



**AL HABTOOR  
RESEARCH  
CENTRE**



# **DE-DOLLARIZATION WHAT IT MEANS FOR THE U.S. ECONOMY**

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H A B T O O R R E S E A R C H . C O M



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# **Dr. Azza Hashem**

Director of Al Habtoor Research Centre

Prepared by

**Pacinte Abdel-Fattah**

Senior Researcher

**Dr. Mohamed Shadi**

Senior Researcher

**Farah El Komy**

Junior Economics and  
Energy Researcher

Designed by

**Abdelazem Mohamed**

Graphic Designer

The United States dollar (USD) prominence as the main global reserve currency can be attributed to the Bretton Woods Agreement of 1944, which created a new international monetary order and directly linked major world currencies to the USD, which was itself pegged to gold at \$35 per ounce. The USD quickly emerged as the primary medium of exchange for most commodity trades and international financial transactions as a result of this agreement, which concentrated trust and liquidity around the currency. In 1971, the Nixon Shock occurred when the United States (U.S.) ended direct USD–gold convertibility, weakening the USD. However, the scope and depth of U.S. financial markets and the petrodollar system - which mandated that oil exports be invoiced and paid in USD- made it incontrovertible, giving the U.S. “the exorbitant privilege”, as economist Valéry Giscard d’Estaing described it, of having substantial control over global monetary policy while financing trade and budget deficits.

It’s crucial to weigh this against factors that continue to uphold the USD’s hegemony though. The unmatched stability liquidity and depth of U.S. financial markets continue to attract global investors worldwide, preserving the USD’s position as the favored reserve asset. Since international trade, finance, and investment infrastructures are still heavily USD-centric, it is also challenging for alternative currencies to quickly replace the USD due to the vast global network effect that has been developed over decades. Moreover, the USD’s status as a “safe-haven” asset persists, particularly during periods of global uncertainty, sustaining demand.

Yet, this hegemonic status is now challenged structurally in ways increasingly understood as de-dollarization- that is, the deliberate reduction of the share of the USD in global trade invoicing, reserve holdings, and payment systems. Debates on the durability of U.S. monetary leadership have been ongoing for decades, but a number of forces have turned de-dollarization from an abstract concept into a global trend since the Global Financial Crisis of 2008. That crisis exposed systemic vulnerabilities within USD-dependent financial networks, underscoring how U.S. monetary policy and financial shocks can transmit worldwide in destabilizing ways—especially across Emerging Markets and Developing Economies (EMDEs).

This postwar order is increasingly under structural pressure from geopolitical fragmentation, rising U.S. debt, sanctions overreach, and the emergence of alternative payment systems. These pressures could lead to two different scenarios for the U.S. economy in a post-dollar world: a sudden collapse due to financial instability and inflation, or a gradual decline with persistently higher borrowing costs and the steady erosion of fiscal and geopolitical leverage. The latter is more likely but still represents a structural shift that redefines the balance of global economic power.

## Drivers of De-dollarization

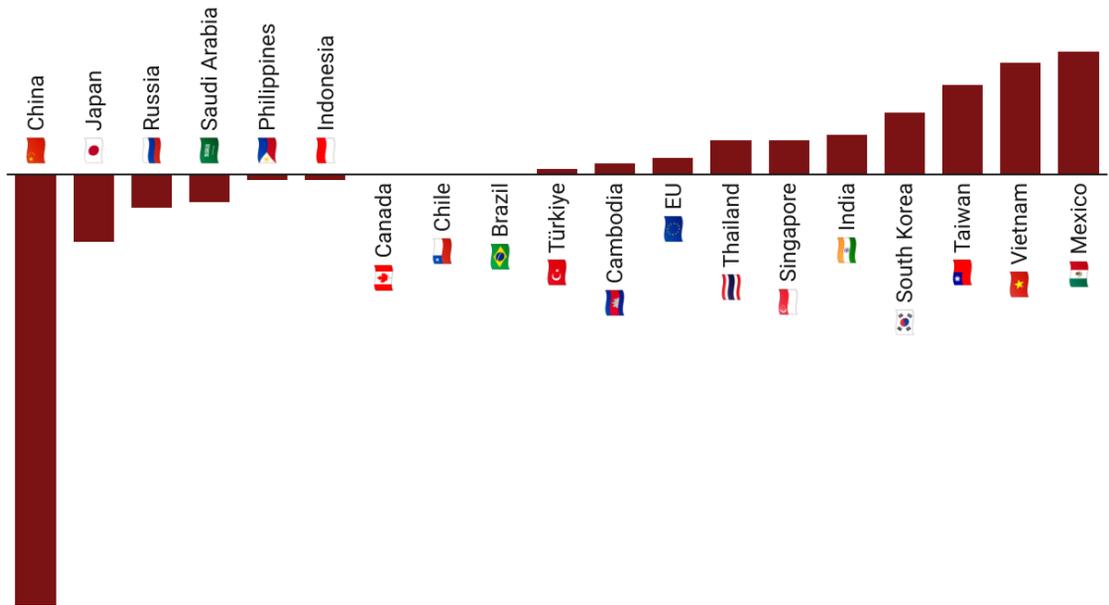
### **Geopolitical Fragmentation and the Rise of Financial Multipolarity**

A decisive geopolitical inflection occurred with the imposition of sweeping U.S.-led sanctions on Russia following its 2022 invasion of Ukraine. The freezing of major portions of Russia's foreign currency assets, primarily in USD, exposed the USD as a powerful geopolitical weapon, upending the long-held notion of the USD as an unpolitical, "safe haven" asset. Countries that do not identify with Russia or the West began to reconsider the hazards of USD reliance as geopolitical tensions and sanctions threats increased, hastening sovereign reserve managers' diversification away from the currency. As a result, they have boosted commerce with non-Western nations such as China, India, Turkey, and the United Arab Emirates (UAE).

