GLOBAL MARKETS RESEARCH

FX Thoughts

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De-dollarization - Slowly but Surely

The de-dollarization process picked up pace amidst growing concerns of over-reliance on the US dollar (USD). This year, Argentina, Brazil, and Bolivia started to pay for Chinese imports in Renminbi (RMB) while trade between Malaysia and India can be settled in Indian Rupee (INR). Several countries within the ASEAN bloc have also committed to push for better regional payment connectivity and increase the use of local currency transactions to transition away from established currencies used for trade. Notwithstanding, the role of the USD in internationally remains irreplaceable at this point for a lack of alternatives even as the share of USD reserves has been trending down. We look at some of the recent de-dollarization efforts and re-visit the role of the USD in the context of central bank reserves, medium of payment and access to capital markets.

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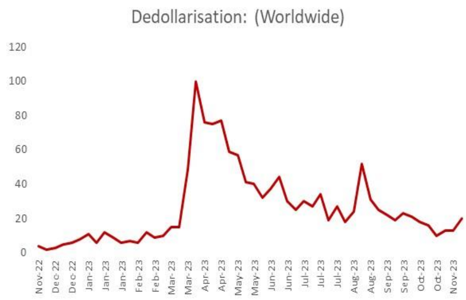
"The greenback's dominance won't last forever because nothing does. But the hype about de-dollarization is much ado about almost nothing. For now, the dollar dominates because there just aren't any good alternatives".

Nobel laureate, Paul Krugman
New York Times, 7 Jul 2023

Shifts Taking Place, Gradually

The topic of de-dollarization has seen recurring interest from time to time. The most recent catalyst was the financial sanctions levied by the US and western allies on Russia following Russia's invasion of Ukraine in 2022. The western alliance froze nearly half of the central bank's US$630bn in foreign reserves; it also removed major Russian banks from the SWIFT payment network in attempt to cripple the economy. Thereafter, there has been an uptick in efforts globally to create alternatives to the USD - as a mean of risk management and diversification.

Google Search Trends for De-dollarization



Source: Google search trends, OCBC Research

This year there has been a handful of RMB-settled LNG deals, including China's CNOOC and France's Engie, CNOOC and Singapore's Pavilion Energy (Oct-2023), PetroChina and UAE's Adnoc (Apr-2013) as well as between CNOOC and France's Total Energies (Mar-2023).

Most recently, in November 2023, Singapore and Indonesia launched cross-border QR payments. The payment linkage is the first step to foster a wider use of local currencies in bilateral transactions via the local currency transactions (LCT) framework that is expected to be completed in 2024. For Malaysia, direct transfers were enabled between PayNow (SG) and DuitNow (MY), allowing customers of the participating financial institutions to send up to S$1,000 daily. This is a continuation from the previously established NETS-DuitNow QR payment linkage in March 2023. Currently, these initiatives are in-place for individuals and small businesses. This may be a small step but is pivotal in setting the stage

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towards commercial use as MAS begins a live pilot of wholesale central bank digital currencies (CBDCs) in the coming year.

In September 2023, Indonesia launched a national "de-dollarization" task force, that is made up of at least 6 ministries. Bank Indonesia and key financial regulators will help facilitate cross-border local currency transactions with regional partners in an attempt to reduce reliance on the USD in ASEAN especially when more than 70% of the exports in the region are invoiced in USD. The move is consistent with the agreement signed by ASEAN members at the 42nd ASEAN Summit (May-2023) to push for better regional payment connectivity and the use of local currency transactions to transition away from established currencies used for trade.

In August 2023, Indonesia, Malaysia, and Thailand inked an MoU for cross border bilateral transactions. This supersedes the MoUs on the local currency settlement framework signed between the 3 central banks in 2015 and 2016. The new framework is expanded to include more transactions beyond trade and direct investments and will be implemented gradually.

Also, in August 2023, BRICS nations extended membership invitations to 6 countries, for the first time since 2010. Notable names include top oil producers: Saudi Arabia, UAE, and Iran. This expansion seeks to further their standings in the world stage to challenge US and Western influence. Though the discussion of a common BRICS currency was not on the agenda, several leaders including Brazil's President Lula and Russian Foreign Minister Sergey Lavrov expressed support for the idea of a common currency among BRIC nations as a means of increasing payment options and reducing their vulnerability to dollar exchange rate fluctuations. BRIC leaders recognise the challenges to creating a common currency. Instead, the focus is on boosting trade in national currencies and providing alternative mechanisms like the BRICS new development Bank (NDB).

