



INSTITUTE OF  
INTERNATIONAL  
FINANCE

# **The USD's Endurance in a Fragmenting Global System: Trade, Tariffs, and Currency Dynamics**

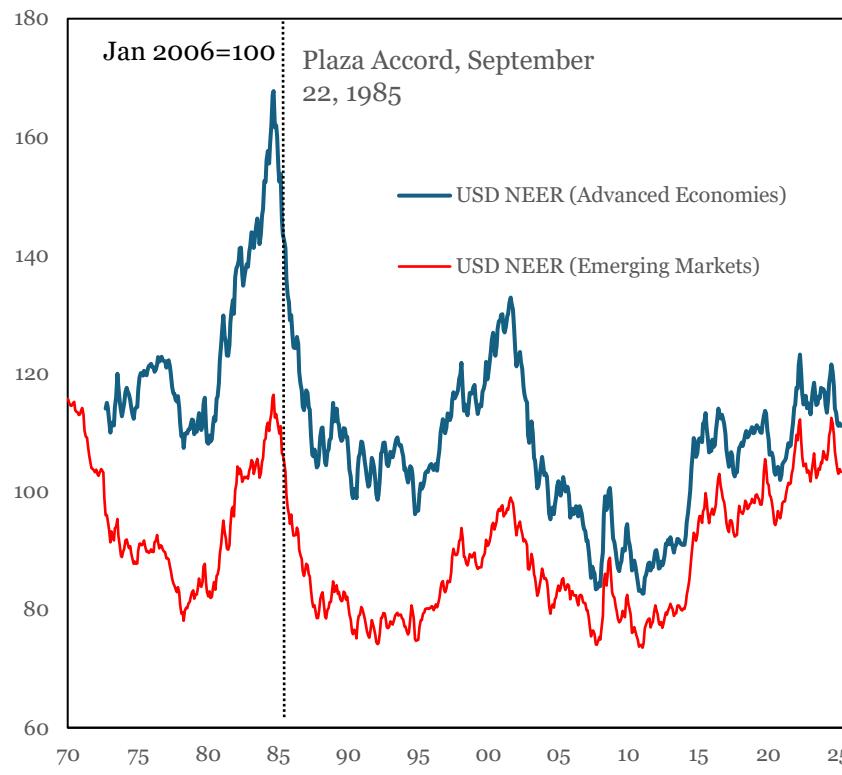
---

Marcello Estevão, Managing Director and Chief Economist

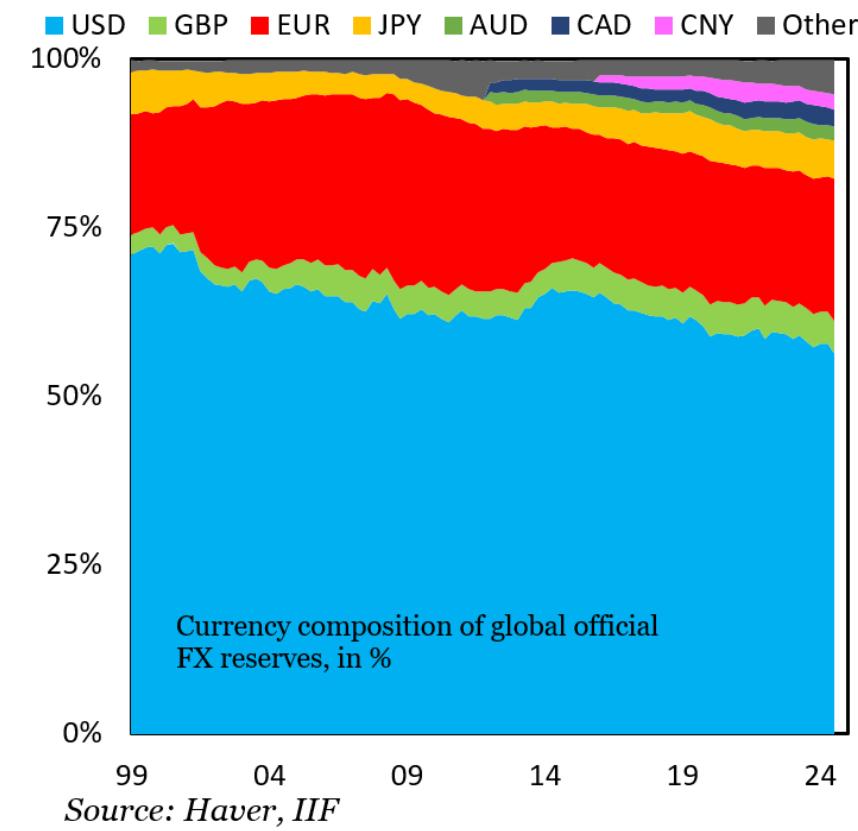
# Trade, FX, and Fragmentation: The New Global Landscape

- Trade and FX reshaped by tariff shocks, divergent monetary paths, and geopolitical realignment.
- The dollar moves in long swings, but none of these have weakened its reserve currency role.
- EM resilience and monetary credibility are strengthening local currencies.
- Digital and local-market channels are expanding the dollar's reach.

Short-term swings do not determine reserve currency status.



The USD dominates on FX reserves.



# The Narrow U.S. Growth Engine

- U.S. growth is increasingly driven by AI-related investment; non-AI investment is stagnating.
- This narrow growth engine reinforces expectations of Fed easing.
- Lower yields → softer USD → easier EM financing.
- FX is reacting more to U.S. structural forces — AI-driven capex, productivity expectations, and Fed policy — than to tariffs alone.

Exhibit 1: Recent real GDP growth is narrow and AI-led.

