

WEEKLY ANALYSIS

M. Alain Freymond—Partner & CIO



ACCELERATED DE-DOLLARIZATION OF THE WORLD ECONOMY

The first signs of the end of petrodollars and the beginning of de-dollarization. China unites the discontented and proposes an alternative to the dollar. Petrodollars, petroyuans and the new BRICS currency. 4 major consequences of de-dollarization.

Key points



- How the dollar becomes THE international currency
- 50 years of dollar hegemony
- Emergence of petrodollars in the 1970s
- The first signs of the end of petrodollars and the beginning of de-dollarization
- The yuan becomes a respectable currency thanks to the IMF
- SWIFT and CIPS to facilitate yuan transactions
- China unites the discontented and proposes an alternative to the dollar
- Petrodollars, petroyuans and the new BRICS currency
- 4 major consequences of an accelerated de-dollarization

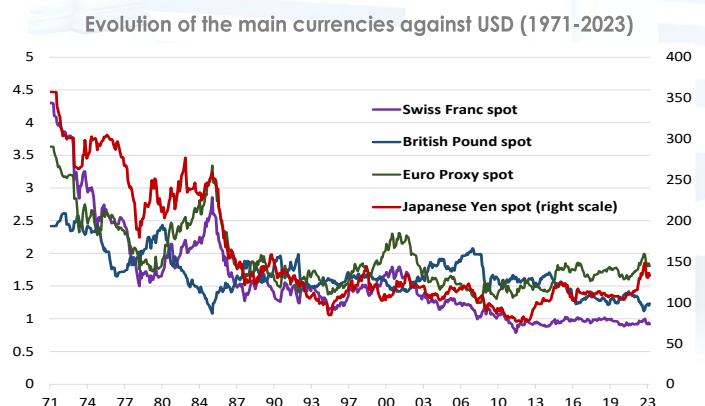
How the dollar becomes THE international currency

A long evolution that began in the 17th century and found its current foundation after World War II. The first banknote to be printed on American soil dates from 1690, by the British colony of Massachusetts. A century later, the dollar was finally adopted by the Congress of the Confederacy on July 6th, 1785 and became the official currency of the United States under the Mint Act in 1792. The face value of the first 1 dollar coins minted in 1794 was indexed to silver: 1 dollar was equivalent to 26.96 g of silver at 892/1000. In 1861, the first greenbacks appeared. The world monetary system known as the Gold Exchange Standard was then put in place by the Genoa agreements in 1922. But in 1933, Roosevelt suspended the convertibility of the dollar into gold to devalue it. Later, the Bretton Woods Agreement in 1944 gave the dollar a prominent place after World War II by ending the gold standard, which implied the convertibility of various currencies into gold on demand.

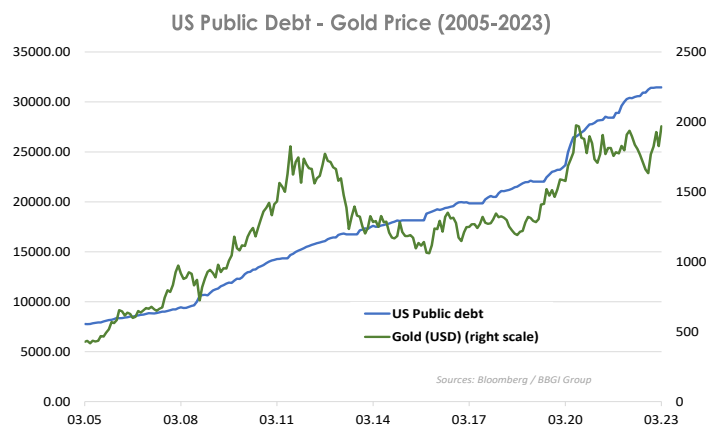
The dollar then became an international currency by pegging all currencies to the greenback. At the time, the United States held the world's largest gold reserve and

accounted for 75% of the world's gold production, which justified the use of the dollar as a reference instead of gold.

