De-Dollarization and You - Part 1

May 07 2018

There are many different types of global economic risks that financial advisors take into account when preparing a financial action plan for their clients. This is where advice and judgment come into play when working with you as a client. One area that is gaining increasing prominence is the role of the United States and its dollar in international affairs.

For example, the recent tit-for-tat tariff moves raise the spectre of a global trade war that could destabilize global economic trade and reverse decades of progress and globalization. The movement towards trade harmonization and globalization since the fall of the Berlin Wall and communism in the early 1990's has ushered in an era of increased wealth and prosperity for many of the poorest people in emerging economies and as well as contributing to growth in Canada and the United States over the same time frame.

The following is a quick high-level march through history and then we will look at how any change in the global reserve currency regime will impact Canadian and US investors and their financial well-being in the coming years.

Globalization and trade is underpinned by trust and the ability to quickly and efficiently, with low administrative costs, complete transactions. The global symbol of that trust has been the U.S. Dollar (USD), firstly since the Bretton Woods Agreement of 1944*, when the USD was partially backed by gold bullion. In 1971 Nixon took the US off the gold standard but maintained the **USD as the global reserve currency** for trade settlement by aligning U.S. geo-political interests during the Cold War with OPEC and launching the era of the US petro-dollar.

The deal was that Saudi Arabia specifically and OPEC generally would only accept USD as the preferred payment option for the settlement of all sales of barrels of oil globally. This allowed the **US to continue to receive the benefits** of having the global reserve currency, which continues to this day. The previous global reserve currency was the British Pound Sterling but its use began to decline when the sun set on the British Empire starting around 1915 during WW1 and was ultimately replaced by the international Bretton Woods Agreement.

Practically speaking, this means that if Bulgaria buys goods from Russia, or Peru, or Canada, it agrees to pay for those goods in USD even though it has its own local currency and the transaction in question has nothing to do directly with the U.S. economy. You can use anything as a unit of trade settlement as long as all major global bodies and trade blocs agree that the chosen vehicle is safe, secure, reliable and will hold its value. The result is that there are more USD in circulation globally than there are within the U.S. economy and the vast majority of global trade has been, until recently, completed in USD.

The U.S. has actively defended the use of the USD as a global reserve currency but has watched its market share for global transactions steadily decline since the early 2000's. Today, the USD is actively being replaced as a trade settlement vehicle due to a number of initiatives led by several emerging economic powers, not the least of which is China, but also India, Russia and other countries globally.

The next article will look at indicators of a possible move away from the USD as the global reserve currency, the impact of an official replacement of the USD as the reserve currency on North America and the likely process for replacing the USD as the global anchor for trade settlement should this event ever occur.

Call our office today for a fuller discussion **[1]** of how these changes over the next few years may impact your personal financial and investment strategies.

Investopedia,** ***Bretton Woods Agreement **[2]. Retrieved on April 11, 2018.**

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