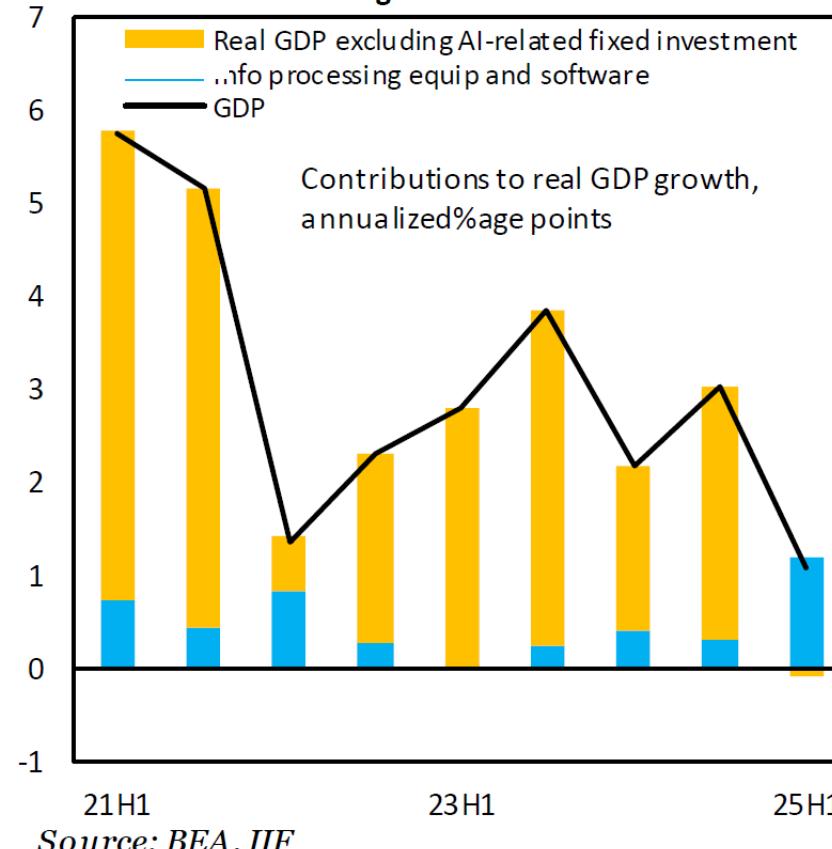
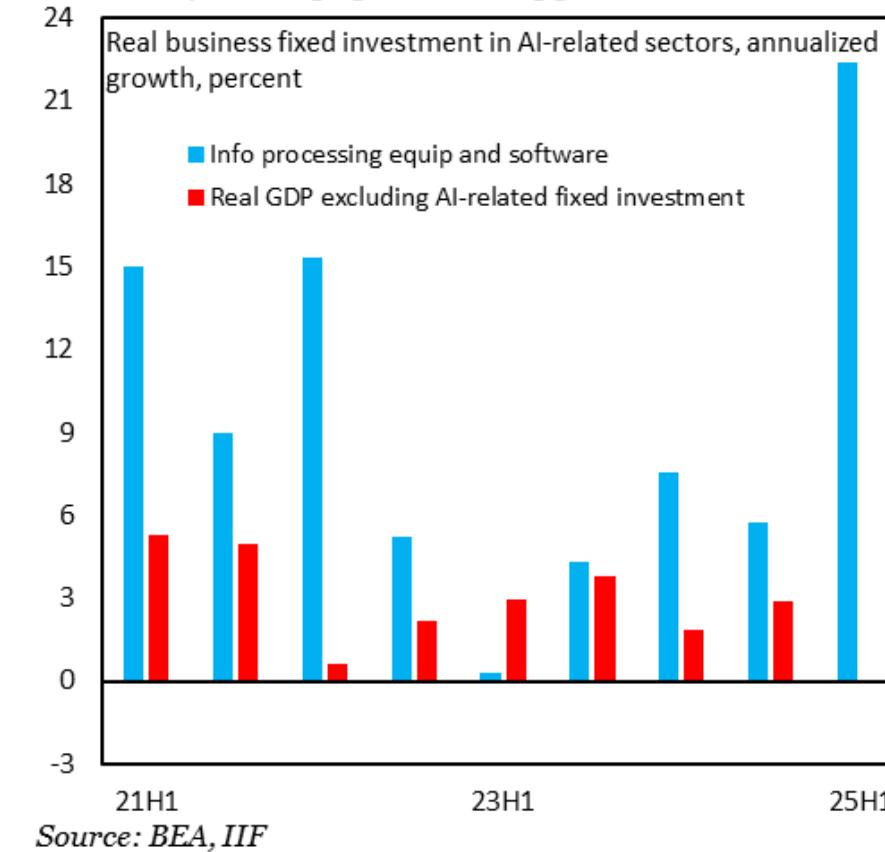


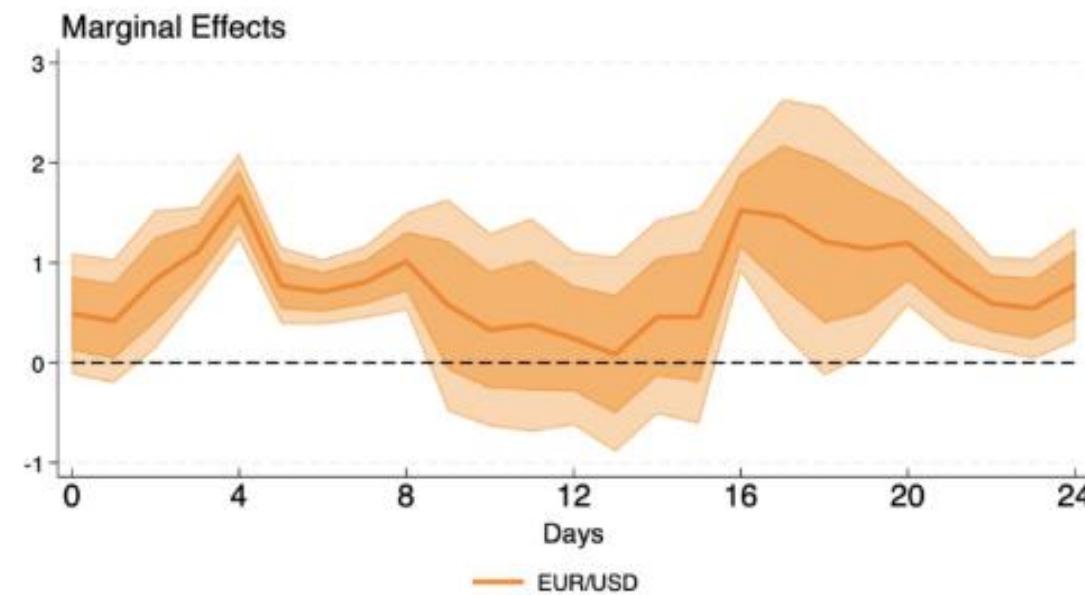
Exhibit 2: AI capex is surging and boosting growth.



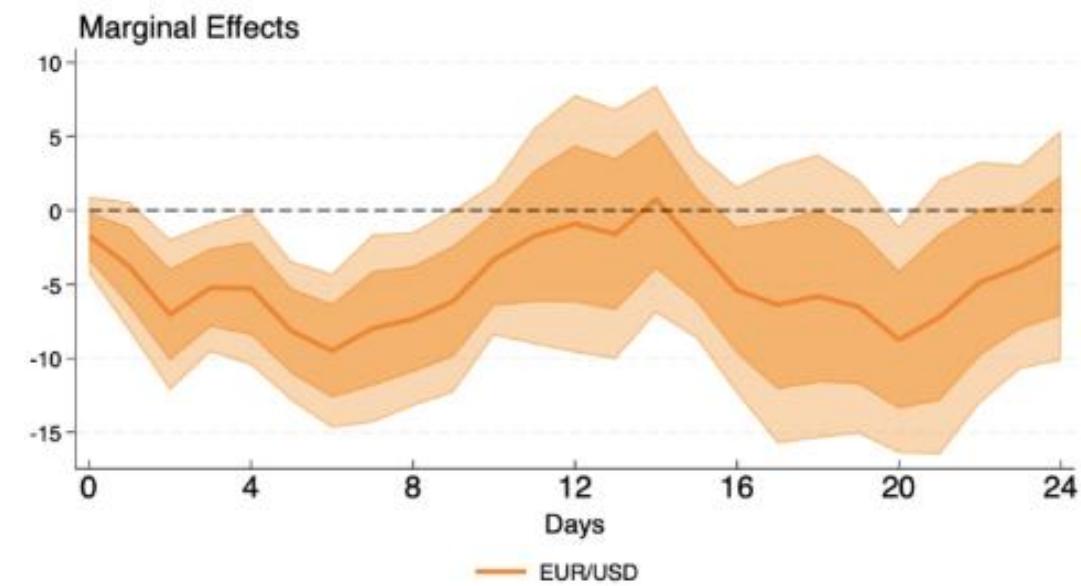
# Why Tariffs Made the Dollar Fall

- Traditional models predict USD appreciation after U.S. tariffs.
- April 2 “Liberation Day” saw the opposite: USD depreciation.
- Reasons: retaliation expectations + anticipated Fed easing + and uncertainty over policy coherence. (Consistent with Ostry et al., Bergin–Corsetti, and Gagnon/Bayoumi’s work.)

