

Crises, Debt & the Future of American Economic Policy

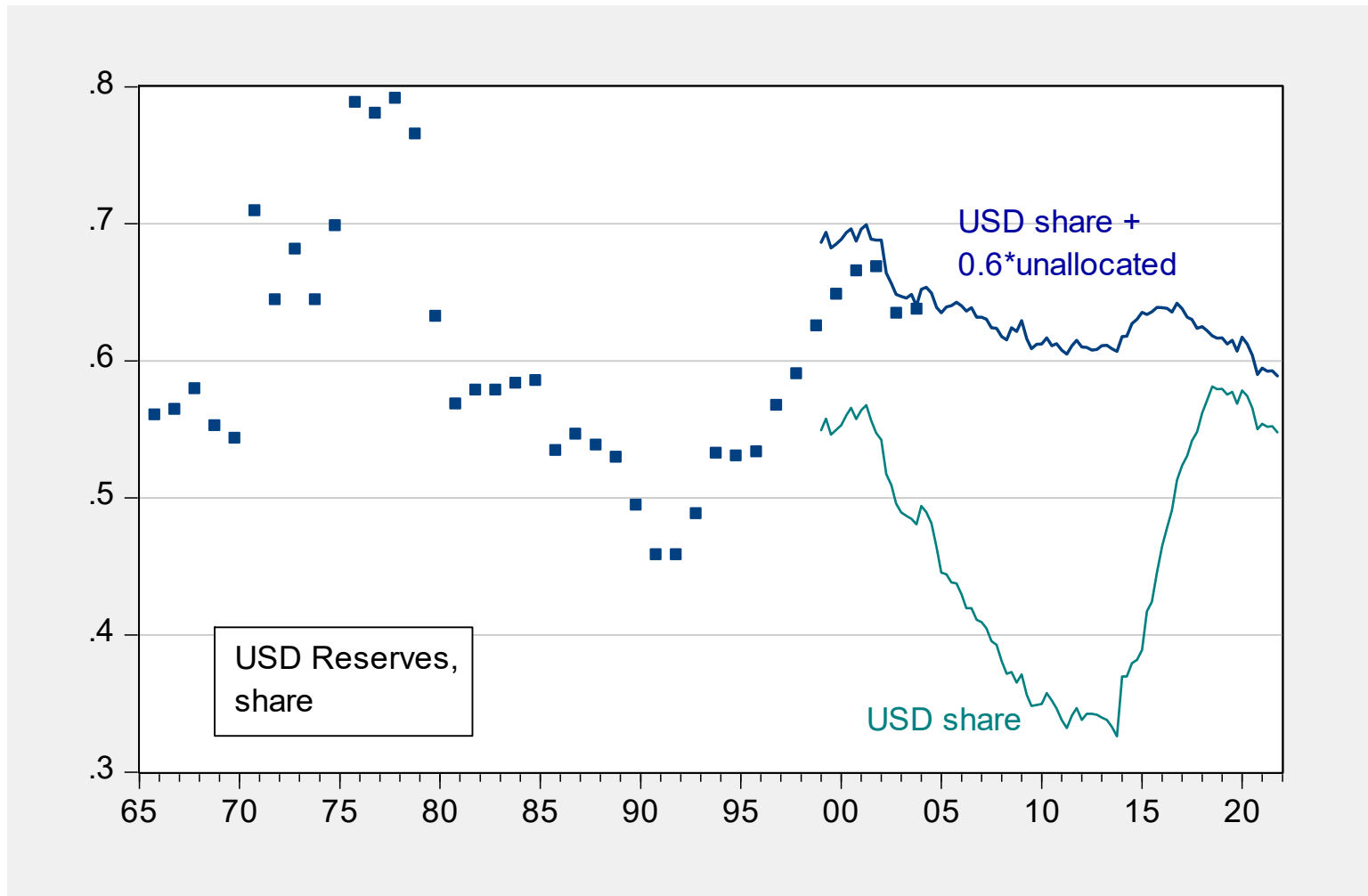
Menzie Chinn

