GLOBAL MARKETS ANALYST

Dollar Dominance and Dollar Depreciation — Moving on Different Tracks (Trivedi/Jenkins)

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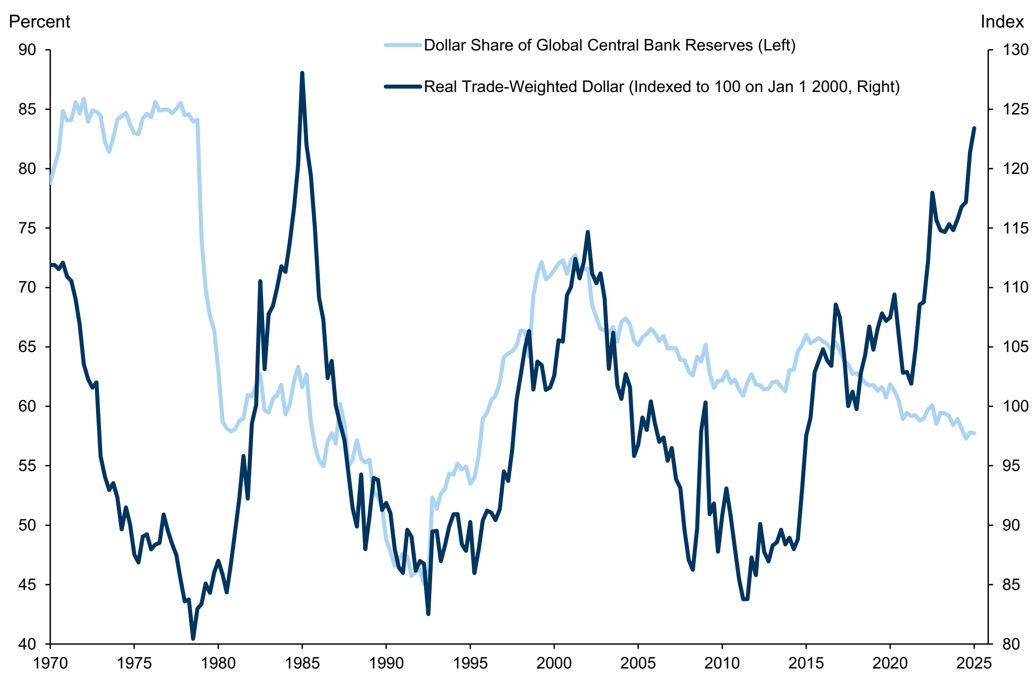
- **The Dollar will not be replaced anytime soon, but it should still depreciate.** Even though there are few alternatives to the multiple roles that the Dollar plays in the international financial system, we think Dollar overvaluation will diminish as the US economy's less exceptional performance makes it harder for the US to attract unhedged capital flows.
- **Limited evidence of de-dollarization in recent years.** Lower US interest rates, tariffs, and trade policies have weighed on the Dollar, but evidence of true de-dollarization is still limited. While the Dollar's share of central bank reserves has declined, it remains dominant in global debt issuance, cross-border transactions and loans, and in spot FX trading volumes. And recent data show no significant shift away from the Dollar so far this year – Dollar dominance persists, with only small signs of erosion on the margins.
- **What would it take to displace the Dollar?** Structural factors like the US's share of global debt, GDP, and global trade matter more for Dollar internationalization than shorter-term financial swings – and inertia in currency choice typically means these changes are slow, and can often be nonlinear. The US's shrinking share of global trade could gradually erode Dollar dominance, but displacement appears to be a long way off. Meanwhile, the rise of Dollar-pegged stablecoins and a lack of credible alternative global currencies should act as reinforcing mechanisms for the Dollar's current global standing.
- **The TINA factor.** Attempts to diversify away from Dollar dominance—especially following the freezing of reserves post the Russia-Ukraine war—are stymied by the unmatched scale, liquidity, and network effects of the Dollar. Alternatives such as the Euro struggle with fiscal unity, while the Renminbi is held back by capital controls; bilateral currency initiatives also face hurdles. As a result, the near future will likely feature a patchwork of currency zones, with the Dollar remaining central.
- **Our forward-looking Dollar view.** The Dollar is poised to depreciate further in coming months, because less exceptional economic and market performance no longer warrants its high valuation. While we expect Dollar dominance to erode only slowly, Europe's growth-supportive fiscal shift and China's robust export sector argue for Euro and Yuan strength. At the same time, investors concerned about institutional governance and FX risks are likely to further hedge against US asset exposure, pushing the currency weaker.

1. The Dollar will not be replaced anytime soon, but it should still depreciate.
One of the most common pushbacks we receive to our forecast of Dollar depreciation is that 'there is no alternative'. We agree that there are few alternatives to the multiple roles that the Dollar plays in the international financial system. But we do not think that will save the Dollar from losing more of its value. Over the past 50 years, Dollar valuation has gone through large cycles, even as the Dollar has been structurally dominant – though there are some signs of gradual erosion now. For example, Dollar valuation declined through the 1970s, then increased in the 1980s and again over the past decade, with relatively muted shifts in the Dollar's share of global central bank reserves (Exhibit 1).

As we discuss below, we expect that the Dollar's role both as a 'medium of exchange' in international finance and a 'store of value' will shift at a more tectonic pace, reflecting shifts in global trade and security architecture and the mix of policies. And the alternatives to the Dollar all have limitations. By contrast, Dollar valuation can shift much faster: the broad Dollar trade-weighted index has depreciated by about 7% this year, and we expect this to extend as the combination of macroeconomic policies and political shifts make it harder for the US to attract unhedged capital flows to fund a large current account (and underlying fiscal) deficit. A cheapening of US local assets or a weakening currency, most likely both, is part of the equilibrating mechanism.

