

UBS podcast

 Tue, Apr 23, 2024 5:13PM  26:22

SUMMARY KEYWORDS

dollar, rmb, instance, sanction, china, weakening, dominant position, gold, central banks, geopolitical, bitcoin, russia, factors, share, investor, euro, global economy, reserve currency, dominance, payment

SPEAKERS

Taylor Pearce, Max Castelli



You're listening to the ONVIF podcast, the show that explores the latest insights and discussions on global finance, economics, and policy for people who love staying informed about the rapidly evolving landscape of the financial world. Join us as we break down complex topics, interview key thought leaders, and provide essential insights to keep you informed about the evolving world of finance.



Taylor Pearce 00:26

Hello, and welcome to the audit Podcast. I'm Taylor Pierce, Senior Economist of Office economic Monetary Policy Institute. Here with me today is Dr. Max Castelli, head of strategy sovereign institutions at UBS Asset Management. We'll be discussing the future of the role of the US dollar and the global economy and financial system. Welcome, Max, it's a pleasure to have you.



Max Castelli 00:48

Thank you very much the pressure is mine. Obviously,



Taylor Pearce 00:50

D dollarization. And the role of the US dollar is a huge topic that's heavily debated right now in an era of increasing geopolitical tensions. So my first question would be whether we're seeing any signs of weakening of the dominant position of the USD in the global financial system?



Max Castelli 01:09

Well, I guess the answer is already in an article that I published in on 15th. I think it was November of 2023. So I'll just go back to the title of that article. Dolore remain dominant,

despite the growing demand for currency diversification. So for sure, my answer is that so far, we have not seen any significant weakening of the dominant position of the dollar. Just to put a little bit into perspective. And given some numbers, if you look at different measure of currency dominance, for instance, if you look at the share of the global effects reserve, just looking at the latest call for data and 2023, the dollar stands around the 58.4%. If you take a long term view, no doubt that the dollar came down just to as a reminder, in early 2000, the dollar was around the 70% of the global effects or service. So we have seen this low reduction trend in the share of the US dollar, which is nothing comparable to a loss of his dominant position, but probably a little bit the reflection of the change in structure of the global economy with of course, emerging market now accounting for a much larger share of growth at global level. And then we are just seeing this this adjustment. Another indication, of course, that is often mentioned, especially in the media, is the share of the dollar is global payment in global cross border payment. The US Dollar still stands at nearly 50% of global payment, followed by the euro more than 20% British Pound and we have done the RMB in fourth position 4%. Although here there is some data issue. For instance, if you're screwed intra payment within the Eurozone, actually the dollar become a much larger around the 60%, the Euro becomes smaller around the 13%. And actually, the RMB goes down at around 2.8%. So your first question, I will say that overall, despite a lot of talking about D dollarization. And the moving away from the dollar, we have not seen a significant change in the global financial system from that point of view.

T

Taylor Pearce 03:30

Right, that makes sense. So more signs of weakening, but definitely nothing threatening the dominant position of the dollar. You mentioned a few but can you elaborate on the key factors pushing for a weakening of the dominant position of dollar? Yes,

M

Max Castelli 03:45

absolutely. I think there are three major factor. The first one, of course, is the rise of China. And the fact that as we know, the Chinese authorities are very keen to internationalise the RMB, basically to make the RMB, a leading reserve currency at the par with the dollar or the Europe. And actually, this trend has been something that we've been monitoring very closely at UBS for for many, many years when we talk to central banks. And when we talk to when we do our survey, and the following the introduction of the RMB. In the SDR basket, actually, we saw a dramatic acceleration in the share, for instance of foreign exchange reserves are located to the RMB to basically RMB fixing onshore assets. Now unfortunately, this trend is actually is slowed down significantly in the last few years. And I think this is largely a reflection of what's going on in China. First of all, of course, the weakness in growth Following the opening up from COVID. As we know, there is a real estate bubble which has burst and still is having an impact on on the Chinese economy, of course as well a geopolitical confrontation between US and China and the rising sanction risk as perceived by global investor, I think all these as low down the increase in the share of the RMB. In global effects reserve. I still believe this is a pose. There are many variables here involved. Of course, the geopolitics is one of them, but also how China will come out from this moment of a cyclical weakness. But for the moment, I don't think the RMB is credible challenger to the dominance position of the US dollar. The second factor, as we already mentioned, is of course, the sanction risk. What happened following the invasion of Ukraine by Russia, is that we had the for the first time and sanction against the leading central banks is

