

Geopolitical rifts: The International Role of the USD and EUR

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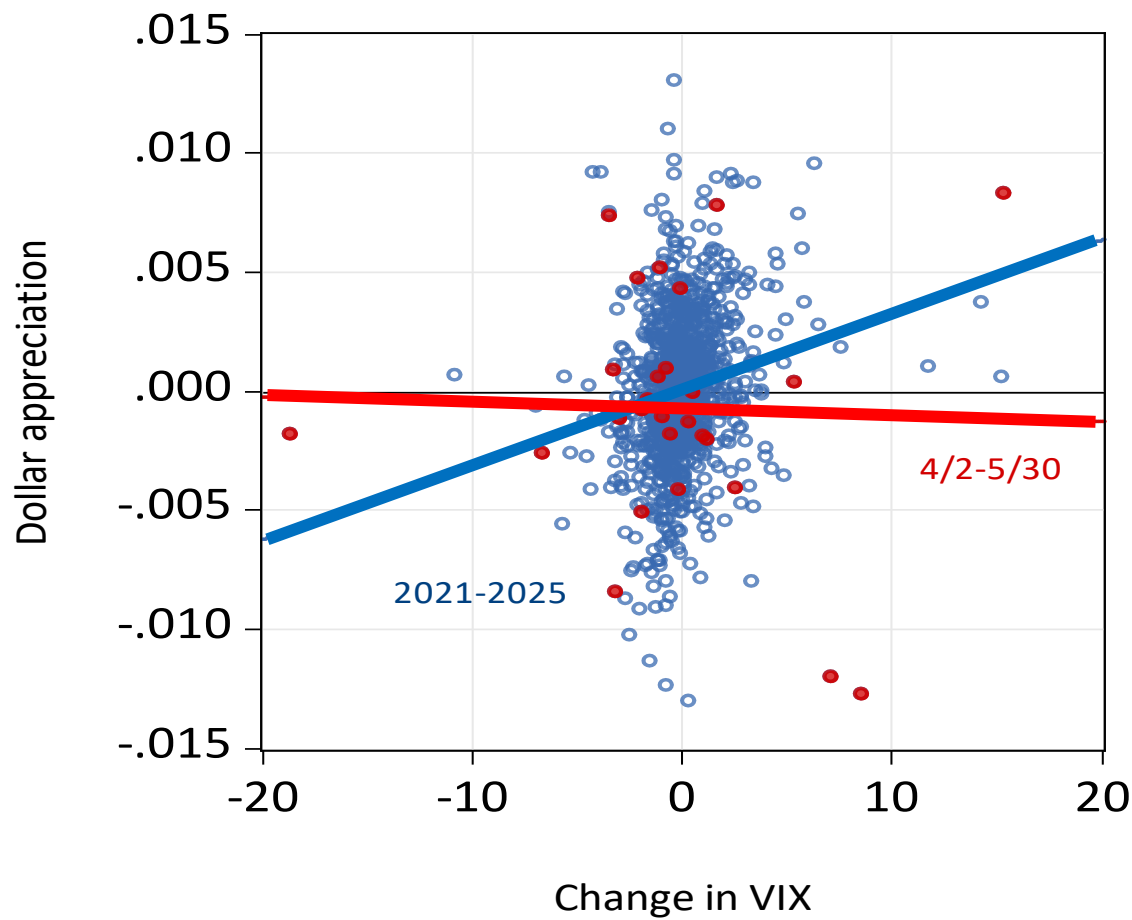
The European Money and Finance Forum

