



Analysis of Trends in Supremacy of Us Dollar from Today's Perspective.

KEYWORDS

US Dollar Values, Currency, Supremacy, dollar index, reserve currency

AUKNOOR GOUTAM

Konanki Srinivas Kiran

ABSTRACT

Supremacy of dollar as International reserve currency is well known. Recent challenges to dollar hegemony from Euro, Chinese Yuan, IMF's SDR has important consequences to world economy. US dollar is important because of store value of its currency, for invoicing, banking & for trade reasons. Analysing the trends and predicting the value of US dollar Vs other currencies is critical for economists of all countries and has great economic & commercial consequences. The value of dollar is measured in terms of Prices (GDP & CPI indicators), House hold expenditure, Wages & Output. Us dollar has two roles as reserve currency and another as national currency of US. The demand for dollar in debt market, central Banks & holding of US dollar assets by foreign institutional investors is measured to analyze the trends & predict dominance of US dollar for near future.

Introduction

US dollar is most important currency in the world. The supremacy of dollar has always been questioned by major currencies and many attempts were made to undermine the dollar value. However each time dollar has bounced back and continues to dominate the world economy.

Since eighteenth century when gold was primary currency, US domination of currency began. Starting with discovery of gold deposits in Alaska to fixing gold price to \$35dollars per ounce and subsequent shifting to floating currency system, US dollar never looked back. Historically value of currency is always related to geopolitical dominance, military might and countries do everything possible to see their value of currencies dominate.

The Value of US dollar is important for all countries in the world as it will have great consequences on their economy & accurate prediction of trends in value of US dollar help countries in planning & budgeting.

Factors that affect the value of Currencies:

The value of dollar currency is affected by various factors such as Balance of Trade, Balance of Investment, Prices, Politics, Budget deficit, Geopolitical events, Terrorism, Tax policies, Government expansions, elections, relative performance of foreign economies and economic factors such as demand for dollars, demand for physical currency outside US, interest rates, climate factors, Acceptance of oil in dollars, Strengthening of Euro, consumer savings, manufacturing sector performance, outsourcing, Entrepreneurship, employment growth etc.

Significance of dollar:

In view of the significance of US dollar in the world market, there are basically two roles for dollars 1) International Reserve Currency 2) As a national currency.

These two roles have to be understood before we estimate the trends in dollar values.

US dollar is major International currency. Approximately 75% of \$100 notes, 55% of \$50 notes, 60% of \$20 notes are held outside US. More than 600billion of 1.2 Trillion dollars in circulation is held outside US. The reasons for attraction for US dollar are many. US dollar is a great store value for quality of money, relative stability of purchasing power, wide acceptance, fair protection from counterfeiting. Strong performance of US dollar along with political & economical stability

has led to role of US dollar as reserve currency.

Foreign holdings of US dollar have increased in recent years and US could increase its seigniorage significantly. One way to estimate the seigniorage or savings is that the US derives from its currency held abroad is to compute a rate of return based on the interest earned on the treasury portfolio held by Federal reserve. This calculation suggests annual savings of more than \$30 billion.

International debt markets are another area in which dollar serves as prominent currency. The currency's status is exemplified by share of all outstanding debt securities issued anywhere in the world. The market is dominated by US dollar with 39%. Analysis of dollar usage region wise suggests Middle East, Asia, Latin America and Pacific are dominated by US dollar. Euro dominates Scandinavia, UK, parts of Africa and new members of European Union.

Dollar also plays great role in cross border currency liabilities of banks that report to Bank of International Settlements. America's all-round banking supremacy hinges on US dollar assets and its relation to axial banks all round the world.