U.S. global tariffs: no retaliation



U.S. global tariffs: with retaliation

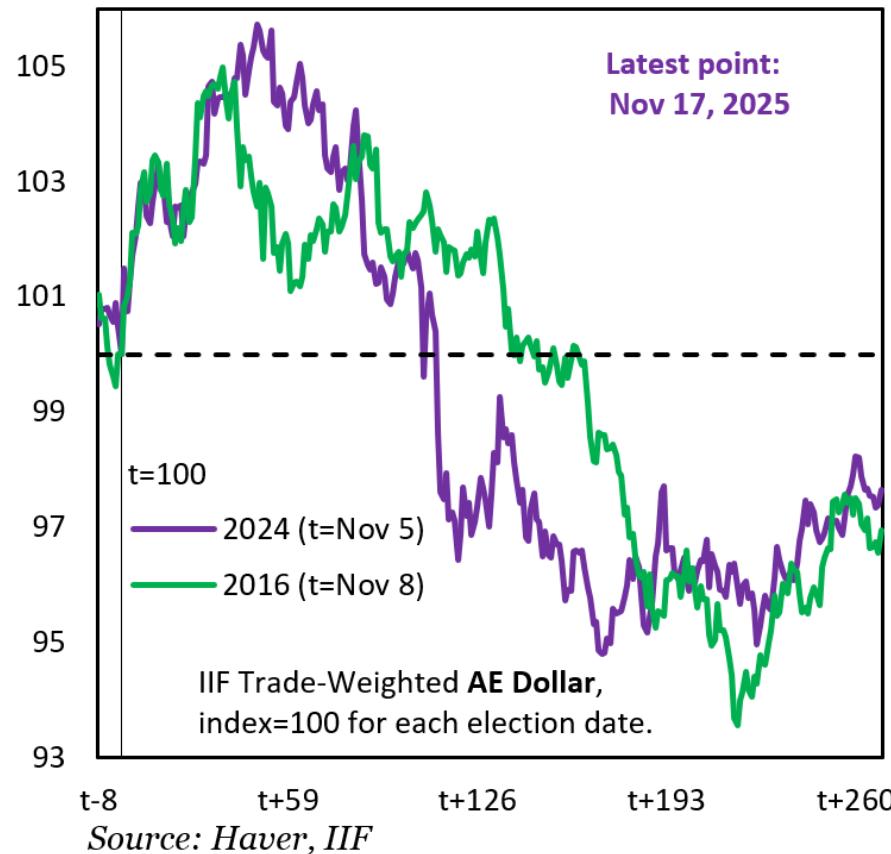


Source: <https://cepr.org/voxeu/columns/tariffs-and-us-dollar-depreciations-not-so-surprising-after-all>

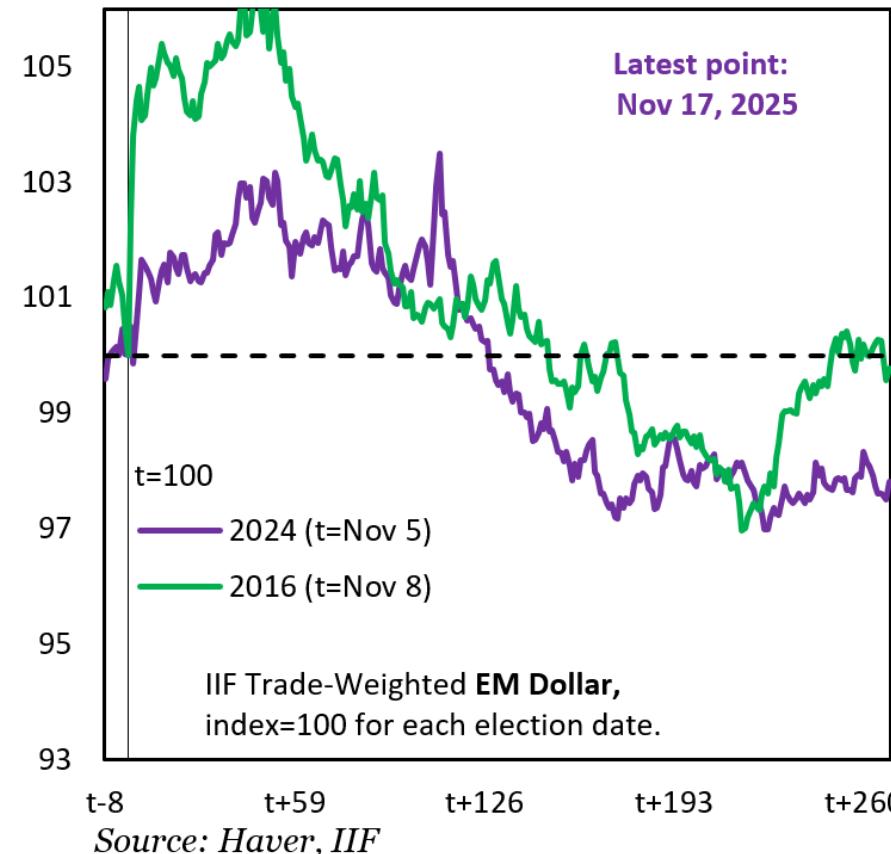
# EMFX Behavior in the 2025 Tariff Shock

- Recent USD weakening bigger with respect to EMFX—unlike in previous cycles.
- EMFX appreciation reflects stronger balance sheets and credible monetary frameworks.
- This is not de-dollarization—it is EM normalization.

AE dollar has mirrored Trump I's path...