Monday, 16 June 2025, 15:30 EU, 9:30 US



The effect of market uncertainty on the \$

Jan. 5, 2021 – May 1, 2025



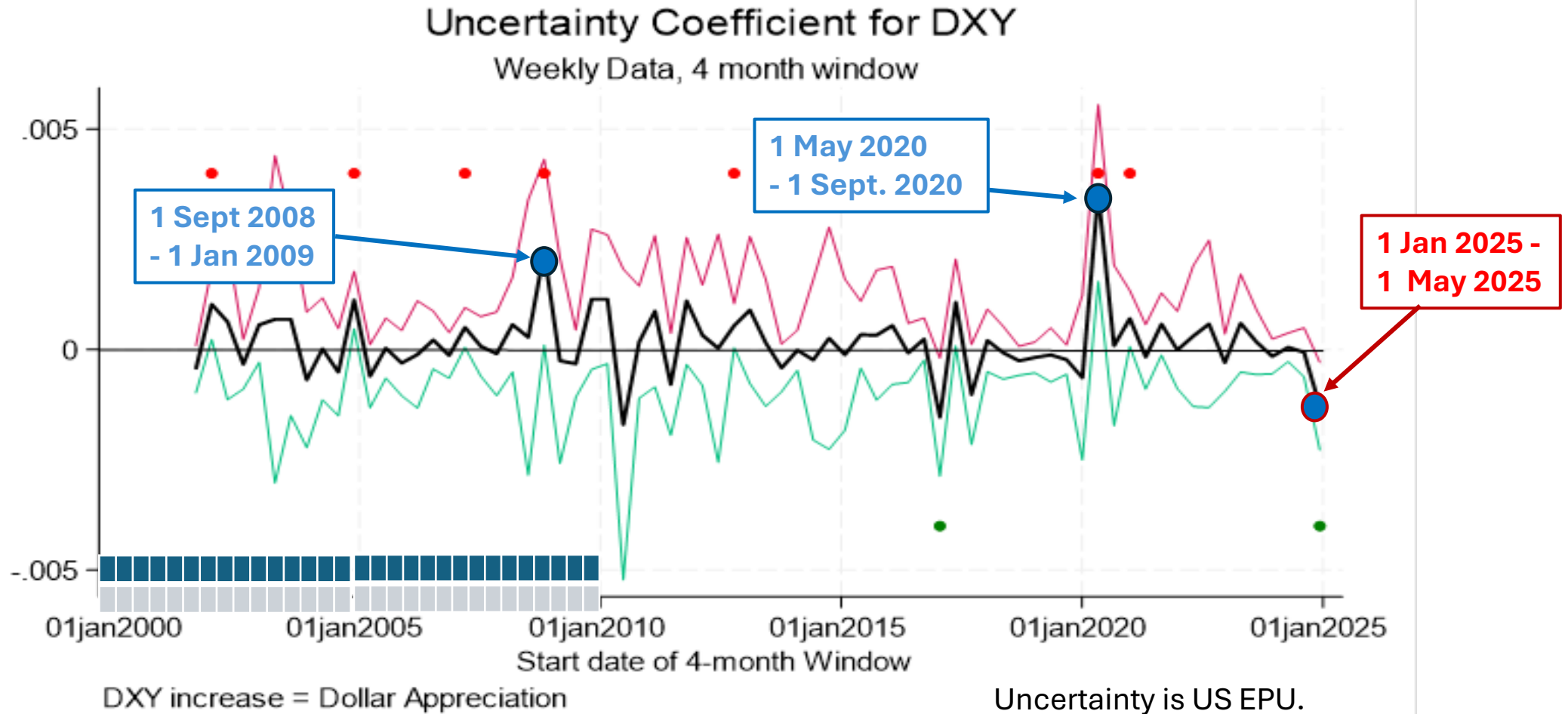
Correlation was positive
before Trump's
“Liberation Day,”

negative after.

The effect of policy uncertainty on the \$

1 Sept 2001 – 1 May 2025

Positive in GFC & Covid, negative under Trump.



Colors show 95 % confidence ● sig. >0; ● sig. <0

Source: Michael Klein, *Econofact*, May 2025

On the dollar & its rivals

- "Still the Lingua Franca: The Exaggerated Death of the Dollar," *Foreign Affairs*, 74, no. 4, 1995, 9-16.
- "Will the Euro Eventually Surpass the Dollar as Leading International Reserve Currency?" with Menzie Chinn, 2007, in *G7 Current Account Imbalances: Sustainability and Adjustment*, edited by Richard Clarida (U.Chic. Press)
- "Internationalization of the RMB and Historical Precedents," in *J. Ec. Integration*, 2012, pp. 329-65.
- "Dollar Rivals," in *50 Years of Floating*, 2024, edited by Douglas Irwin and Maurice Obstfeld (Columbia U. Press for PIIE). NBER WP 31476.
- "The Dollar versus the Euro as International Reserve Currencies," with Menzie Chinn & Hiro Ito, 2024, *J.Intl.Money & Finance*, vol.146, Aug. NBER WP 32387.

Much has changed

- The “new view” of Eichengreen: the literature had over-emphasized the impregnability of the incumbent lead currency.
 - Eichengreen (2010, 11a), Eichengreen & Flandreau (2009):
A unipolar system is not the only possible global equilibrium. Rather, **multi-polarity**.
 - Think of it as a trade-off between network externalities & abuse of exorbitant privilege.
 - Empirically, a slow shifting out of \$ has continued
 - but **not into €**.
 - Rather, into **smaller currencies**. Arslanalp, Eichengreen, & Simpson-Bell (2022, 23)
 - Plus, now, **gold**.
- Newly emphasized determinants:
 - Rule of law
 - An independent central bank
 - A 2nd interpretation of abuse of exorbitant privilege: excessive **use of sanctions**.
 - Particularly US financial sanctions, e.g., curtailing foreign use of reserves in time of crisis.
 - In reaction, Russia, in particular, shifted its international reserves out of dollars.
 - But effects of alliances & sanctions on \$ not easy to find econometrically, on data up to 2022.

Effects of alliances & sanctions on reserve holdings not easy to find econometrically, on data up to 2022. So far.

Chinn, F. & Ito (2024 & 2025)
Using Ito-McCauley bilateral data.