To reduce exposure to U.S. policy risks and the potential weaponization of USD liquidity, foreign governments have been encouraged to diversify away from USD denominated assets due to the aggressive U.S. tariff policies, especially since 2018 against strategic rivals. Significant sell-offs of U.S. debt and stocks were sparked by worries about the USD's hegemony, which put pressure on the currency's value. The economic impacts of U.S. tariffs have been particularly evident in bilateral trade flows. China tariffs have significantly decreased U.S. imports of Chinese goods since 2018 with the most significant declines in machinery electronics and communication equipment showing the biggest drops. China's imports had dropped by almost half by 2025. Similar declines were noted in trade with Canada and Mexico where new tariffs limited the flow of manufactured goods and energy. Central American and Caribbean developing economies that are largely dependent on the U. S. market access in the event of a severe trade war faced even more severe projected export losses. These disruptions are in line with more extensive research that demonstrates how tariff increases raise production costs lower global demand and compromise consumer welfare.

## U.S. Import Share Change by Country

2017-2024



This data directly illustrates the fragmentation caused by U.S. protectionism, reinforcing a long-term trend toward de-dollarization as many nations began to use more alternative currencies in trade settlements. As exporting to the U.S. became more expensive this process accelerated pushing nations in Latin America Asia and Africa to strengthen regional trade agreements. As transactions in currencies like the euro or the Chinese yuan become more common, the U.S. is gradually losing its pivotal role in the global trade system as emerging economies fortify their networks of intraregional commerce.

However alternative sourcing and trade realignment were also prompted by these trade shocks. About \$21 billion in trade was redirected toward economies like Vietnam Mexico Taiwan and Malaysia in 2019 alone especially in industries that were previously dominated by China. Southeast Asian nations had solidified these gains by 2025 becoming vital suppliers in the global furniture and electronics markets. Beyond trade diversion toward the U.S., emerging economies increasingly traded with one another to mitigate exposure to both U.S. tariffs and geopolitical leverage. While Brazil India Turkey and Gulf states expanded regional agreements that circumvented the U.S., China deepened its ties with ASEAN and Latin America.

Importantly, the emergence of regional trade and finance blocs reflects a larger strategic trend toward economic and financial multipolarity, which includes these tactical economic adjustments. This tendency is best illustrated by organizations like ASEAN and the expanded BRICS (Brazil Russia India China South Africa and new members like Saudi Arabia and the UAE). This bloc currently accounts for nearly half of the world's GDP and half of its population, giving it considerable sway over international finance and trade. Cross-border payment systems, loans in member currencies through the New Development Bank, and plans for commodity exchanges priced outside of the U.S. are some of its initiatives. These efforts are further motivated by geopolitical considerations, such as the freezing of Russian reserves and removal from the SWIFT network, which highlighted vulnerabilities tied to USD dependence.

The U.S. views the rapid expansion of BRICS influence as a strategic threat, given that the USD's status confers a unique "exorbitant privilege." In response, BRICS has focused on incremental substitution rather than immediate replacement of the USD. Internal disagreements also limit the pace of reform: countries such as India and South Africa have opposed the introduction of a unified BRICS currency, citing concerns over potential economic instability and the risk of U.S. retaliation.

These blocs actively promote intra-regional commerce settled in local currencies, such as the Chinese yuan, Indian rupee, or Brazilian real, thereby bypassing the USD as an intermediary currency. The strategy extends to building bilateral currency swap lines and adopting alternative payment and settlement infrastructures. Concrete evidence of this shift is visible in the growing role of the Chinese renminbi (RMB).

According to the International Monetary Fund's (IMF) Currency Composition of Official Foreign Exchange Reserves (COFER) data, the RMB accounts for roughly 2–3% of allocated global reserves as of 2024, up from around 1% less than a decade ago—reflecting steady internationalization of the currency. Meanwhile, data from the SWIFT RMB Tracker indicate that the RMB's share in global payments has risen to about 4.5% in early 2024, compared to less than 1% 10 years earlier, marking a notable increase in its role in international transactions. In parallel, the People's Bank of China has established around 40 bilateral currency swap agreements with foreign central banks, according to the Council on Foreign Relations and Federal Reserve Board estimates. These swap lines collectively provide hundreds of billions of USD in RMB liquidity, facilitating trade settlement, investment flows, and financial stability between China and its partner economies. Together, these developments underscore the yuan's gradual but measurable progress toward becoming a more widely used reserve and transaction currency in the global financial system.