not the first time ever, but still definitely is the first time that there are sanctioned widespread sanction against the central banks of a leading economy in the world. I think for sure, we saw that this has created some concern, among particular reserve and central banks as far as the reserve is concerned. But if you ask me whether we this impact has been large enough to really dive into the dominant position of the US dollar, my answer so far will be no. There is still a lot of question, there is a lot of attention over this issue. But I don't think sanction has yet the significant impact. It doesn't mean that it will not have in the future, particularly if, of course, the sanction remains of tool of the foreign policy for the US. And let's say for the Western world. I think the point is that the sanction actually the broader impact not only on the dollar, but they have a broader impact across all their denominated assets, for instance, a Euro, or a British pound. So the reality is that so far, there are no many alternatives to the dollar, or to the euro, as far as over currency are concerned. So the question of central becomes more whether there is scope for having a different tool compared to foreign exchange reserves, in order to have more freedom in the use of these accumulated wealth. And when needed. It's interesting that there are many countries which are non aligned, if I can call them I think neutral is not the right word, but non aligned, for instance, not applying sanction, not following basically the Western world in imposition of sanction against the Central Bank of Russia. But this has not really changed the way they look at the dollar. Think about, for instance, the Gulf economies, which are still pegged one to one to the dollar, or even countries like Hong Kong itself, which is still pegged to the dollar, or even older emerging market, which may want to have less dollar but in reality, when they look at exchange rate regime is still very much linked to the US dollar. So I think also that factor is there. But there's not really at the beginning. But the first one is, of course, the whole question of the digital innovation and Central Bank's digital currency. I think I agree 100%, that they could be a game changer, because the way I see the impact of CtbC on this topic is that basically, they increase the competitiveness of a secondary reserve currency visa vie, the dollar and the other leading reserve currency. But the reality is that if you look at the timing of this innovation, I think it was CtbC have been are debated, we know that China is in the lead is really made the many progress. But there are still some concern among central banks to really go all in we CtbC. This concern are numerous. Apart from the cross border interoperability, I would also say that our concern about the impact that this could have, for instance, on the role of banks and on the transmission of monetary policy. So I have the feeling there has been a little bit of a slowdown in at least in terms of timing, about really making these massive innovation in the global financial architecture. And I don't think the timing is close enough to really have a significant impact on the US dollar dominance in the next few years. Of course, if you take a very long term view, they said that's a different story. So if I pull together all these different factors, you can see that there is a quite so far. I mean, all these factors together are there are important, but they've not they've really dented the position of the US dollar.

T

Taylor Pearce 09:28

Right? So you mentioned the rise of China and the internationalisation of the renminbi sanctions risk in digital innovation CBDCs as risk factors, but you said that they're not yet or not so far, weakening the US Dollars position. So looking ahead to the future. What do you see as the outlook for the role of the USD internationally?

M

Max Castelli 09:48

Yeah, that's where he becomes more complicated and more interesting the conversation

because of course, I think the question becomes as well. Basically, the fundamental question we are starting to ask scared all of us who are looking at this is, of course, what will be the role of the US dollar in this new geopolitical context that we are moving in. We all agree that we are in a different geopolitical environment, the globalisation theories and fragmentation, US China confrontation, also the sort of Western versus North South type of confrontation that seems to be emerging. But I think the picture is still a very, very complicated, it's very difficult to make a call on how the global economy will be in the next, let's say, five years, or 10 years time because things could develop, I also start to see a more critical view about all these factors, I'll give an example deglobalization, I read very interesting. And they say that maybe this the globalisation story is largely exaggerated. If you disentangle the numbers a little bit more, we are just seeing a slowdown, but not really a reversal of globalisation, which will be something like similar to a sort of Cold War type of situation like we had in the post war period. So I believe that however, there are some factors, which I think could then to the US dollar dominance, and I interesting enough that this would be more self inflicted, rather than coming from competitors. And let me mention two of them. The first one, of course, is the it's about the US, and what's happening in the US economy and then the US political arena. So I would, I would mention two fundamental factors to watch. The first one is the domestic political polarisation, which seems to be really extreme at the moment, we have a very important presidential election coming up, there is a high possibility of a victory of Trump. So I think many investor and also many central banks start asking themselves for what would mean for the US dollar a Trump victory? And here, I think there are, for instance, question regarding the independence of the Fed that we know that in the past, Trump has been critical of the Fed, and these tracker for instances records in terms of fighting inflation, when inflation started. So we might see some more, let's say, let's call it institutional weakness in the US, which has been one of the fundamental pillar of the dominance of the US dollar. I don't think this would happen really in a sort of a sudden way. But let's say if you start to see a weakening in institutional strength of the US in the rule of law, and more political infighting, this could have a negative impact on the dollar, at least as an asset class, but also eventually down the road as a reserve currency. The second one, of course, is about a topic which is reemerging very strongly, which is, which has been completely absent from the debate so far, which is about the depth sustainability. I mean, all of you. So this recent blog from the IMF about the US fiscal position is not a us a unique story. We know that this is a global story, but particularly for advanced economies, which in the end, they are the issuer of the leading reserve currency. So euro, US, UK and some others, there is a strong increase in depth. And what is also more important is that there is a sort of bipartisan support for the increase in depth in the US, for instance, Republican favour more depth, largely because of tax cuts, the more Democrats favour more debt, maybe more for public spending. But the ultimate impact is the same is that you have a very high deficit, you have also very high and rising public debts. So far, this factor is not been there. I remember very well in August, last year, when there was an increase in long term interest rate that they went to just us 110 year went short to about 5%. I was wondering myself, Is this about interest rate expectation, or it is about a weakening of demand for government bonds for US Treasury. I remember I even checked, anecdotally with Portfolio Manager. Last year, there was no weakening of demand for government bonds. And actually, there is no weakening of demand for government bonds now. But of course, I think as we move into this US presidential election period, I think we're going to see more attention of investors on the depths of stability. And of course, a weakening of demand for US Treasury could start to have an impact on the dominant position of the dollar in the sense that this gentle decline in the share of the US dollar in the global effects itself could accelerate a little bit, if it is concerned grow. Apart from these two factors. I really don't see in the short term, a dramatic change. Of course, China is one factor, a strong recovery in China and the turnaround also in the sort of geopolitical situation of China with respect to the US could once again accelerated

