

Chuck Kawakami's Eye #16: Is the dollar reserve currency system sustainable?

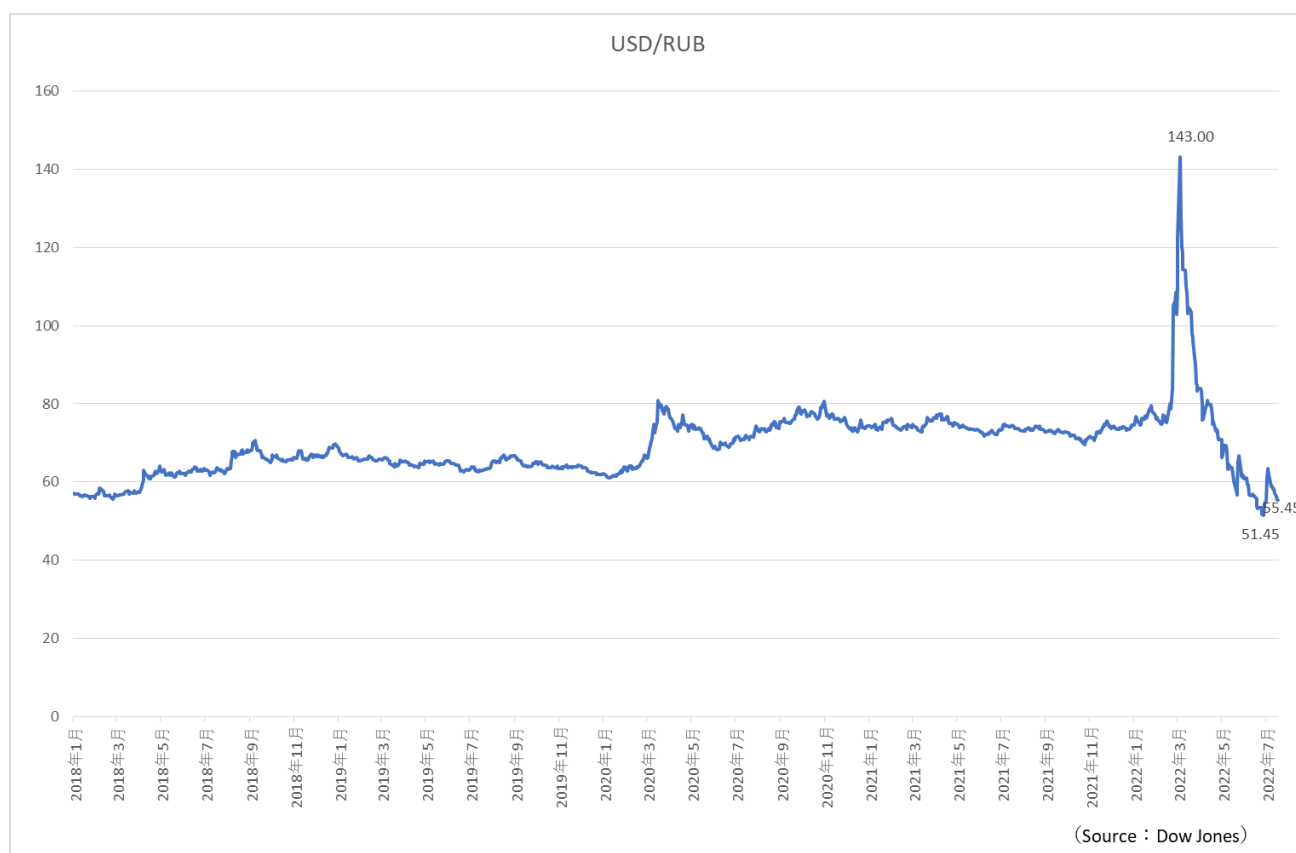
20th July 2022



After Russia's invasion of Ukraine, Russian stock prices fell sharply, to less than half their value. Many thought that the Russian currency, the ruble, would suffer the same fate, but on the contrary, the ruble has been appreciating.

The sanctions have slowed down imports of consumer goods, which has led to an improvement in the balance of trade. They have also restricted the withdrawal of foreign currency and the exchange of rubles into foreign currency. This naturally curbs remittances and imports abroad, which further reduces the outflow of funds through imports and other means.

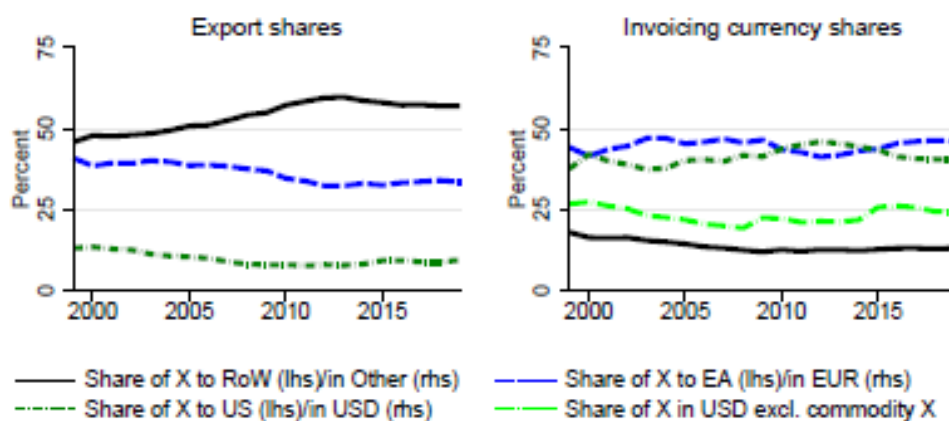
In response to the sanctions, Russia has demanded that energy exports be settled in rubles rather than dollars. In May, Italian Prime Minister Draghi revealed the reality: 'In practice, most gas importers in the EU zone open ruble-denominated accounts with Gazprom and do business with them'. This is another clue, but it should be seen as an increase in the procurement of rubles, in the sense that rubles are used for settlement. The RUB, which once depreciated significantly immediately after the invasion, is now higher than before the invasion.



This implication is important. It means that a non-dollar settlement currency area is being formed, albeit partially. There are indications that actual trade settlements between countries subject to US sanctions, such as China, Russia and Iran, are already taking place using their own currencies, and it appears that this is in fact progressing, involving countries subject to Chinese financial support and former non-aligned countries.

According to ECB research, the US dollar accounts for 40% of global trade invoice settlements, 25% of non-commodity trade and 15% of commodity trade settlements, and if these are settled in the currencies of other countries, notably Russia, this will reduce settlement demand for the dollar and lead to a large dollar surplus in currency markets. It remains to be seen whether such a development will expand in the future. It should be noted that if this actually happens, it will in reality shake up the existing dollar reserve currency system. Currency markets have forgotten an ongoing fact of a significant deterioration in the external balance in US.

Figure 3: Share of global exports to (and trade invoiced in) the US (dollar), EA (euro) and the rest of the world (other currencies)



(Source : ECB Working Paper No 2574)

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