	Baseline (1)
Share(<i>t</i> -1)	0.907 (0.010) ^{***}
USD	-0.651 (0.287) ^{**}
EUR	-0.977 (0.216) ^{***}
JPY	-0.846 (0.127) ^{***}
GBP	-0.567 (0.105) ^{***}
RMB	-0.643 (0.229) ^{***}
GDP share in world	2.364 (1.071) ^{**}
Share of trade w Big5	1.109 (0.204) ^{***}
Political distance from Ctry <i>i</i>	0.022 (0.034)
Financial sanctions by big-5	-0.075 (0.073)
Trade sanctions by big-5	0.102 (0.111)
<i>N</i>	2,002
Adj. R2	0.93
# of countries	43
Years covered	1999 - 2022

UN voting distance significantly affects € & £. And \$, but with a positive sign. The same (surprising) result in Goldberg & Hannoui (2023) for a military alliance dummy.

Eichengreen, Mehl & Chitu (2017) and Arslanalp, Eichengreen & Simpson-Bell (2022) don't find an effect of whether a country has a defense pact with the US.

Mehl et al (2025):
confiscating central bank assets... erodes trust of official reserve managers

MacDowell (2023):
sanctions have shifted, e.g., China & Russia.

Arslanalp, Eichengreen & Simpson-Bell (2023); Laser, Mihailov & Weidner (2025) & Ferranti (2023): countries facing a higher risk of US sanctions increased the share of gold in their international reserves.

Is Trump accelerating the decline of the \$?

- Analogy: Vietnam-era spending pre-empted the Triffin Dilemma in 1971
- A view of US trade deficit has been trending in DC:
 - TD is rooted in \$ appreciation (2015-2024);
 - the fundamental reason is not the traditional shortfall of National Saving
 - but, rather, the world's demand for \$ as the safe haven asset.
 - World CB reserves levelled off after 2014.
 - => it has to be *private* demand for safe assets.
 - Less supportable claims:
 - The trade deficit is the reason for US decline in manufacturing,
 - which in turn is the reason why workers have been left behind. I don't think so.
- “Mar-a-lago Accord”?
 - It is not real, not even in the way that Trump talks about Greenland.
 - Nevertheless...

Yes, Trump is accelerating the decline of the \$.

- False remedies are afoot.
 - Crazy tariffs
 - Gratuitous ruptures with allies.
 - Quitting international institutions.
 - Pressuring the Fed to inflate.
 - Responding to ever-growing (downgraded) debt by flirting with default or with taxing foreign-held debt
 - A general maximization of policy unpredictability.
- Their cumulative effect:
 - to sledgehammer the once-unshakeable primacy of \$,
 - and the larger post-war role of the US in the world system.

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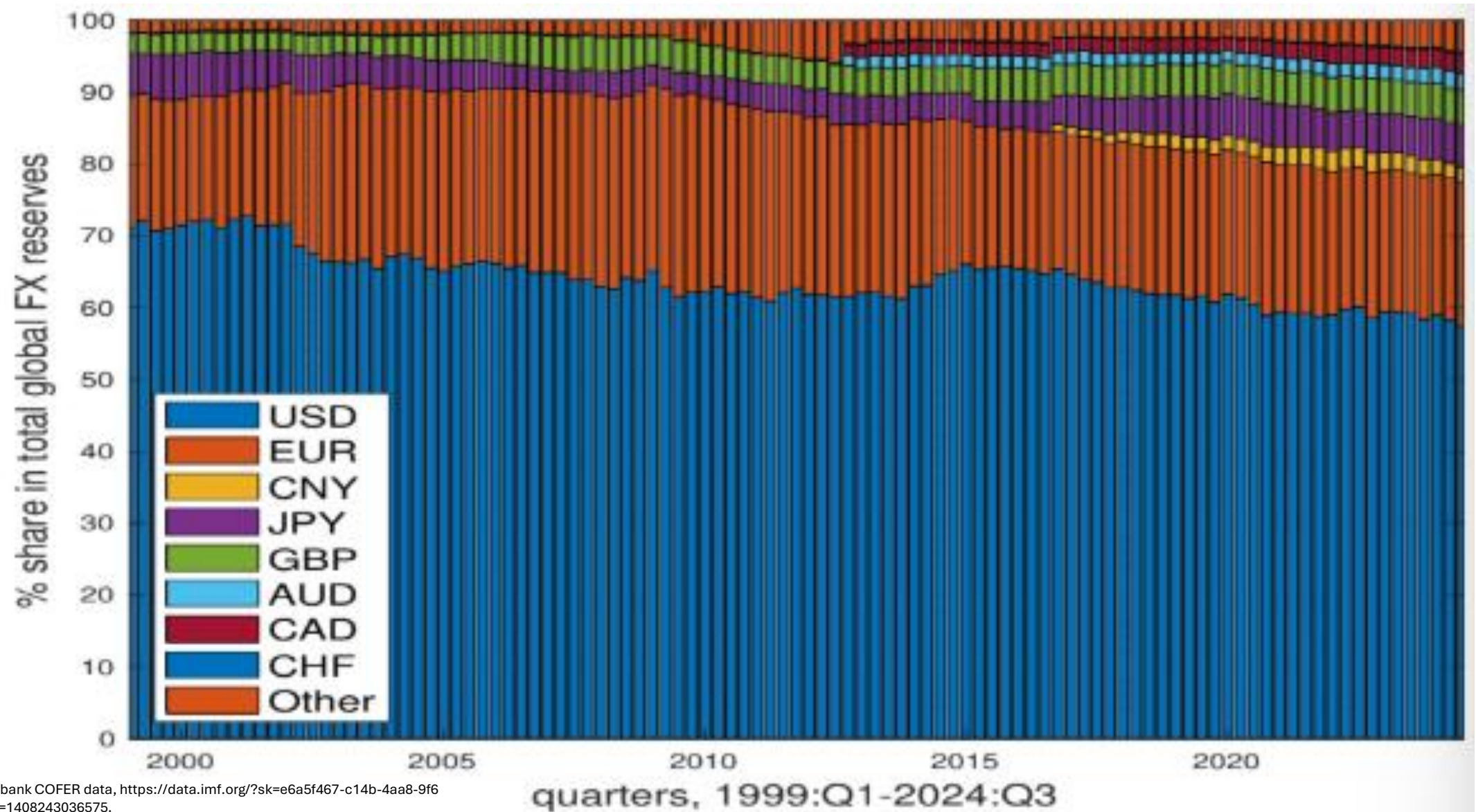