This agreement was based on two main pillars: the first was a system of fixed exchange rates between currencies (with very small margins of fluctuation) and the second was the recognition of the dollar as an international reserve currency (as good as gold), which remained convertible into gold, but only in the context of trade between central banks. At the same time, the World Bank and the International Monetary Fund were created to control the operation of the new monetary system. The accumulation of U.S. deficits, further increased by the expenses related to the Vietnam War, led to very strong pressure on the U.S. currency at the beginning of the 1970s, which nonetheless benefited from its function as a world reserve currency until August 15th, 1971, when the dollar's convertibility with respect to gold was abolished. The reason for this decision was the increased risk that other central banks would demand that their surplus dollars be converted into gold, since the dollar was convertible into gold. It heralded the death of the Bretton Woods system, since the value of each of the currencies was determined by reference to a weight of gold. The pressure on the dollar then increased as its trade balance deteriorated, but its balance of payments did not suffer because of the dollar's status as an international reserve currency. Several political meetings were held to agree on a devaluation of the U.S. currency and to attempt to overhaul the system.

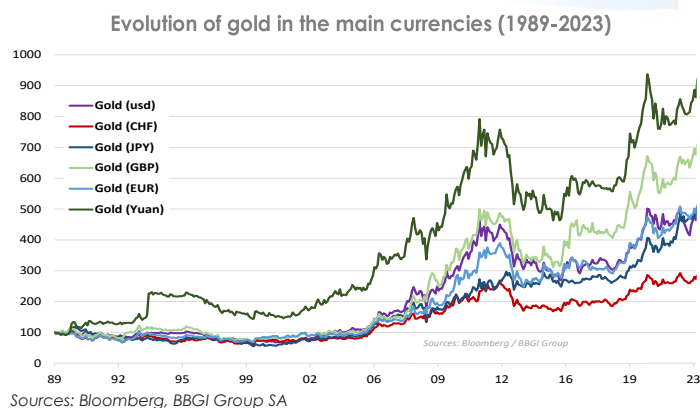


Sources: Bloomberg, BBGI Group SA



They led to the "Washington Agreement", concluded on December 18th, 1971 by the finance ministers and central bankers of the "Group of Ten" (the EEC, Sweden, the United States, Canada and Japan), which established central parities and fluctuation margins reduced by 2.25%. As the dollar weakened, the other central banks accumulated dollars to respect these fluctuation margins, which led them to devalue the dollar by 10% on February 13th, 1973, which led to the emergence of a new exchange rate regime. On March 19th, 1973, the "Group of Ten" decided to abandon the "fixed" exchange rates of the various currencies in relation to the dollar standard, which allowed the central banks of the other countries to stop buying dollars to maintain their parity, according to the principles inherent in the existing system. A new international monetary system called "floating exchange rates" was born and is still in force.

The floating exchange rate system was supposed to stabilize the exchange rate system, but in fact it has not been able to stabilize the exchange rate and the value of the dollar, which has suffered significant shocks. The subsequent fall of the dollar by about 50% could only be countered by a rise in real interest rates to 11% in 1980, attracting international capital to the dollar, allowing it to recover its 1973 value. The obvious overvaluation of the dollar was corrected by the Plaza Accords of 1985, which organized the devaluation of the dollar to its 1979 low. Two years later, in a further effort to stabilize the dollar, the Louvre Accords (1987) attempted to halt the decline of the greenback, without success, as the dollar continued to depreciate. The USD/CHF exchange rate fell between 1971 and 1995 by almost 75%. The volatility of the exchange rate has subsequently been reduced in a more moderate decline lowering the exchange rate from 1.12CHF for 1 dollar to 0.89 today.



50 years of dollar hegemony

Today, the dollar is not only the currency of the United States, but also of Puerto Rico, Ecuador, Zimbabwe, the Federated States of Micronesia, the Marshall Islands, Palau, Panama, El Salvador, East Timor, the Turks and Caicos Islands, the British Virgin Islands and the BVI. But it is also indirectly the currency of many countries that have fixed the exchange rate of their currency on the dollar, including the Gulf countries (Saudi Arabia, United Arab Emirates, Bahrain, Oman, Qatar). The dollar is the most widely used currency in the world for transactions and the first in terms of quantity of money in circulation. It is also the reserve currency used in the world, representing 58% of the reserves of central banks worldwide in 2022 and the most used currency in international trade. It is also the main currency traded in the foreign exchange market before the Euro. More importantly, it is the currency of quotation for commodities. Finally, for much smaller amounts, it is a widely used fiat currency in the world, with more than 50% of its outstanding banknotes actually held outside the United States.

