

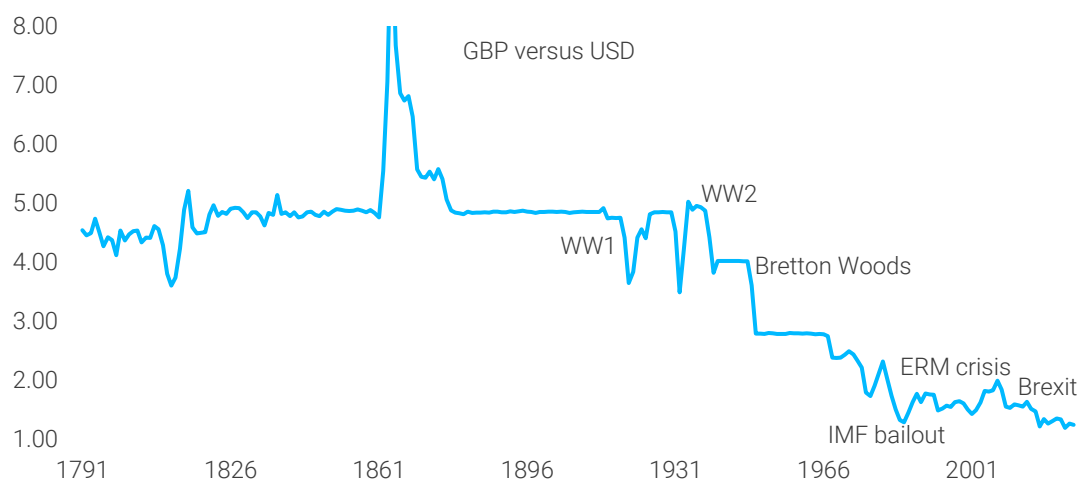
Macro Picture

THE FUTURE OF THE DOLLAR

Dario Perkins

America is not about to lose its reserve currency status, but we are seeing some decay to the dollar system as geopolitical allegiances, trading patterns and investment incentives shift. The US has chosen this path even if there is no clear evidence of an “exorbitant burden”. The market implications are clear: structural dollar weakness and the end of US exceptionalism.

Chart 1: How to trash a reserve currency (just ask the experts...)



Source: Bank of England

DOLLAR DOMINANCE

The US dollar has been dominant since WW2, when it replaced sterling as the world’s preeminent reserve currency. Most international trade is invoiced in USD, supported by a complex and geographically dispersed network of funding relationships (the eurodollar system). All sectors of the global economy – public, private and financial – have contributed to the dollar’s supremacy.

EXORBITANT BURDEN?

For decades, it was assumed that America was a net beneficiary of these arrangements – it had an “exorbitant privilege”. The new Trump administration doesn’t share that view. Based on various misconceptions about how the system works – particularly its reliance on perpetual US deficits and an overvalued exchange rate – officials want to curb the dollar’s “exorbitant burden”.

DOLLAR DESCENT

Regardless of its merits (both the costs and benefits are often overstated), the dollar system is starting to decay. We think this will continue, albeit gradually. Where could we end up? Eventually there could be a multi-polar currency system, perhaps even linked by a digital stablecoin. But this is speculative. The relevant point for investors is that the dollar is likely to trend lower over time.

THE FUTURE OF THE DOLLAR

The dollar has been the world's preeminent currency since (at least) WW2, when delegates from 44 countries met in Bretton Woods, New Hampshire, to agree a set of new rules for the postwar international monetary system. Although those rules were eventually diluted, there was no stopping the dollar's ascendancy. Even as America's share of global GDP declined, its dominance of international finance continued to grow. It is not an exaggeration to say that the dollar is the world's basic *numeraire*. Most trade is invoiced in dollars, even when no US counterpart is involved. Most commodities are priced in dollars. The dollar accounts for more than 50% of cross-border bank loans. And it is involved in around 90% of all foreign exchange transactions. Almost half of all international bonds are issued in dollars. There are famously three functions of money: as a medium of exchange, as a unit of account and as a store of value. The US dollar performs all three roles for the global economy, supported by a complex and geographically dispersed network of funding relationships (the somewhat elusive "eurodollar" system). All sectors – governments, corporates and financial institutions – have their own incentives for using the dollar, and it is the interaction of these transactions that produces powerful network effects.

For decades, the world has looked on with envy at America's position of monetary dominance. As early as the 1960s, then French Finance Minister Valéry Giscard d'Estaing spoke of the "exorbitant privilege" this gave the US, because it didn't have to worry about capital flight or a sudden stop to international funding. Structurally strong demand for US assets not only reduced American borrowing costs but – according to modern definitions of exorbitant privilege – it also allowed the US to exploit foreign investors. Yet the Trump 2.0 administration – [like Nixon in the 1970s](#) – has a different take on the desirability of the dollar standard. Instead of an exorbitant privilege, they see an exorbitant burden, as a constant outflow of USD liquidity "forces" the US to run a perpetual current-account deficit, while a persistently overvalued exchange rate "hollows out" American manufacturing. For the most part, the administration's thinking is flawed. Not only is it a myth that reserve status "forces" the hegemonic country to run perpetual trade deficits' it is also wrong to believe that the US will be stuck with a permanently over-valued currency. History shows that hegemonic dominance is consistent with a range of trade positions and exchange rates – and even the US has lived through several different regimes during its post-WW2 reign.

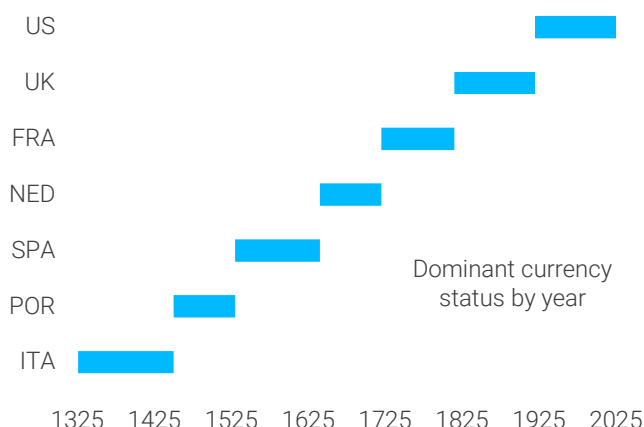
While we can debate the costs and benefits of reserve status, the dollar system is starting to decay. Naturally, much of recent focus has been on official USD holdings, where the repeated weaponization of America's currency has encouraged foreign governments to diversify out of the dollar (producing a strong central bank bid for gold as a potential replacement). But we shouldn't take the concept of "reserve asset status" too literally. The more interesting question is about what happens to private sector demand for dollars, which we can split into two components. Among *financial* companies – specifically institutional investors – we do see an incentive for greater diversification. Relative US returns are likely to be lower and the Trump administration is doing things that could ultimately erode the safe haven properties of US government bonds. The good news for dollar supremacy is that the other component of private demand – *non-financial* corporates – is likely to be stickier. As long as international trade is invoiced in dollars, it will need funding in dollars; and this is where the US is likely to enjoy a continued advantage in terms of powerful network effects. Sure, we can speculate about alternative arrangements, such as a multi-polar hegemonic system tied to a digital SDR; but right now that seems a long way off (fantasy macroeconomics). Fortunately, we don't need to be able to predict the endgame. The relevant point for investors is that the dollar is likely to trend lower – reserve asset status or not.

1. DOLLAR DOMINANCE

How did the dollar become so dominant?