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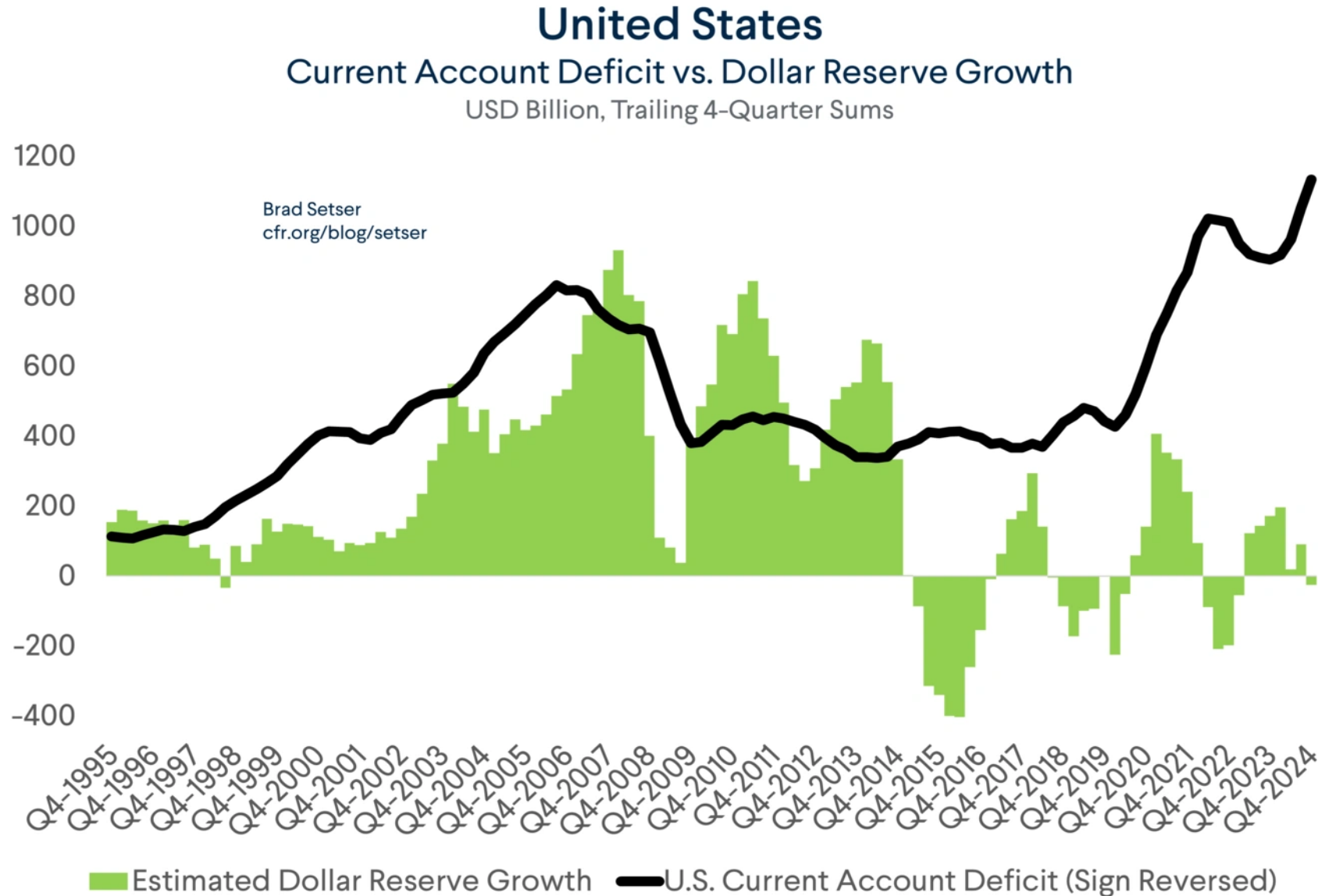
Appendix 1: Dollar share of reserves held globally