## Foreign Exchange Reserves Holdings

year	Canadian dollar	Australian dollar	Euro	Pound sterling	Swiss franc	US dollar	Japanese yen
2016	163,144	142,303	1,611,026	365,858	13,694	5,501,930	332,758
2017	202,798	180,494	2,019,378	454,790	17,604	6,280,660	490,308
2018	197,216	174,463	2,217,578	474,876	14,782	6,624,672	556,906
2019	205,989	187,882	2,279,459	513,518	16,564	6,725,711	649,763
2020	246,567	216,871	2,526,414	561,388	20,738	6,990,854	715,348
2021	286,932	221,321	2,481,340	579,382	20,789	7,085,004	665,103
2022	263,610	217,083	2,248,992	540,916	25,210	6,460,212	611,831
2023	296,470	245,535	2,284,366	557,139	22,266	6,690,613	651,685
2024	318,074	235,463	2,275,618	542,754	20,476	6,629,977	667,012

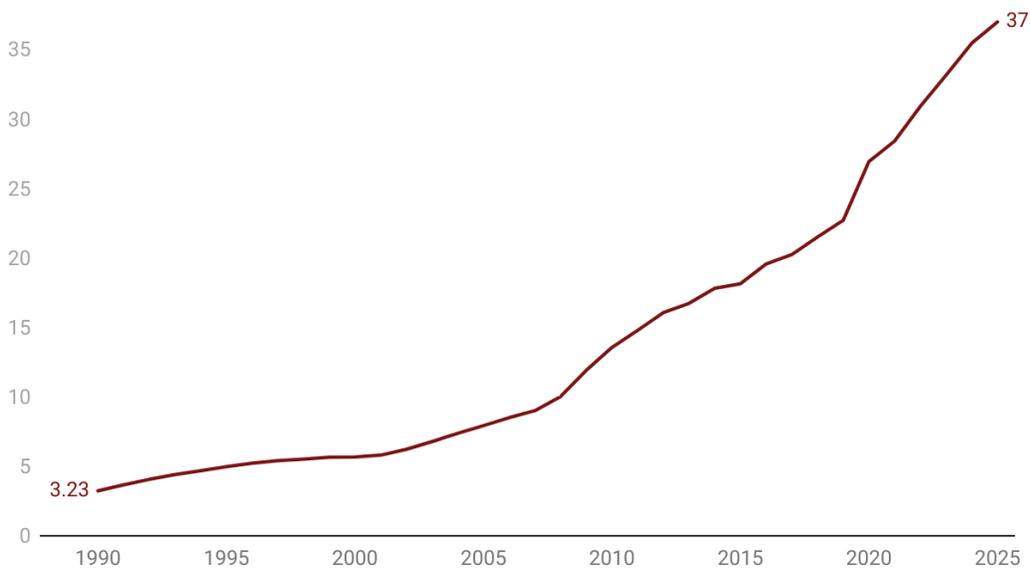
In addition, China, as the world's largest exporter and a dominant force in key supply chains, has positioned itself as the U.S.' most significant long-term competitor, creating structural dependencies that encourage trade settlement in alternative currencies through the Belt and Road Initiative and the promotion of yuan-based transactions. This focus on local currency trade is tangible, as demonstrated by the rapid rise in the proportion of Russia-China trade settled in local currencies, which now exceeds 95%.

## Macroeconomic Vulnerabilities and Strategic Reserve Diversification

This de-dollarization is supported by economic fundamentals such as growing concerns about the U.S.' fiscal trajectory; the country's debt has recently reached \$37 trillion and is expected to surpass 120–143% of GDP by 2035, increasing fiscal pressures and market anxiety over U.S. creditworthiness. Credit rating agencies have already downgraded U.S. sovereign debt several times in recent years, eroding the accepted notion of U.S. treasury securities as the ultimate risk-free asset, which is integral to the USD's reserve currency appeal.

### U.S. National Debt

(in \$ Billions, Rounded)



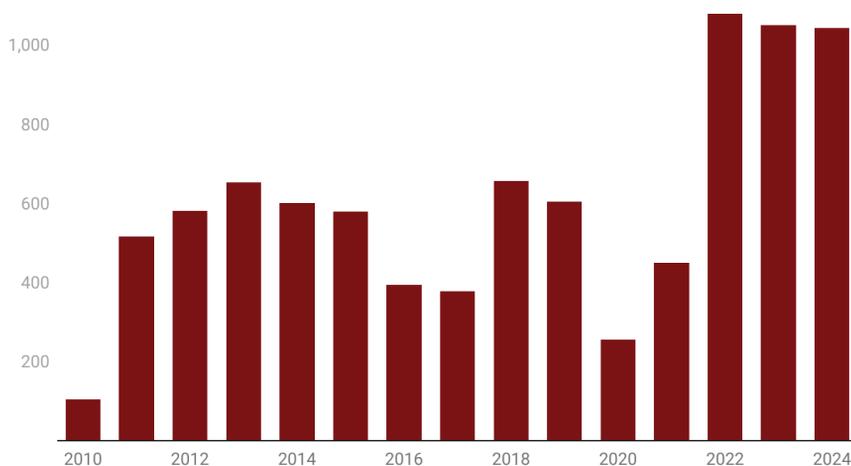
These developments have contributed to debates over the timing and extent of a potential USD decline, with some analysts arguing the USD's global primacy will erode gradually over decades, while others warn of more abrupt shifts. The uneven pace of de-dollarization across different countries, regions, and sectors means that the USD will likely remain dominant in many areas for the foreseeable future.