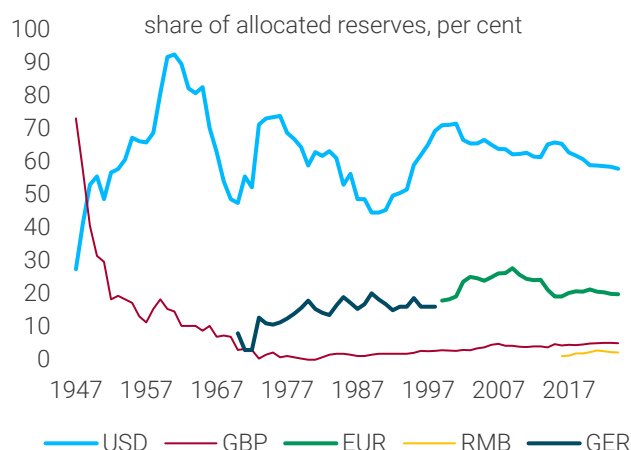
Officially, dollar dominance started in Bretton Woods, New Hampshire in 1944, when 44 countries agreed a set of new rules for the postwar international monetary system (which included the creation of the IMF and the World Bank). Under the Bretton Woods system, everyone fixed their exchange rates to the dollar, and the dollar itself was pegged to gold (specifically, at \$35 per ounce). For several years before that agreement, there had been a heated debate about the design of the new framework. From the British side, John Maynard Keynes pushed the idea of a powerful global central bank and a new international currency called the *bancor*. The US, under the advice of Harry Dexter White (chief international economist at the Treasury), preferred a more modest institutional structure, with the dollar at the centre of the system rather than a new global currency. In the end, it was the US view that won out. That is not surprising. America's role in the global economy had been growing for decades, whereas Britain's was in decline. In fact, some historians argue that America's "reserve currency" status started as early as the 1920s.

Chart 2: Reserve status usually lasts a century



Source: TS Lombard, BoE

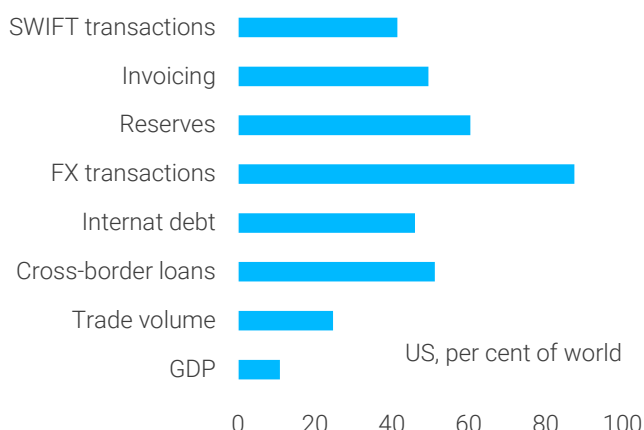
Chart 3: American dominance since WW2



Source: IMF, TS Lombard

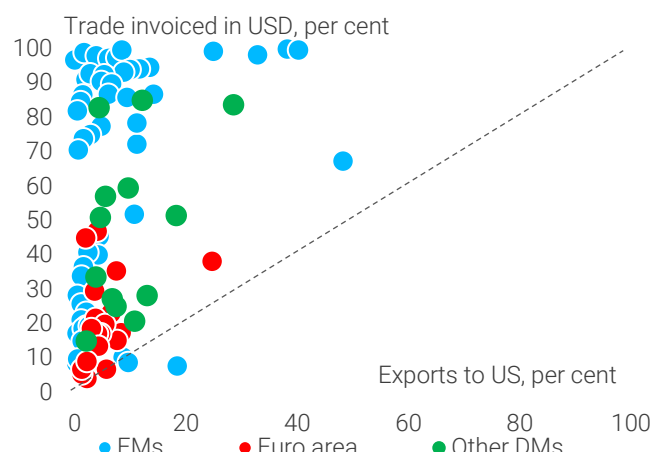
The formal Bretton Woods system collapsed because the link to gold ultimately became untenable. By the late 1960s, inflation was rising in the US and the country's international competitiveness was declining, triggering a run on the nation's gold. In the classic gold standard, gold outflows were part of the adjustment mechanism: when gold left, the money supply was squeezed, deflating the economy and forcing a current account adjustment. But in the Bretton Woods system, where only the external value of the dollar was linked to gold, those outflows only fuelled more speculation about currency devaluation and thereby accelerated the outflows, as the rest of the world started to doubt the US Treasury's ability to fund its external obligations. The Nixon administration responded in 1971 by "temporarily" severing the dollar from gold – a policy that was never reversed, despite various attempts. While the "Nixon shock" was messy and disorderly, contributing to the macro chaos of the 1970s, this episode did nothing to stop the dollar taking over the international monetary system. In fact, American dominance continued to grow, leading to the situation in which we find ourselves today, where the dollar reigns supreme.

Chart 4: Dollar dominance in global markets



Source: BIS, TS Lombard

Chart 5: The world invoices in USD



Source: IMF

Just how dominant is the US? What are the best metrics?

Chart 4, [from an excellent BIS paper](#) on dollar funding networks, illustrates US dominance across a range of metrics. It shows that while the US economy now accounts for just a quarter of global GDP – and a mere 10% of trade – America’s currency is still the main *numeraire* for global finance. Crucially, 50% of international trade is invoiced in dollars, even when there is no US counterpart. (For example, a Brazilian company sending products to the UK will invoice in dollars even though neither country uses that unit of account domestically.) And, of course, if you trade in dollars, it is helpful to fund those transactions in the same currency. That is one reason why half of all cross-border loans (and international debt securities) are denominated in USD, with the dollar accounting for an even greater share of FX transactions and SWIFT payments. Economists like to remind us that there are three basic functions of money: as a medium of exchange, as a store of value and as a unit of account. Among the 180 currencies of the world, the US dollar is the predominant provider of all three functions for the international monetary system.

Why does the world want to hold dollar assets?

Obviously, the three functions of money interact, producing powerful network effects. If you invoice in dollars, you need to borrow dollars, and you probably want to hold dollars for precautionary reasons (or as a store of value). This creates a natural monopoly. And if people are accustomed to using dollars in international transactions – meaning they will readily accept dollars from others – this, too, makes the dollar more useful. But we find it helpful to think in terms of three separate groups of dollar users: the official/public sector, the private financial sector and the private non-financial sector (particularly corporates). These groups can be conflated in discussions about the currency’s role, as a result of which “reserve status” is often taken too literally. Dollar dominance is *not* just about central banks holding dollar reserves:

- (i) **The official sector:** Central banks hold foreign FX reserves for several reasons: to manage the value of their currency (particularly if they run a fixed exchange-rate regime), to meet their international financial obligations (especially if they have foreign debt outstanding) and for precautionary reasons (to ensure that they have funds available to insulate their currency or to protect their banking system in times of crisis). In the case of the dollar, around a quarter of the world pegs their exchange rates directly to the US and that the precautionary motive became particularly

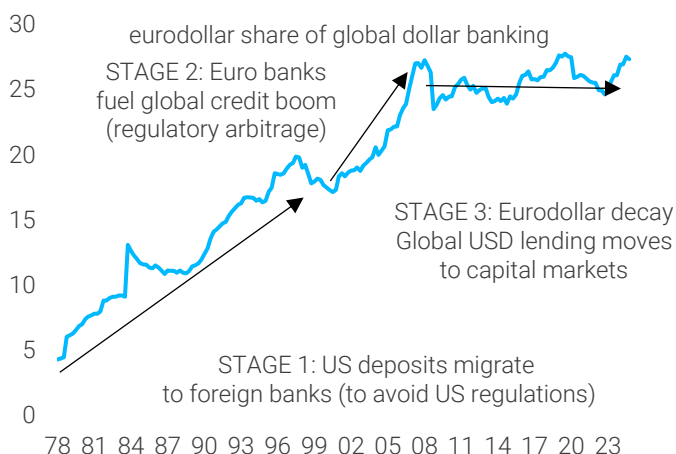
powerful after the Asian crises in the late 1990s, when central banks in the region decided to build up their USD reserves as a buffer against future instability. Although official FX holdings must reflect perceived domestic vulnerabilities, there is a strong geopolitical angle to them. Central banks typically hold the [currency reserves of their military allies](#) (although these are also the countries with which they tend to trade).