University of Wisconsin

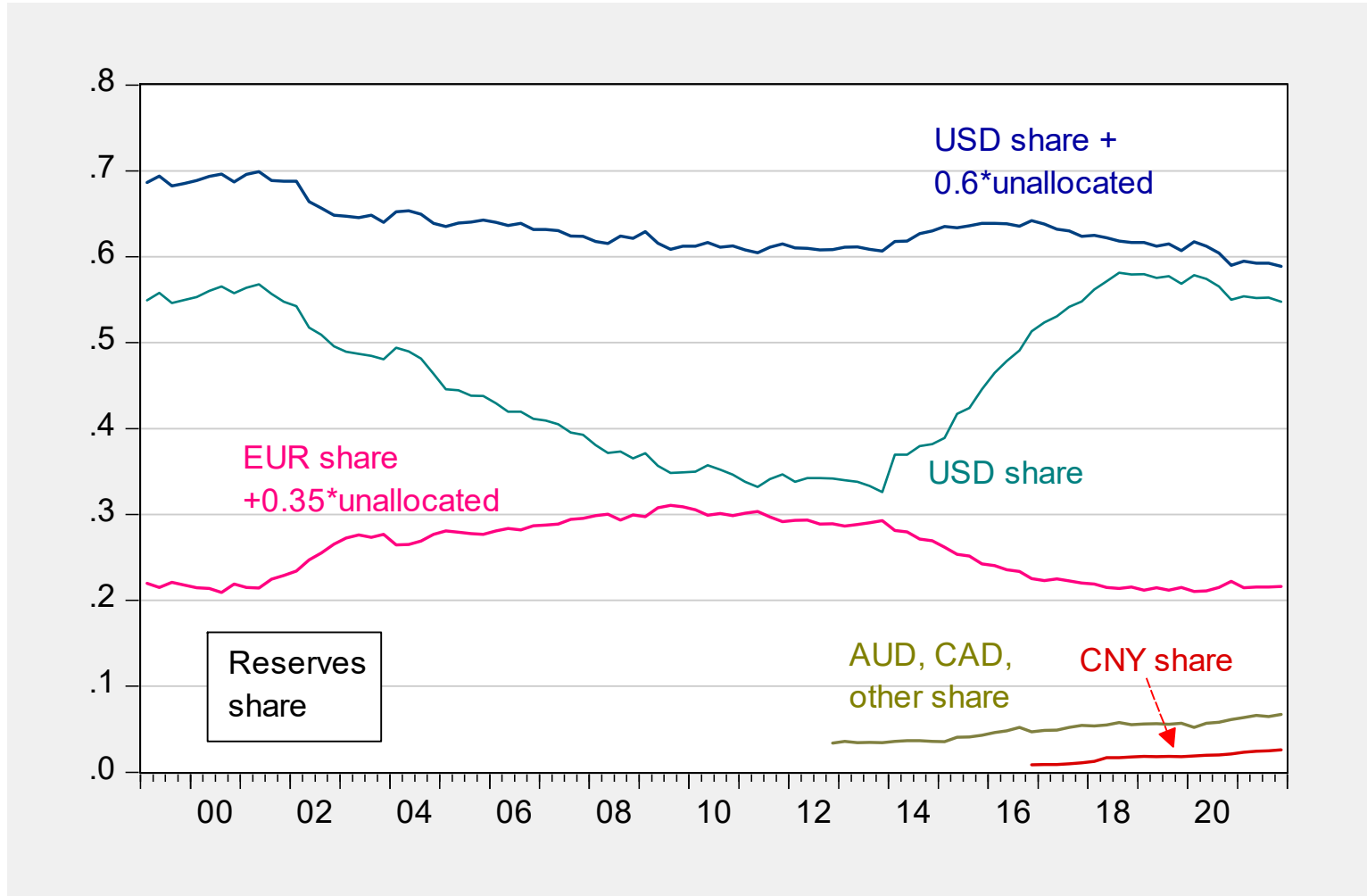
May 4, 2022

Is Dollar Primacy
Eroding?

