De-dollarization: When the World Begins to Hedge Against the Dollar

"The U.S. dollar remains central to the global financial system, as the global economy increasingly emphasizes systematic diversification."

From Global Anchor to Political Risk: Questioning the Dollar's Neutrality

For more than seven decades, the US dollar has formed the backbone of the global financial system. It is not merely a reserve currency, but the operating language of global trade, finance, and investment. Oil is priced in dollars, trade contracts are written in dollars, and central banks hold dollar-denominated assets as the core of their foreign exchange reserves. This dominance rests on structural strengths few currencies can replicate: the scale of the US economy, the depth of its capital markets, and the unparalleled liquidity of US Treasuries, long regarded as the world's safest and most tradable assets.

That perception began to shift in 2022. When Western governments froze roughly USD 300 billion of Russia's foreign reserves following the invasion of Ukraine, a previously theoretical risk became tangible. The episode demonstrated that reserves held in major Western currencies could become inaccessible if geopolitical alignments turned hostile. While this action did not undermine the dollar's economic foundations, it permanently altered how political risk is priced into a financial system once assumed to be neutral.

De-dollarization as Risk Management, Not Rebellion

Despite frequent headlines, de-dollarization is not a coordinated challenge to the United States. Rather, it reflects a pragmatic response to a more fragmented and confrontational geopolitical environment. Financial sanctions, once exceptional, have become a routine policy instrument, prompting governments to reassess the risks of excessive reliance on a single currency system.

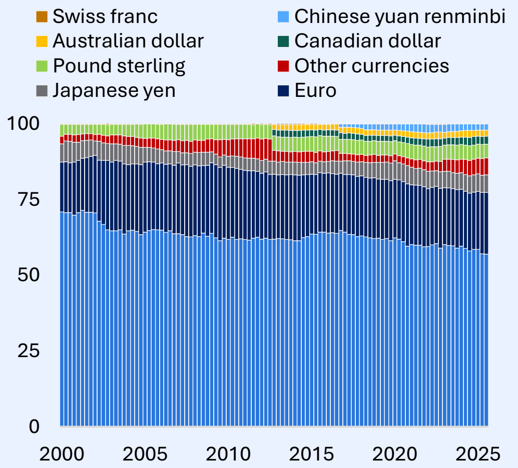
Most countries are not abandoning the dollar. They are hedging against overdependence. Central banks have increased allocations to assets perceived as politically insulated, particularly gold. In recent years, global central bank net gold purchases have exceeded 1,000 tonnes annually, the highest levels in decades. In parallel, bilateral trade arrangements allowing settlement in local currencies have expanded quietly, while central bank currency swap lines have grown as alternative liquidity backstops. Together, these developments point to diversification rather than disengagement.

Expanding Alternatives, Structural Limits, and the Absence of a Successor

China has been the most proactive in promoting alternatives to the dollar. Since 2015, it has expanded the use of the renminbi in cross-border trade and invested heavily in parallel payment infrastructure. By 2023, renminbi settlement accounted for roughly one-quarter of China's cross-border trade in goods, a sharp increase from a decade earlier. Trade between China and Russia has also shifted overwhelmingly toward local-currency settlement, particularly in energy transactions.

Yet the limits of these alternatives remain evident. Despite its growing role in trade settlement, the renminbi still represents only about 2–3 percent of global foreign exchange reserves, constrained by capital controls, limited transparency, and persistent geopolitical uncertainty. The euro, while more established in reserve portfolios, lacks a unified fiscal authority and a single deep sovereign bond market comparable to US Treasuries. Gold, though increasingly attractive as a reserve diversifier, cannot function as a scalable settlement currency for modern trade. Alternatives are expanding, but none replicates the dollar's full ecosystem of liquidity, trust, and institutional depth.

Currency Composition of Official Foreign Exchange Reserves, Quarterly (1999–2025)



Source: IMF, Currency Composition of Official Foreign Exchange Reserves (COFER)

A Fragmenting Monetary Order and the Cost of Autonomy

The deeper consequence of de-dollarization lies in the gradual fragmentation of the global financial architecture. Rather than transitioning from one dominant currency to another, the system is evolving toward a multi-currency structure shaped by regional and political blocs. Trade, payments, and capital flows increasingly pass through parallel channels designed to reduce reliance on any single system.

Fragmentation, however, carries economic costs. Multiple settlement currencies raise transaction expenses, complicate hedging strategies, and dilute market liquidity. Research by the International Monetary Fund suggests that severe financial fragmentation could reduce global GDP by several percentage points over the long term, with emerging economies bearing the greatest burden. In periods of stress, the absence of a universally accepted safe asset could amplify volatility rather than contain it. For many governments, these trade-offs are nevertheless viewed as acceptable in exchange for greater financial autonomy.

Emerging Economies and Thailand's Pragmatic Adjustment

For emerging economies, de-dollarization is a double-edged process. Reduced reliance on the dollar can limit exposure to US monetary tightening and exchange-rate volatility, while local-currency settlement can lower transaction costs and support regional trade integration. At the same time, smaller currencies lack deep global markets, making capital flows more volatile and reserve management more complex.

Thailand illustrates a pragmatic response. As a highly open economy, it cannot disengage from a system in which the dollar remains dominant in trade finance and global banking. Yet Thailand has gradually expanded local-currency settlement arrangements with regional partners, strengthened financial cooperation within Asia, and participated in cross-border payment innovations. The objective is not to replace the dollar, but to ensure it is no longer the sole pillar supporting the system.

The Dollar Endures, but Unquestioned Dependence Has Ended

The dollar is not losing its throne. It still accounts for roughly 58 percent of global foreign exchange reserves, appears in nearly 90 percent of foreign exchange transactions, underpins about half of global trade invoicing, and dominates around 60 percent of cross-border banking. De-dollarization is therefore not about dismantling the existing order, but about adjusting to a world in which political risk can no longer be separated from financial architecture.

The real challenge ahead is not whether the dollar will fall, but whether the global economy can manage a more fragmented monetary system without transforming financial insurance into systemic instability.

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