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Why the US dollar is of particular importance internationally

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Time and again, there are discussions about the perhaps overly dominant position held by the US dollar within the global financial system. Rising hopes of US interest rate cuts followed by disappointment have repeatedly resulted in fluctuations on the currency markets. The role of the greenback, which continues to assume a special role at a global level, is briefly placed in a historical context and explained in the commentary below. While there are clearly challenges with respect to the particularly important role played by the US dollar worldwide, there are currently almost no real alternatives to the greenback as the most important means of payment for global trade in goods and services, with this being especially true for financial services.

Towards the end of the Second World War, a system for organising global currencies was put in place in 1944 in response to the need for economic stability in the post-war period. It should come as no surprise that the US, as the world's strongest nation economically at that time, made its currency the anchor of the new monetary regime, which was named "Bretton Woods" after the conference venue in New Hampshire where the new system was drawn up. After so much time has passed, it may seem more astonishing that the US dollar continues to retain its place as the anchor of the global monetary system. Despite everything, it has remained the ultimate reserve currency and the preferred international means of payment. But why is this the case? The world needs a monetary anchor and to date there has been no real alternative to the greenback.

While the Eurozone, which is home to the euro as the bloc's single currency, is of some significance in terms of population size and the economy, the financial markets of Eurozone countries are still no match for the US in terms of importance and progress. This is not least due to the fact that the Eurozone does not have a bond benchmark comparable to US Treasury bonds, with each currency issuing its own government bonds.

Thanks to its global significance, the US is able to pay for most of its international purchases using its own currency, which proves advantageous despite the greenback often having been considered expensive. The latter consideration is often justified by making reference to the high and persistent US trade deficit. Nevertheless, the US dollar has so far held onto its title as the world's most important currency. In fact, it has become even more important than in the days of the Bretton Woods system, especially as the global significance of the British pound has diminished. Even though the system of fixed exchange rates and the gold standard have made way for a more flexible currency system since the 1970s, the global anchor role played by the US dollar has remained unchallenged.

"It is likely to be years, perhaps decades, until the greenback's global dominance comes to an end."

Gérard Piasko, Chief Investment Officer

This situation can also be attributed to the fact that over the years many countries, especially emerging markets, have issued ever more debt securities in US dollars in addition to bonds in their local currencies with the aim of raising money on the international capital market. The increasing prominence of the emerging markets since 2000 has thus indirectly increased the significance of their financing via the greenback, making the US dollar even more important at a global level.

Over the decades, international interest in investing in US firms has also increased, further boosting demand for the greenback. The percentage of global market capitalisation accounted for by US equities has risen to in excess of 66% or more than two-thirds due to the popularity of US companies.

Furthermore, the US economy remains the most impor-

tant in the world despite the increased significance of China and many countries in the Eurozone. The sum of direct foreign investments flowing into the US is much greater than the direct investments of the US into other countries. The Eurozone does not represent an alternative as a reserve currency owing to its lack of common fiscal sovereignty and no uniform budgetary policy. And China has not become any more popular with international investors, not only due to the fact that it has posted lower economic growth, but also due to the spiking political tensions with the West. Although China and Russia are trying to develop an alternative to SWIFT, the global payment system, the role of the US dollar remains globally dominant. This thus allows the US to continue to pay its external liabilities using its own currency and maintain its high level of debt. However, debt in the Eurozone has also risen.

In addition, global commodity trading remains denominated in US dollars, even though commodities have long since been produced also in other countries. It is therefore likely to be years, if not decades, until the greenback's global dominance really comes to an end.

Gérard Piasko

Gérard Piasko is Chief Investment Officer and head of the investment committee of private bank Maerki Baumann. Before he was for many years Chief Investment Officer of Julius Baer, Sal. Oppenheim and Deutsche Bank.



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