Appendix 2: Loss of US manufacturing jobs

Appendix 1: Shares of reserves held globally, 1999-2024



Private investors finance US CAD since 2014, not central banks

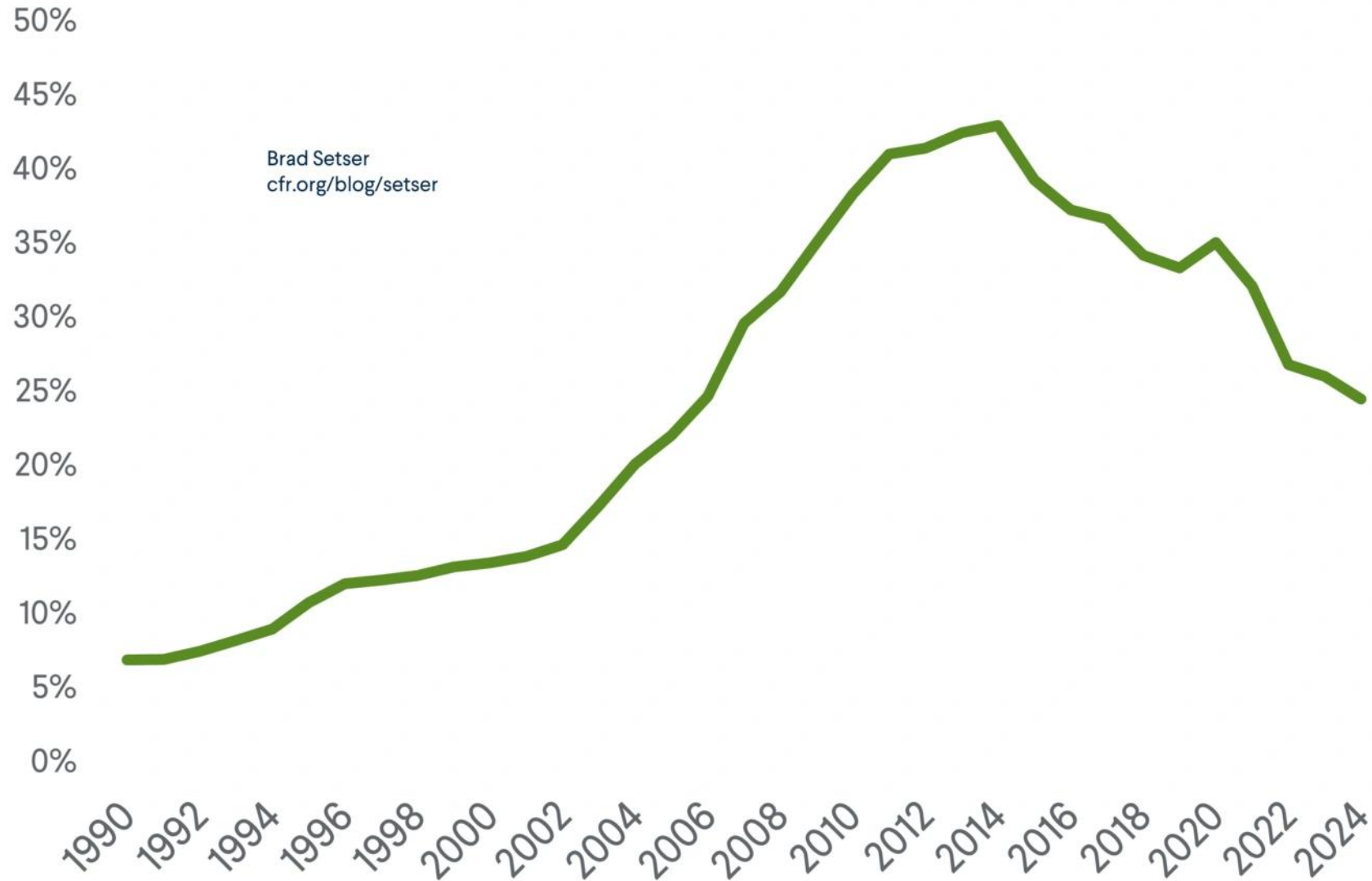


Source: Brad Setser, June 2025

[//www.cfr.org/blog/dollars-global-role-and-financing-us-external-deficit](https://www.cfr.org/blog/dollars-global-role-and-financing-us-external-deficit)

