan. This in turn would require an end to capital controls and what would likely be a significant increase in the value of the currency. This would be a disaster for a country dependent upon exports. Currently, the yuan comprises a little more than 2% of total foreign currency reserves. Finally, there are many countries who have issued debt in U.S. dollars who in turn will need dollars to pay back the bondholders. If they default on that debt, it is almost impossible to see their own currency ascend to the status as the reserve.

Possessing reserve currency status is undoubtedly both a blessing and a curse. **It is a blessing to the extent to which it keeps inflation lower and interest expenses on sovereign debt lower than they would be ordinarily. But it can also be a curse to the extent to which it allows the country with the advantage from fully realizing the long-term consequences of its own fiscal mismanagement.** A 12-year reliance on quantitative easing to solve all the world's ills further isolated policymakers from realizing the potential constraints on economic growth and prosperity when the bill eventually comes due. America's total outstanding debt is now \$31 trillion with more than half of it maturing in the next three years. Without the benefit of financial repression, Uncle Sam's interest expenses are set to explode as a share of its total budget in the coming years.

Reserve Currency's Exorbitant Privilege: Graveyard of Empires

Rome	1 st Century BC – 4 th Century AD
Byzantine Empire	5 th Century
Arabian Dinar	7 th – 10 th Centuries
Florence	13 th – 15 th Centuries
Portugal	1450 – 1530
Iberian Union	1530 – 1640
Netherlands	1640 – 1720
France	1720 – 1815
U.K.	1815 – 1920
U.S.	1920 –

The dollar will not lose its special place in the world any time soon but without any serious attempt on the part the U.S. to live within its means, its purchasing power is likely to meaningfully deteriorate. This will only make the Fed's attempt to control inflation over the long term more difficult. [We remain overweight Energy, Materials, and gold.](#)

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