The reference currency of the post-war world and often considered a safe haven, the US currency quickly became the currency of the vast majority of commodities traded in the world. Approximately 90% of commodities are traded in dollars and the largest trading centers for agricultural, energy and precious metal futures are located between New York and Chicago, such as the Chicago Board of Trade, the Chicago Mercantile Exchange, the Nymex, Comex or the Intercontinental Exchange. The commodities market represents 20 to 25% of the world economy and with exports estimated at 6 trillion dollars, it constitutes nearly 30% of global exports. As oil is the most traded commodity, it is important to highlight the role it has played in the evolution of the world demand for the dollar since the beginning of the 1970s.

Emergence of petrodollars in the 1970s

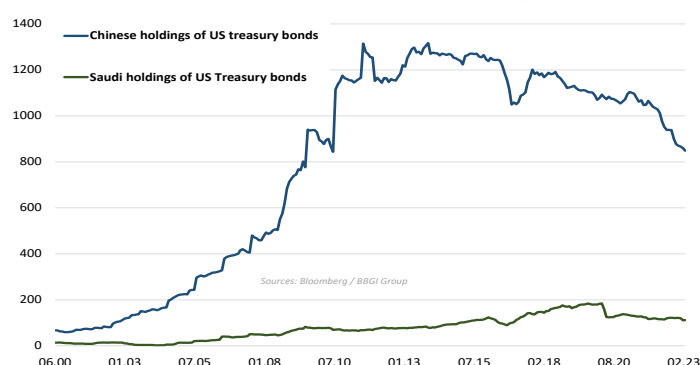
As a result of agreements between the United States and oil-producing countries, the majority of oil supply contracts in the world have been denominated in US dollars for several decades. Oil-buying countries have thus become dependent on their foreign exchange reserves in dollars for their oil supplies. The oil shocks of the early 1970s caused an explosion in the price of oil in dollars and a massive influx of capital into the exporting countries, which could not absorb it; the latter invested in the capital markets through commercial banks and recycled part of the income in dollars from their transactions into the Western economies.

These petrodollars enabled the United States to finance its budget deficit. Indeed, the country's deficit is all the greater because it imports so much. But these imports are often denominated in dollars implying that these dollars leave the American economy and end up abroad, especially in Europe and East Asia. By forcing countries to buy oil in dollars, foreign exchange reserves in dollars are centralized by these exporting countries, which, through their sovereign wealth funds, reinvest them in the United States in U.S. Treasury bonds.

The formation of the U.S.-Saudi Joint Commission on Economic Cooperation after the 1973 oil embargo and rising crude oil prices strengthened ties between the two countries by establishing a clear basis for cooperation, in which Saudi Arabia agreed to sell its oil in dollars and reinvest its excess dollar reserves in U.S. Treasury securities and U.S. companies that contribute to Saudi infrastructure development, in exchange for which the United States provided security for the country. This agreement was later extended to other OPEC countries.

In recent years, however, the oil-producing countries have reformulated their economic development strategies, in particular by wishing to diversify their economies by investing oil revenues in their own countries, thereby reducing their de facto investments in the United States.

**US Treasury bond holdings
China - Saudi Arabia (2000-2023)**



Sources: Bloomberg, BBGI Group SA

The first signs of the end of petrodollars and the beginning of de-dollarization

The petrodollar system began to falter after the oil-for-food program in 1996, when France and Germany decided to denominate oil contracts with Iraq in euros. As of 2016, Iranian oil contracts are also denominated in euros. Today, Saudi Arabia has declared its readiness to conduct crude oil transactions in yuan. For the time being, these first steps towards de-dollarization have no real effect on global commodity trade. The dollar remains by far the dominant currency in which oil is denominated.

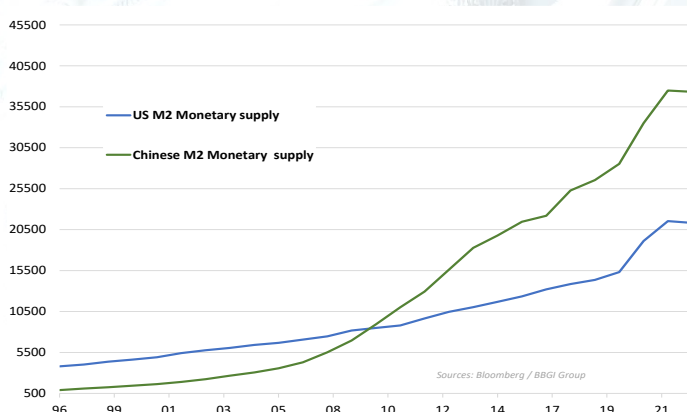
Over the past decade, however, oil producers have been the first to consider strategies to reduce their dependence on the dollar. But another important trading partner of the United States, which also recycled its trade surpluses into U.S. debt, began to develop its own strategy to destabilize the dollar from its role as a global currency.