- (ii) **The financial sector:** The private financial sector wants dollars for two main reasons: as a “safe” store of value and for superior returns. In terms of being a safe asset, the dollar has had two desirable properties from the point of view of international investors. First, US Treasuries have typically rallied when global equities have sold off. That correlation in returns has been strongly negative since the late 1990s, reflecting the types of shock that have been hitting the US economy and the perceived credibility of US policymakers (particularly the Fed). Second, the dollar exchange rate also tends to appreciate in times of economic stress. That has provided another level of protection for foreign investors, which has further enhanced the hedging properties of US Treasuries (and other US debt instruments). But, of course, it isn’t just the safe-haven properties of US assets that appeal to foreign demand. Relative returns have been attractive, too, both in debt and equity markets. Higher US interest rates [encouraged powerful carry trades](#) and – until recently – [US stocks have continuously outperformed most of their peers](#) (“US exceptionalism”).
- (iii) **The private non-financial sector:** Because exporters typically invoice in dollars, it makes sense for those companies to borrow in the same currency, particularly in an increasing globalized world. The modern era of hyperglobalization involves long and complex international supply chains, and those supply chains create enormous funding needs. Consider an auto manufacturer that makes engines in Japan, ships them to Canada, where they undergo further assembly, and then sends the cars to be finished in Mexico. This process involves large inventories of engines, semi-finished autos and finished autos. These are assets which the company needs to finance and the longer the value chain, the greater those financing needs. With global value chains expanding rapidly since the 1990s, the dollar became even more important as an international funding currency. Over time, this has led to creation of a complex and geographically dispersed network of dollar funding relationships (the somewhat elusive “eurodollar system”).

Tell us more about the eurodollar system?

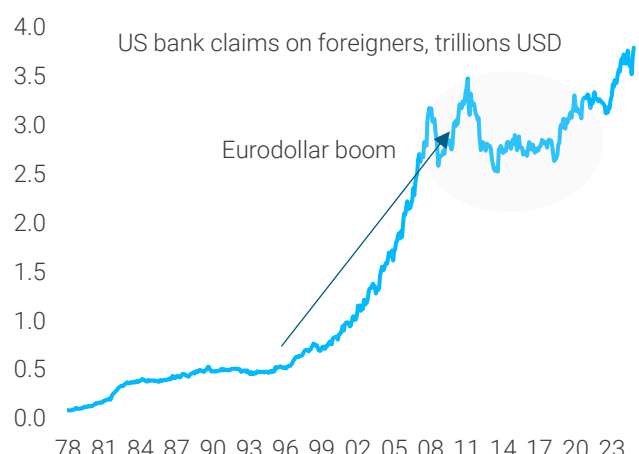
The eurodollar system is somewhat murky and intractable, making it a popular topic for conspiracy theorists and the [macro tinfoil-hat brigade](#). If anything weird happens in global markets, just blame the “eurodollar system”! Originally, eurodollars were simply USD-denominated time deposits held outside the United States (though not necessarily in Europe). By the 1970s, the system was growing rapidly as investors tried to circumvent US controls (e.g., Regulation Q) and sought higher interest rates outside the US. In [an influential paper in 1971](#), Milton Friedman showed that banks in the eurodollar system could create a new US currency by themselves, at the “stroke of a bookkeeper’s pen”. Since most of those extra dollars were not included in official US M3 statistics, there was a lively debate about whether the Fed had “lost control” of monetary conditions. Some pundits even blamed the Great Inflation of the 1970s on Eurodollars, which shows that the penchant for macro conspiracy theories is not just a modern phenomenon.

Chart 6: The traditional eurodollar system



Source: BIS, TS Lombard

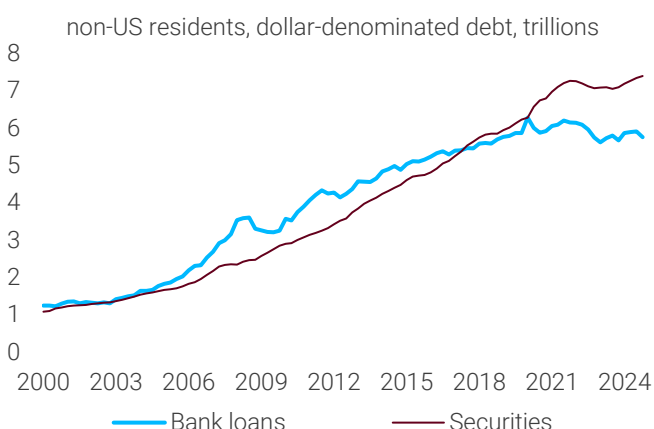
Chart 7: US funding of the eurodollar system



Source: BIS, TS Lombard

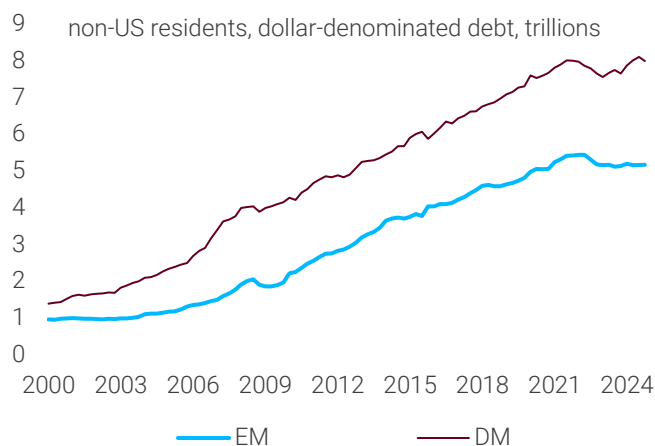
The Eurodollar system became even more complicated after the 1990s, with global banks creating new dollar liquidity through an explosion in the size and complexity of their balance sheets. The original Basel regulations clearly played a role, giving financial intermediaries a powerful incentive to “game the system” by increasing their leverage and developing increasingly sophisticated funding products (such as derivatives, repo and asset-backed securities). Today when people talk about the eurodollar system, they are often using a term that commonly covers offshore USD deposits, global banks’ wholesale funding and – increasingly – developments in international capital markets. In short, global dollar credit-creation. There is no doubt that these sorts of activity contributed to the global financial crisis (GFC) in 2008, with European investment banks playing a particularly influential role (the “investment banking glut”). And although new regulations curtailed international banking after the GFC, causing the traditional eurodollar system to decay, euro-dollar activity did not disappear. Instead, the system migrated to capital markets, with international lenders issuing huge amounts of dollar-denominated debt. Both DM and EM borrowers got involved, and there was an insatiable appetite for USD-denominated debt securities from institutional investors (the “Buyside Bubble” of the 2010s).