Further compounding this instability is the Federal Reserve's monetary policy dynamic known as the Reaction Shock Mechanism. Recent empirical research distinguishes between "real shocks" (Fed rate hikes in response to robust U.S. economic growth) and destabilizing "reaction shocks"—hikes prompted by abrupt shifts in policy stance to combat inflation—which aggressively tighten global financial conditions and nearly double the probability of financial crises in vulnerable EMDEs. For example, a Fed tightening triggered via an exogenous shift in its reaction function is shown to lead to sharper falls in output, tighter financial conditions and more exchange-rate depreciation in these economies.

Mounting fiscal and monetary vulnerabilities — including concerns over foreign-exchange exposure, sovereign balance-sheet risk, and the reliance on USD based assets — have driven a structural shift in central-bank reserve management. In response, many central banks are explicitly diversifying their portfolios, reducing their USD share in favour of a broader array of reserve assets and enhancing holdings of gold as a strategic sovereign buffer. According to the World Gold Council, central banks added roughly 1,045 tonnes of gold in 2024 alone, marking the third consecutive year in which annual net purchases exceeded 1,000 tonnes well above the 473 tonnes annual average observed during 2010-21. Unlike USD-based reserves, gold is a non-sovereign asset immune to counter-party risk, asset freezes or sanctions, reinforcing its appeal as a hedge of financial sovereignty. These trends reflect a longer-term recalibration of reserve policy rather than a fleeting episode of risk aversion.

### Central banks Net Gold Purchases

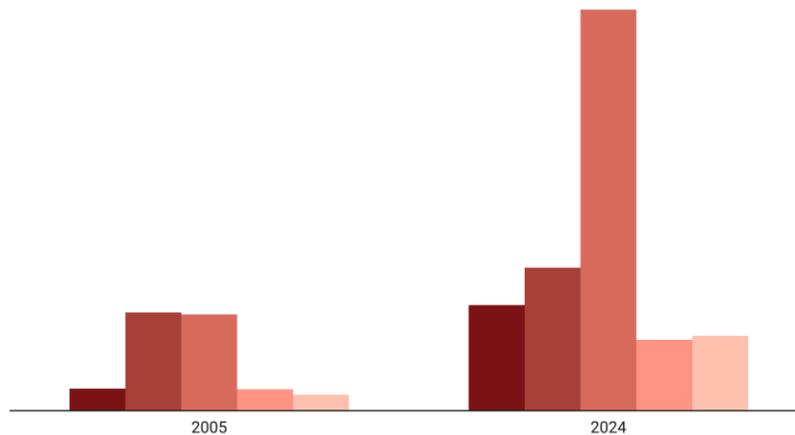
In Tonnes



### Total Gold reserves

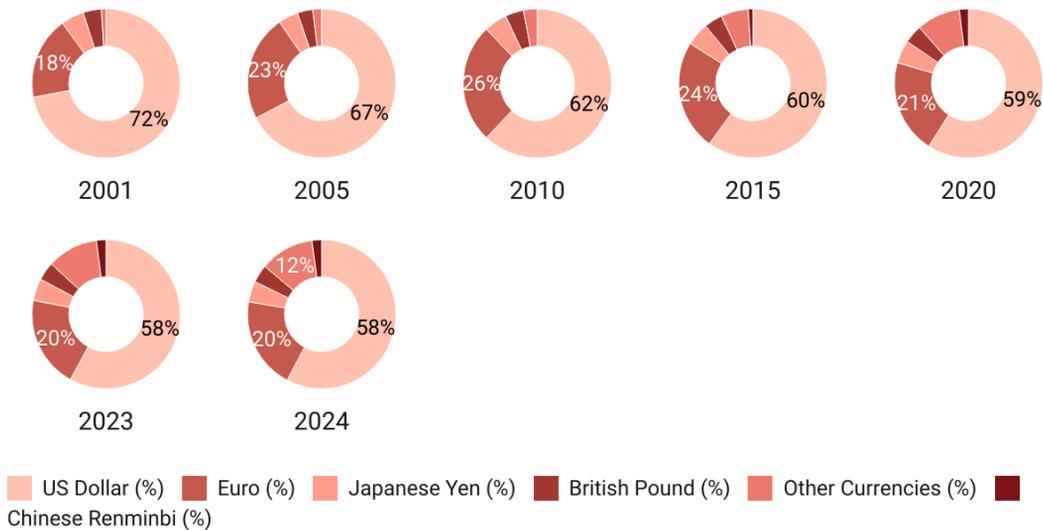
(In Million U.S.\$)

United States of America Japan China Russian Federation India



This shift is evident in global reserve compositions. According to IMF COFER data for Q2 2025, the USD’s share of official foreign exchange reserves fell to 56.32%, down from roughly 72% in 2001. The euro now represents 21.13%, the Japanese yen, Canadian dollar, and Australian dollar collectively account for over 20%, while the Chinese renminbi has gradually risen to around 2–3%, primarily concentrated among aligned nations. These figures reflect a broader trend toward reserve portfolio diversification rather than outright replacement of the USD.