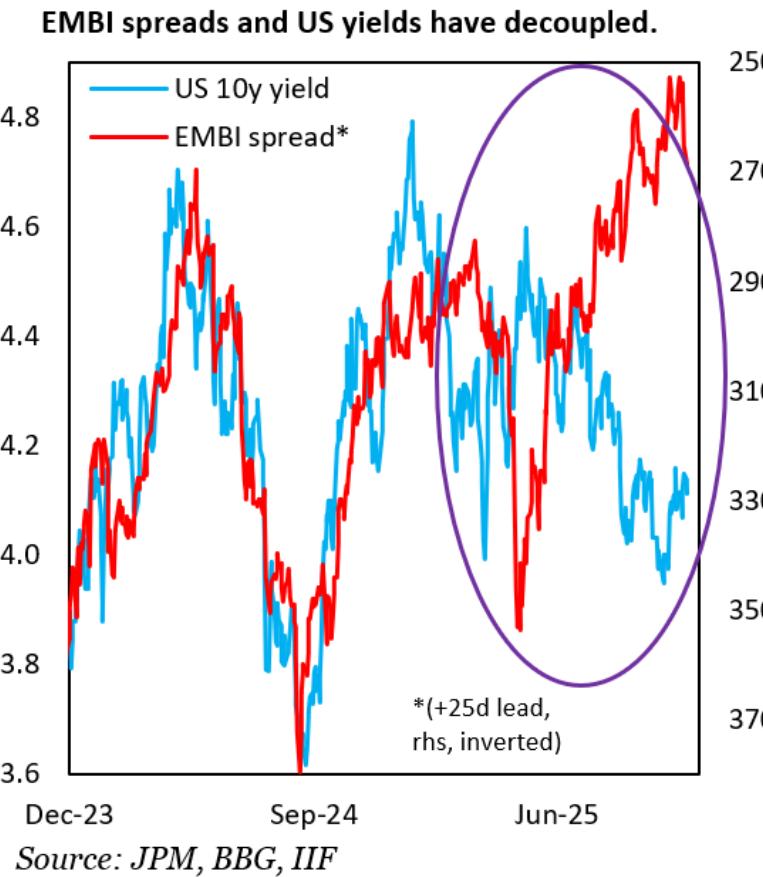
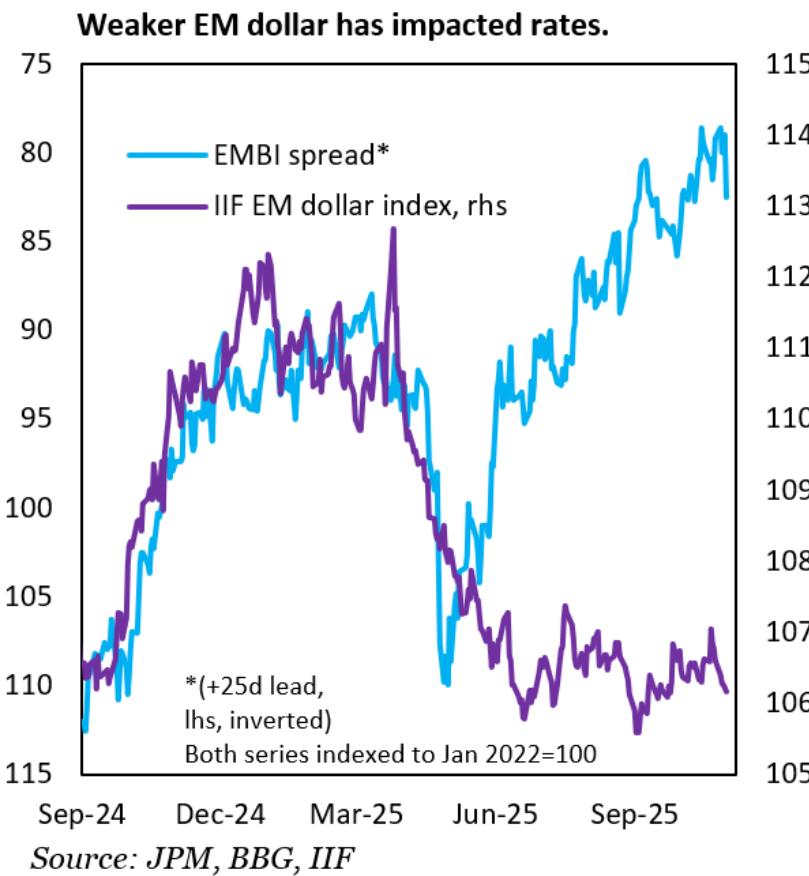


... while EM dollar is indeed weaker.



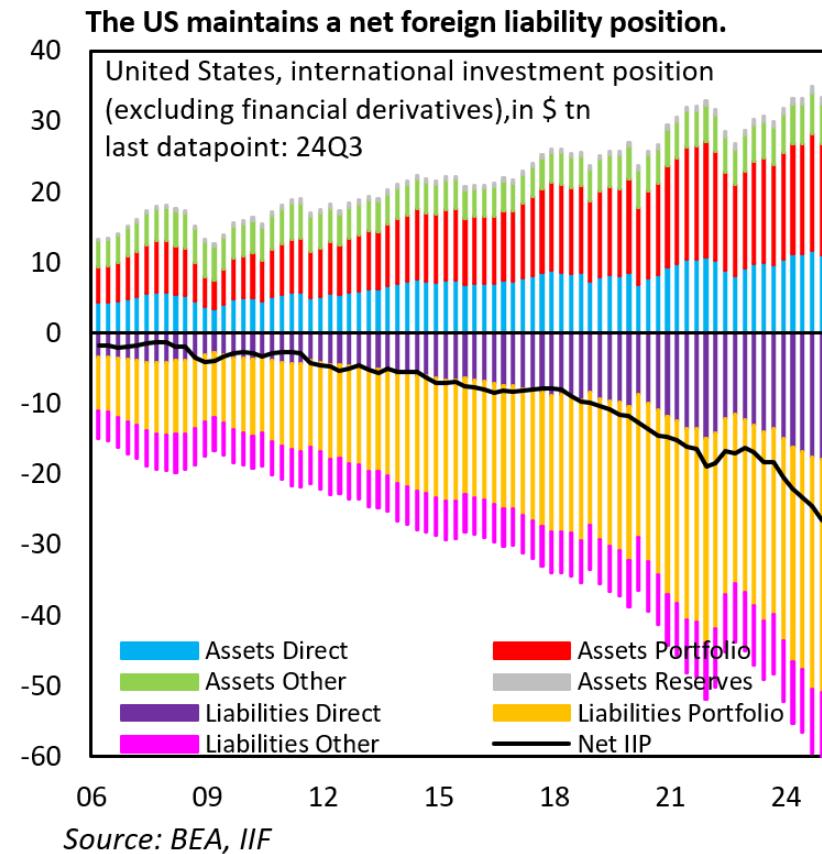
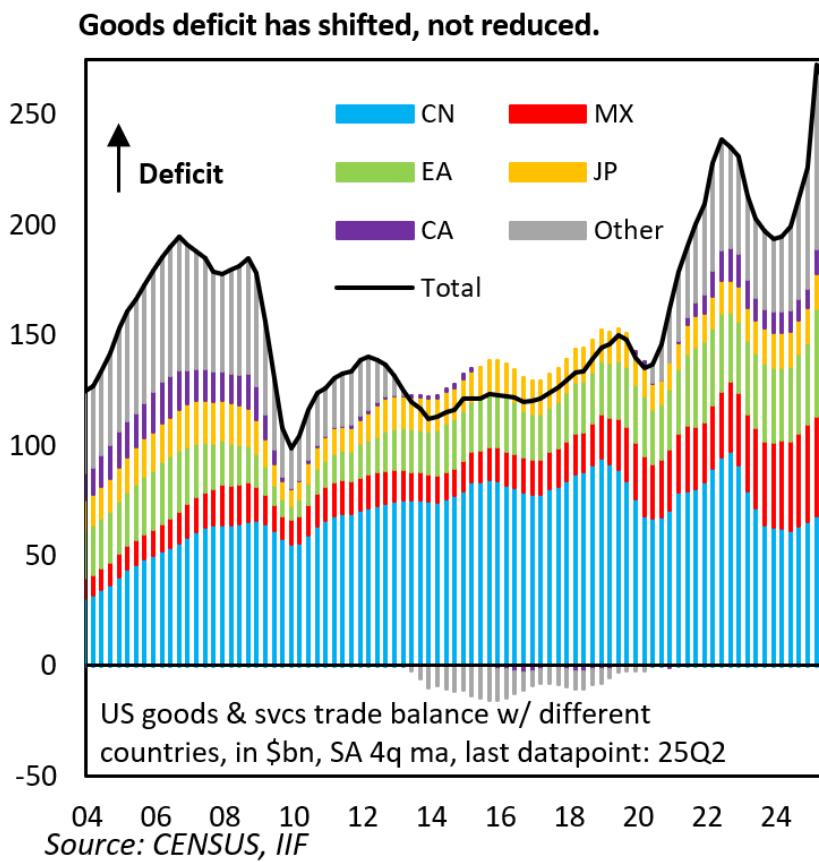
# What's Really Driving the USD this Year