In April 2023, it was reported that Argentina aims to pay around US$1.0bn of Chinese imports in RMB instead of USD and thereafter, around US$790mn of monthly imports will be settled in RMB. In Oct 2023, Argentina tapped on its US$18bn RMB swap lines to pay part of the US$2.6bn due to the IMF.

In April 2023, trade between India and Malaysia can be settled in Indian rupee (INR), in addition to the current modes of settlement in other currencies. Trade between the 2 countries was at US$19.4bn in FY2021-22. This initiative by the RBI was aimed at facilitating the growth of global trade and to support the interest of the global trading community in INR.

Earlier this year, China and Brazil reached a deal to use their own respective currencies in trade and financial transactions directly without going through the USD. China-Brazil trade stood at US$171.49bn in 2022.

Bolivia also uses the RMB to pay for imports and exports, though the amount was small for a start. Bolivia's Economy Minister Marcelo said that Bolivia conducted financial operations worth about US$38.7mn between May and June 2023. This accounted for about 10% of its foreign trade.

Sufficient to Challenge USD's Dominance?

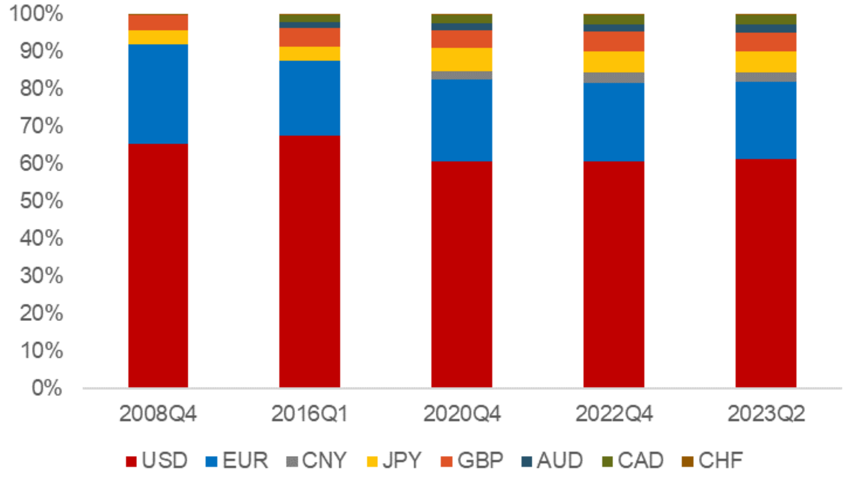
The above-mentioned list is non exhaustive but offers a glimpse into how there is slightly more walk and less talk on the shift to a USD alternative. This raises questions about whether de-dollarization this time is different in light of a fragmented geopolitical landscape and growing fears of one's foreign reserves/financial resources being potentially held hostage to USD hegemony in an increasingly polarised world.

To answer this, we look at the role of US dollar in the context of 1/ reserve accumulation by central banks; 2/ global trade and invoicing; 3/ international payments; 4/ access to debt markets and role in global financial markets.

1/ Reserve Accumulation

While US dollar's share of global currency reserves has held steady this year at 58.9% in 2Q 2023, the share has been trending down from 72% in 2001.

% Share of Foreign Exchange Reserves



Source: IMF-COFER, OCBC Research

A working paper published by the IMF[1] highlighted a few key points: 1/ that the decline in dollar share of international reserves since the turn of the century reflects **active portfolio diversification** by central bank reserve managers. 2/ In particular the **decline in USD's share was not**

[1] Arslanalp, S., Eichengreen, B.,and Simpson-Bell, C. 2022. The Stealth Erosion of Dollar Dominance: Active Diversifiers and the Rise of Nontraditional Reserve Currencies. IMF WP/22/58, Washington DC: USA

accompanied by increase in share of other major FX, such as EUR, JPY, or GBP. 3/ Instead the **shift out of USD has been in 2 directions: a quarter into the Chinese renminbi (RMB), and three quarters into the currencies of smaller countries** that have played a more limited role as reserve currencies. The paper classified AUD, CAD, RMB, KRW, SGD, and SEK as nontraditional reserve currencies.