### Global Reserve Currency Shares



Regional and emerging-market blocs are also actively reducing reliance on the USD as the dominant settlement and reserve asset. The ASEAN+3 Chiang Mai Initiative Multilateralisation provides a multilateral currency-swap facility among East Asian economies, supplying liquidity in non-USD form. Similarly, the BRICS Contingent Reserve Arrangement — a pooled reserve of approximately \$100 billion — signals an alternative liquidity buffer beyond the IMF/USD matrix. Parallel discussions within BRICS around a new settlement instrument, commonly referred to as the “Unit,” could combine gold, basket-currency backing, and digital-token architecture. While still nascent and without a launched single currency, these efforts represent a meaningful shift toward shared monetary autonomy rather than a simple one-to-one replacement of the USD.

### Digital Pathways Beyond the Dollar

The evolution of these diversification patterns increasingly relies on digital innovation, which provides the infrastructure for operationalizing monetary autonomy beyond the U.S. led financial system dominated by the SWIFT network and correspondent banking systems.

Distributed ledger technology (DLT), the backbone of systems like the Bank for International Settlements' Project mBridge, represents a pivotal innovation that enables secure, transparent, and immutable records across distributed networks, facilitating near-instant cross-border payments without intermediaries. The Payment-versus-Payment mechanism ensures simultaneous currency exchange, thereby minimizing settlement risk and reducing reliance on USD-centered messaging systems and banking intermediaries subject to U.S. jurisdiction and control.

Several central banks are involved in Project mBridge, which was started under the BIS Innovation Hub's auspices and has advanced to the minimum viable product stage. Project mBridge, which is based on DLT, allows for immediate peer-to-peer cross-border transactions and currency swaps settled in central bank digital currencies, completely avoiding the USD and the associated counterparty risks that come with it. China's Cross-Border Interbank Payment System, which enables trade settlement in yuan, complements this digital advancement. This parallel digital infrastructure provides increasingly feasible, resilient, and geopolitically balanced routes for international trade and finance, even though the USD continues to be the main medium of exchange.

The digitalization of monetary systems further accelerates non-USD transactions in strategic sectors. The digital yuan (e-CNY) is gaining traction in energy and commodity trade, gradually eroding the USD's transactional hegemony in critical markets. Meanwhile, Japan has entered the digital currency arena with its first yen-pegged stablecoin, JPYC, marking a step toward digitizing payments in a country traditionally dominated by cash and credit cards. Issued by the startup JPYC, the digital currency is fully backed by Japanese government bonds (JGBs) and convertible 1:1 with the yen. The firm plans to issue up to 10 trillion yen (approximately \$ 66 billion) over the next three years, generating revenue from JGB interest rather than transaction fees—a model that exemplifies how digital assets can serve both fiscal and strategic objectives.

The systemic vulnerability brought about by U.S. fiscal risks, the geopolitical catalyst of financial weaponization, and the technological pathway made possible by digital currency platforms are all contributing factors to de-dollarization, which is gradually weakening the once indisputable network effect of the USD as the world's reserve currency. This transformation has direct implications for the U.S. economy, necessitating a close examination of the true cost of the unravelling impact through two possible scenarios.

## Scenario Analysis: Financial Market Shocks and Systemic Risk

The following scenarios outline two divergent but interrelated pathways through which the erosion of USD dominance could unfold. They span a continuum from a sudden, disorderly collapse to a gradual, managed adjustment. A sudden disruption of USD hegemony could trigger a severe stagflationary crisis marked by a deep recession, currency collapse, sharp GDP decline, soaring interest rates, runaway inflation, and a major asset crash reminiscent of 2008, with stocks and bonds potentially losing half their value and immediate sovereign debt pressures. Conversely, a gradual decline in the USD's reserve currency role would impose a persistent drag on the economy—higher structural interest rates, ongoing inflationary challenges, slower growth, reduced fiscal flexibility, less public investment, and diminished U.S. global influence. Although gradual erosion is more likely due to structural inertia, it still carries the risk of reaching a tipping point that triggers cascading financial and geopolitical crises.

### **Scenario A: Sudden, Disorderly Collapse (5-Year Horizon)**

In this scenario, a severe crisis of confidence in the USD triggers a rapid flight from U.S. assets. Potential triggers include a U.S. sovereign default scare or a major geopolitical rupture that leads foreign creditors to mass-divest U.S. Treasury securities. The immediate effect is a precipitous USD crash—on the order of a 25–50% depreciation in a very short time. U.S. interest rates would spike virtually overnight as global investors flee the USD. A significant risk premium would be demanded on U.S. government debt and other USD assets, pushing the 10-year Treasury yield into double digits.