The de-dollarization of the world now seemed timidly but surely underway with the increase in yuan transactions gradually replacing those previously conducted in dollars, notably with Australia, Brazil, the European Union, India, Iran, Japan, Russia, Saudi Arabia, Venezuela and other countries.

At the same time, China's economy has grown far outpaced that of the United States, making it the world's second largest

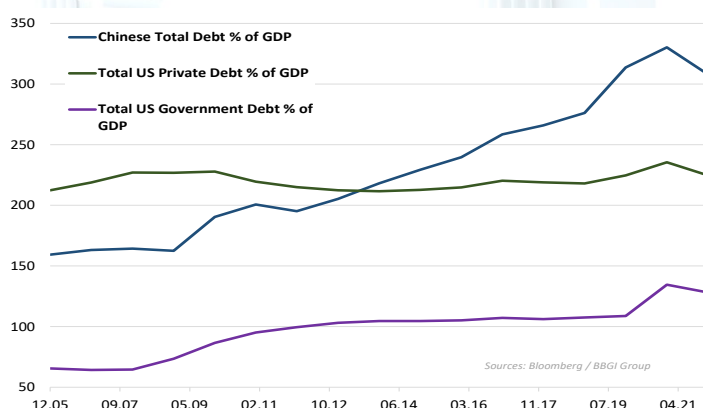
economy ahead of Japan. This development has been accompanied by extraordinary growth in China's money supply that has outpaced that of the United States, as well as a trend in the Chinese economy's total debt as a percentage of GDP that is now similar to that of the United States.

**Evolution of M2 (money supply) in the United States
and China (1996-2021)**



Sources: Bloomberg, BBGI Group SA

Debt as % of GDP for the US and China (2005-2021)



Sources: Bloomberg, BBGI Group SA

The yuan becomes a respectable currency in 2016 thanks to the IMF

In 2016, the IMF could no longer resist China's insistent demands to see its currency become one of the main reserve currencies admitted by the IMF. After a few refusals, the IMF finally gave the yuan its letters of nobility by considering that the Chinese currency meets the criteria imposed to be part of the extremely restricted circle of reserve currencies. It includes the renminbi in the basket of currencies of the special drawing rights (SDR) which constitutes an international reserve asset allowing to complete the official reserves of its member countries. The composition of the SDR currency basket is therefore represented by the US dollar, the euro, the yen, the pound and the yuan. The IMF's two criteria specify that an SDR currency must be issued by the world's largest exporting countries playing a central role in the world economy and secondly, the currency must be freely usable, that is, widely used in international transactions and commonly traded in major foreign exchange markets. In 2022, at the end of the IMF's five-year review of the weighting of this basket of

IMF's five-year review of the weighting of this basket of currencies, the weight of the dollar was raised to 43.38% from 41.73% and that of the yuan increased from 10.92% to 12.28% at the expense of the euro, yen and pound. The emergence of the yuan in the SDRs is clearly a major step towards de-dollarization by offering all central banks the possibility to hold yuan directly and indirectly as a reserve currency. The hardest part was done for the Chinese government, which could now also rely on this new status as a respectable currency that could now represent a real alternative to the dollar.

SWIFT and CIPS to facilitate yuan transactions

Founded in 1973 to address the drawbacks of physical document flows, SWIFT provides standardized interbank transfer messaging services and interfaces to more than 10,800 institutions in over 205 countries, with an estimated total daily transaction value of several trillion dollars. It has become a major component of the international financial system. SWIFT acts as an intermediary facilitating the transport of messages containing payment instructions between the financial institutions involved in a transaction. In the context of cross-border transactions, this is often done through accounts held at correspondent banks by the financial institutions between which the payment takes place. Since the establishment of the Bretton Woods system, the dollar has been used as a medium for international trade, making it possible for the U.S. Treasury Department to monitor the SWIFT financial transfer network, which allows it to exert significant influence over global financial transaction systems, with the ability to impose sanctions on foreign entities and individuals. The China International Payments System (CIPS), also known as the Cross-Border Inter-Bank Payments System, is a cross-border inter-bank payment system, established in 2015, which provides clearing and settlement services to its participants for cross-border yuan payments and exchanges similar to the SWIFT system.

