



## The Daily Dish

# The Future of the Dollar

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A very common question is: What is the future of the dollar? Another variant is: Will the dollar lose its status as the world's reserve currency? Even though the dollar is involved in 90 percent of international transactions and constitutes three quarters of the reserves held by central banks, there are good reasons to be concerned.

First, the 21st century has witnessed a steady rise in U.S. debt, even measured relative to gross domestic product (GDP), and the next decade will likely see the historical high during World War II eclipsed. At some point - not imminently - global capital markets will have to be concerned over the capacity of the U.S. economy to support prompt payment of interest and principal. At that point, countries will bail out of holding dollars, its value will plummet, and its status as a reserve currency will end.

Second, and more immediate, is that policymaking in Washington, D.C. is dysfunctional. The inability to manage the debt ceiling effectively, the threat of government shutdowns, and other failures of financial management have led credit rating agencies to put the spotlight on the United States for downgrade, reducing the attractiveness of Treasuries and the dollar.

The third element is the increasing use of economic sanctions. As more and more countries fall into the sanctions web, other countries will be warier of having their holdings in dollars lest they be frozen suddenly.

The fourth issue is that other countries - notably Brazil, Russia, India, China, and South Africa - have actively begun trying to displace the use of dollars in international finance. They have agreed to settle their trades in their own currencies or a new alternative to the dollar.

These forces have been in play for a while. Over the past several years, however, these dollar-weakening forces have been overwhelmed by the interest rate policy of the Federal

Reserve. The sharp rise in rates has led the dollar to appreciate (see graph, below). One could reasonably expect this to reverse as the Fed normalizes policy and especially if Donald Trump is elected president. During his tenure in office he publicly and actively pushed for a weak dollar. One can expect more of the same.

The good news in this is that the United States controls its fate. Responsible fiscal policies, effective financial management, and a less heavy-handed international finance presence will ensure the continued strength and dominance of the dollar.