the interests of central banks for RMB Fixed Income. Also in terms of interest rate differential, we might see some rebalancing there. But overall, I think the future will really remain dependent on how the overall geopolitical situation will evolve in the future.

T

Taylor Pearce 15:14

Yeah, so it sounds like there are some external challenges in the short term. But the key factors which could weaken your role, the USD would be self inflicted. Just taking a longer term view, do you think that there's scope for a low threshold challenge to dollar dominance, this would be a currency or group of currencies not replacing the dollar in the current financial system. But having the robustness to skirt around US sanctions, for example?

M

Max Castelli 15:42

I think is a very good question, if you remember there was and this was actually has been my view, for a while there has been a lot of talk about a multipolar currency system. So what will mean, basically, the multipolar currency system would be a system where you have, let's call it region of influence, I would say probably, we can think about three, which are one area which is dominated by the US dollar, which I think would include, of course, United States, Canada, and I would say large parts of Latin America, the second one will be the euro area, probably also with the dominance of the euro. This could also become stronger, particularly in Europe, if we start to see significant progress. For instance, in Capital Markets Union, in more integration from a fiscal perspective, something which has already been happening, at least on the fiscal side, partly as a result, also the emergency measure launch after COVID. But definitely, we see a trend there. And of course, the first one would be the one in Asia dominated by the RMB. We know that many Asian currency actually currently look at the RMB as a sort of reference currency when they think about their exchange rate regime. But so this, I can see a future like that. But the question will become to what extent there is interoperability across these three different zone? And as well, what is the level what payment system if there is a payment system serving all three of them? And here, I think the question becomes, first of all, the impact of sanctions. So sanction, I think, can become a big driver. So far, we can say that as far as the sanction against Russia, I believe the impact has been relatively limited, probably also, because Russia de facto is not a very big economy. In the global economy. Countries, of course, is an important player. But if you look at for instance, the share of GDP of Russia, in the global economy is still relatively small. And also the integration of Russia from a financial perspective is relatively limited. So for Russia, what we see in order to go around sanction was more about payments. And we know that they've been leveraging, for instance, the relationship with China with other countries to switch payment away from the dollar. That's something that we know that and it's actually reflected very well, in the share of cross border payments. If you look at the countries which shifted more towards, for instance, the RMB, or Russia, Sri Lanka, if I remember well, and a few others. And I think you also discussed this at length in a recent event, the US dollar, the question will be whether we're going to see more sanction, more widespread sanction, particularly, of course, targeting China, eventually, in a worsening of the US China confrontation over many issues, which are at the moment there. They're quick, the question then will become it's not a question of the RMB dominance. But it's more a question whether the China and in Asia will be able to develop a very quickly an alternative payment system. I believe that this is something that it is in the sort of policy agenda of China. But I think it will take some time, this could be accelerated by digital innovation, no doubt about

that. I think this could happen over the next few years. But I believe we are not there. The question then, of course, is what type of geopolitical situation we are in when we talk about geopolitical fragmentation. So far, we have been talking about areas where there is a clear separation between different zones, different areas in the world. Just take an example technology, technology sector is becoming more fragmented. No, no more, no doubt about that. But we have not seen Yes, the fragmentation to court from international cool would mean that you start to see really isolation and separation across the border for different economies, something similar to what was the Western world versus the Soviet Union. At the time. I don't think we are there yet. I'm not ruling it out because we learned that we should be prepared for everything but I don't think we are there yet. And we should see some substantial weakening in the relationship between the West and China in order to see something like that. So if we bar this type of more extreme Szenario I can see China making more progress in payment in the next few years, creating eventually, competing payment system visa vie the US. But I don't think this will yet really basically move \$1 away from the sort of dominant position it is now, at least in the foreseeable future.