Chart 8: Eurodollar migration into capital markets



Source: BIS, TS Lombard

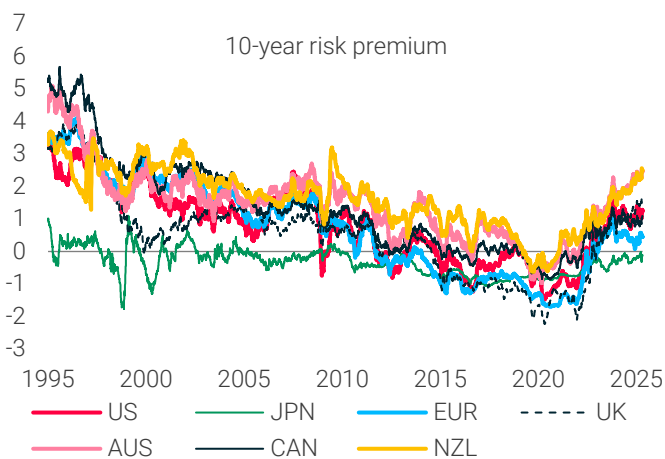
Chart 9: Both DMs and EMs borrowed in USD



Source: BIS, TS Lombard

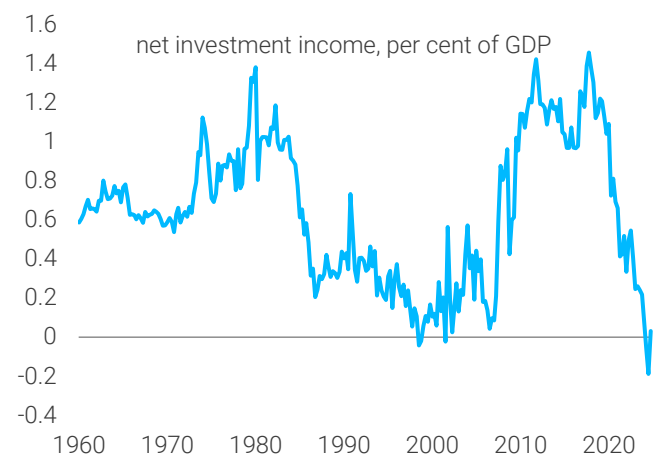
One often overlooked point about the eurodollar system is that it provides a source of global dollar liquidity that has nothing to do with the US current account position. When European investment banks contributed to the US credit bubble in the early 2000s, they played this role, despite the euro-area current account being more or less in balance. European banks were “round-tripping”, that is, borrowing funds in US money markets and investing them in US asset-backed securities. This possibility raises another important point, one that is relevant to the discussion of “global imbalances”: even if a country’s current account is in balance or the country is neither importing nor exporting, all its investment expenditures could still be financed from abroad. Looking at “gross” financial flows, not “net” trade flows, is the only way to understand what is going on below the surface. This will be important in Section 2, when we discuss the costs and benefits of America’s “reserve status”, especially in the context of a Trump administration that believes there is a direct link between the global provision of “dollar liquidity” and net trade. And there really isn’t!

Chart 10: No real evidence of exorbitant privilege



Source: MacroBond, TS Lombard

Chart 11: Investment puzzle disappearing



Source: BEA, TS Lombard

2. EXORBITANT BURDEN?

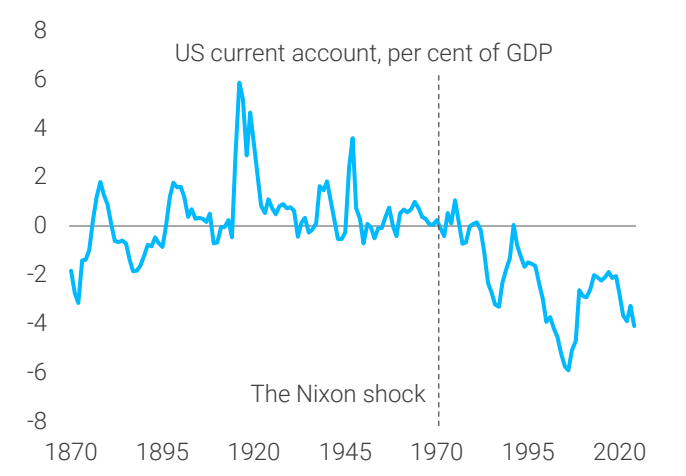
What is America’s exorbitant privilege?

The world has always been envious of America’s reserve asset status. Because the international financial system needs the dollar, the US is less likely to experience a “sudden stop” to foreign investment or a balance of payments crisis. In fact, there is often a scramble for “safe” dollar assets during times of stress. This was what Valéry Giscard d’Estaing, French finance minister in the 1960s, called America’s “exorbitant privilege”. It means the US can borrow more cheaply in international capital markets. While the mainstream consensus has widely accepted the Giscard d’Estaing proposition, it has not been that easy to put a precise number on America’s exorbitant privilege, despite an extensive body of empirical work. Comparing bond yields is difficult, because the level of long-term interest rates is not just a matter of risk premia (there can also be differences in yield due to macro fundamentals). And even when economists have compared estimates of term premia, the US advantage isn’t immediately obvious: the US government’s borrowing cost is often in the middle of the range vs other developed nations (Chart 10).

Perhaps America’s exorbitant privilege has been competed away, at least in terms of bond yields where other DM governments are now regarded as “nearly as safe”. Yet there is another measure

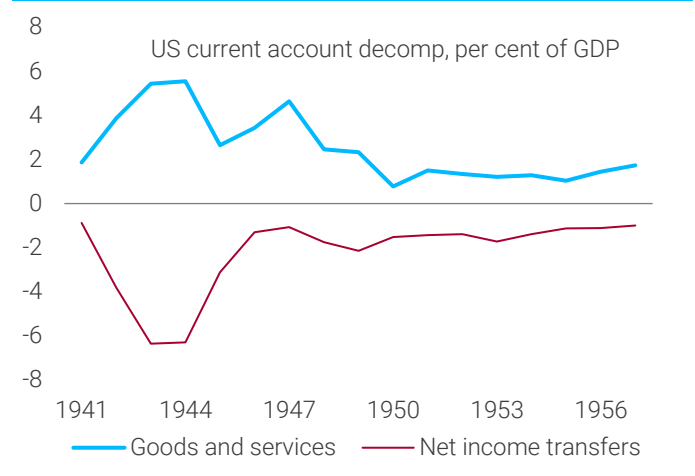
that has been popular in empirical work: the differential between the rate of return on US assets and the return US investors earn overseas. Looking at this metric reveals an “investment puzzle”: the US typically earns more on its international investments (and lending) than it pays on its external debt. This is a puzzle because it is odd that a country that runs a negative net international investment position earns a positive income flow from the RoW (and that rate differential is not small – it has been worth 1.5 percentage points in real terms since the 1950s). Some believe this is the true metric of America’s exorbitant privilege. Others have argued that privilege comes from the US acting like a private equity fund, borrowing from overseas to invest in higher yield assets abroad. A less exotic argument is that it is the result of tax evasion. Brad Setser has shown that the investment puzzle disappears when various tax havens are excluded. (And even before that adjustment, America’s positive return differential is beginning to fade.)

Chart 12: Perpetual US deficits?



