Macro Insights Weekly

De-dollarisation update

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Philip Wee
Senior FX Strategist
philipwee@dbs.com

Ma Tieying
Senior Economist
matieying@dbs.com

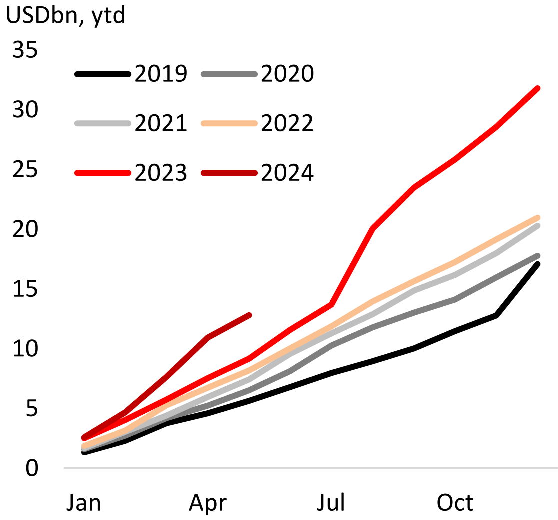
For Alliance Bank clients, please direct your enquiries to Malaysia Research +603 2604 3915 general@alliancedbs.com

- *In the first half of 2024, the global financial landscape witnessed an increase in the momentum of dedollarisation*
- *Many countries are not looking to decouple from the USD but to reduce reliance on the greenback and other Western reserve currencies*
- *Dedollarisation is a response to rising geopolitical tensions and the need to mitigate pressures on their exchange rates from the domestic policies of significantly large countries*
- *While the current momentum will not unseat the USD's entrenched role as the world's dominant reserve currency, America has little room for complacency, particularly given its significant budget deficits, which are enlarging its federal debt*
- *In the long term, the dedollarisation process has implications for global markets, particularly the trend towards a more multipolar currency environment*

Chart of the Week: China's BRI investment

China's non-financial outward direct investment (ODI) in Belt and Road Initiative (BRI) countries surged to USD 12.8bn in the first five months of 2024, marking a robust 40% increase from USD 9.2bn in the same period last year. This growth significantly outpaced the 16% YoY increase in China's total non-financial ODI during Jan-May. Reports also highlight ASEAN as a key investment destination, with non-financial ODI surging 37% YoY in 1Q.

China's non-financial ODI in BRI countries



Source: CEIC, DBS

Commentary: De-dollarisation update

In the first half of 2024, the global financial landscape witnessed an increase in the momentum of dedollarisation. Dedollarisation refers to the gradual reduction of reliance on the USD in international trade, finance, and central bank reserves. The movement is driven by various geopolitical, economic, and strategic factors by countries seeking to diversify their currency holdings and reduce vulnerability to the US monetary policy and financial and economic sanctions.

BRICS enlargement

In January 2024, Egypt, Ethiopia, Iran, Saudi Arabia, and the United Arab Emirates joined BRICS. This inclusion doubled the bloc's membership from the original five – Brazil, Russia, India and China in 2006 and South Africa in 2010. Malaysia and Thailand have expressed interest to join the grouping in June 2024.

Strategically, the expansion of BRICS reflects the countries' desire to enhance economic cooperation and integration, diversifying trade partners, reduce reliance on traditional Western markets, and using local currency more regularly for trade.

An enlarged BRICS can develop alternative financial institutions and systems, reducing dependence on traditional institutions like the IMF and the World Bank. BRICS countries could also increase their collective influence in international forums like the United Nations and the G20, creating a counterbalance to Western alliances such as NATO and the EU, leading to a more multipolar world.

Reducing reliance on the USD and the EUR

In June 2024, the US expanded sanctions against Russia, which prompted the Moscow Exchange (MOEX) to halt USD and EUR trading and adopt the CNY/RUB as the benchmark exchange rate. The Russian central bank confirmed that the CNY became the primary currency on MOEX, accounting for 54% of transactions on the exchange.

In the Middle East, the UAE started trading with China in CNY for oil. In October 2023, China used digital RMB to settle first cross-border oil transaction for one million barrels of oil from the UAE. The UAE has expressed interest in participating in the Shanghai International Energy Exchange, where oil futures contracts are denominated in CNY. The UAE also wants to expand the Comprehensive Economic Partnership Agreement (CEPA) signed with India in February 2022 to boost trade and economic ties.