Global Dollar Reserves

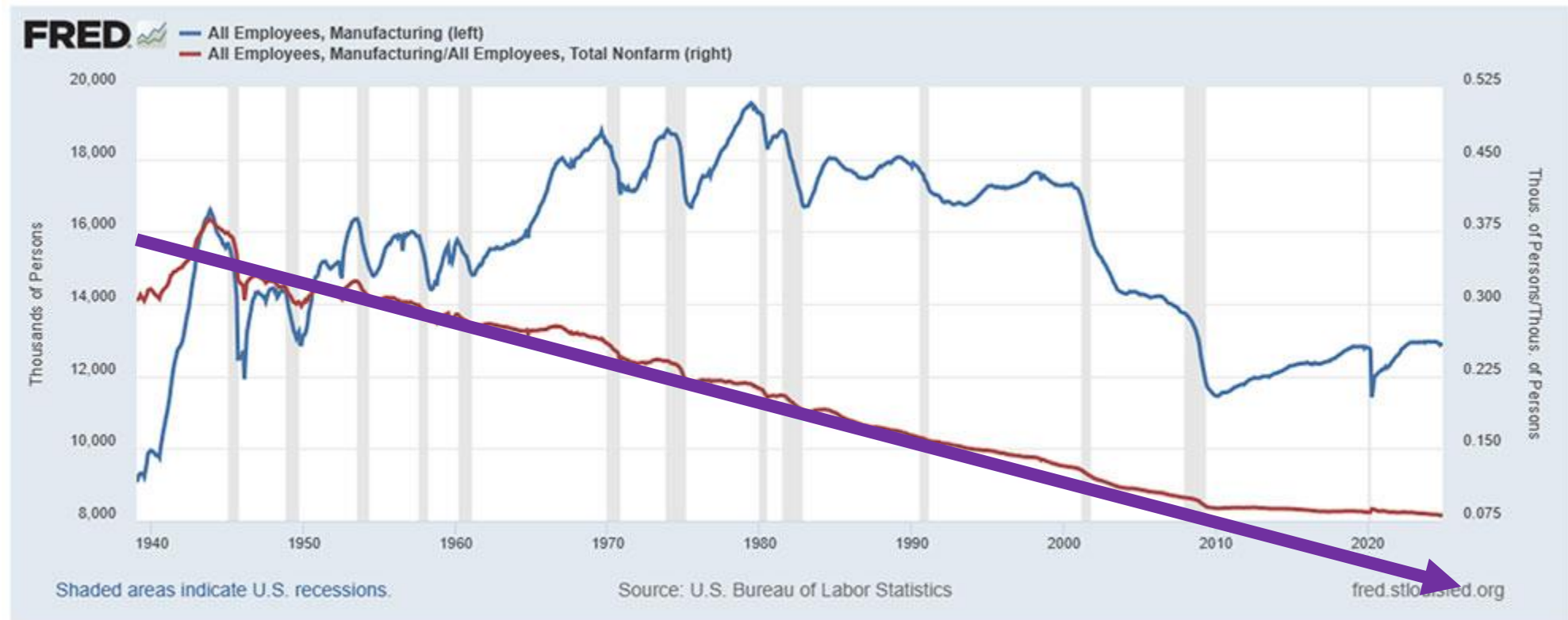
Percent of U.S. GDP



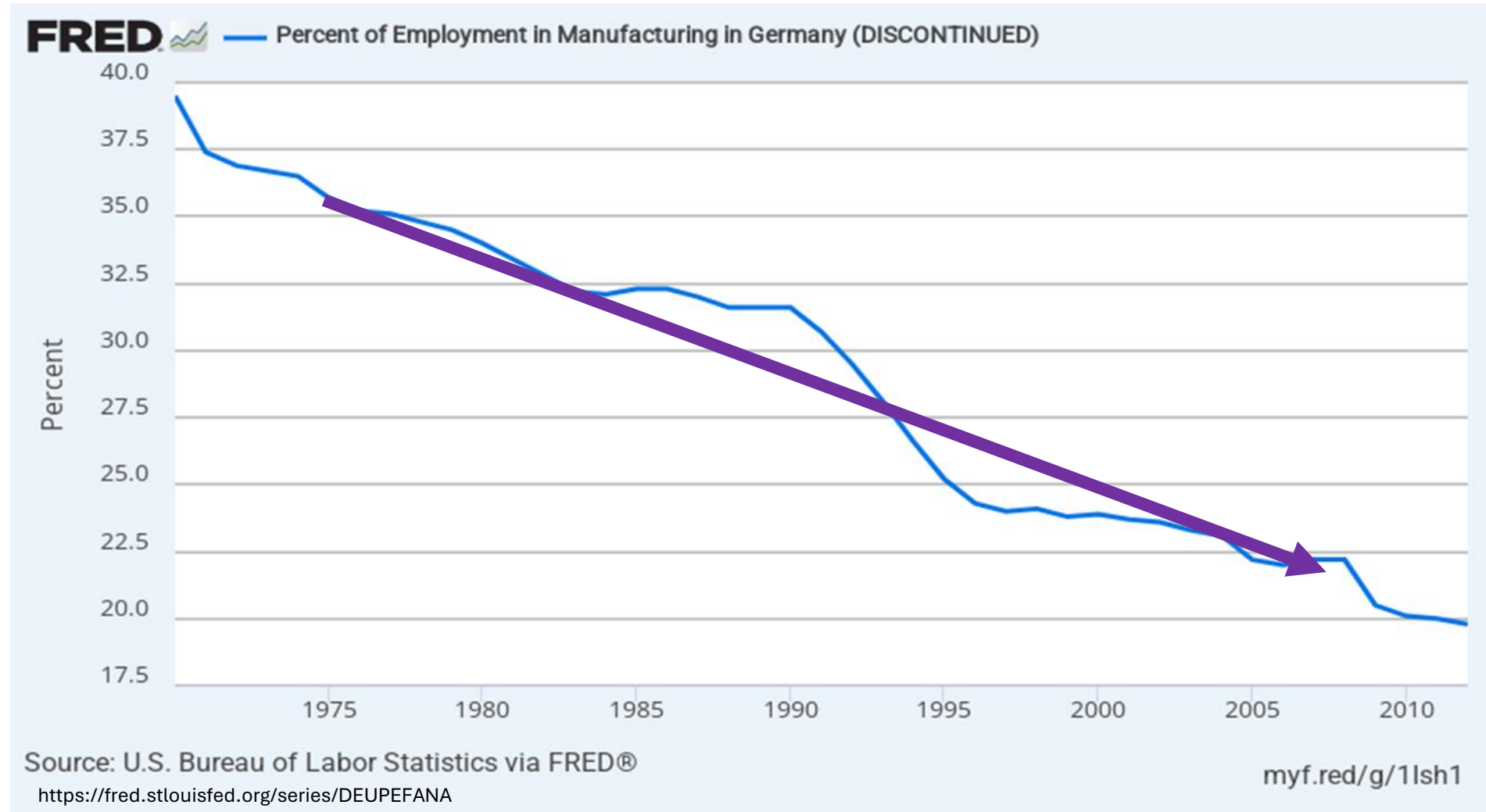
Source: Brad Setser, June 2025

[//www.cfr.org/blog/dollars-global-role-and-financing-us-external-deficit](https://www.cfr.org/blog/dollars-global-role-and-financing-us-external-deficit)