It is a financial market infrastructure in China, but also has a growing international dimension, so negotiations are underway with the SWIFT network to promote transactions in yuan.

China unites the discontented and proposes an alternative to the dollar

The hegemony of the dollar has displeased many countries in recent decades, starting with the BRICS coalition, who have resented the use of the dollar by the United States as a means of influencing and controlling their political and economic activities. The pandemic and then the war in Ukraine undoubtedly served as a gas pedal for the dynamic they have been seeking to put in place since 2016 to free themselves from the dollar, starting with increased bilateral transactions in currencies other than the dollar.

The last few weeks have seen a series of policy decisions from Latin America to Russia, Africa and the Middle East, supporting the development of a Chinese currency alternative and increased economic relations. The weight of the BRICS in terms of population, exports and raw material reserves is already considerable, and could be further increased if the current movement were to spread to other countries. It is estimated

that the global GDP of such an expanded coalition could exceed the US GDP by 30%.

In the Middle East, discontent has also recently grown against the United States because of its policy in Afghanistan and in the war in Yemen. The rapprochement orchestrated by China between Saudi Arabia and Iran could have significant implications, as the first Saudi crude oil transactions have been arranged in yuan, much to the surprise of the US in recent weeks.

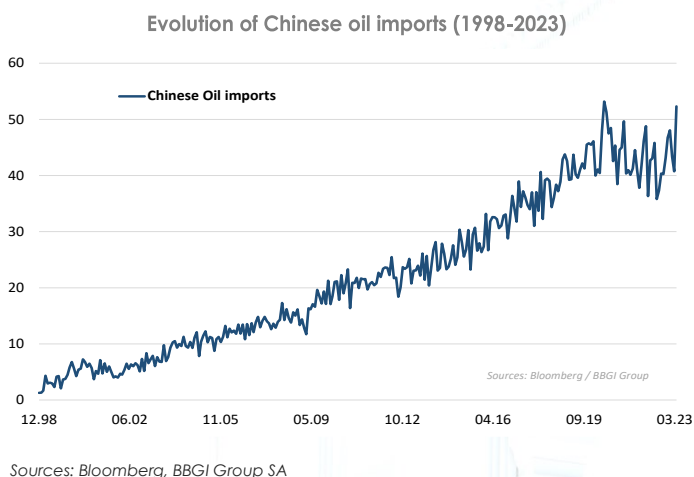
The New Development Bank created in 2014 by the BRICS states (Brazil, Russia, India, China and South Africa) laid the foundations for an alternative to the existing World Bank and the International Monetary Fund with the aim of promoting greater financial cooperation and increasing development between emerging countries, by financing infrastructure projects and creating a "currency reserve" that would allow the support of member countries in the case of crisis and financial shocks. It is expected to play a larger role in the future by expanding its membership, recently, the United Arab Emirates and Egypt joined the founding members in the institution. The political and economic initiatives of the BRICS beyond the prospects of strengthening trade within the bloc of member countries, seem to seduce more and more countries ready to join them. In particular, the ideas revolving around the creation of a new currency allowing them to emancipate themselves from the United States and the dollar. The sanctions imposed by the United States and Western countries on Russia after the invasion of Ukraine surprised by their scale and speed, making many other countries fear a similar treatment and forcing them to take the step of creating an alternative monetary system.

Petrodollars, petroyuans and the new BRICS currency

By opening the door to oil transactions in yuan, Saudi Arabia is putting an end to more than 50 years of dollar hegemony over its oil revenues. In recent months, China's initiatives have accelerated, pushing the adoption of the yuan in commodities trading in countries that are closely linked to the United States, thus creating major precedents on which new trends with significant developments capable of undermining the dollar's hegemony in global commodity trade will be based. The tide seems to have turned in the Gulf, as Saudi Aramco has made its largest ever yuan acquisition of a Chinese refinery giant (Rongsheng Petrochemical), while TotalEnergie signed its first liquefied gas contract in yuan through the Shanghai Petroleum and Natural Gas Exchange for 65,000 tons of liquefied gas with the United Arab Emirates, paving the way for other commodity transactions in yuan.