The financial market fallout would be catastrophic: U.S. stock indices could lose roughly half their value, long-term treasury bonds might drop 70–80% in price as yields skyrocket, and real estate values would likely fall by about one-third. Crucially, these declines would be tightly correlated, leaving investors with no haven—unlike in a normal global crisis, U.S. treasuries and the USD become sources of risk rather than refuges. This scenario effectively marries a financial crash with a currency crisis. The result is a self-reinforcing stagflationary spiral: the Federal Reserve would face an impossible choice between raising rates to defend the USD (thereby deepening the recession) or lowering rates to help growth (further undermining the currency).

## Scenario Analysis: Financial Market Shocks and Systemic Risk

### **Scenario B: Gradual, Orderly Decline (20-Year Horizon)**

This scenario envisions a slow structural erosion of the USD's international role rather than a sudden shock. Over two decades, the USD's share of global reserves and trade would drift downward as countries incrementally diversify. The consequence would be a persistent but controlled rise in U.S. borrowing costs. Losing the USD's unique "exorbitant privilege" (the extra trust and convenience premium) might by itself add on the order of 50–100 basis points (0.5–1.0%) to treasury yields. In addition, as foreign demand for treasuries gradually recedes, long-term rates would face further upward pressure. U.S. interest rates could stabilise several percentage points higher than in a USD-dominant baseline.

Rather than a market crash, a gradual decline is akin to a continuous headwind. U.S. financial markets would likely underperform international peers. Equity valuations would compress (lower price/earnings ratios) and credit spreads would widen modestly, reflecting slightly higher risk premiums on U.S. assets. While outright crises are avoided, the cumulative effect over the years is significant: U.S. portfolios would realise lower long-term returns, and the U.S. would slowly relinquish its status as the world's investment haven. Capital flows would also adjust – instead of readily attracting the world's surplus savings, the U.S. would need to rely more on domestic savings or pay higher rates to borrow externally.

Crucially, the gradual path still carries risk. The system's stability assumes confidence is maintained throughout the orderly decline. If at some point holders of USD assets doubt that the process will remain orderly, they could accelerate their exit, turning a slow drain into a sudden run. Thus, the gradual path is fundamentally a period of accumulated latent risk: beyond a certain tipping point, it could rapidly cascade into a self-fulfilling collapse resembling Scenario A.

### **Quantitative Basis and Methodology**

The quantitative estimates presented—such as a 25–50% USD depreciation in a sudden shock or a 0.5–1.0% rise in treasury yields during gradual erosion—are grounded in a combination of historical precedents, econometric model simulations, and expert consensus. For instance, the sharp currency depreciation range draws on past episodes of currency crises in emerging and advanced economies, adjusted for the structural size and liquidity of the USD market.

Yield increases reflect both empirical measurements of risk premia expansion observed during past sovereign credit events and projections from Federal Reserve and IMF macro-financial models that simulate the impact of diminished demand for U.S. debt securities. The assumed gradual yield rise of 50–100 basis points aligns with scenarios where the USD loses its “exorbitant privilege” incrementally, supported by cross-country analyses of borrowing costs before and after shifts in reserve currency status. These assumptions also factor in market liquidity, investor behavior, and geopolitical developments to capture a realistic range rather than precise forecasts, enhancing the robustness and credibility of the scenario projections.

## Comparative Quantitative Outcomes of De-Dollarization Scenarios (2024–2045)

Metric	Current Baseline (c. 2024-2025)	Scenario A: Sudden Collapse (Peak/Trough over 5 Yrs)	Scenario B: Gradual Decline (Cumulative/End-state over 20 Yrs)
<b>Financial Shocks</b>			
Peak 10-Year Treasury Yield	4.0% - 4.5%	> 10% (driven by 250% rate shock)	+4.0 percentage points
Max Dollar Depreciation (Broad, real)	N/A	-25% to -50%	-20% to -30% (cumulative)
Peak Corporate Bond Spreads (BBB)	~1.5%	> 5.75%	+1.0 to +1.5 percentage points
Max Equity Market Drawdown (S&P 500)	N/A	-44% to -55%	Negative relative returns
Max CRE Price Decline	N/A	-30% to -40%	N/A (cyclical)
<b>Macroeconomic Impacts</b>			
Cumulative Real GDP Loss (%)	N/A	> 7.8%	Slower potential growth
Peak Unemployment Rate	~4.0%	> 10.0%	Higher structural unemployment
Peak Annual CPI Inflation	2.5% - 3.0%	> 10% (potential for hyperinflation)	+0.5% to +1.0% annually
Change in Trade Balance (% of GDP)	-3.1%	+2.5% to +3.75% (amid trade collapse)	+1.5% to +2.0% (cumulative)
<b>Fiscal Consequences</b>			
Increase in Annual Debt Service Costs (% of GDP)	N/A	Crisis-driven spike	+3.0% to +4.0%
Reduction in Sustainable Debt/GDP Ratio (%)	N/A	-22% to -30% (immediate)	-22% to -30% (realized)
Loss of "Exorbitant Privilege" (bps on Treasuries)	10 - 30 bps	Full loss (>30 bps + risk premium)	Full loss (10 - 30 bps)

## Macroeconomic Consequences: Transmission to the Real Economy

Building on the initial financial market shocks described in Scenarios A and B, this section analyses how a sudden collapse or a gradual erosion of the USD's role transmits systemic risk to the real economy, altering inflation, employment, real output, and trade patterns. Using the Aggregate Demand–Aggregate Supply (AD–AS) framework, this section quantifies how financial shocks transmit through price levels, production capacity, and external balances, drawing upon Federal Reserve simulations, NBER macroeconomic models, and empirical studies of exchange-rate pass-through.