Two significant developments occurred in Saudi Arabia in June 2024. First, the kingdom's 50-year petrodollar agreement with the US expired on June 9, leaving it open to using currencies other than the USD for its oil trade. Second, Saudi Arabia joined Project mBridge, a multi-central bank digital currency (CBDC) initiative launched in 2021 by the Bank of International Settlements in collaboration with the central banks of China, Hong Kong SAR, Thailand, and the UAE. The project seeks to ensure faster, cheaper, and more efficient transactions than traditional methods like SWIFT. It has reached the Minimum Viable Product stage, signalling a readiness for broader implementation and further development through collaboration with private-sector financial firms.

Over the past few years, ASEAN countries have entered into bilateral currency settlement agreements to facilitate using local currencies for trade. For example, Indonesia, Malaysia, Singapore, the Philippines, and Thailand have adopted a universal QR code payment system for cross-border transactions, promoting the use of local currencies. These efforts are part of broader efforts to promote financial stability and reduce exposure to global currency fluctuations.

Conclusions

Many countries are not looking to decouple from the USD but to reduce reliance on the greenback and other Western reserve currencies, like the de-risking policy pursued by the US and the EU with China. They are responding to rising geopolitical tensions, particularly between the US and Europe against Russia and China, and the resultant sanctions and trade tariffs.

The other incentive is the need to mitigate the economic and financial fallout from domestic policies of large economies. For example, many countries have been mitigating volatility in their exchange rate due to the USD's strength, which was brought about by the Fed's high interest rate policy to regain control of inflation.

Nonetheless, the dedollarisation process has long-term implications for global markets, trade dynamics, and the international monetary system. The rise of regional currencies and regional payment systems that facilitate transactions in local currencies supports the trend toward a more multipolar currency environment.

Overall, this year's pickup in the dedollarisation momentum this year will not unseat the USD's entrenched role as the dominant reserve currency in the world economy and global financial markets. According to the BIS, the USD accounts for almost 90% of global FX transactions in trade and investments, well ahead other significant currencies such as the EUR and the CNY. The IMF COFER showed the USD's share of the world's allocated reserves at 58.4% at the end of 2023, barely changed from 58.5% the previous year.

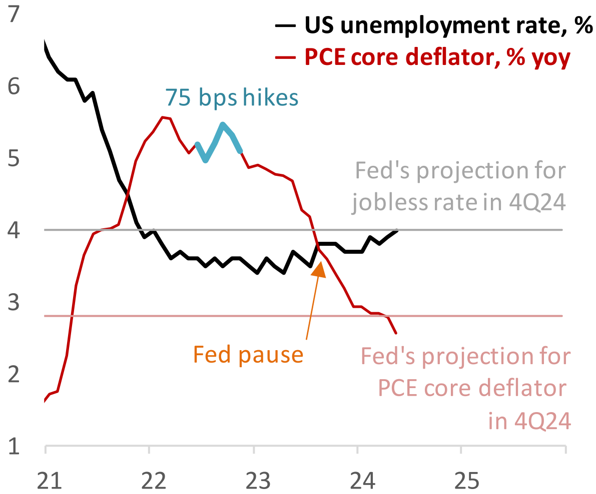
However, there is little room for complacency. In August 2023, Fitch Ratings became the second international rating agency to axe America's triple-A debt rating by one notch to AA+. Fitch attributed the downgrade to the expected fiscal deterioration over the next three years, particularly the significant budget deficits lifting government levels, not helped by repeated political brinksmanship over the debt ceiling. The Congressional Budget Office (CBO) projected the US federal debt to exceed its all-time high (106% of GDP during World War II) in 2027. The IMF also expressed significant concerns over the rapid increase in US government spending and the substantial rise in the federal deficit to USD 1.7 trillion in 2023. Not surprisingly, the US fiscal situation has become a prominent topic in the upcoming US Presidential Election on November 5.

Philip Wee

FX: USD is unlikely to repeat its strength in 2H

This Friday's US monthly jobs report will significantly assess if the Fed is approaching the September interest rate cut indicated in the futures market. Per its Summary of Economic Projections in June, the Fed did not need PCE inflation to hit the 2% target to deliver the 1-2 rate cuts projected in the dot plot for 2H24. **Core PCE inflation fell a second month** to 2.6% YoY in May, **below the 2.8% level the Fed projected for 4Q24**. The Fed's recent narrative suggested that **the labour market has become as important as inflation data in providing the Fed the confidence to lower the highest real interest rates since 2009**.