Dollar as the Reserve Currency



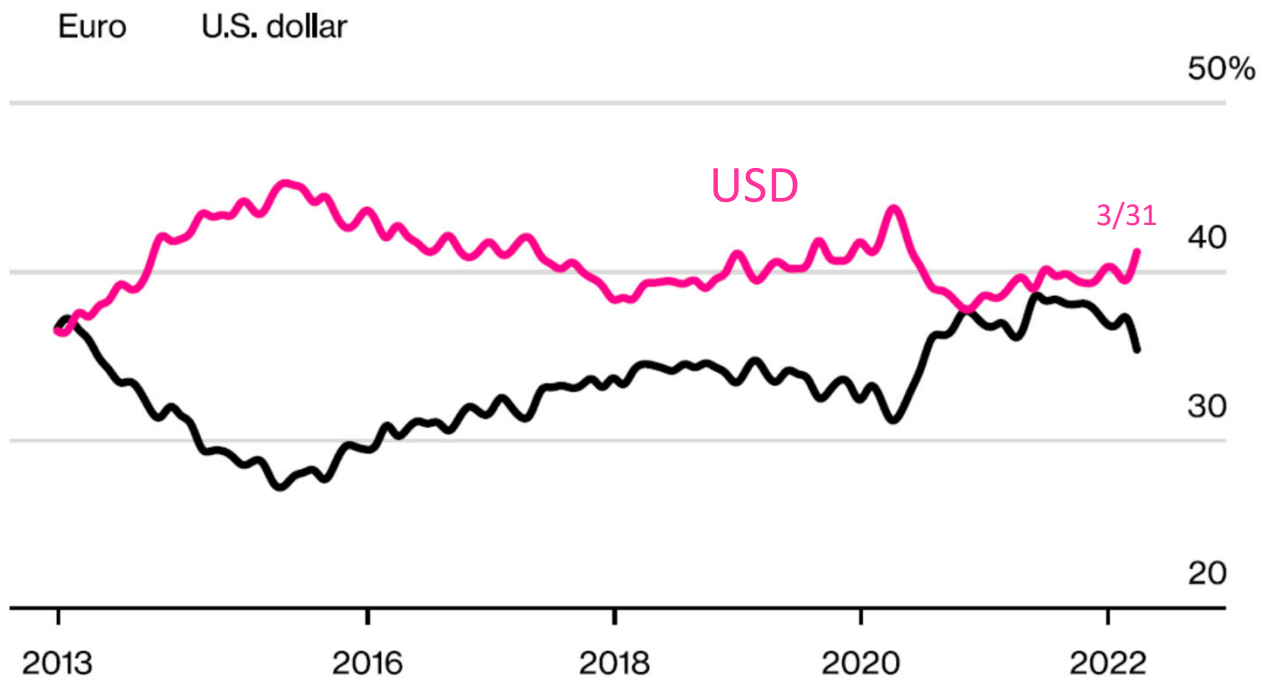
Competitors



In financial transactions

Growing Apart

U.S. Dollar and Euro take diverging paths as the top payments currencies



Source: Swift

Note: Based on customer initiated and institutional payments values messages exchanged on the Swift platform