Source: MacroHistory, TS Lombard

Chart 13: Dollar liquidity with a trade surplus



Source: BEA, TS Lombard

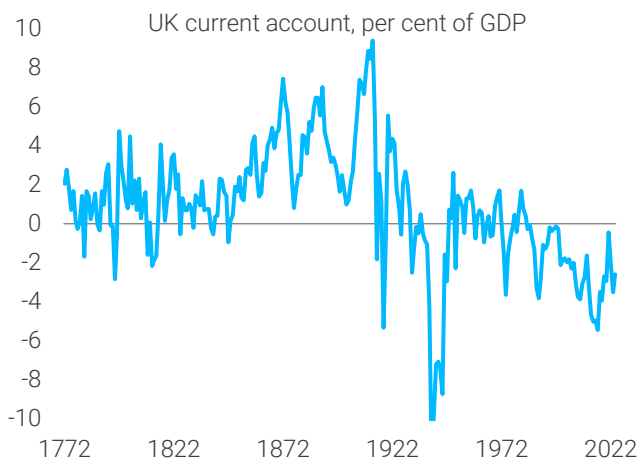
Could there be an exorbitant burden?

Given the evidence, we think America’s exorbitant privilege is often overstated. But the new US administration takes the argument even further, with some officials claiming that reserve status has become an “exorbitant burden”. Again, this is not an entirely new idea; it was also popular among US policymakers in the 1960s, which – as Perry Mehrling reminds us – was one of the main reasons for the 1971 Nixon shock. The basic theory is rooted in the Triffin dilemma, the idea that being the world’s reserve currency can generate a conflict between the world’s need for hegemonic liquidity and domestic policy goals (such as low inflation and full employment). Steve Miran, chairman of Trump’s Council of Economic Advisers, is particularly obsessed with the Triffin dilemma. It was a central part of his controversial paper on the Mar-a-Lago accord. Miran believes that reserve status is the main reason why the US runs persistent current-account deficits. There is a structural bid for dollars, which keeps the currency overvalued, de-industrializing the US economy, hollowing out the American middle class and forcing the government to run unsustainable fiscal deficit. (Again, these were all arguments that were popular among US policymakers in the 1960s.) Left unchecked, Miran thinks the current situation will eventually hit crisis point, because the global demand for dollars will exceed America’s capacity to borrow.

We disagree with the Miran thesis for two reasons. First, it is not true that the global hegemonic currency needs to run persistent trade deficits. While the world needs the US to provide gross external liabilities, there is nothing to say this needs to be linked to a specific net trade flow (as

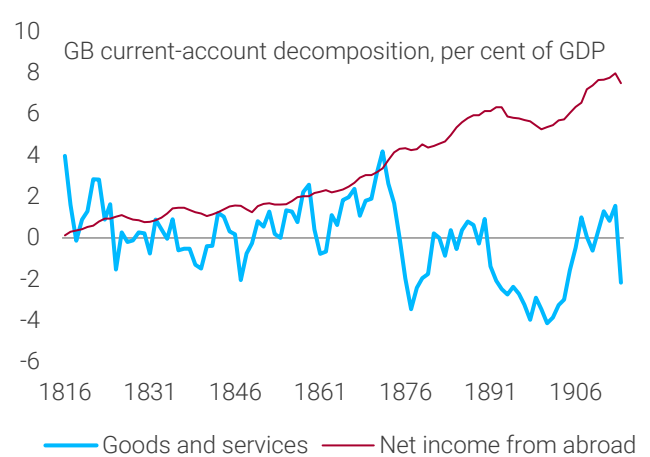
captured by the current account balance). That is why, when we look at the past, we find examples of the global hegemon also running persistent external surpluses, including the UK before 1915 and even the US before the mid-60s. Britain's Edwardian economy was interesting because the current account surplus came from excess savings, as wealthy Brits deposited their cash in domestic banks, which invested the funds in rapidly growing parts of the British Empire (Indian railways, etc.). This generated a large income surplus, which dwarfed the trade deficit. And in the case of the US until the mid-60s we have a hegemonic nation providing external capital directly – in the form of loans and grants (e.g., the Marshal Plan) – which the rest of the world then spent on US manufacturing goods, delivering a significant current account surplus. But the basic point stands: whereas Miran assumes a mechanical relationship between reserve asset demand and the trade balance, history (and theory) points to a wide range of possible outcomes. The world's main reserve currency provider can either swap hegemonic liquidity for goods (current account deficit) or it can swap that liquidity for assets (current account surplus).

Chart 14: Britain was surplus hegemon pre-1900s



Source: Bank of England

Chart 15: Edwardian savings flowed abroad



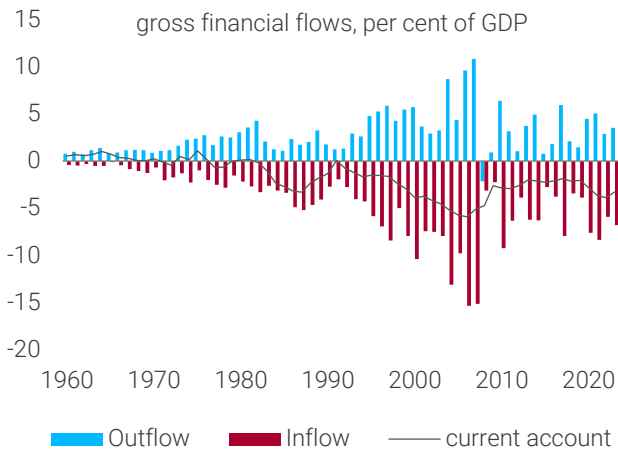
Source: Bank of England

The second problem with the “exorbitant burden” thesis is that it places too much emphasis on dollar “overvaluation”. Miran, in particular, blames the overvalued exchange rate for hollowing out US manufacturing. But the link between reserve status and the value of the currency is vastly overstated. Indeed, looking at the dollar exchange rate over time, there are distinct “regimes”. Sometimes – such as in the 1980s, the late 1990s and the 2010s – a strong dollar correlates closely with a larger current account deficit. At other times – such as in the 1970s, the early 1990s and the early 2000s – the relationship is flipped on its head: the deficit widens even as the dollar depreciates (or the currency is already very weak). That makes sense: there are periods when international investors want more exposure to US assets and bid up the currency to get them. But there are also times when US assets are less attractive and the dollar decline fails to attract more demand – that is, the world accumulates dollar liquidity only “reluctantly”. During the late 1990s and the 2010s, investors wanted more USD exposure; that was not the case in the 70s or the early 90s. But the role of the US as the world’s hegemonic currency was never in doubt.

More generally, we do not think persistent dollar strength is the decisive factor in explaining the US current account deficit. The US has been in deficit because US domestic demand has been growing faster than that of America’s main trading partners, which means US imports have continuously outpaced exports in other parts of the world. And the dollar exchange rate has been strong because, expecting US outperformance to continue, the rest of the world has wanted

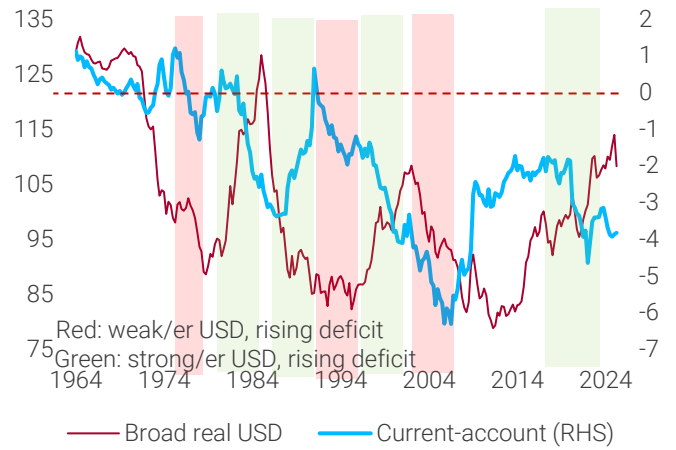
exposure to US assets. Miran has cause and effect backwards. Realistically, there are only two ways to reduce America's current account deficit: either the rest of the world must grow more quickly or the US must grow more slowly. Obsessing over the value of the dollar or trying to force other countries to revalue their exchange rates would not be an effective way to rebalance the global economy. In the modern system, exchange rates are not as important as Miran thinks.

