

Why the US Dollar is important to us all

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Tacit strategies have historically had a significant allocation to US Dollar assets, be they equities in the Growth element or US government bonds in the Stabiliser. The unique role of the US Dollar in the global economy makes it a very important risk management tool during periods of market stress. We have been asked many times about why it is important to UK investors in a world with growing interest in Digital and Crypto currencies.

The question we ask is: how likely is a change in the global dominance of the US Dollar ?

In short, to us the role of the US Dollar stretches far beyond risk management in the modern world.

Debates about the future of the international monetary system often underappreciate the 'full-spectrum' dominance of the Dollar. Understanding its role in public and private markets is complicated in the modern world.

We acknowledge, there are threats to the Dollar, both globally and nationally. The currency's primacy and pervasiveness in the global financial system has become a major issue in the power struggle between the United States, China, and Russia. These geopolitical challenges are happening against a backdrop of high interest rates and America's polarised politics, which prompted the drawn-out negotiations over the US debt ceiling earlier this year. Taken together, they risk undermining the perceived safety of Dollar assets. But for the US Dollar to be unseated, multiple factors must play out in tandem due to the scale of its dominance in the world.

Moreover, the US and potentially other countries have a vested interest in preserving the Dollar's status as the world's only truly global currency. Americans benefit from the ease and convenience of transacting in the Dollar's, seigniorage, monetary flexibility, and being the world's safe haven in times of crisis. For the US government, it serves as a non-military instrument of coercion with which to influence the world.

In the post-Cold War era, governments have been motivated primarily by economic factors when deciding whether to bulk up on a foreign currency. The liquidity, depth, and breadth of the Dollar market has made it widely accessible and cheaper to use than alternatives. Feedback loops between official institutions and private users have also encouraged governments and monetary authorities to accumulate Dollar-denominated reserves.

For example, in times of crisis, many rely on central banks to supply them with Dollar assets, sometimes via swap lines extended by the US Federal Reserve. Private institutions' willingness to use and hold Dollar is also a choice based on economic considerations: they are likely to settle payments, and thus store value in the invoicing currency.

So in reality, to bring about a Dollar collapse and forge a new world order in which it plays a diminished role would require all users to break these network effects and suffer the consequences. Governments would need to sever economic and political ties to the US. To fulfil the BRICS' pledge to create an alternative reserve currency and payment system, for example, many of its members would have to stop relying on US liquidity and consumer demand.

Such initiatives depend on the participation of major economies or a preponderance of minor ones. It is unlikely that the major economies would come on board, because, with the exception of China, they all enjoy access to Dollar swap lines. Moreover, if governments abandon the Dollar before another currency becomes dominant, they risk losing a liquidity lifeline in times of crisis. It will not happen.

The currency is only as valuable as the economy behind it along with all the ties that bind a modern, open, trading nation: law, enforceable property rights, checks and balances between the judiciary, executive and legislature. Bluntly the world wants to “save” in the United States of America because it is safe, secure, and free from the discretionary and arbitrary use of state coercion. That means buying and owning the Greenback.

Contrast that with Russia and China: the Rouble is non transactable in the West and the Yuan is not convertible.

In theory the US Dollar dominance in the world should be under threat, however in practice, it is too important to too many people for this theory to become reality in the foreseeable future.

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