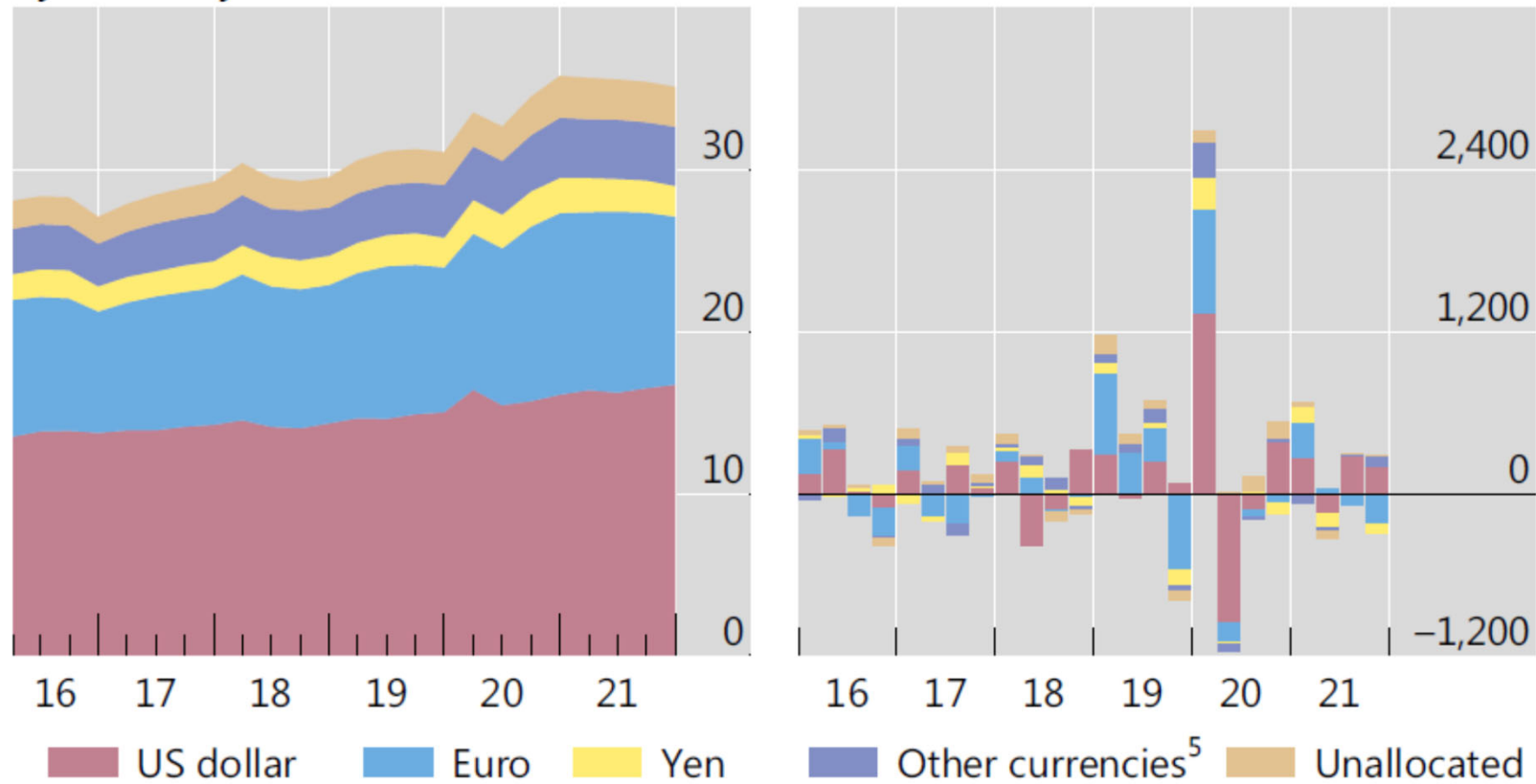
In cross-border borrowing

Cross-border claims by sector, currency and instrument

Amounts outstanding, in USD trn¹

Adjusted changes, in USD bn²

By currency



Sanctions Blowback?

Economic sanctions reconsidered

- Conventional wisdom was that economic sanctions could seldom change policy in the sanctioned countries
- Iran sometimes viewed as an exception
- Sanctions against Russia have demonstrated significant economic pain can be inflicted
- Still unclear whether policy is affected in the short run
- Although it seems that 2014 sanctions might have affected military readiness

Erosion of dollar primacy

- Only 7 Russian banks removed from SWIFT
- Sanctioning dealing with Russian banks has been much more effective
- Sanctioning Russian central bank particularly damaging
- Even Chinese firms have avoided sanctioned Russian banks
- Over time, development of alternative messaging systems might allow circumventing SWIFT
- But moving away from holding dollar assets is expensive, and limited

Balancing Act

Tradeoffs:

- Staying away from USD assets, diversifying
- And holding assets in other central banks, firms not under control of Western government

versus

- Ease and low costs of accessing and transacting in USD
- And safety in general of USD assets

How Is China Trying to Prepare?

- China has already responded by forcing firms to make choice between following US sanctions and being able to operate in China
- Sanctions on Russia much more wide-ranging
- Recent high level meeting of regulators and banks on how to protect Chinese overseas assets from sanctions
- Conclusion – diversification was infeasible
- The costs to US of imposing Ukraine/Russia sanctions are viewed as so high as to make unlikely – except in extreme cases
- Financial linkages much greater, e.g, US FDI in China