Nontraditional currencies in Global FX reserves (End 2020)

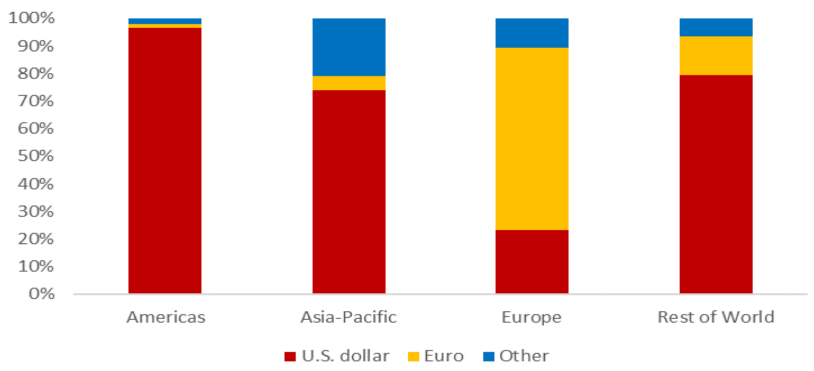
	in bil US$	as % of Total
Total	1070	100%
Australian dollar	217	20%
Canadian dollar	247	23%
Chinese renminbi	272	25%
Swiss franc	21	2%
Other	315	29%
Korean won	81	8%
Swedish krona	63	6%
Singapore dollar	51	5%
Norwegian krone	49	5%
Danish krone	47	4%
New Zealand dollar	12	1%
Hong Kong dollar	11	1%

Note: The size of "other" currencies is estimated based on Arslanalp and Tsuda (2014).
Source: IMF, COFER, CPIS

2/ Global Trade and Invoicing

Despite the US only accounting for 10% of global trade, trade invoices denominated in USD accounts for half of global trade, albeit its share faces a varying contrast depending on regions. In fact, other than Europe, the remainder of world still largely relies on USD for global trade invoicing. According to Boz et al[2], the share of USD in invoicing has varied little over history across different regions.

% Share of Export Invoicing through 1999 to 2019



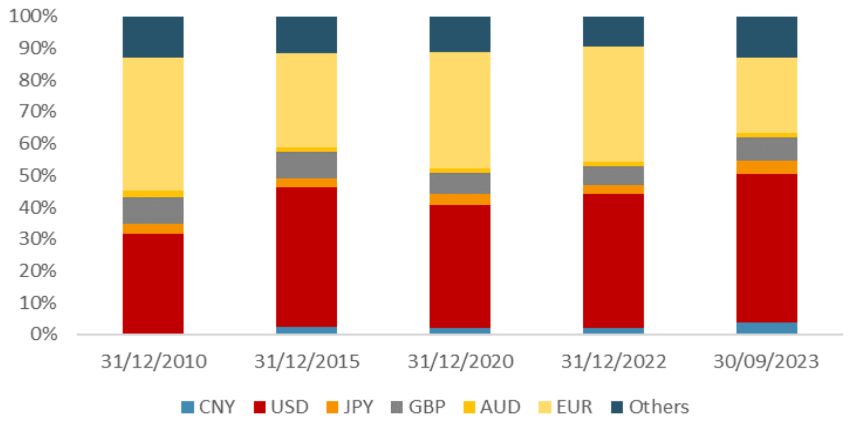
Source: IMF Direction of Trade; Central Bank of the Republic of China, Federal Reserve, OCBC Research

[2] Boz, Emine and Casas, Camila and Georgiadis, Georgios and Gopinath, Gita and Le Mezo, Helena and Mehl, Arnaud and Nguyen, Tra, Patterns in Invoicing Currency in Global Trade (July 1, 2020). IMF Working Paper No. 20/126, Available at SSRN: https://ssrn.com/abstract=3670607

3/ International payments

The dollar continues to play a key role in international payments. Latest data (3Q 2023) from SWIFT showed that 46.6% of transactions were made in USD. Despite the shifting geopolitical landscape in recent times, the USD continued to extend its dominance. In fact, USD's transaction via SWIFT saw a sharp increase from 41.9% to 46.6% during the period from 4Q 2022 to 3Q 2023.