T

Taylor Pearce 20:21

Right. So it could be a perfect storm digital innovation and geopolitical fragmentation or tensions. But we're far away from that now, and that's not the most likely scenario. Makes

M

Max Castelli 20:32

sense. I would agree on that statement. Yes.

T

Taylor Pearce 20:34

My last question is related to the price of gold and Bitcoin, both of which have been going up significantly over the past few weeks and months. So I wonder if you could elaborate on that. And if you see a link to the D dollarization. Trend, yeah,

M

Max Castelli 20:51

this is something which is always there, you know, every time like gold and Bitcoin, not necessarily always at the same time, go up, but you have gold or Bitcoin bucks, right? These are the sorts of survey who believe that basically, when we talk about gold is about debasing of currency that the world is moving into a world where you need to find an alternative store of value because a fiat currency are doomed. Will you have the same attitude for the sort of stronger advocate of Bitcoin, but the reality sorry, let me start. First of all with gold, we know that gold is being an important cycle over the last few years, for instance, central banks have become a net buyers of gold over the actually not this year, but over the last few years has been going on for a while, after decades of being net sellers. And of course, this coincided with an increase in the price of gold, which has been going on for a few years now, the recent rise in gold that we experienced, which has been pretty robust 10 12%, year to date in 2024, is actually a bit more surprising, because he happened with actually one key variable for gold price, which is interest rates in the US not moving down. But actually, there has been an

increasing view, that interest rate might not go down as fast as we were expecting, for instance, in the last quarter of last year. And there are also some will think that given the least recent inflation dynamics, interest rate may even go up. And there's no me saying that, but also some important back central bankers, actually in the last few days in the US and some leading economies. So from their point of view, this rising gold is a little bit surprising. And the question is why this is happening. I suspect that is not about gold, the becoming a sort of a new backbone of the future global financial system. But I think it is more about geopolitics. And as well, there may be some inflation ageing, I suspect the between the to that geopolitics is more important. I say that because as you saw, gold is a commodity, we know that commodity tend to do well during inflation, but I still remain in the view that inflation will eventually continue going down, rather than up. So I think this is just the modern market sort of debate about exactly when central banks will eventually decrease rate. geopolitics seems to be the best candidate for two reasons. First of all, because we are entering a period of high uncertainty, not only geopolitically globally speaking at the geopolitical level, but as well in the US. I mean, the more we go close to November, the more investor will become nervous to see what is going to be the final outcome of the presidential election. And it's not just a question of who wins, but also question of how he wins, and the where everything will be smooth. We should not forget, we have history of contested election in the US. We have history of infighting between Democrats and Republican, we cannot rule out that we are going to end up in November in our scenario, which remain very uncertain. So gold is there as a geopolitical edge. Second factor, I think, apart from the Middle East ongoing conflict in Gaza, I think also the Russia NATO story is there it is debated, the scenario of a potential direct confrontation between NATO and Russia is no longer a sort of impossible scenario. I still believe it is a low probability scenario, but still is a scenario which is being fooled. And last but not least, rising debt level as well can create uncertainty among the investor on holding a lot of fixed income, and then you want to start edging with gold. With Bitcoin. I think Bitcoin is going up not because there is a demand for replacement to fiat currency. Personally, I think Bitcoin is going up before a lot of items including kradic factors, including something happened within the Bitcoin market and also because of course, the ETF approval is has really given a lot of tailwind to Bitcoin, simply because we have now a new class of investor, which before we probably was not invested in Bitcoin and now feel more comfortable. We are instrumental like an ETF, and to conclude interesting dynamics in Bitcoin and gold over the last few months, but I don't believe that this will have a big impact long term on the new global financial architecture, and the role of the US dollar that we've been debating in this podcast.

T

Taylor Pearce 25:29

Great. Well, those are all my questions. So thanks so much, Max. It's been a pleasure. As always,

M

Max Castelli 25:34

thank you very much to you. And he's always a pleasure to talk to on Fifth. Thank you, of course.

T

Taylor Pearce 25:42

And thank you also to our listeners, be sure to follow our other podcasts wherever podcasts are

available. And also check out our coverage of D dollarization, and other key macro topics on the website. Thanks. Thank you.



Thank you for joining us for this edition of The ONVIF podcast. If you found today's conversation engaging. Make sure to stay tuned for additional thought provoking discussions on worldwide Finance, Economics and Policy by subscribing to our channel. Stay connected of the latest developments by following us on our LinkedIn page on Fifth Economic and Monetary Policy Institute.