Exhibit 1: Historically, swings in Dollar performance have had a relatively muted correlation with shifts in the Dollar's share of global central bank reserves



Source: IMF, Haver Analytics, Goldman Sachs Global Investment Research

2. Limited evidence of de-dollarization in recent years.
The Dollar's weakness year-to-date has raised doubts about whether Dollar dominance

is also on its way out amid US administration policies that involve raising trade barriers and withdrawing from major global institutions. We certainly think there are limits to Dollar dominance, but in our view conventional macro developments so far this year have much clearer implications for Dollar performance than they do for Dollar internationalization. Shifts to the latter tend to be more gradual processes, and are likely to have a limited imprint even in the most frequent data on the Dollar's international role.

This matters because the Dollar's role at the center of the international monetary system makes Dollar assets the primary choice for official and private sector investors seeking safe assets, above and beyond risk and return calculations. The upshot of this has been that the US has been able to attract unhedged capital flows to fund its deficits, putting downward pressure on US interest rates and upward pressure on US asset prices. An erosion of Dollar internationalization and the accompanying 'exorbitant privilege' would reverse some of these helpful impulses.[1]

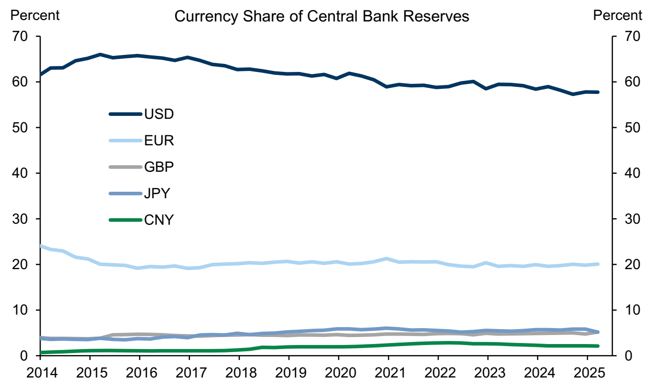
In the rest of the section, we look systematically through a range of the Dollar internationalization measures, and note limited evidence of de-dollarization, both in the data we have so far this year and in the broader trend in previous years encompassing the prior Trump administration. We examine five of these internationalization measures in turn, and then together on a valuation-adjusted basis.

- First, IMF data on the Currency Composition of Official Foreign Exchange Reserves (COFER) shows an 8pp decline in the Dollar's share of reserve usage since 2015 (Exhibit 2), and that decline is slightly larger in valuation-adjusted terms (Exhibit 3). Of the five internationalization measures we consider, data on central bank reserves constitute the clearest argument that de-dollarization has been taking place over the past decade. But even here, we have argued it is mostly more idiosyncratic factors at play, rather than broad-based shifts away from the Dollar. We think a large part of the decline in the Dollar's share of reserves in the past ten years can be explained by a rotation away from Dollar reserves by the Central Bank of Russia, a search for yield in smaller reserve currencies, and some indirect Dollar exposure via the Yen basis trade. In some instances, central banks have also diversified reserve holdings into gold, supported by demand for alternative stores of value, though in practice also often in response to the imposition of sanctions by major economies.[2]

[1] See Bayoumi, T. and Gagnon, J., 2025. The US Trade Deficit and Foreign Borrowing: How Long Can It Continue? Peterson Institute for International Economics Working Paper, (25-14).

[2] Arslanalp, S., Eichengreen, B. and Simpson-Bell, C., 2023. Gold as international reserves: A barbarous relic no more? Journal of International Economics, 145, p.103822

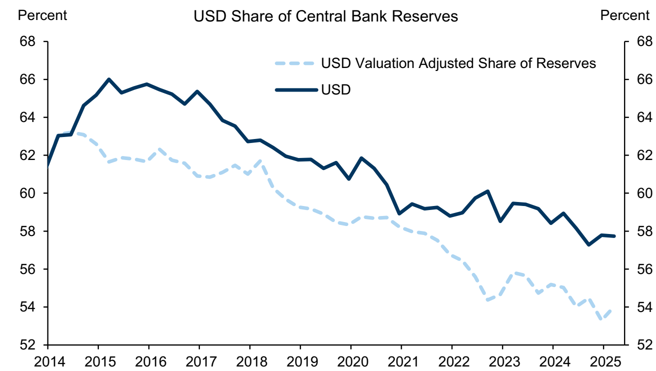
Exhibit 2: The Dollar's share of central bank reserves has declined by around 8pp since early 2015



Quarterly data, last observation is Q1:2025.

Source: IMF, Haver Analytics, Goldman Sachs Global Investment Research

Exhibit 3: That decline over the past 10 years is fairly large in valuation-adjusted terms

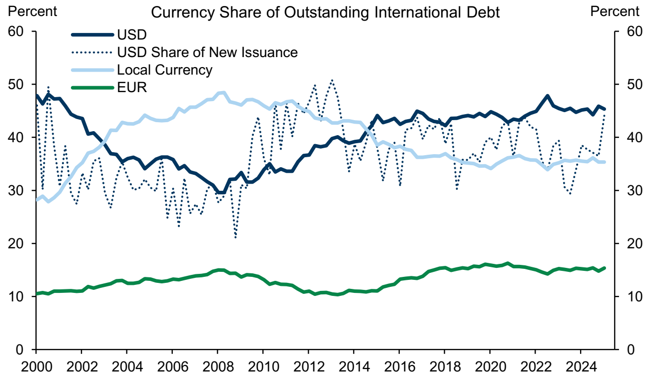


Quarterly data, last observation is Q1:2025.