- Fed cuts since Sept 2024 and shifting rate differentials have softened dollar support.
- Foreign investors are hedging more USD exposure, muting the FX impact of U.S. inflows.
- The U.S. tech equity correction has been removing another source of dollar strength.
- EMFX resilience reflects stronger policy frameworks—structural shifts, not USD decline cuts.



# Trade Deficits and the Dollar: The Structural Link

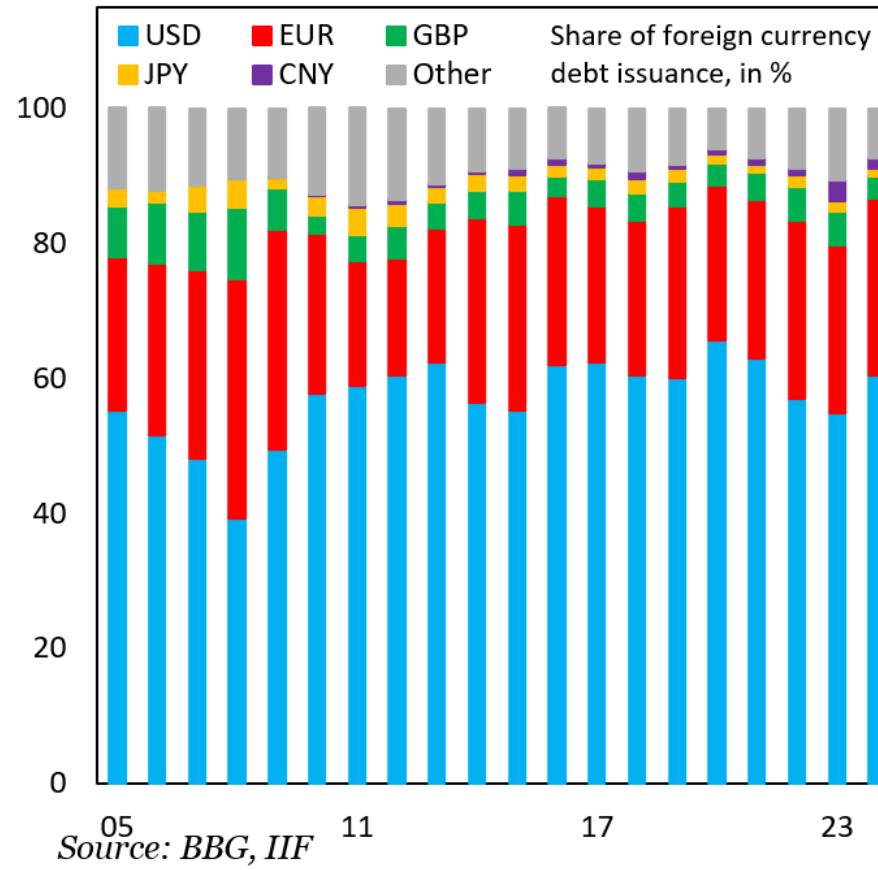
- The U.S. trade deficit and NIIP position reflect USD's global role—not the other way around.
- “Exorbitant Privilege” allows U.S. to run persistent deficits with lower financing pressure.
- Sustainability requires smaller deficits, implying gradual USD depreciation over time.
- Tariffs alter the short-term path but not the structural drivers.



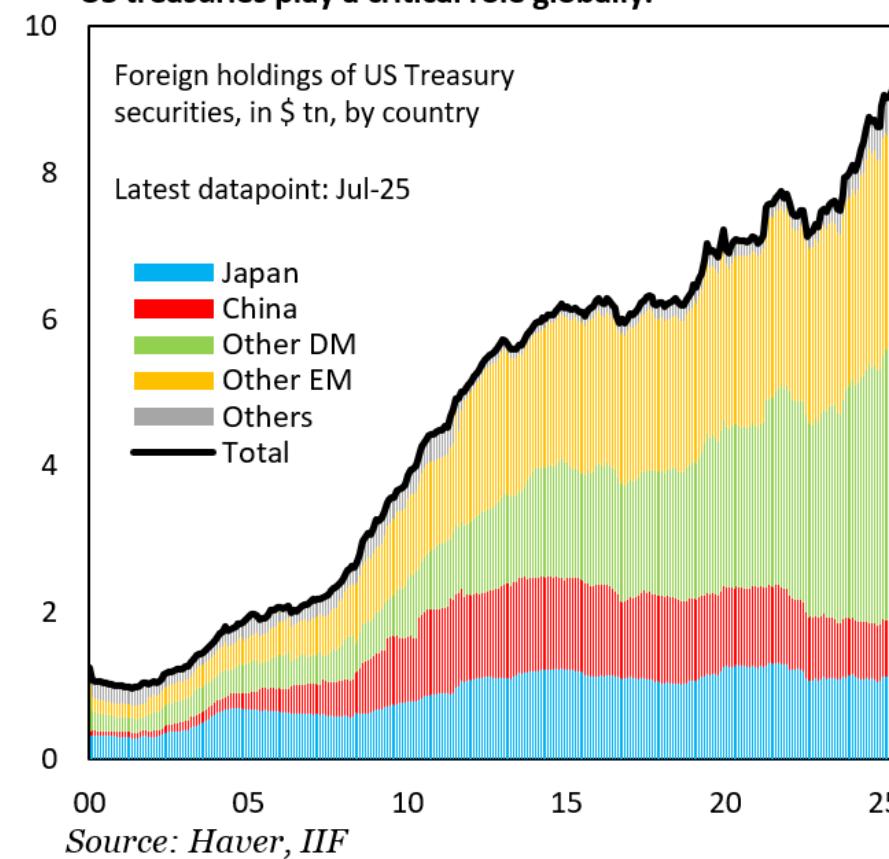
# The Dollar's Dominance in Global Finance

- Dollar share of global issuance remains unmatched.
- Hard-currency spreads for EM remain tightly linked to USD cycles.
- Despite lower official holdings, private demand for Treasuries is rising.
- Issuance outpacing foreign buying explains falling foreign share—not declining demand

The USD still dominates on debt issuance.

