



De-dollarisation is all about de-risking

Description

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Exactly a year ago, I wrote about the process of [de-dollarisation](#). Following the Russian invasion of Ukraine in 2022, G7 currencies lost some of their international attraction because global reserves held in these currencies dropped by 8%. Central banks began to favour gold instead. The relative positions of these currencies however remained stable, with 59% of all reserves still held in dollars. Global reserves held in G7 currencies remained broadly similar in 2023 at this new lower level.

One cannot talk convincingly about shifting trends with only two years' worth of data, but the reasons behind the reduced popularity of G7 currencies did not go away. For example, the weaponisation of finance in the form of sanctions, the freezing of Bank of Russia reserves, and more recently, the use to help fund the war in Ukraine of the profits that those reserves generate, all feed into fragmentation.

Fragmentation means that the international role of the G7 currencies will be reduced, as will the hegemony role of the US dollar and then the euro. However, to understand how this will happen and at what horizon, one needs to make a distinction between the two roles of currencies: first as a store of value and second as a settlement infrastructure. The first is affected by economic factors and the latter by the need to do business.

When it comes to the US dollar and the euro as a store value, I have no doubt that they will continue to be popular. They are two of the most stable currencies, the value of which

reflects policies that exist within a system of reliable checks and balances. The US dollar and the euro belong to sophisticated financial systems that can promote and handle innovative products for payments and finance.

Moreover, the only other sizable economy that could challenge the roles of the dollar or the euro in global reserves is China, but its currency, the renminbi, is not traded internationally. Until this changes, the US dollar and the euro (and the rest of the G7 currencies) will not be challenged in any significant sense. Central banks around the world will not shift their reserves away from them in any meaningful way.

However, there is the settlement role to think about and here there are developments that could challenge the status quo. Bitcoin as the first and still most popular cryptocurrency, it may not be a good store of value. But it is accessible globally and has become an enabler for both digital payments and trade. Consider a European exporter who wishes to trade with Africa but only if they could price in euros. If euros are not available easily for African importers, Bitcoin offers a readily available alternative. Naturally, there is an exchange rate risk, which European exporters can minimise by converting Bitcoins back into euros almost immediately on receipt. Trade is thus enabled by the fact that pricing is in the preferred currency of the exporter, but payments are in the currency available to the importer without forcing the exporter to take a huge exchange rate risk. Such a payment innovation can have important financial inclusion effects and create trade opportunities that would otherwise be impossible.

Similarly, it may provide alternatives to countries that do not want to, or cannot use, dollars. Consider for example the countries that are under financial sanctions. The reason why Putin asked European energy importers to pay in rubbles, in spring 2022, rather than per contract in euros, is because Russia did not have access to the euros paid. All euro transactions must be settled through the European settlement infrastructure, which requires that both sides of the settlement are not under sanctions. As a result of sanctions, Russia is cut off from the US dollar and euro and consequently from a big part of global trade and capital markets.

China has developed a Cross-Border Interbank Payment System (CIPS) to promote the yuan as an international currency. Even if the currency has not managed to become a sought-out store of value, it does offer a settlement infrastructure that Russia can use, and through it also access other countries. If fragmentation continues, China's infrastructure will no doubt be a suitable alternative.

Another settlement infrastructure, when and if they take off, are provided by central bank

digital currencies (CBDCs). Interest in CBDCs accelerated after the Russian invasion of Ukraine as countries began to worry about their overdependence on the US dollar for participating in international markets.

As the EU discusses and prepares to achieve strategic autonomy, it must reckon with the fact that the rest of the world is also engaging in the same act of de-risking. Part of that process will necessarily mean moving away from the two dominant currencies, the euro, and the US dollar.

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