Source: IMF, Haver Analytics, Goldman Sachs Global Investment Research

- Second, the Dollar-denominated share of outstanding international debt issued by governments and corporate entities has gained ground on local currency equivalents over the past two decades, reversing its decline in share seen throughout the 2000s (Exhibit 4). There is some anecdotal evidence that as demand for non-USD denominated fixed income is rising from global asset allocators, issuers are shifting their issuance mix, with a larger share of Euro or CNY denominated issuance, but these shifts are still small, and have a long way to go to erode the dominance of the Dollar's share.
- Third, the Dollar's share of global SWIFT financial transactions has increased significantly over the past three years – particularly relative to the Euro – and peaked above 50% in January 2025 (Exhibit 5). The Dollar's share of transactions dropped slightly in June of this year, but remains near all-time highs in the data's 2011-present sample. It is worth noting that the SWIFT data include intra-Euro area cross-border transactions, which drives the Euro's share of total transactions higher relative to the other internationalization measures we cite here.

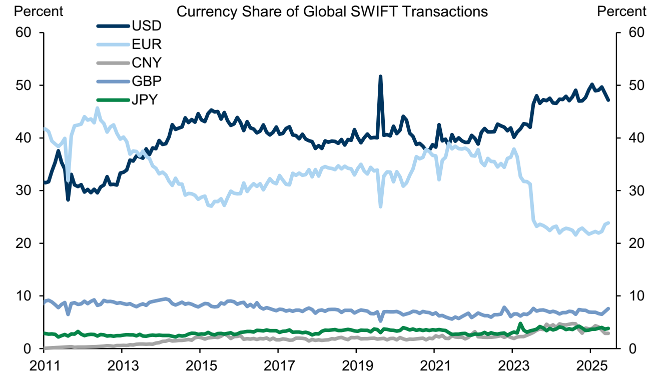
Exhibit 4: The Dollar's share of outstanding international debt has gained ground over local currency equivalents in the past two decades



Quarterly data, last observation is Q1:2025.

Source: BIS, Haver Analytics, Goldman Sachs Global Investment Research

Exhibit 5: The Dollar's share of SWIFT transactions has increased notably over the past three years

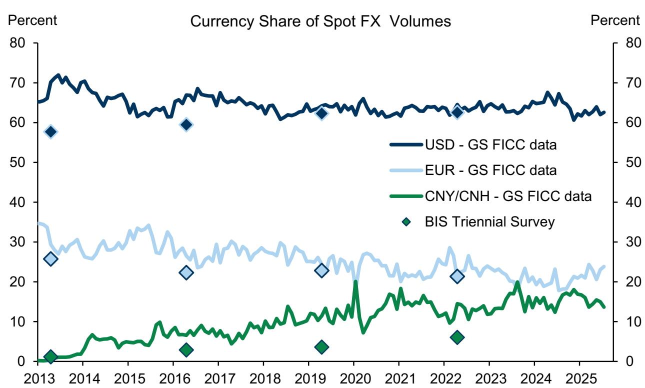


Monthly data, last observation is June 2025.

Source: SWIFT, Bloomberg, Goldman Sachs Global Investment Research

- Fourth, our measure of the Dollar's share of spot FX trading volumes has dipped slightly in recent years to just above 60%, but has stayed relatively stable over the past decade. Meanwhile, the Euro's share has declined more meaningfully over the same timeframe, and the Renminbi has been gaining. The BIS's triennial FX survey is a benchmark source of FX statistics, including trading volumes. We find that currency shares of traded volumes using GS proprietary data tend to match the trends in the BIS's equivalent measures relatively well over time, and point to limited shifts in the Dollar's share of total volumes so far this year (Exhibit 6).
- Fifth and finally, the Dollar's share of cross-border bank loans has held steady in a 40-50% range since the year 2000 (Exhibit 7).

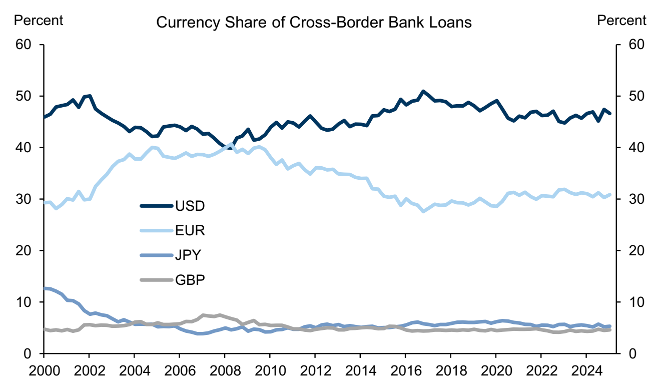
Exhibit 6: Both BIS and GS FICC data point to a relatively stable Dollar share of spot FX volumes over the past decade



GS data is monthly with a last observation of July 2025. BIS data is triennial with a last observation of 2022.

Source: BIS, Haver Analytics, Goldman Sachs FICC and Equities, Goldman Sachs Global Investment Research

Exhibit 7: The Dollar's share of cross-border loans has held steady in a 40-50% range since the year 2000