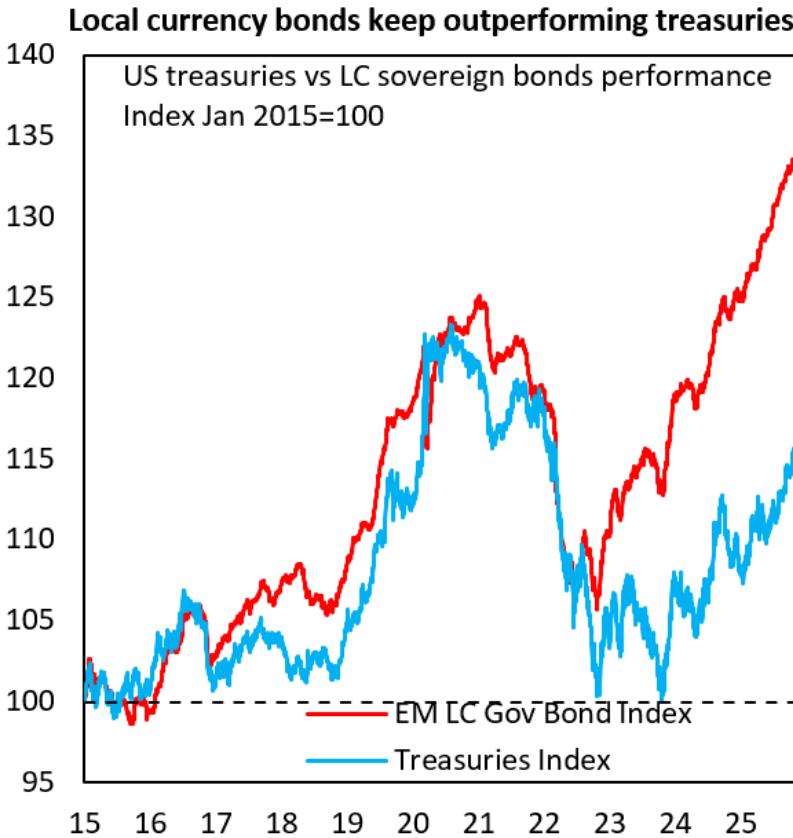


US treasuries play a critical role globally.

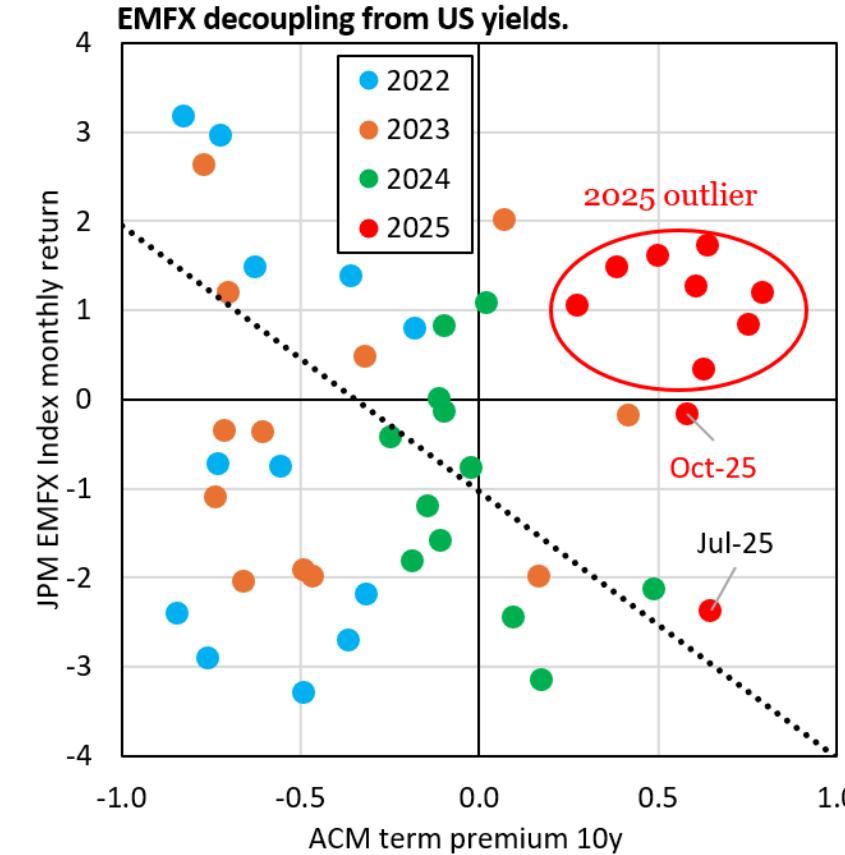


# Why EM Local Markets Matter More Now

- Strong EM monetary credibility has pulled investors back into local-currency debt.
- Local returns beat USTs and hard-currency EM indices.
- FX volatility is falling in key EMs despite global uncertainty.
- This reduces “fear of floating” and shifts global response to U.S. rate cycles.