Chart 16: Gross flows swamp net flows



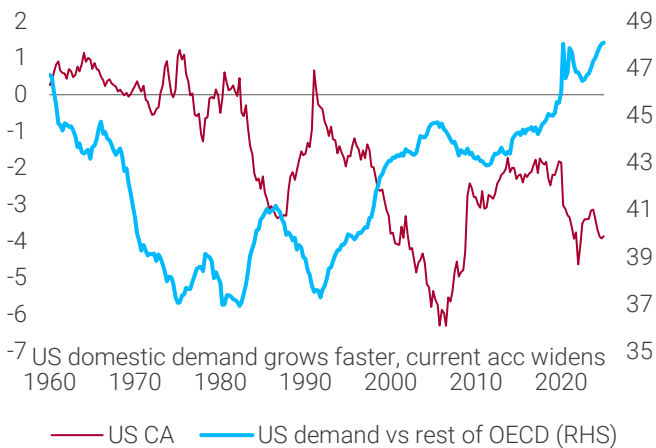
Source: BEA, TS Lombard

Chart 17: Dollar cycles despite reserve status



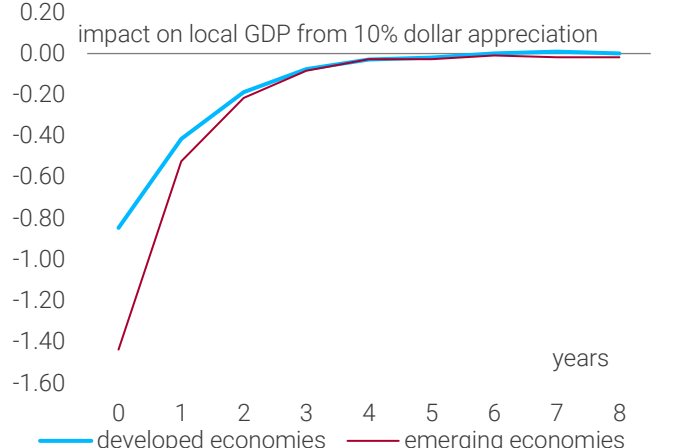
Source: BEA, TS Lombard

Chart 18: What drives US trade position



Source: BEA, TS Lombard

Chart 19: Dollar is an amplifier, at best



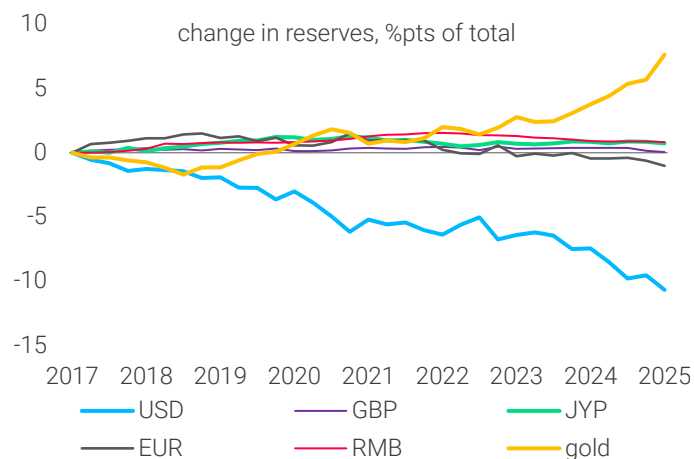
Source: Bank of England

So, are US complaints about the dollar standard totally wrong?

While the Trump administration is wrong to regard reserve asset status as a burden, there does appear to be a coordination problem at the heart of the dollar standard. This is often missed by mainstream economics. According to most economics theories, exchange rates act as shock absorbers: if the US is growing faster than the rest of the world, the dollar should appreciate and that helps restore balance – by eroding US competitiveness and curbing America's economic advantage. But in the real world, where most of the planet invoices in dollars and most cross-border lending is denominated in USD, these adjustments break down. In fact, there is evidence that dollar movements amplify US-RoW differentials, because episodes of USD strength typically reduce international trade and squeeze cross-border capital flows, which hurts RoW even more

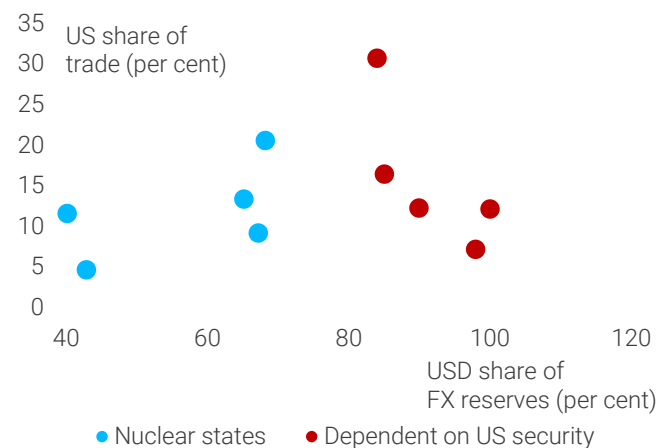
than it hurts the US. [Recent analysis from the Bank of England](#) shows that every 10% appreciation in the dollar reduces DM GDP by around 0.8%, with an even bigger EM squeeze. This is far greater than the impact on the US economy. These sorts of dynamics can lead to [a coordination failure at the heart of the dollar standard](#). The whole world would be better off with a weaker US exchange rate, but there is no mechanism to force the dollar down.

Chart 20: Weaponizing USD has consequences



Source: IMF, TS Lombard

Chart 21: The geopolitics of FX reserves



Source: Barry Eichengreen

3. DOLLAR DESCENT

Are there reasons to worry about the dollar's status?

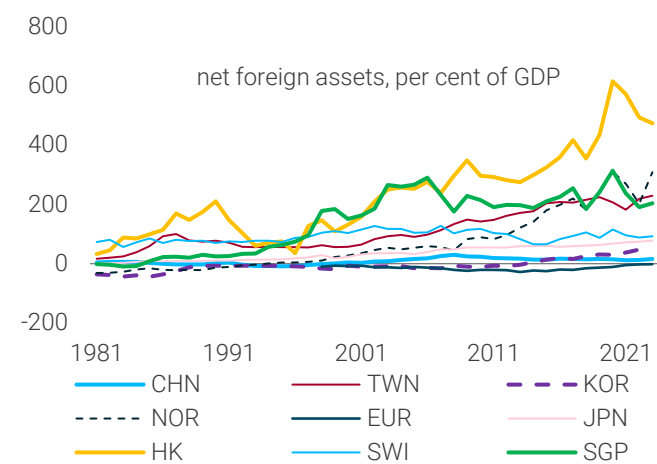
US reserve status clearly has inertia on its side. People are used to using the dollar; and given powerful network effects, that is unlikely to change quickly. That said, former Fed Chair Ben Bernanke [once outlined some more specific reasons why the dollar standard had endured](#): (i) stability of value (inflation had stayed low and the Fed was "credible"); (ii) liquidity (those network effects again – America's deep and liquid financial markets); (iii) safety (based on the behaviour of USTs and the dollar during "risk-off" periods); and (iv) the fact that the system had a lender of last resort in the form of the Fed's swap lines with the rest of the world (facilities that allow foreign central banks access to USD liquidity from the Fed during times of crisis). A decade on from Bernanke's comments, dollar dominance is perhaps less assumed than it was when he published his analysis. Although the network effects remain, doubts have started to creep in about the other points on Bernanke's list. Can we still assume that Treasuries and the dollar will rally during times of stress? They didn't after Liberation Day, after all. Can we assume the Fed will hit its inflation target, even after several years of misses and with the central bank under overt political pressure from the Trump administration? Who will Trump appoint as chair of the FOMC when Powell's term expires, and will they protect Fed independence? And finally, can the rest of the world rely on central bank swap lines, especially in an era of geopolitical tension?