The sustained recovery of economic activity in the first quarter of 2023 (+4. 5%) surprised observers by surpassing the forecast of +4% growth. China's crude oil imports have already rebounded to a level close to their previous peak in 2019 before the pandemic began, and support the argument that China can increasingly pressure its crude oil suppliers to denominate oil transactions in yuan.

In a few years, China has become Saudi Arabia's largest customer, the largest trading partner of the GCC countries, but also of other commodity producers such as Brazil. This situation clearly gives China special power and leverage to influence its economic partners.

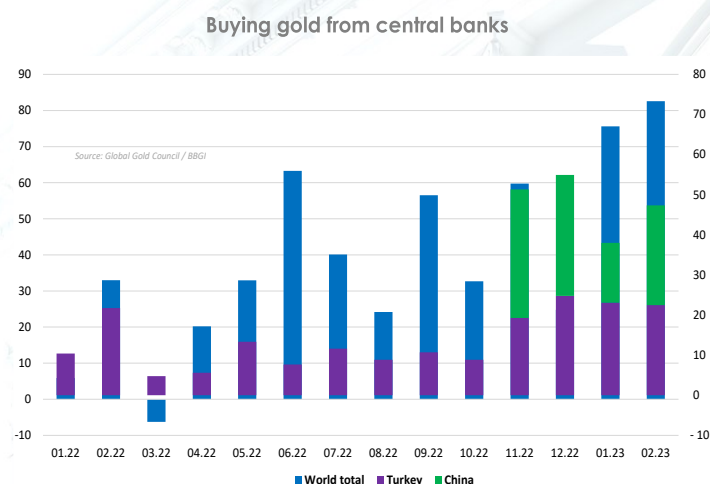


This is what it did during its historic visit to the Middle East when President Xi declared that a new paradigm of energy cooperation was taking shape and that the Shanghai Petroleum and Natural Gas Exchange would be the platform to settle these growing yuan transactions. Since March 2018, a future contract on Brent crude oil had been launched there in yuan, offering the opportunity to compete with other dollar contracts. China explicitly linked this contract with the ability to convert yuan into physical gold through the Shanghai and Hong Kong markets to reassure investors, with PetroChina and Sinopec vouching for the liquidity of these future oil contracts.

The yuan will certainly be increasingly used in commodity transactions, but the BRICS+ may seek an alternative to the dollar closer to SDRs by creating a similar tool based on a currency basket of their own currencies that could indirectly be backed by dedicated commodity reserves. The creation of a BRICS coin will be discussed at the next BRICS summit in August, in the meantime settlements in national currencies have already started. The realization of this project will have consequences for global trade and monetary policies beyond the BRICS. But the most likely solution may simply be the expanded use of the yuan as the reference currency for their trade, especially if the yuan can be backed by a large gold reserve

We wrote a few years ago that China's long-term vision for establishing the yuan as a credible alternative currency would certainly be to give it a solid foundation of proven physical gold reserves. However, for the past few years China has not published accurate statistics on its own annual gold production that could be used to build up these reserves. We believe that

Chinese policy is now focused on the goal of building up a large physical gold reserve, as suggested by its recent massive purchases of gold in 2023.



4 major consequences of de-dollarization

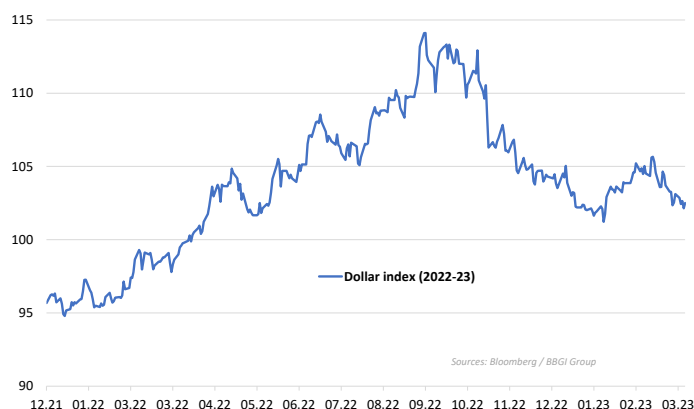
A huge change is thus taking place in the global commodity trade and potentially beyond this sector into the global trade of goods and services. De-dollarization now seems to be accelerating and is ready to upset the existing balances. The Wall Street Journal is not alone in its concern and points out that these developments may challenge the current supremacy of the greenback in the international financial system. In the long term, we see various negative trends for the United States.