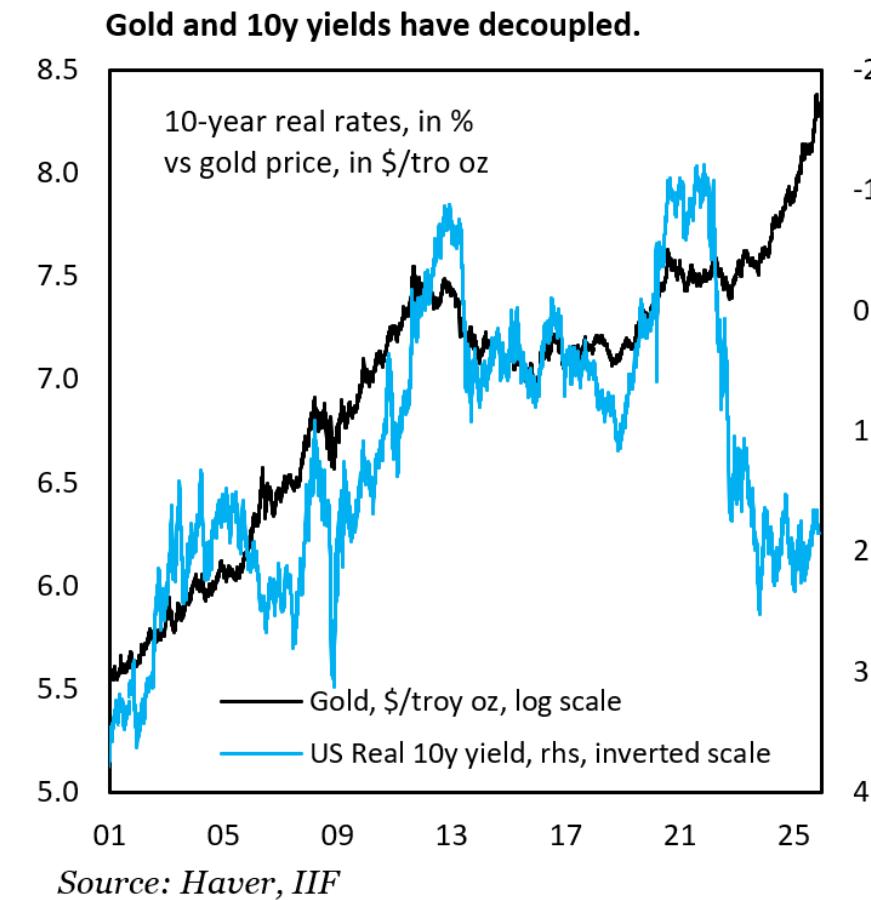
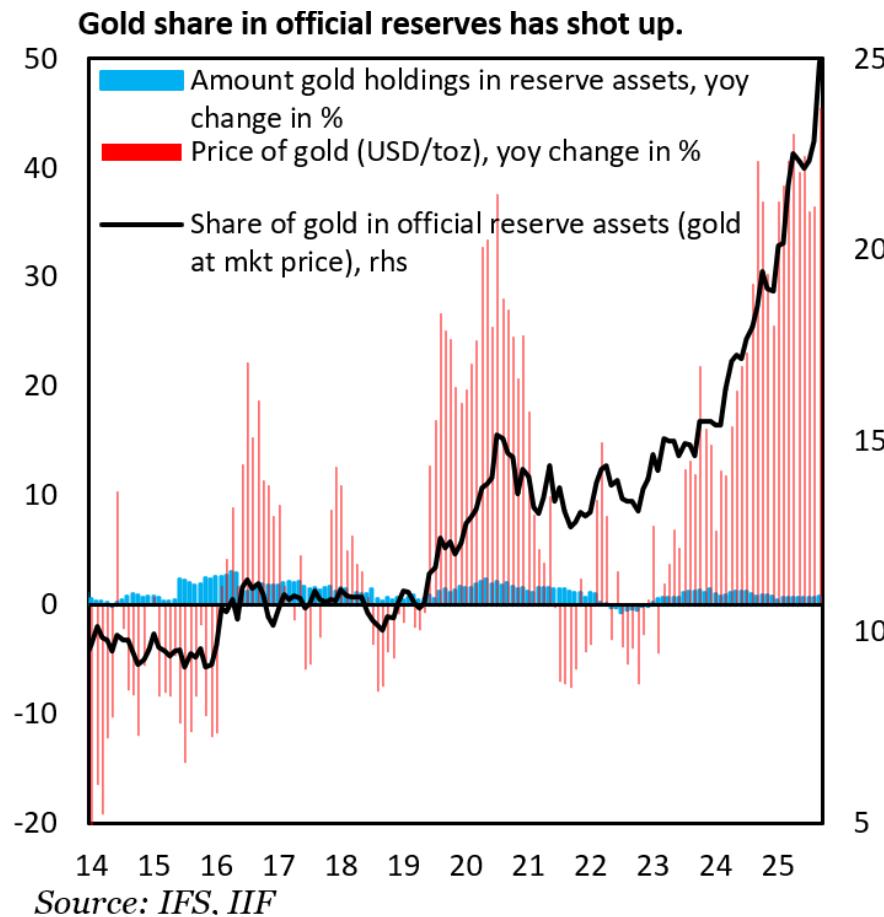
Source: BBG, IIF



Source: FRED, BBG, IIF

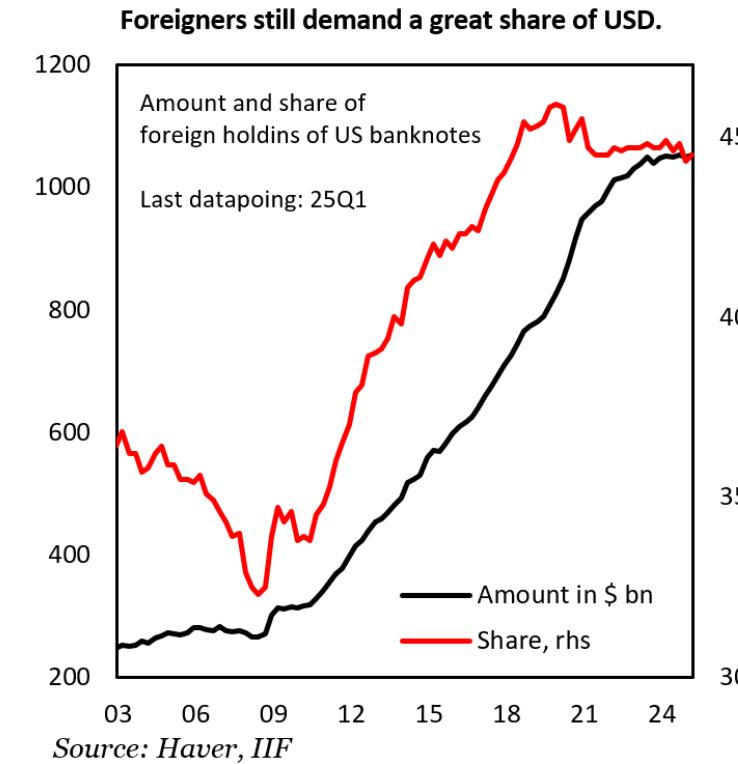
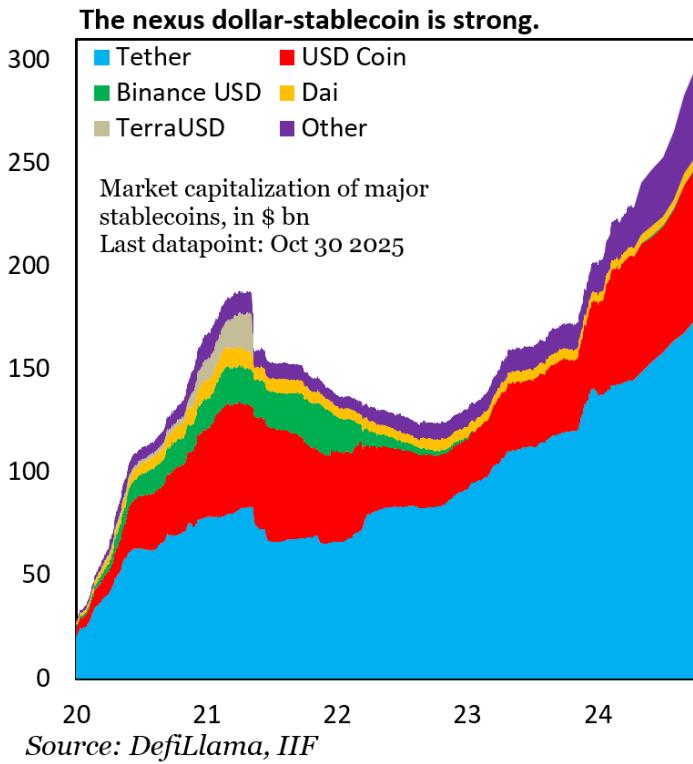
# Gold's Rising Share: Mostly a Price Story, Not a Shift Away From USD

- Gold holdings have risen, but higher reserve share is mostly valuation.
- Ounces held by central banks have grown only modestly.
- This supports the argument that dollar dominance persists.