Why might RoW diversify out of dollars?

To be more specific, we can return to the three sectors of the dollar system we examined in Section: the official sector, the financial sector and the non-financial sector. This exercise reveals some areas of decay, a situation that is likely to intensify over the next decade:

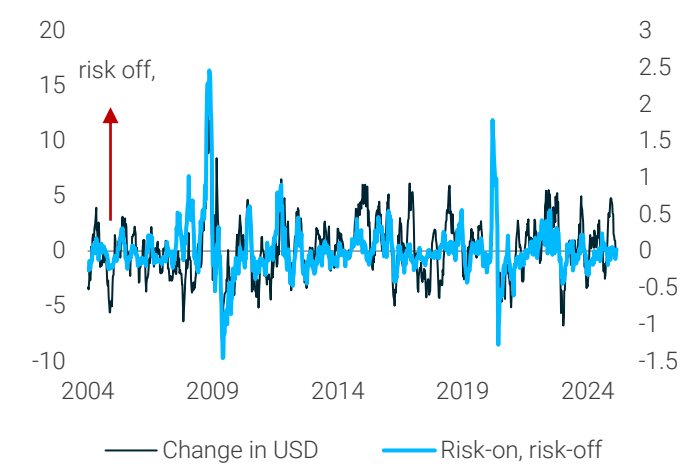
- (i) **The official sector:** The repeated weaponization of the dollar through international sanctions (Iran in 2012, Afghanistan in 2021 and Russia in 2014 and 2022) has created a strong incentive for certain countries to shift their FX reserves out of US currency. This process has been under way for several years and has accelerated since Russia's invasion of Ukraine, when the NATO countries froze Russia's overseas assets and kicked Russian banks out of the SWIFT payments system. No one should be surprised about this trend. We know that official reserve holdings have always had a strong geopolitical component, which is why Japan, for example, holds a larger share of its FX reserves in dollars than does China, and why Saudi Arabia holds the bulk of its reserves in dollars, unlike Russia, which exports a similar set of goods. As military alliances shift, we will see these dynamics in central bank behaviour change, too. So far, gold has been the big winner, with official purchases pushing prices to new record highs.
- (ii) **The financial sector:** While all the media attention has been on official reserve holdings, the behaviour of the global financial sector is much more important. We think the Trump 2.0 administration is already undermining the safe haven properties of US Treasuries. Not only are supply shocks (such as tariffs and deportations) likely to weaken the negative correlation between equities and bonds, but Trump's attacks on the Fed's independence are unhelpful from the point of view of the US term premium. The risk, of course, is that these dynamics become reflexive. Once the safe haven properties of US assets are undermined, investor behaviour shifts, which further erodes those very properties. But this isn't just a question of how US assets perform in "risk-off" scenarios. If the US administration is serious about rebalancing the global economy over the medium term, they may also want net inflows of foreign capital to decline. And that could be bad for US asset prices. We think the era of US exceptionalism is over because global rebalancing will happen via a combination of weaker US growth and stronger growth in the rest of the world.

Chart 22: Global USD accumulation



Source: Macrobond, TS Lombard

Chart 23: Dollar correlates with risk-on/off cycle

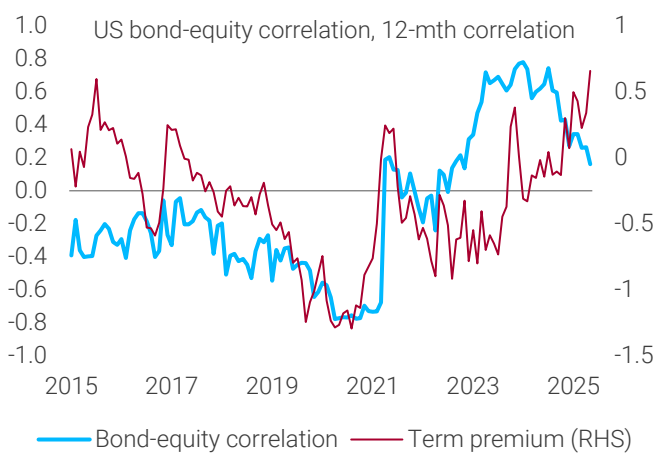


Source: TS Lombard

- (iii) **The private non-financial sector:** Corporate demand for the US currency is likely to be stickier because it is a function of trading patterns and the ability of exporters to fund those transactions. This is where network effects will be most powerful. But even here, we are likely to see some long-term decay. Globalization peaked after the

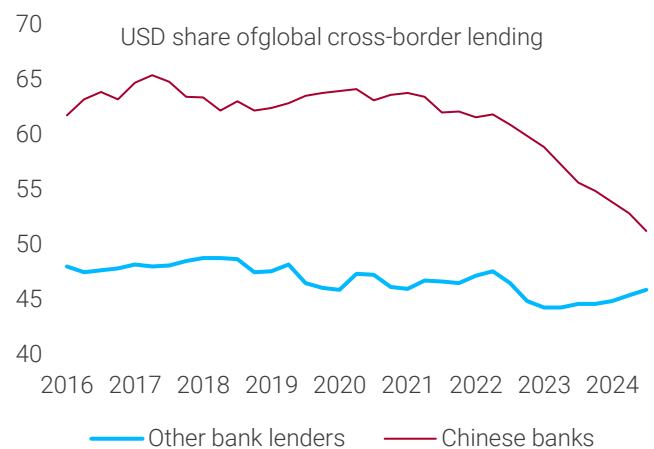
GFC, and we continue to think that international trading patterns will reconfigure around regional trading blocs. Supply chains will shorten, and some intraregional trade will no longer be invoiced in dollars, and this will mean deep dollar funding markets will not be as essential as they were during the era of hyperglobalization. We are already seeing shifts in this direction – for example, increased bilateral trade between Russia and China (increasingly invoiced in RMB) and the recent agreement between Saudi Arabi and China to trade oil for a new gold-backed “petroyuan”. Moreover, a [Fed study has found evidence of de-dollarization in Chinese bank lending](#) to other EMs. Since 2022, Chinese banks have increasingly lent in RMB (Chart 25). The good news – for USD reserve status – is that this sort of decay is likely to happen slowly.

Chart 24: Treasuries’ hedging properties deteriorate



Source: Datastream, TS Lombard

Chart 25: Chinese banks now lend RMB overseas



Source: [Fed study](#), May 2025

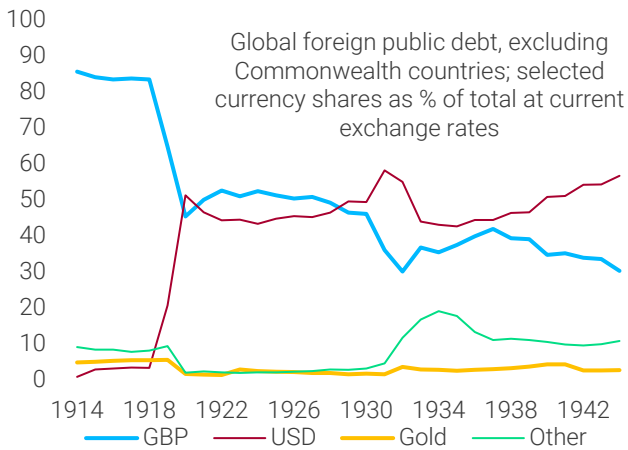
What could replace the dollar standard?