### Inflation Dynamics and Exchange-Rate Pass-Through

A USD depreciation makes imports more expensive, but the degree of exchange rate pass-through to consumer inflation can vary. In recent decades, U.S. inflation has been relatively insensitive to moderate currency moves: a 10% USD decline might raise consumer prices by only around 0.5% in the long run, due to factors like anchored expectations and foreign exporters absorbing margins. However, a sudden collapse would overwhelm these dynamics. A 25–50% USD plunge would send a massive cost shock through the economy, likely de-anchoring inflation expectations. Prices of energy, food, and manufactured inputs would skyrocket, and the Federal Reserve might even be driven to finance government deficits directly (monetisation), further feeding the inflationary spiral. The result could be hyperinflationary dynamics reminiscent of an emerging-market meltdown.

#### Inflation Pass-Through Dynamics under Dollar Depreciation

Study / Period	Type of Shock Modeled	Dollar Depreciation / Appreciation (%)	Estimated CPI (Consumer Price Index) Impact (%)	Implied Pass-Through Ratio	Time Lag / Duration	Source
High-Inflation Era (1970s – 1980s)	Historical econometric studies	10 % depreciation	+ 2.0 % rise in CPI	0.20	Long-run (1–2 years)	Federal Reserve speech series (2008)
Stable-Inflation Era (2000s – 2010s)	Modern empirical estimates	10 % depreciation	+ 0.5 % rise in CPI	0.05	Within 1 year	Federal Reserve Board (2017 memo)
Federal Reserve Staff Analysis (2017)	Dollar depreciation shock simulation	N/A	+ 0.09 – 0.10 percentage points (core PCE inflation peak)	≈ 0.01	6 months lag; fades within 1 year	FOMC 2017 Staff Memo
Boston Fed Working Paper (2015)	15 % appreciation	– 0.4 % CPI change	0.027 (long-run elasticity)	≈ 0.03	2 years	Boston Fed Research (2015)

In contrast, the inflation effect would be moderate but persistent under a gradual decline. A gentle 1–2% annual USD depreciation might add only 0.2–0.5% to the yearly inflation rate. This would not spark runaway inflation, but it would complicate the Federal Reserve’s job of maintaining its 2% target and somewhat push up baseline interest rates.

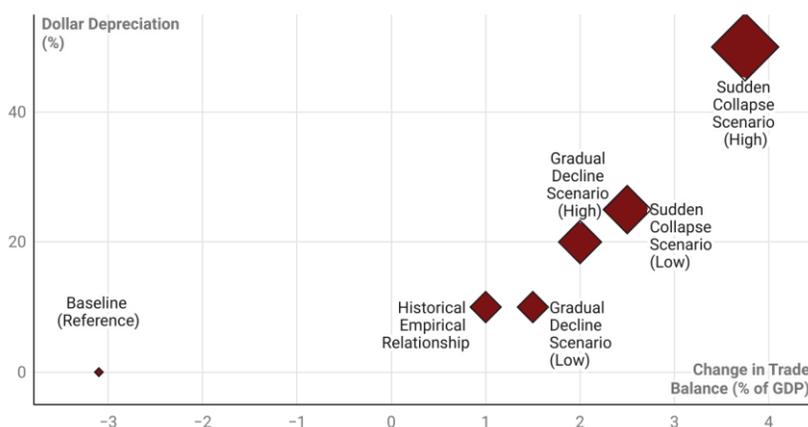
### Output, Investment, and Employment

The two scenarios have very different implications for real GDP and jobs. A sudden USD collapse would create a severe stagflationary shock by constraining supply and crushing demand. Costlier imported inputs (oil, commodities, components) would drive up business costs and depress the economy’s productive capacity (a leftward shift of the SRAS curve). At the same time, the asset market collapse and credit crunch would cause AD to plummet as consumption and investment dry up. The result would be a deep recession with surging prices – a combination far worse than a typical downturn. Real GDP could fall dramatically, and unemployment would quickly shoot into the double digits. Worse, policymakers would be largely paralysed by the impossible choice described in the financial analysis: cutting interest rates to fight the recession would risk further currency free-fall, while raising rates to defend the USD would amplify the economic contraction. This trap means the downturn could be extraordinarily painful and difficult to reverse.

