

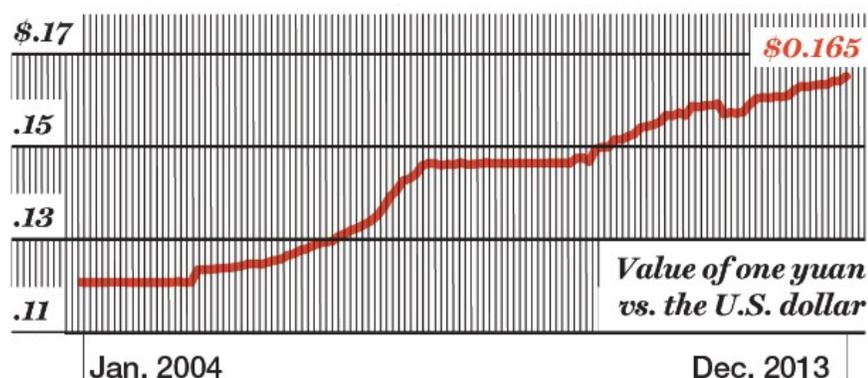


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Forget China's yuan: America's mighty dollar still reigns

By John Cassidy @FortuneMagazine February 6, 2014: 8:09 AM ET

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THE YUAN ALSO RISES The yuan is at an all-time high relative to the U.S. dollar. But is it the next global reserve currency?

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(Fortune)

About a decade ago I asked a (very) senior economic policymaker what he worried about in private. The dollar, he replied. If the U.S. didn't deal with its spiraling deficits, foreign investors would eventually lose confidence in the greenback, and all sorts of nasty things would ensue: a financial crisis, a big rise in interest rates, a recession, and a lasting blow to American living standards. Well, we got the financial crisis and the recession, but the dollar has done fine. If anything, the past few years have seen a strengthening in the dollar's role as the global reserve currency. Talk of the renminbi, or even Bitcoin, taking its place is just talk. During the recent selloff in emerging markets, where did global investors and foreign central banks park their money? At the U.S. Treasury. In late January, as investors fled Turkey, Brazil, and other places, the yield on 10-year Treasuries fell back to 2.75%.

Why is this? In his new book, *The Dollar Trap: How the U.S. Dollar Tightened Its Grip on Global Finance*, Eswar Prasad, an economist at Cornell and the Brookings Institution, points out that the U.S., for all its problems, is still the most reliable and liquid option for investors seeking a safe haven. "My argument is that it is going to be very difficult to be a viable competitor to the dollar," Prasad told me over coffee in Times Square. "I'm not a man to make predictions for 50 years ahead, but I can say that for the next 10 or 20 years there is not going to be a viable alternative to the dollar."

To be sure, many people would like one. For non-Americans, the sight of the U.S. continually borrowing from the rest of the world at ultralow interest rates is irksome -- and costly. Calculations by the Inter-American Development Bank suggest that overseas governments, which are big buyers of Treasuries, earn an annual return on their investments of about -2%. For want of a better alternative, they are paying the U.S. government to hold their money.

Where else could they go, though? Euroland, whose currency has remained stable despite the region's recent problems, is a possibility, but it lacks a common bond market. Japan hasn't inspired confidence for the past couple of decades, and its government is keen to avoid speculative inflows. Switzerland is too small, as is the U.K. Bitcoin, even if it eventually becomes a commonly accepted means of payment, hardly looks like a reliable store of value. (For another take on Bitcoin's potential, see [Dan Primack's column](#).) Neither, given its recent roller-coaster ride, does gold.

That leaves the renminbi, which already plays a significant role in global trade. As China overtakes the U.S. as the world's largest economy, and Beijing removes restrictions on capital flows, the renminbi's role as an investment medium is sure to grow. Already the Chinese central bank has established swaps lines with its counterparts overseas, such as the Bank of England, some of which have started buying bonds denominated in the Chinese currency. But will the renminbi replace the dollar as the ultimate safe haven? Prasad, who used to work at the International Monetary Fund, is dubious. In buying Treasuries, foreigners are ultimately expressing confidence in the U.S. legal framework and the U.S. political system, he points out: "It all comes down to trust. Although China has economic strength and dynamism on its side, it has yet to develop a strong framework of public and political institutions."

So can we relax? Not necessarily. For now, despite the deficit, the government shutdown, and the Tea Party, the rest of the world has faith in us -- or more faith than it does in the Greeks, the Italians, and the Chinese Communist Party. But trust has to be earned. The biggest threat to the dollar is still dysfunction in Washington.

John Cassidy is a Fortune contributor and a New Yorker staff writer.

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