There are several possible candidates. First, another currency could become dominant, assuming the dollar’s mantle. This is the historical pattern: one country steals reserve status from another, with those transitions happening, on average, once a century. On that timeline, we are due another transition. Usually, however, loss of reserve status is the result of a military conflict in which the incumbent hegemon is defeated. Britain defeated the Spanish Armada. Then, the UK saw its industrial base ravaged by two world wars, was unable to defend its empire and handed the throne to the US. Nobody wants to forecast another world war. But right now, there are obvious practical problems for other currencies wanting to displace the dollar. In the case of RMB, China’s closed capital account is a major constraint. While – contrary to the popular trope – the world does not need China to run current account deficits, it does need access to Chinese assets. The euro is in a weak position, too. Europe’s capital markets are incomplete, and the absence of a fiscal union doesn’t help (the world will need a new, risk-free securities). These are problems [the authorities plan to address over time](#), but until then the dollar will remain Number 1.

A likelier scenario is that we end up in a multi-polar system, particularly if we are right about the world fracturing into regional trading blocs. Both RMB and the euro would become more important over time, especially as the authorities address their institutional weaknesses, but they would not replace the dollar. The dollar standard would decay, but there would be no “moment of truth”, no sudden “dollar crisis”. It is true, of course, that a multi-polar system would break the historical norm, but we have seen examples of that in the past – [most notably in the interval](#)

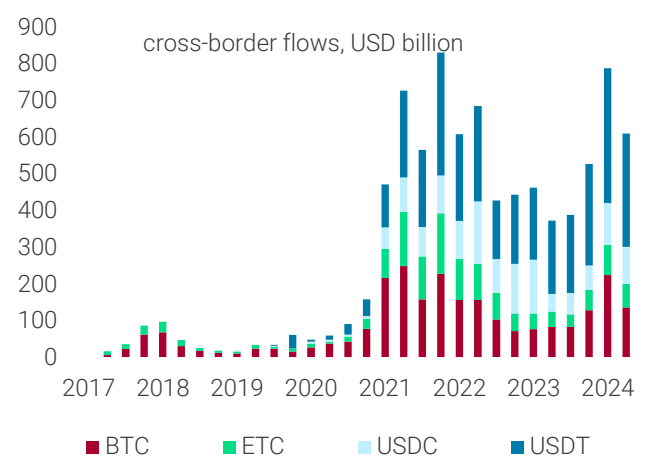
between the two world wars. The dollar was growing in importance, but the British pound and the French franc were in widespread use, too. As Barry Eichengreen explained in a series of papers (see [here](#) and [here](#), for example), the dollar was not used at all in international transactions before WW1, but that changed thanks to the creation of the Fed (which expanded the liquidity of US capital markets), the US decision not to embargo gold exports and the recycling of WW1 reparations, which America sent to Europe as part of the rebuilding effort (and to take advantage of high returns).

Chart 26: Polar reserve system before WW2



Source: Barry Eichengreen

Chart 27: The rise of the stablecoin



Source: BIS

An interesting variation of the multi-polar system would be a system that deploys a digital stablecoin as the main unit of account. [This is an idea we first examined in 2020](#). Consider, for example, an international digital currency tied to a basket of existing currencies, such as the US dollar, RMB, sterling, the euro and the Japanese yen. If exporters started to invoice in this new stablecoin, which would be similar to the IMF's Special Drawing Rights (SDR), we could imagine a situation where, over time, a new financial structure would emerge, providing SDR-based liquidity and cross-border lending. And this system would have several advantages over the current system: (i) being tied to a basket of currencies, the digital SDR would be more stable than the USD; (ii) SDR "monetary conditions" would be a weighted average of the policies of the various central banks, meaning less global reliance on the Fed; and (iii) the supply of risk-free assets would increase, which would encourage less hoarding of dollar assets. In the end, we could see a multi-polar synthetic hegemon, not a million miles away from Keynes's "bancor" idea.

Beyond a stablecoin-based SDR, we see no real prospect of a crypto replacement for the dollar. We do not agree with the likes of BlackRock's Larry Fink, who thinks we are headed to a Bitcoin standard (based on the fact that the US is building a BTC "strategic reserve".) The big problem with Bitcoin is that its supply is fixed. Although enthusiasts like this, because it protects holders from "debasement", it is not the quality you want in a reserve currency. In fact, there would be obvious parallels between a Bitcoin standard and the 1880-1914 gold standard, which tied most major currencies to the quantity of gold available. Under that system, both the money supply and the price level were, in effect, fixed and beyond the control of central banks. If that sounds appealing, it is worth remembering that the gold standard suffered frequent bouts of financial instability and there were times – most notably during the Great Depression – when adherence to fixed monetary rules was a source of acute macro pain. Famously, those countries that abandoned the gold standard earliest were the fastest to recover from the Depression. And with

Bitcoin there is the added problem that it doesn't even behave like a "safe asset". It is positively correlated with equities, which means its value declines when investors need it most.

What are the investment implications?

We do not think there is an imminent threat to the dollar's reserve status. But that has no real bearing on our main investment thesis – that the US exchange rate has entered a structural bear market. As we have explained, it is important to make the distinction between the dollar's dominance of global capital markets and the exchange value of the US currency. The two concepts are not as closely connected as everyone assumes. And the reason we expect sustained dollar weakness is much more mundane than anything related to a "dollar crisis" or some grandiose scheme to devalue the dollar (such as the various "Mar-a-Lago accords" touted in the press). We think the Trump 2.0 administration is damaging the US economy (as tends to be the way with populist regimes) while simultaneously forcing the rest of the world to get its act together. That will make US assets – and America's currency – relatively less attractive to international investors. In a sense, this is exactly the outcome the US administration wanted: Trump himself wants a weaker dollar and a smaller current account deficit. There are only two ways to get the deficit down: either the US economy has to be weaker or the rest of the world has to be stronger. Right now, ironically, the administration is proving "successful" on both fronts.

Bottom line

The dollar has dominated global finance for almost a century, with foreign governments, financial institutions and non-financial corporates all having distinct incentives to hold and transact in the US currency. Today, those transactions are supported by a complex and geographically dispersed network of funding relationships – the ubiquitous "eurodollar system". For decades, the world (particularly France) has looked on enviously at American supremacy, jealous of its "exorbitant privilege". But not everyone sees reserve-asset status as a blessing, including prominent members of the Trump administration, who claim that the world's structural bid for USD delivers a permanently overvalued exchange rate, hollowing out American manufacturing and forcing the country to run perpetual deficits. For the most part, the administration's thinking is flawed, rooted in a fundamental misunderstanding of how dollar hegemony works. There is nothing in the system that "forces" the US to run deficits, and there is no reason the dollar cannot depreciate – perhaps significantly – even if America retains its dominant position. In fact, there is a good chance the administration will get its wish for a weaker currency, precisely because it is doing things that will damage the US economy while simultaneously forcing the rest of the world to get its act together. Looking to the longer term, we can imagine some alternatives to the current setup, such as a multi-polar global hegemon tied together with a digital stablecoin (not Bitcoin!). But that thesis remains highly speculative. For now, investors just need to know that the era of US exceptionalism is over, and the dollar exchange rate is headed lower.

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