% Share of SWIFT Payments denominated in foreign currency



Source: SWIFT, Bloomberg, OCBC Research

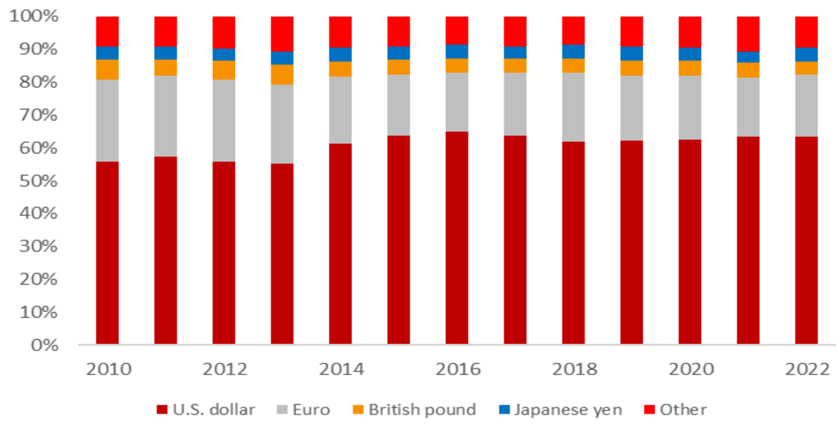
While RMB's share of international payments via SWIFT remains low at 3.71% (3Q 2023), RMB's share has been on the rise from about 1.6% in 2020.

In China's own Cross-Border Interbank Payment System (CIPS), RMB's share of cross border payments and receipts hit a record high of 49% in 2Q 2023, surpassing the USD for the first time. This may bring to question as to whether China's growth in global commerce could make a case for a strong alternative to the USD. However, there remains much to be seen from RMB before the picture clears.

4/ Access to Debt Markets and Role in Financial Markets

The USD has also been the dominant currency in international banking. Bank of International Settlement (BIS) data shows about 60% of foreign currency liabilities remain denominated in US dollars and it has remained largely steady since 2000.

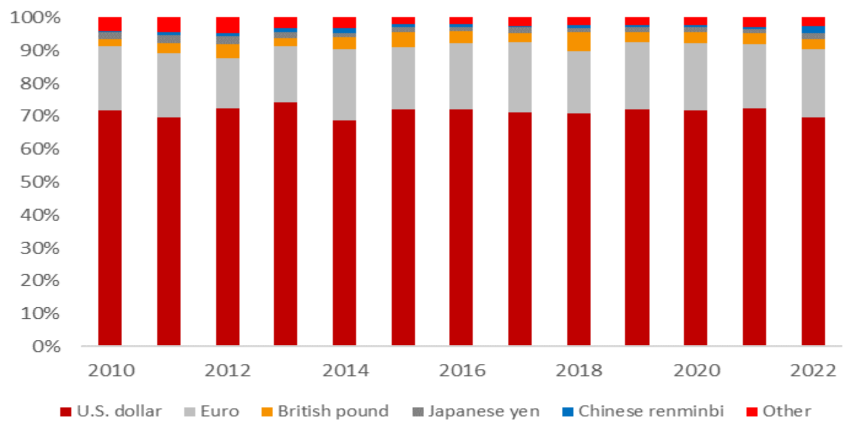
% Share of banking liabilities (deposits) across national borders or denominated in foreign currency



Source: BIS, Fed, OCBC Research

In the space of foreign currency debt issuance (debt issued in a currency other than home country), the US dollar is also dominant with its share standing steady at around 70% since 2010.