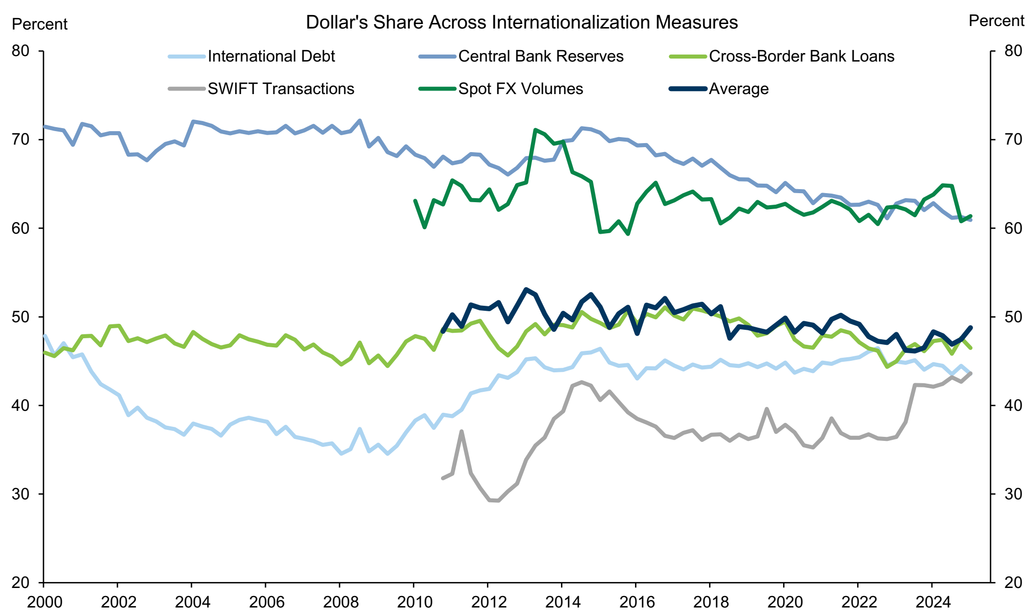
Quarterly data, last observation is Q1:2025.

Source: BIS, Haver Analytics, Goldman Sachs Global Investment Research

Our main takeaway from this set of Dollar internationalization measures is that, on aggregate, there have been only limited signs of de-dollarization in recent years. It is important to note that these data-sets may not be exhaustive measures of global currency usage. They often rely on inputs from national central banks, where participation can vary. And while alternative payment systems to SWIFT – including, for example, China's Cross-border Interbank Payment System (CIPS) – are still responsible for a much lower portion of global cross-border transactions, they will likely often have lower percentage shares of Dollar-denominated transactions.

Another key consideration for these internationalization measures is the scale of the impact from foreign exchange valuation effects. Shifts in Dollar exchange rates will directly impact the relative nominal shares of Dollar and foreign currency usage. To better approximate the 'real' shifts in internationalization across currencies, we adjust the measures discussed above to remove valuation effects, which we show in Exhibit 8. Across this set of valuation-adjusted internationalization measures, the Dollar's share of total usage varies from approximately 44% in international outstanding debt and SWIFT transactions, to just over 61% in its share of spot FX volumes. However, the Dollar's average share across these measures has been relatively stable over time, remaining close to the 50% mark over the past 15 years.

Exhibit 8: An average across the Dollar internationalization measures we consider has remained relatively stable close to 50% over the past 15 years



Quarterly data, last observation is Q1:2025. All measures are valuation-adjusted for exchange rate moves.

Source: BIS, SWIFT, IMF, Haver Analytics, Goldman Sachs FICC and Equities, Goldman Sachs Global Investment Research

Zooming in on this year specifically, the limited data that we do have shows no concerted shift in Dollar internationalization so far. This is not altogether surprising: shifts in a currency's internationalization tend to be very gradual processes, and we remain in the early stages of the Trump administration's policy agenda. For this reason, we turn to evidence from historical shifts in Dollar internationalization, and its relationship to both market performance and more structural economic variables, to assess potential paths for the Dollar's global standing ahead.

3. What would it take to displace the Dollar?

The determinants of currency internationalization are multifaceted and complex. Macro, financial, geopolitical, and institutional factors are all relevant in shaping a currency's global standing. Moreover, inertia tends to play a fundamental role in currency choice across a range of functions, with network effects benefitting the incumbent predominant currency, and switching costs to alternatives often being high. The presence of inertia can often lead to lagged and nonlinear relationships between the above factors and currency internationalization.

That said, looking systematically for the correlates of shifts in Dollar internationalization over the past 25 years – admittedly a period where Dollar dominance has been entrenched – it is typically moves in the more structural economic factors rather than in the more cyclical, financial ones that tend to have larger implications for internationalization.[3]

Using univariate linear regressions on quarterly data from 2000 to the present, and proxying Dollar internationalization with the five measures discussed in section 2 (all of which are expressed as the Dollar's percentage share of a measure of global currency usage), we derive two sets of results. In one the internationalization measures are taken at nominal face value, without adjustment for exchange rate valuation effects (Exhibit 9). And in the other we do adjust for valuation effects (Exhibit 10). We make the following observations on the regression results.

First, shifts in Dollar internationalization have a statistically significant positive relationship with shifts in the US's share of global outstanding debt, albeit with a relatively small beta. Second, Dollar internationalization also has a small but significant positive beta to shifts in the value of the trade-weighted Dollar. Third, while less significant, Dollar internationalization has a positive beta of a similar magnitude to US versus global relative equity returns. Fourth, while less significant still, Dollar internationalization has a notably higher beta to shifts in the US's share of global GDP and of global trade.[4] Between these two measures, the US's share of global trade has higher significance across internationalization measures in our sample, though we would note that academic work using panel data with a different sample to ours and that allows for a non-linear relationship finds that country share of global GDP typically produces more significant results.[5] And fifth and finally, when accounting for valuation effects in the internationalization measures, the pattern of the regression results remains broadly similar, though generally with smaller betas and reduced significance.

A key caveat to all of these results, though, is that our 2000-2025 sample – which allows for an inclusion of a broader range of internationalization measures – is relatively short compared with the gradual nature of shifts in currency internationalization. Given that small sample, a multivariate approach would see the statistical significance of these

3 Eichengreen, B., 2021. The dollar and its discontents. Seoul Journal of Economics, 34(1).

4 We view these results on the structural internationalization drivers as consistent with our prior work on quantifying the drivers of countries' reserve currency choices. We have previously found that the Dollar's share of global government debt is a significant driver of reserve allocations to the Dollar over time, while trade relations between reserve allocators and the US are typically positive, albeit with lower significance than for the Dollar's debt share.