### The Trade Balance and External Adjustment

A weaker USD should, in principle, help reduce a trade deficit by making exports cheaper and imports dearer. In reality, the adjustment is uneven. U.S. exports (mostly priced in USDs) become much cheaper for foreign buyers when the USD falls, so export volumes tend to rise substantially. But U.S. imports are also predominantly invoiced in USDs, so foreign producers often do not raise USD prices one-for-one with American Stock Exchange rate for fear of losing U.S. market share—a dynamic known as "pricing-to-market." The upshot is that import volumes do not contract as much as theory would predict.

**Trade Balance Response to Dollar Depreciation Across De-Dollarization Scenarios**



Confronted with this funding shock, U.S. authorities would face three unpalatable avenues. One is a formal default—an outright failure to meet contractual obligations—which would crystallise losses for holders, permanently raise risk premia on U.S. liabilities, and impair the functioning of domestic financial intermediation. A second is debt monetisation—relying on the central bank to absorb and finance government borrowing—which risks an inflation–depreciation spiral, further eroding real balances and potentially de-anchoring inflation expectations. The third is immediate and severe fiscal consolidation—draconian expenditure cuts and/or abrupt tax hikes—to restore solvency mechanically, which would depress AD, deepen the recession, and strain the social and political fabric.

Any of these paths entails extreme economic and political costs. In practice, crisis management often combines elements of all three—selective restructuring, constrained monetary backstops, and front-loaded consolidation—yet the distributional fallout, financial instability, and loss of policy credibility would remain substantial under any mix.

### **Gradual Decline – Long-Term Fiscal Squeeze (Scenario B)**

Even without a crisis, a gradual decline of the USD's hegemony would exert severe fiscal pressure over time. The projected higher long-term U.S. interest rates in a post-USD world (as outlined in Scenario B) would translate into hundreds of billions of USDs in extra annual interest costs when applied to a \$30+ trillion federal debt. Over the coming decades, interest payments would consume a growing share of the federal budget, crowding out other expenditures. The government's ability to fund discretionary programs, invest in infrastructure, or respond to crises would be increasingly constrained by its debt-servicing burden.

Reduced fiscal flexibility could also force the U.S. to scale back its global military commitments. That creates a feedback loop: if the U.S. retrenches internationally for fiscal reasons, key allies may see less reason to hold USDs or U.S. bonds, weakening external demand for U.S. debt. In essence, a slow decline could devolve into a doom loop of rising debt costs and waning geopolitical influence feeding into one another.

In a sudden collapse scenario, the trade deficit might shrink on paper, but mainly because domestic demand is collapsing along with global trade. The improvement in the trade balance would be a small consolation amid a severe recession. There could be a more genuine rebalancing over time in a gradual decline. U.S. exporters would steadily become more competitive globally, and consumers might incrementally substitute toward domestically produced alternatives for some goods. The U.S., which has long run sizeable trade deficits financed by foreign capital, would need to start consuming more in line with what it produces. A slowly weakening USD could partially reverse the “Dutch disease” effect, helping U.S. manufacturing and other tradable sectors regain some footing. However, given the starting deficits, even a sustained depreciation is unlikely to eliminate the trade gap; it would more likely reduce it to a somewhat more manageable size rather than produce trade surpluses.

### **Fiscal Ramifications: The End of Exorbitant Privilege**

The U.S. government has long enjoyed unique fiscal benefits from the USD’s premier status. This so-called exorbitant privilege means the U.S. can borrow more cheaply and at a greater scale than any other nation. Global demand for USD’s and Treasuries creates a “convenience yield” estimated to lower U.S. interest rates by roughly 10–30 basis points. Just as importantly, the extraordinary trust in USD assets allows the U.S. to sustain a much higher public debt-to-GDP ratio – perhaps 20–30% of GDP more – than would otherwise be feasible without a crisis. Erosion or loss of this privilege would dramatically worsen America’s fiscal position.

### **Sudden Collapse – Immediate Debt Crisis (Scenario A)**

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A rapid loss of USD dominance would almost certainly trigger an acute sovereign debt crisis. In a sudden collapse, global investors would dump U.S. Treasuries alongside the USD, sharply increasing term premia and pushing government bond yields to prohibitive levels. The Treasury would struggle to roll over maturing obligations except at punitive rates, effectively losing routine market access and confronting a classic “sudden stop” in sovereign funding.

## Conclusion

The USD's "exorbitant privilege," once guaranteed by the Bretton Woods and petrodollar systems, is now under a decisive structural threat. This de-dollarization trend is not abstract, but a direct global response to the systemic risks introduced by U.S. policy: the weaponization of sanctions, chronic fiscal strain from rising debt, and the destabilizing monetary shockwaves emanating from Federal Reserve policy. These dynamics have driven foreign central banks and trading blocs such as BRICS and ASEAN to pursue monetary sovereignty, exemplified by strategic gold accumulation and the creation of alternative payment platforms like Project mBridge. While the immense network effect of the USD makes a sudden, disorderly collapse a low-probability risk, the most probable trajectory is one of gradual structural erosion. This loss of financial exceptionalism translates directly into a long-term fiscal headwind for the U.S. economy, necessitating persistently higher borrowing costs and severely limiting the government's ability to fund domestic investment and global commitments. The international monetary system is irreversibly shifting toward a multipolar, fragmented, and digitally-driven architecture.

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