Appendix 2: It is true that US manufacturing jobs have declined, from 39 % of total employment in 1939, to 8 % in 2024.

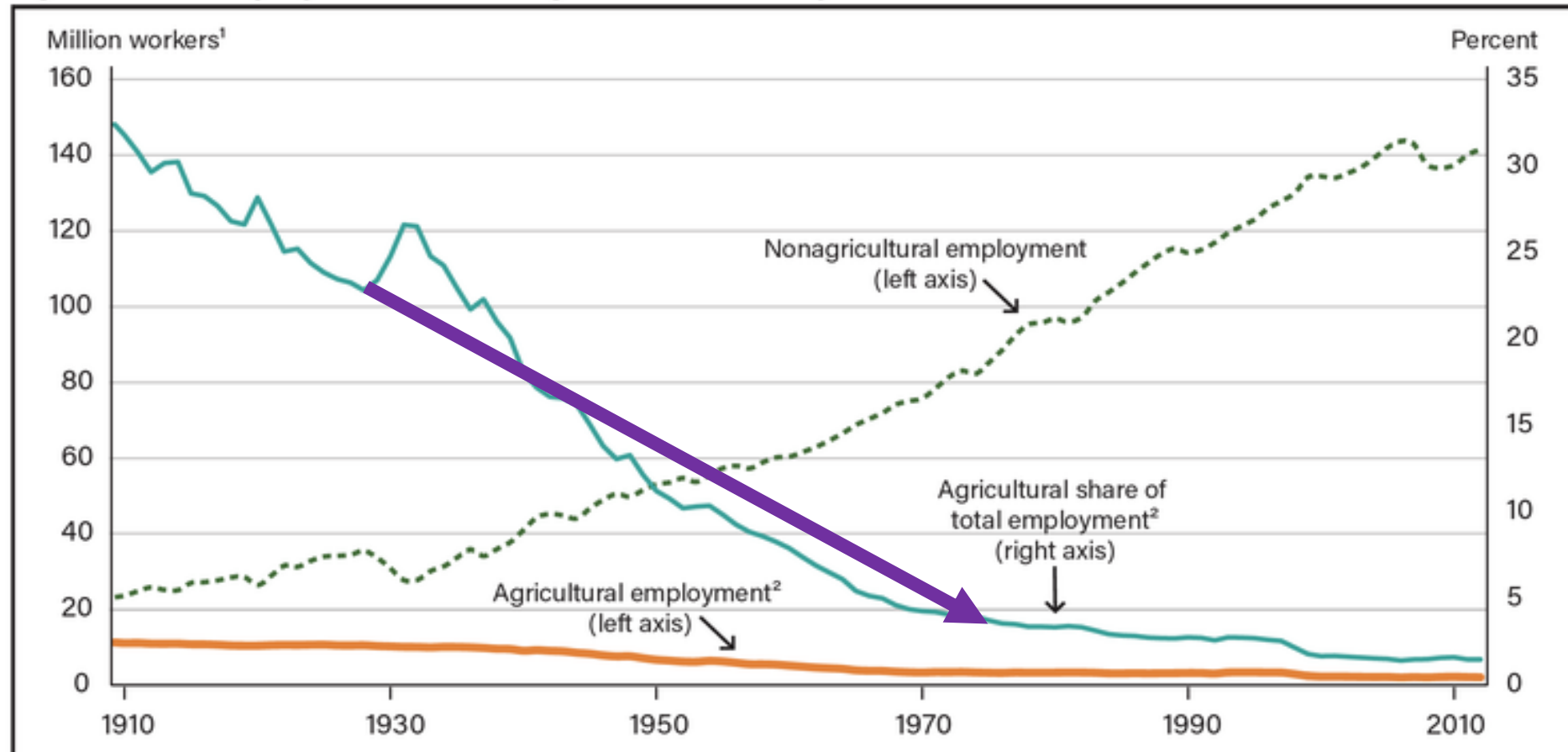


Is the decline in US manufacturing jobs due to trade deficits?
No, the same holds in Germany & Japan, which run trade surpluses.