% Share of foreign currency debt issuance

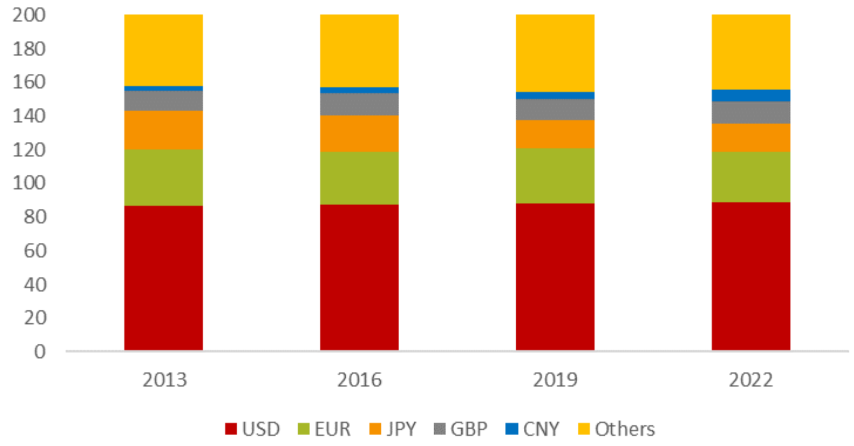


Source: Refinitiv, Fed, OCBC Research

The FX markets is predominantly concentrated in USD with 88% (2022) of spot, forward and swap markets featuring USD in one leg of the transactions. As a comparison, the EUR, being the second most trade currency, is trailing behind with a rather large margin. CNY in the past decade has begun picking up in FX turnover from <1% in 2010 to 7% in 2023; while this likely corresponded with the slight decline within the other major currencies, the USD's significance within the FX markets is still seemingly unshaken. The USD's role as a vehicle currency for FX transactions has remained steady (not fallen below 87% since 2013).[3]

[3] Based on BIS Triennial OTC derivatives statistics

% Share of FX Turnover by Currency



Source: BIS, OCBC Research

Conclusion

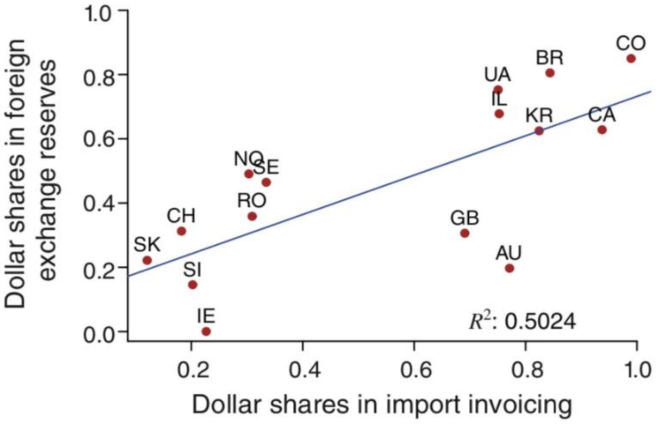
Attempts to reduce reliance on the use of USD for trade settlement is picking up pace but the progress remains slow. The USD share in trade invoicing and payments still makes up the majority (in the range of 40% - 50%) and has been largely stable over the years. While USD's share of reserves has been on a downtrend since 2001 as reserves managers engaged in reserve diversification towards nontraditional reserves, it is also true that the share of USD reserves is still significant (slightly under 60%) and remains a key reserve currency. In the context of global FX markets, international banking and foreign debt issuance, the USD has continued to play a dominant role.

In conclusion, the USD still plays a dominant role in trade & invoicing, international payments, reserves, and access to capital and FX markets as there is a lack of suitable alternatives in the foreseeable future. But this does not hinder the de-dollarization trend, which may be slow for now.

What could be worth keeping a close watch is the relationship between reserve holdings and trade as well as payment alliances, trade invoicing. Efforts to create alternatives to the USD seem to be picking up pace this year. One research documents a significant correlation between a country's trade with China and its holding in RMB as reserves while another IMF study[4] shows a link between trade invoicing and central bank reserve holdings.

[4] Gita Gopinath & Jeremy C. Stein, 2018. "Trade Invoicing, Bank Funding, and Central Bank Reserve Holdings," AEA Papers and Proceedings, American Economic Association, vol. 108, pages 542-546, May.

Strong correlation between USD share in import invoicing and USD share in FX reserves



Source: Gita Gopinath & Jeremy C. Stein, 2018

"So far, the data do not show substantial changes in the use of international currencies. But they do suggest that international currency status should no longer be taken for granted, and that we should be really attentive to the currency in which trade transactions are organized."

Christine Lagarde, President, European Central Bank
At the Council of Foreign Relations, 17 Apr 2023

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