5 Chen, H. and Peng, W., 2010. The potential of the renminbi as an international currency. In Currency internationalization: Global experiences and implications for the Renminbi (pp. 115-138). London: Palgrave Macmillan UK.

results reduced further. Our results also do not explicitly control for inertia effects, as have been employed in levels regressions in the academic literature.[6]

Exhibit 9: Non-valuation-adjusted Univariate Regression Results

Univariate Beta of Quarterly Changes in Dollar Internationalization to Changes in Market and Structural Variables - Non-valuation-adjusted						
	Average Across Dollar Internationalization Measures (pp change)	Dollar Share of International Debt (pp change)	Dollar Share of Global Central Bank Reserves (pp change)	Dollar Share of Cross-Border Bank Loans (pp change)	Dollar Share of Global SWIFT Transactions (pp change)	Dollar Share of Spot FX Volumes (pp change)
USD TWI Performance (% change)	**0.10 (3.06**)**	0.22 (5.62***)	0.14 (4.27**)	0.20 (5.08***)	0.06 (0.66)	-0.04 (-0.46)
Relative Equity Performance (S&P 500 vs MSCI World, % change)	**0.12 (1.85*)**	0.25 (4.02***)	0.16 (3.12***)	0.22 (3.62***)	-0.11 (-0.69)	0.07 (0.45)
US Share of Global GDP (pp change)	**1.14 (1.35)**	0.45 (0.41)	1.09 (1.25)	1.22 (1.14)	4.79 (2.27**)	-0.97 (-0.48)
US Share of Global Trade (pp change)	**0.90 (2.20)**	1.46 (3.70)	1.15 (3.64)	0.83 (2.06)	2.71 (2.61**)	0.75 (0.72)
US Share of Global Government Debt (pp change)	**0.13 (3.47**)**	0.25 (4.24***)	0.23 (5.05***)	0.24 (4.05***)	0.15 (1.38)	-0.01 (-0.07)

T-stats in brackets, * p<0.1, ** p<0.05, *** p<0.01. Quarterly data, 2010:Q2 - 2025:Q1 for Spot FX Volumes regressions and composite measure regressions, 2011:Q1 - 2025:Q1 for SWIFT Transactions regressions, and 2000:Q1 - 2025:Q1 for all other regressions.

Source: BIS, SWIFT, IMF, Haver Analytics, Goldman Sachs FICC and Equities, Goldman Sachs Global Investment Research

Exhibit 10: Valuation-adjusted Univariate Regression Results

Univariate Beta of Quarterly Changes in Dollar Internationalization to Changes in Market and Structural Variables - Valuation Adjusted						
	Average Across Dollar Internationalization Measures (pp change)	Dollar Share of International Debt (pp change)	Dollar Share of Global Central Bank Reserves (pp change)	Dollar Share of Cross-Border Bank Loans (pp change)	Dollar Share of Global SWIFT Transactions (pp change)	Dollar Share of Spot FX Volumes (pp change)
USD TWI Performance (% change)	**0.08 (2.25**)**	0.16 (4.20***)	0.09 (2.31**)	0.15 (3.53***)	0.06 (0.66)	-0.04 (-0.46)
Relative Equity Performance (S&P 500 vs MSCI World, % change)	**0.13 (2.07**)**	0.24 (4.17***)	0.15 (2.72***)	0.24 (3.97***)	-0.11 (-0.69)	0.07 (0.45)
US Share of Global GDP (pp change)	**1.05 (1.25)**	-0.05 (-0.05)	0.54 (0.56)	0.76 (0.70)	4.79 (2.27**)	-0.97 (-0.48)
US Share of Global Trade (pp change)	**0.50 (1.19)**	0.28 (0.71)	-0.15 (-0.41)	-0.55 (-1.35)	2.71 (2.61**)	0.75 (0.72)
US Share of Global Government Debt (pp change)	**0.09 (2.30**)**	0.16 (2.69***)	0.20 (3.77***)	0.19 (3.09***)	0.15 (1.38)	-0.01 (-0.07)

T-stats in brackets, * p<0.1, ** p<0.05, *** p<0.01. Quarterly data, 2010:Q2 - 2025:Q1 for Spot FX Volumes regressions and composite measure regressions, 2011:Q1 - 2025:Q1 for SWIFT Transactions regressions, and 2000:Q1 - 2025:Q1 for all other regressions.

Source: BIS, SWIFT, IMF, Haver Analytics, Goldman Sachs FICC and Equities, Goldman Sachs Global Investment Research

Our results imply that for the roughly 4% depreciation in the trade-weighted Dollar that we forecast over the coming year, an average measure of the Dollar's share of global usage could fall by just ~0.4pp – and a portion of that shift would be the direct result of valuation effects. Meanwhile, our relative equity views would imply a ~0.2pp *increase* in these measures of Dollar usage. These simple linear calculations imply to us that, in isolation, our forecast trajectories for FX and equity markets imply only modest shifts to Dollar internationalization to come.