The Fed is getting nearer to lowering rates

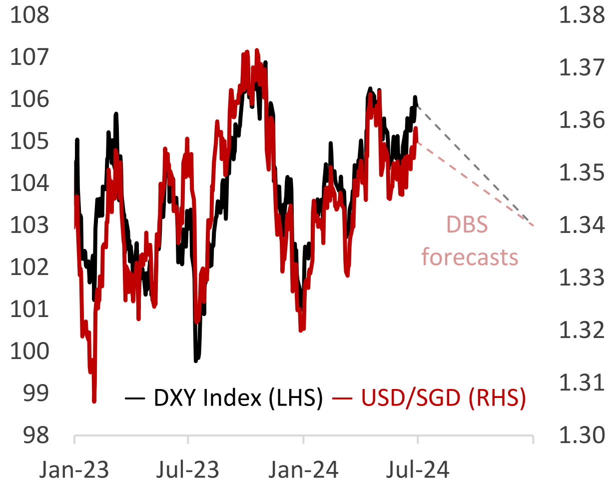


Sources: DBS Research, Bloomberg data

Hence, **please pay close attention to Fed Chair Jerome Powell** at the European Central Bank Forum in Sintra on July 2 and his semi-annual testimony to the US Senate Banking Committee on July 9. During the FOMC meeting on June 12, Powell played down the higher nonfarm payrolls (NFP) in May and considered the unemployment rate – which hit the Fed's 4% level projected for 4Q24 – an important statistic. Notably, **Powell said the Fed was ready to respond if US jobs weakened unexpectedly**. Hence, the market is bracing for June's NFP to decline below the 200k level for the second time in three months and is wary that the unemployment rate might push further above 4%.

Our view remains that the USD will depreciate due to two Fed cuts in 2H24. Fed cuts should eclipse the efforts of other central banks (including Singapore) to remove top-level restrictions in their monetary policies.

USD/SGD is a price-taker that closely tracks the DXY Index



Sources: DBS Research, Bloomberg data

While we do not rule out volatility from this week's elections in France and the UK, global financial markets have demonstrated resilience and adaptability to geopolitical risks such as Russia's invasion of Ukraine, the Israel-Gaza crisis, and trade tensions between the US/EU and China. The **US Presidential Elections in November will likely be more significant for the USD**. Apart from an increase in the momentum of dedollarisation this year, attention is also falling on the sustainability of large fiscal deficits and federal debt in America.

Philip Wee

Group Research

Economics & Strategy

Taimur BAIG, Ph.D.
Chief Economist
Global
taimurbaig@dbs.com

Wei Liang CHANG
FX & Credit Strategist
Global
weiliangchang@dbs.com

Nathan CHOW
Senior Economist
China/HK SAR
nathanchow@dbs.com

Han Teng CHUA, CFA
Economist
Asean
hantengchua@dbs.com

Mo JI, Ph.D.
Chief Economist
China/HK SAR
mojim@dbs.com

Byron LAM
Economist
China/HK SAR
byronlamfc@dbs.com

Violet LEE
Associate
Publications
violetleeyh@dbs.com

Tracy Li Jun LIM
Credit Analyst
USD Credit
tracylimt@dbs.com

Eugene LEOW
Senior Rates Strategist
G3 & Asia
eugeneleow@dbs.com

Teng Chong LIM
Credit Analyst
SGD Credit
tengchonglim@dbs.com

Tieying MA, CFA
Senior Economist
Japan, South Korea, Taiwan
matieying@dbs.com

Radhika RAO
Senior Economist
Eurozone, India, Indonesia
radhikarao@dbs.com

Amanda SEAH
Credit Analyst
SGD Credit
amandaseah@dbs.com

Daisy SHARMA
Analyst
Data Analytics
daisy@dbs.com

Joel SIEW, CFA
Credit Analyst
SGD Credit
joelsiew@dbs.com

Mervyn TEO
Credit Strategist
USD Credit
mervynteo@dbs.com

Samuel TSE
Economist/Strategist
China/HK SAR
samueltse@dbs.com

Philip WEE
Senior FX Strategist
Global
philipwee@dbs.com

Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations)