DE-DOLLARIZATION?

What Trumpian Chaos Is Doing to the Dollar

One potential long-term casualty of continued political instability sown by the administration: America's centrality to the international monetary system.

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Natural gas futures charts on the floor of the New York Stock Exchange on January 20. Stocks, bonds and the dollar fell after President Donald Trump threatened tariffs on various European countries before high-level meetings in Davos, Switzerland.

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For more than 80 years, the U.S. dollar has been central to the international financial system, in no small part because it is the primary global reserve currency. But as in politics, narratives are incredibly important in understanding stock market moves. The past week has seen the return of stories on the so-called “sell America” trade—the idea that investors are hedging their bets by selling U.S. assets because they are worried about President Donald Trump’s threats to the global economic order.

The role of the dollar is unlikely to be diminished in the immediate future, and its status as the global reserve currency is not currently under any serious threat the instability of the Trump administration could lead to a slow erosion in trust in the dollar, which in the long term—think years or decades hence—could reshape global monetary infrastructure.

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“What it typically takes to be a reserve currency is a deep and liquid market—which the U.S. has unquestionably—clear rule of law, and policy predictability. And the latter two are a lot less clear these days,” said Karen Petrou, co-founder and managing partner at Federal Financial Analytics.

The “sell America” trade seemed to be booming as recently as last Tuesday, as Trump escalated tensions over his desire to obtain Greenland while at the World Economic Forum in Davos, Switzerland. He compounded this by threatening to apply tariffs on European allies who opposed him; as a result, U.S. bond prices fell, the U.S. Dollar Index dropped relative to other currencies, and American stocks tumbled. By last Wednesday, however, Trump had walked back these tariff threats and announced the existence of a “framework” for a deal on the future of Greenland. The U.S. stock market bounced back, the S&P rallied, Treasury yields eased, and the dollar rebounded.

The wild swings of the past week are representative of a now-familiar pattern. The market response to Trump’s threats on tariffs is typically muted; when it seems as if he’s poised to take a significant action, that’s when it’s most likely to respond. At that point, Trump frequently backs down, as he did in Davos. Equilibrium is temporarily restored—but the threat of future tumult creates only a brief respite.

“If Trump not only says something, but then does it, you could see significant market turmoil—shock, panic—but so far, adverse market reaction seems to slow him

down," said Petrou. This is sometimes referred to as the "TACO" effect: "Trump Always Chickens Out."

On Monday, gold prices surged, in an indication of investors seeking haven in a safe asset. This comes amid the risk of government shutdown this week, as Democratic senators threatened to block a funding bill including new money for the Department of Homeland Security, after federal agents shot and killed a second U.S. citizen during protests in Minneapolis over the weekend. Trump also on Saturday threatened to impose a 100 percent tariff on goods from Canada if it went thr Edit Article with a trade deal with China.

In the long term, continued upheaval in American policymaking has raised the specter of an eventual "de-dollarization," in which the use of the dollar in global trade and financial transactions would diminish. However, central banks' decision to diversify their reserves does not equate to a diminishment of the dollar's role in the global financial system, or indicate that there is currently a viable alternative for a reserve currency.

"I think what we've been seeing is dollar hedging, or de-risking, but not de-dollarization," said Stephen Kaplan, associate professor of political science and international affairs at George Washington University. He noted the "cyclical trends" that may have contributed to the relative weakness of the dollar in 2025, such as the U.S. Federal Reserve's cutting of interest rates beginning in the summer.

When there is a threat of disruption to important institutions like the Fed or international alliances such as NATO, that's when markets can get nervous. The dollar dropped earlier in January when Fed Chair Jerome Powell announced that he was under criminal investigation by the Trump administration, casting the future of the Fed's autonomy under question.

"With each of these events, from a long-term perspective, you're incentivizing central banks and then investors more broadly to think about diversification, to think about hedging, to think about alternatives," Kaplan said.

That hedging comes after decades of dollar primacy. The currency's dominance is profound, a truth of international economics that stretches back at least since the end of World War II. Because of the stability and liquidity of U.S. Treasury securities,

central banks of foreign countries hold large amounts of American currency in reserves. The dollar accounts for around 57 percent of global foreign exchange reserves, as well as nearly 90 percent of global foreign exchange transactions, and 54 percent of global trade.

By comparison, only around 20 percent of global foreign exchange reserves are held in the Euro, and the Chinese renminbi accounts for roughly 2 percent. Investing in the Chinese renminbi is more of a risk than in the dollar, said Petrou, because it has neither the requirements of clear rule of law nor the policy predictability to b global reserve currency.

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When the dollar replaced the British pound sterling in the twentieth century, the U.S. economy was ascendant. The same cannot currently be said for Europe or China to the same degree, said Steven Kamin, a senior fellow at the American Enterprise Institute. Although Europe "shares many of the characteristics of the United States in terms of politics and economics," Kamin explained, it "doesn't seem to have that economic vibrancy that we had, and in fact, still have."

This primacy has long benefited the American economy. A French official once said that the dollar's status as the global reserve currency amounted to an "exorbitant privilege" for the United States. At the very least, it comes with some significant perks. Because there is high demand for Treasury assets, the U.S. can borrow money at relatively low rates, helping ensure stability during periods of economic volatility. Lower interest rates for Treasurys extends to lower interest rates in other areas of the economy, such as the rate homebuyers pay for a mortgage. It also means that American sanctions pack a punch: Dollar-based global transactions use American banking infrastructure, so the U.S. government is more easily able to seize assets and freeze activity.

If the dollar lost its status as the primary reserve currency, the country could see a reversal of those benefits. Rates on mortgages and car loans, for example, closely track to Treasury yields. When the federal government is paying higher interest rates, that trickles down to the American consumer.

"If there is less demand for Treasurys, because there's less demand for all dollars in general, it raises private borrowing costs for mortgages, for auto loans, for business loans," said Caleb Quakenbush, associate director of economic policy at the

Bipartisan Policy Center. "That, of course, makes things less affordable, and it can slow investment and economic growth over time."

Concerns over whether the U.S. can pay off its debts—a semi-regular question, given frequent political fights over lifting the nation's borrowing cap—can also threaten the stability of Treasury assets. Since the Great Recession, the share of foreign investors holding U.S. debt has declined; weakening international demand could be damaging to the American economy in the long term.

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"If there's less demand for dollars and fewer people abroad are holding dollai dollars don't flow back into the United States, and that can slow foreign investment in the United States," Quakenbush continued.

Again, any pivot away from the dollar would take time, and a readjustment of how the global financial system functions. Kamin noted that the greenback benefits in part from inertia: Everyone uses the dollar because everyone *else* uses the dollar. American consumers thus do not need to worry about de-dollarization in the immediate future.

But concerns over the stability of U.S. Treasury assets in the long term could continue to encourage investors to turn away from the dollar. Although Trump has, over the past year, shown the tendency to back down from his more extravagant threats—thus cooling the markets—the kerfuffle over Greenland is emblematic of the kind of chaotic development that cumulatively could lead to a decline in dollar primacy over several years. That's where diversification comes in: to mitigate risk, investors may choose to hold more reserves in other currencies.

The outright replacement of the dollar as the dominant currency may be a less likely scenario than a global monetary system where multiple currencies hold weight. Although the renminbi only accounts for a small percentage of global financial reserves, for example, it is being increasingly used in trade transactions between China and other parties. Over several years, and if the Chinese currency strengthens, it may become even more prevalent in global transactions overall.

"I kind of imagine that the future involves not the replacement of the dollar by some other single hegemon, but rather just a more equally balanced, multipolar world than we're in right now," said Kamin.