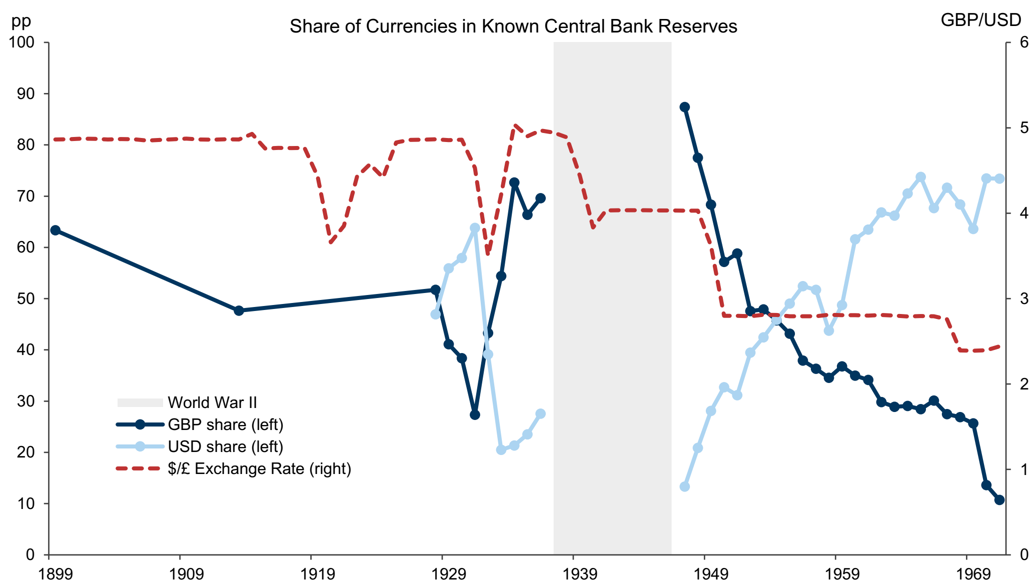
But from a broader perspective, the US's evolving policy agenda will likely impact more than just US asset performance. The shift in US trade and security policies may well have implications for more structural economic variables as well. Tariffs and other trade barriers, for example, have the potential to directly lower the US's share of global trade, which, based on our regression results, could have sizeable implications for Dollar internationalization. A 5pp reduction in the US's share of global trade would imply a ~2.5pp decrease in the Dollar's global usage, and as large as a ~5pp reduction in the Dollar's share of global central bank reserves specifically.

[6] Eichengreen, B., Chiţu, L. and Mehl, A., 2016. Stability or upheaval? The currency composition of international reserves in the long run. IMF Economic Review, 64(2), pp.354-380.

And as the US dominance in global trade declines – China has caught up to the US share of global trade over the past 25 years – trade-sensitive Dollar internationalization measures like the dominance of USD trade invoicing will also likely move lower. While data are less up-to-date relative to the financial measures considered above, there is some evidence that as China continues to gain market shares in global exports, its trade invoicing share has risen from low levels, and the Euro is the dominant trade invoicing currency in regional European trade. But the overall picture is still one of the dominant share of USD in global trade invoicing staying broadly stable.[7]

Lessons from history also point to more complex relationships involving institutional and geopolitical considerations than these simple linear estimates allow for.[8] The UK is a primary example of this, as we have studied before. From 1900-1950, the UK's share of global manufacturing trade halved from ~30% to ~15%, but Sterling's share of global central bank reserves remained broadly unchanged. In Sterling's case, its displacement from reserve currency hegemony took place long after its shrinking share of global trade and GDP would have suggested. Part of that delay likely reflects the inertial processes behind reserve currency allocations, though the UK also employed a range of policies and capital controls to effectively prolong Sterling's predominance. Ultimately, external catalysts can help accelerate shifts in currency choice, as was the case for shifts away from Sterling reserves. Weaker UK economic outcomes and a rotation in reserves toward gold-backed currencies in the decade after WWII came as a tipping point in reserve allocations shifting away from Sterling (Exhibit 11).

Exhibit 11: The Dollar replaced Sterling as the reserve currency of choice in the decade following WWII



Source: Bank of England, Eichengreen (2020), Goldman Sachs Global Investment Research

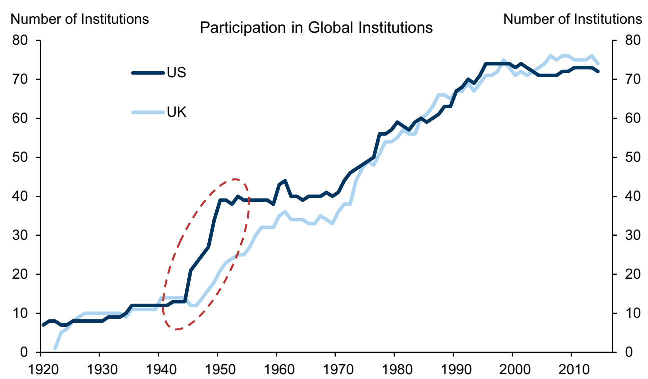
The Dollar's displacement of Sterling in the decade after WWII also occurred alongside a

[7] See Boz, E., Brüggen, A., Casas, C., Georgiadis, G., Gopinath, G. and Mehl, A., 2025. Patterns of Invoicing Currency in Global Trade in a Fragmenting World Economy.

[8] See, for example: Chey, Hyoung-kyu. "The political economy of currency internationalization." Handbook of the international political economy of monetary relations (2014): 39-53.

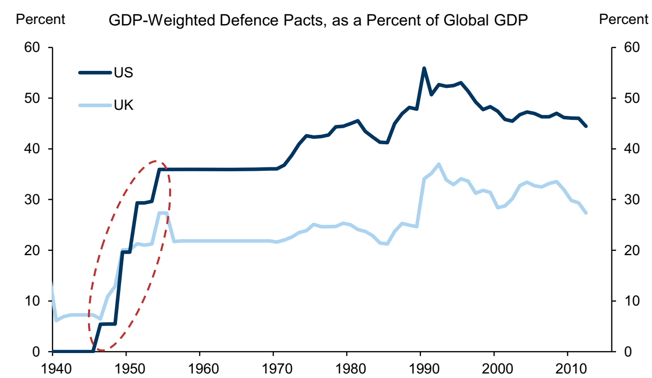
sharp rise in the US's participation in global institutions, relative to the UK (Exhibit 12), as well as an increase in the US's defense pacts with foreign nations (Exhibit 13).[9] While both the shift to Dollar dominance and the US's improved international standing were likely byproducts of the US's broader ascent to being a dominant actor in global trade and in the global economy, we expect these political outcomes themselves likely also played a supporting role in the Dollar's rising usage.