Analogously, US farm jobs fell from 90% in 1790 to 2% today.

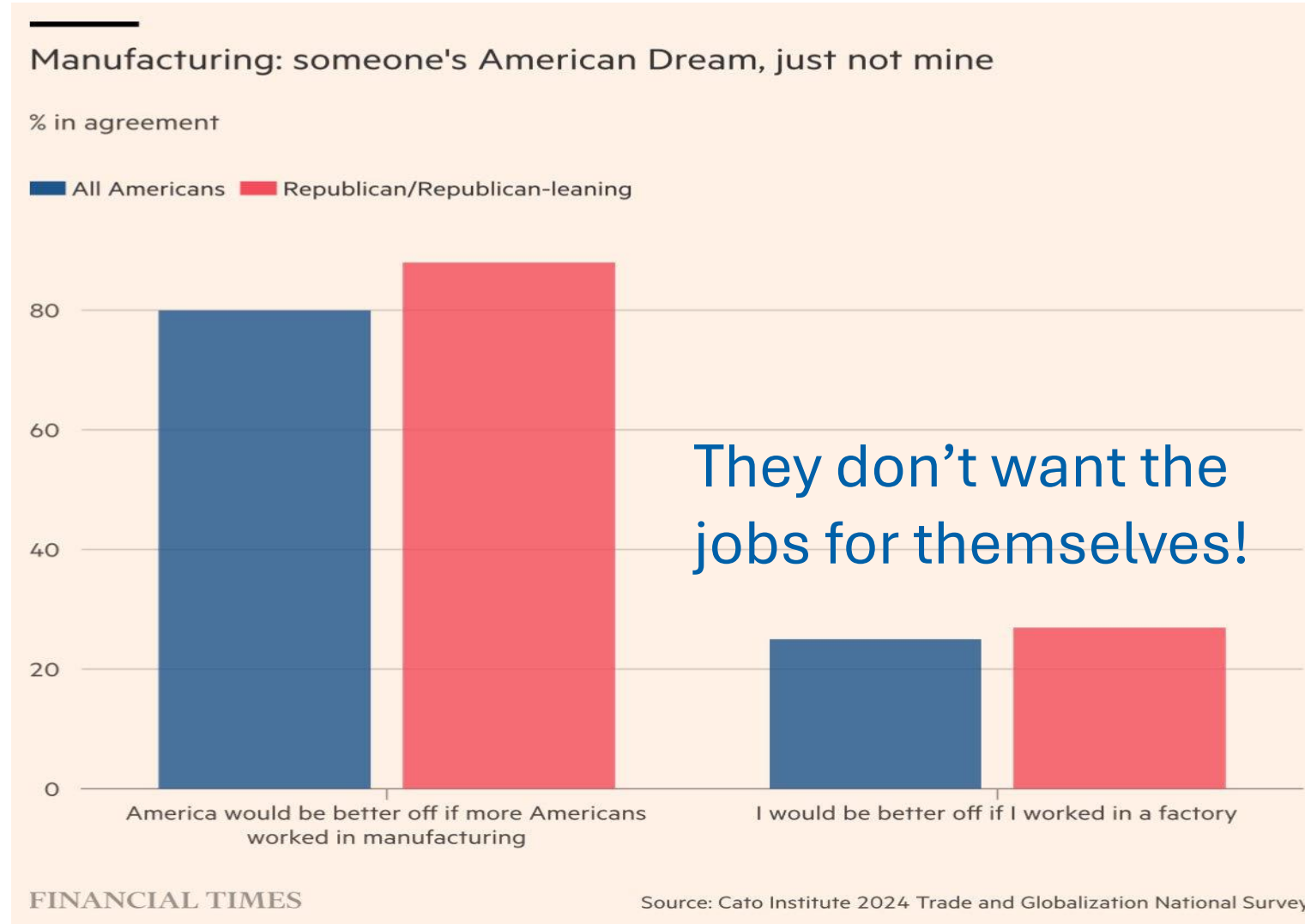
Agricultural employment fell during the 20th century



Americans should celebrate productivity gains in agriculture & manufacturing, rather than wishing to go back to the backbreaking jobs of the past.

Why do voters yearn for return to manufacturing?

Maybe nostalgia.



FT, April 14, 2025

www.ft.com/content/845917ed-41a5-449f-946f-70263adbaeb7