Role of US dollar in the world Economy:

US dollar plays six major roles in the world economy

1. Vehicle: It is important to distinguish between three types of transactions. First between nonbank firms. Second - retail foreign exchange market in which forms deal with banks, here dollar plays no special role. Finally the interbank exchange. Almost all interbank exchange all over the world involves dollars purchase or sale.
2. Intervention: Central Banks usually intervene in private interbank exchange, making dollar interventional currency.
3. Invoice: US dollar is preferred by global business for invoicing between two countries.
4. Peg: Almost all currencies are pegged their values to US dollar.
5. Reserve: US dollar accounts are held most as non-gold reserves.
6. Banking: Dollar in New York & Euro Dollars in London provide much needed liquidity for dollar currency.

Measurement of Value of dollar is done considering the following indicators

1. Prices: Two price indicators CPI (Consumer Price indicator) and GDP deflator. The CPI or Retail Price Indicator is

bundle of products /commodities confined to consumer goods & services. The GDP deflator is bundle of goods & commodities that incorporates in the economy, investment and all Government provided goods & services.

- 2) Household Consumption: The amount spent by household on goods Over the period, households spend more money indicating higher standard of living or higher inflation (higher cost of goods & services)
- 3) Wages & per- capita GDP income are indicators of income.
- 4) Output: Total market value of goods & services produced in the economy.

Estimating the dollar dominance:

Measuring the value of dollar through the above mentioned parameters and also relative performance of other major currencies is important to estimate and determine the dollar supremacy.

Trends in value of US dollar are indicated by US dollar index. The index measures the US dollar value against basket of major currencies of the world such as Euro, Indian Rupee , Chinese Yuan, Japanese Yen, UK's Pound Sterling etc.

USD / Euro



Figure:1
Source: www.oanda.com



Figure:2



Figure3

The long term index values of Euro & INR is not shown great improvement indicating the strengthening of dollar (Figure1 & Figure2).

The average British Pound conversion rate over the last 12 months was 0.64. The average rate over the last 10 years was 0.59. A Higher British Pounds to US Dollars exchange rate over the last 12 months compared to the average rates over the last 10 years serve as an indicator that the long term trend in

GBP/USD is up (strengthening US Dollar against the British Pound).

The relative strength of Dollar is also indicated by amount of US dollar assets held by Foreigners in Debt market. (Figure 4)



Total investments of foreigners in US Financial market has been growing steadily from year 1945 and is continuing to increase . This trend reflects optimism of market on US dollar currency as reserve currency of the world with no sign of any great competition from other currencies.

Conclusion

A decade after the euro introduction, dollar keeps its significance internationally. In 2007, economic turmoil and small variations in the value of the dollar was started. Use of the currency continues to have a range of consequences for the United States. Generally it helps to:

- Decrease transaction cost in finance and trade
- Develops the global transmission of U.S strategy
- U.S economy from foreign crisis

For non-U.S. economies, broad use of the currency in reserves and in international transactions is typically associated with greater sensitivity of trade, inflation, and asset values to international movements in the value of the dollar. Global currency utilization may change with the change in structure and size of the international economy. Evidence of the dollar's vitality, the currency's preeminence is most likely to continue in the future although historical precedent exists for the rise and fall of the international status of currencies. For example, the dollar overtook the pound sterling as the dominant reserve currency at the beginning of twentieth century.

For the value of dollar, safety across economics, and global transmission of shocks, the changes in international economy could have main significance. As a result, it is essential to know the potential reasons and effects of the dollars and for policymakers to observe the use of dollar in global economic role. According to Engdahl (2006), as America's major allies and financial associates were ready to hold the dollar for economic and political reasons, the dollar domination seized the American alliance system as well as international economy at the period of Cold War. The great position of dollar has been a main provider to US international supremacy stated by Oxford Analytica (2008).

US generate dollars and remaining world creates goods which can buy by the dollar in world trade. To obtain a relative benefits, interrelated economies in the world are no longer trade. It struggles to obtain dollars to service dollar controlled foreign debts and gather dollar reserves. Central banks should have large dollar reserves to avoid manipulative and speculative effects on their currencies and it makes dollar as stronger. It is simpler to estimate the domination of monetary system as well as US dollar in further few decades.

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