Exhibit 12: The Dollar's ascendance to global reserve currency status occurred alongside a sharp rise in the US's participation in global institutions ...



Source: The Correlates of War Project, Goldman Sachs Global Investment Research

Exhibit 13: ... as well as alongside a sharp rise in the breadth of the US's defense pacts with foreign nations



Excludes both US and UK GDP from both series.

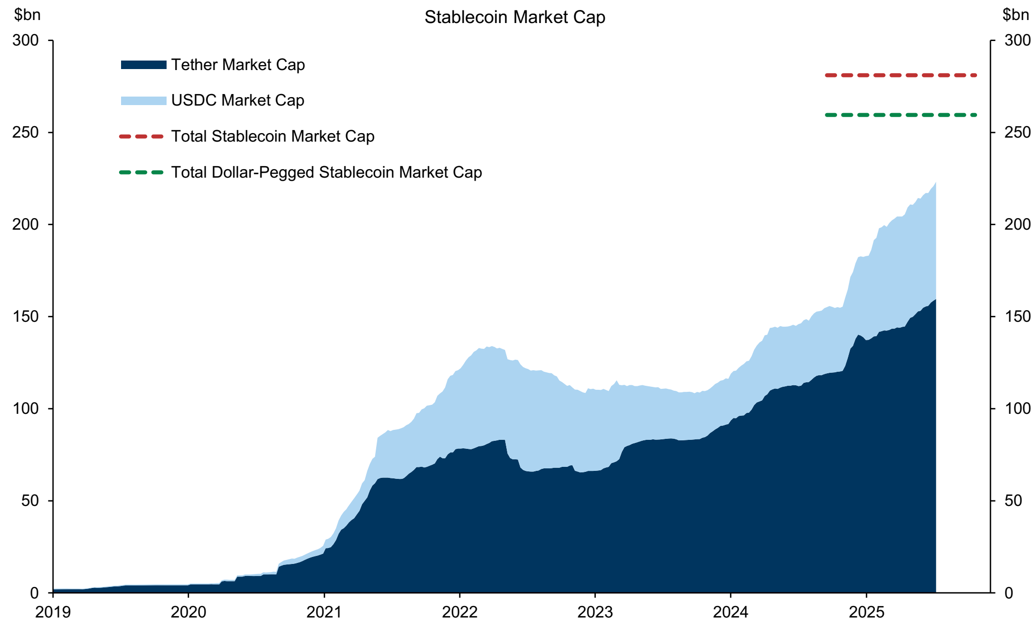
Source: The Correlates of War Project, Goldman Sachs Global Investment Research

Taken together, while there are understandably growing concerns on the future of the Dollar's global role, the prospects for a concerted shift away from the Dollar in the coming few years remains limited in our view. A persistent, multi-year trend of a shrinking US share of global GDP, trade and capital markets should gradually weigh on Dollar internationalization. But the gradual pace of that trend is key and, in the meantime, the inertial nature of these internationalization processes through network effects and high switching costs – as well as ongoing challenges to the major alternative currencies – should continue to provide a firm base for Dollar dominance.

Moreover, we note that other policy initiatives and reinforcing mechanisms can serve to bolster Dollar dominance in the international system. The sharp rise in the global market capitalization of stablecoins is one such example. The vast majority of circulating stablecoins are Dollar-pegged, and as that stablecoin ecosystem grows over time, the implicit global connections to the Dollar should grow in tandem. We discussed stablecoin-related issues in more detail in prior work, including on the mechanics of stablecoins, their implications for financial systems and broader macro, as well as their position in the evolving digital payments ecosystem more generally.

9 Our own prior work also shows that countries' reserve allocations depend in part on whether there exist security ties with the US.

Exhibit 14: The Dollar's dominance in the growing stablecoin ecosystem adds a reinforcing mechanism to broader internationalization



Source: DefiLlama, Goldman Sachs Global Investment Research

4. The TINA factor.

Over the years there have been many incentives for key players in the global financial system to seek to diversify away from Dollar dominance. The freezing of Dollar reserves post the Russia-Ukraine War was the most recent tangible action, but the spectre of the Dollar's dominance in the global finance and payments system being weaponized is a key motivation for other jurisdictions to seek alternatives.

The challenge is that all the alternatives have their own limitations, and none matches the scale and depth of Dollar asset markets, the freedom of capital flows, and the network effects that those advantages bestow.

- The Euro has important advantages – it has a large trading bloc with liquid investible assets – but, as the sovereign crisis showed, financial markets remain fragmented and, without a corresponding fiscal authority to back the monetary union, there are risks for international investors in stressed situations. More central fiscal authority is evolving (for example, Covid-related issuance, and mechanisms to enable increased defense spending across the bloc), but managing political fissures remains a consistent challenge.
- The Chinese Renminbi is somewhat of a mirror image. It is a large trading bloc with unitary monetary and fiscal authority, but with highly controlled capital markets. Moreover, the primary focus still appears to be on financial stability and trade competitiveness over the capital flow and local asset market volatility that genuine internationalization of the CNY could engender. Still, China's large and growing role in global trade flows, and the pick-up in CNY invoicing and trade settlement could well presage a gradual increase in this dimension of CNY internationalization.
- The repeated efforts to invoice trade in bilateral currencies repeatedly runs into

issues when trade is not balanced over time, and there are limited alternative uses or natural investments in the respective jurisdictions. For example, Russia has struggled to use Rupees accumulated from the bilateral energy exports to India. That is also an issue with other initiatives such as BRIC currencies, which also encompass significant political divisions.