# Stablecoins: The New Dollar Rail

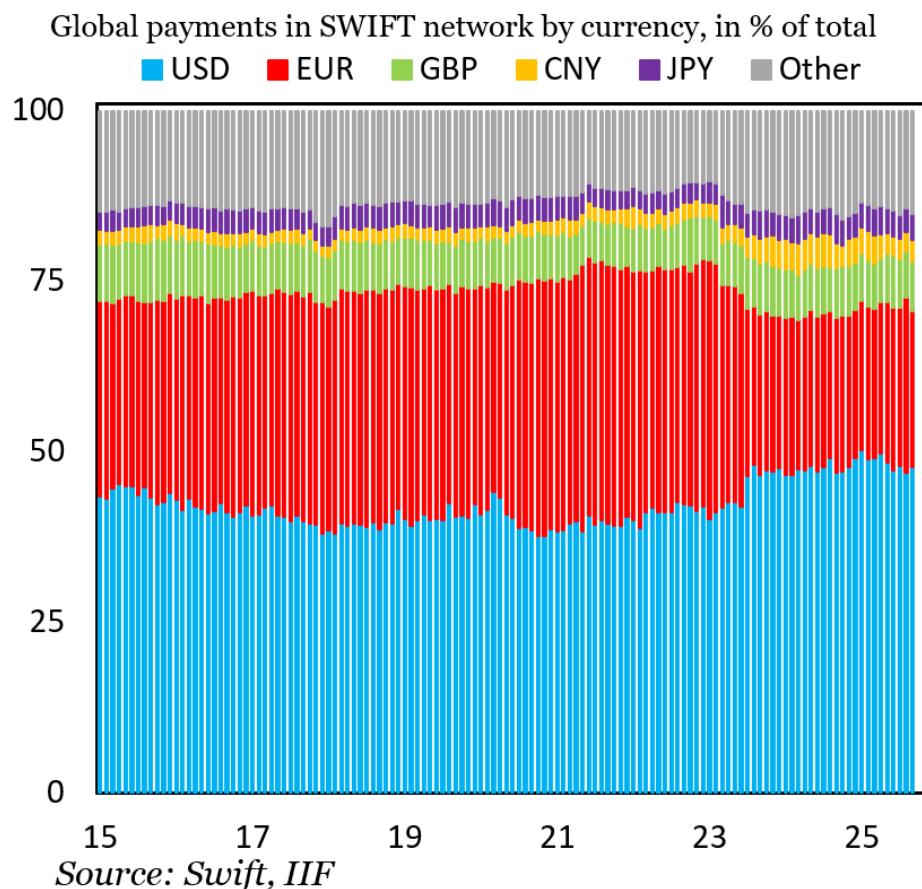
- Stablecoins increasingly provide informal access to USD liquidity in EMs.
- Use cases: payments, savings, cross-border transactions in shallow financial systems.
- Regulatory perimeter is expanding in U.S., EU, and Asia—formalizing these flows.
- This extends the dollar's global reach beyond official banking channels.



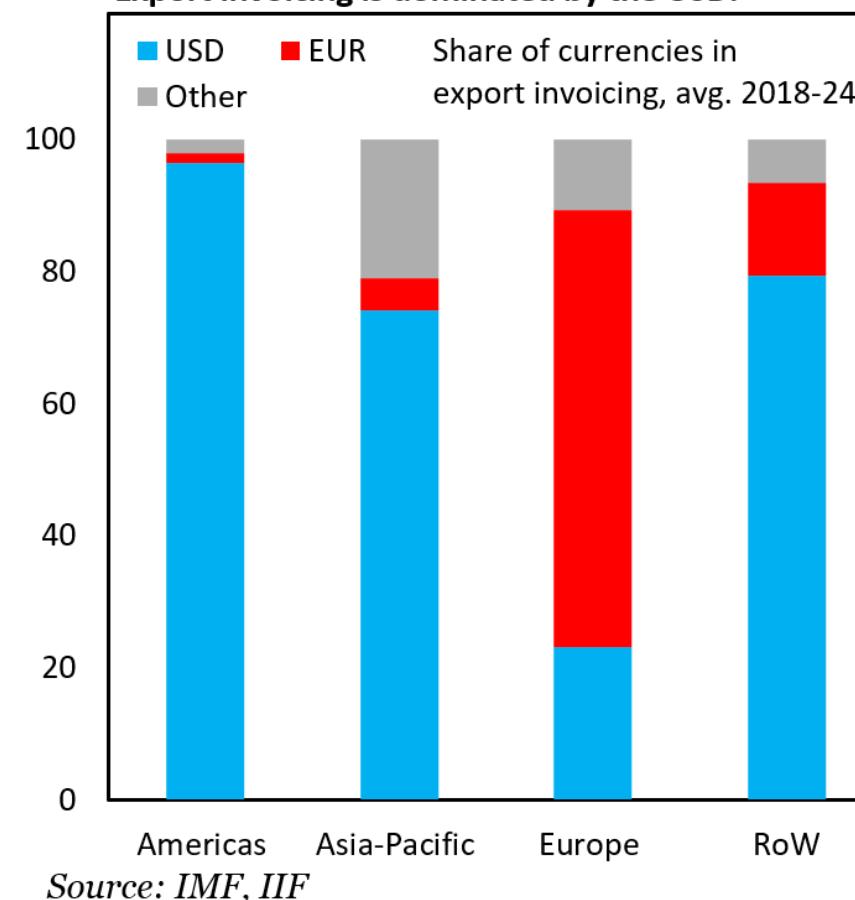
# Settlement Systems Still USD-Anchored

- SWIFT remains overwhelmingly dollar-based.
- Even if bilateral trade is shifting, settlement remains in USD.
- Combined with the digital layer, this creates a two-tier USD system (official + digital).

**The dollar is still the main payments currency.**



**Export invoicing is dominated by the USD.**



## The Dollar Isn't Declining – It's Evolving

- Tariff shocks reshape short-term FX reactions, but structural dollar demand is stable.
- EM resilience is producing a more multipolar FX expression but not a post-dollar world.
- Trade fragmentation + digital dollar rails = a more layered system, not a replaced one.
- The USD's role is shifting from centralized dominance to distributed ubiquity.
- Note: In the long term, the role of the U.S. dollar depends on many aspects, including geopolitics and the quality of U.S. domestic and international policy. This is a topic for another day ...