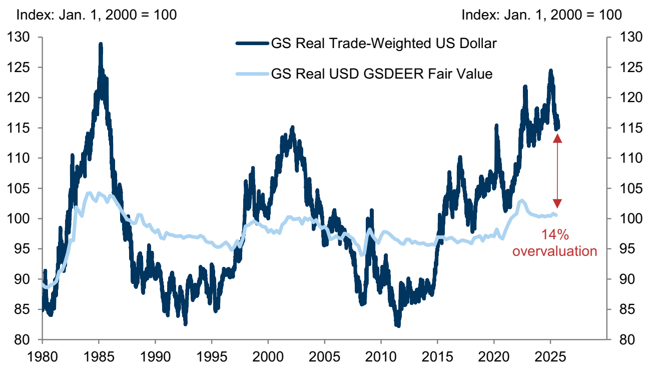
Of course, it is possible that actions by policymakers accentuate the advantages or limitations discussed above. Some of the potential actions discussed previously by senior members of the US administration – such as taxing foreign investments into the US – would further compromise the Dollar's dominance by introducing arbitrary frictions into capital markets. But risks are not all one-sided toward more diversification away from the Dollar. Legislation that allows a Dollar-based stablecoin ecosystem to grow and thrive could further harness the network effects of Dollar dominance, and entrench it in a more digital financial landscape at the expense of other currency jurisdictions.

Bottom line, there is no immediate single replacement for the Dollar. Over a multi-year time frame, the global monetary system is likely to continue to evolve toward a patchwork of interlocking dominant currencies: a EUR-denominated zone around the Euro area, and a CNY-denominated zone in parts of Asia, and a more global USD that remains dominant in trade and finance and serves as a conduit between the zones. That type of pattern has repeated itself historically as trade and security architectures have shifted, and a sustained shift toward US trade protectionism and a narrowing in security commitments could mean that those types of tectonic moves will occur again. In fact, it is worth noting that the recent high water marks in the Dollar's reserve share in 2000 and again in 2016 both reflected a temporary diversion from this more typical pattern, as the decline of Japan, the advent of the Euro and negative-yielding Euro area debt combined to make reserves more concentrated than normal. Viewed through this lens, the recent gradual decline in Dollar dominance could be seen more as a return to the old normal than necessarily the start of a new one.

5. Our forward-looking Dollar view.

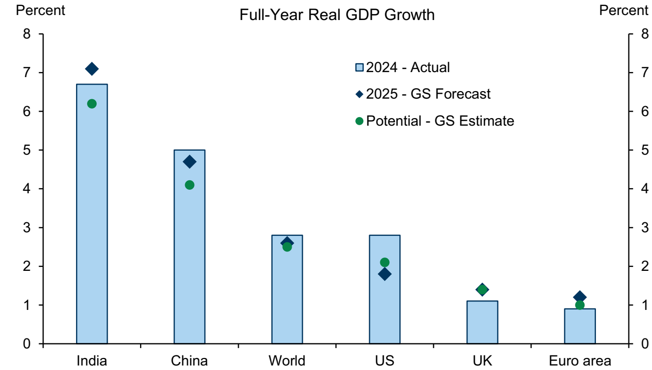
Our expectation for Dollar depreciation is not contingent on an erosion in Dollar dominance. We expect the Dollar to depreciate largely because US economic and market performance is less exceptional than before; so the US is finding it harder to attract unhedged capital flows to fund its large current account (and underlying fiscal deficit), and the currency's high valuation needs to correct further (Exhibit 15). We think that the softening in the US labor market is providing support to that view, and our read of both the incoming data and latest Fed speak is consistent with our baseline expectation of some further room to run in front-end rates. And we expect the Dollar can continue to underperform its typical relationship with other cyclical assets against the backdrop of a more globally balanced economic outlook and portfolio flows (Exhibit 16).

Exhibit 15: The Dollar remains substantially overvalued on a real trade-weighted basis



Source: Goldman Sachs Global Investment Research

Exhibit 16: US growth this year looks likely to undershoot potential, unlike in other major economies



Source: Haver Analytics, Goldman Sachs Global Investment Research

While there are still structural question marks, cyclically Germany's fiscal policy shift has made for a more growth-supportive policy mix in Europe, and our Euro area growth forecast is above consensus for the next couple of years. This should lead to continued portfolio flows into Europe, with Euro strength outperforming interest rate differentials and cyclical variables. We also continue to see good grounds for a steady move stronger in the Chinese Yuan. The strength of China's export sector and the undervalued levels of the currency, both on a real trade-weighted basis but especially versus the Dollar, point to the potential for a stronger CNY as an offset to more reasonable outcomes from trade negotiations with the US.

That said, it is clear that institutional governance concerns are an important issue for global asset allocators in particular, and we think this can lead to some incremental Dollar depreciation as they reassess their safe-haven investments. Those asset allocators, dealing with the Dollar dominance in their portfolios, are likely to continue to seek ways to hedge the FX risk that has contributed a large portion of the variance in international portfolios this year. So it is certainly possible that there are some common impulses that push both toward less Dollar dominance and more Dollar depreciation, especially if other jurisdictions can raise their game. The mid-2000s, the halcyon days of the BRIC economies and another period of political polarization in the US, also saw Dollar weakening come alongside a decline in the Dollar share of reserves.

But, for the most part, we continue to see these two shifts moving at very different speeds and operating on very different tracks. Any erosion of Dollar dominance is likely to be a multi-decade process, whereas we expect further Dollar depreciation in coming months.

Disclosure Appendix

Reg AC

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