1. Depreciation of the dollar through reduced global demand

While most of the dollar money in circulation is used in the United States, a significant portion of it is currently outside the U.S. borders and used by governments, businesses and individuals. The first important consequence of the challenge to the supremacy of the dollar by the growing use of alternative currencies in international trade will be a reduction in the need for dollars outside the United States, both for the acquisition of products and services and for reasons of monetary reserves, in favor of the yuan and gold in particular.

A fall in demand for dollars will mean that a proportion of dollars will no longer be used by non-domestic investors, which will no longer be "recycled" in US banks or in Treasury bonds. The "end" of the petrodollar system is bad news for the value of the dollar, which will suffer from the reduced demand for dollars if the overall dollar money supply remains unchanged, potentially causing a significant depreciation of the US currency.

Evolution of the Trade Weighted USD Index

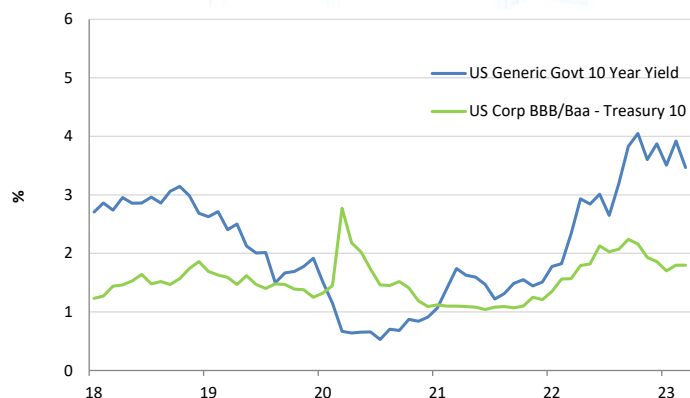


Sources: Bloomberg, BBGI Group SA

2. Rising inflation and dollar interest rates

The second consequence for the US could be an increase in the difficulties of financing US budget deficits that have been supported by the recycling of petrodollars and the need for dollar reserves in the form of purchases of US Treasury securities. It is estimated that there are several trillion dollars in US Treasury bonds held by foreigners.

US Treasury Yields and BBB (Spread) Bonds



Sources: Bloomberg, BBGI Group SA

A rise in interest rates would also be the consequence of such a disengagement of foreign investors in US assets. Moreover, a de-dollarization of the world would necessarily have to be accompanied by a corresponding reduction in the dollar money supply to avoid the potential inflationary effects caused by an excess of dollars over the actual needs of the US economy and those of the rest of the world. The monetary

authorities and the American government will not have many qualms about preferring a fall in the dollar to a rise in interest rates that would damage their entire economy.

3. Massive appreciation of gold

Gold and silver were for millennia the heart of many financial systems until the "Gold standard" of the 20th century. Following the end of the convertibility of the dollar into gold, for several decades now, we have observed a flow of transactions from West to East estimated at 2,000 or 3,000 tons per year, confirming the disengagement of Western countries and the interest of Asia and the emerging countries for this asset capable of protecting against fluctuations in the value of "paper" currencies. These transfers are relatively large in relation to the world's gold production, which will only reach 3,600 tons in 2022. Since 1971, the purchasing power of gold has only increased in all major currencies, and we believe that this trend is accelerating, particularly for gold quoted in dollars, now seems very likely. China is probably recreating a system that is also based in some way on the value of gold. Its gold reserves could exceed the officially announced by about 8'000 tons. Indeed, over the past 15 years, the Shanghai Gold Exchange reports having arranged for 23,000 tons of physical deliveries of yellow metal, of which an unspecified portion could have been acquired by the PBoC. We estimate that gold prices could reach USD 3,000 per ounce in the described context of de-dollarization in progress.

4. Loss of influence of the United States

The de-dollarization of the world and the gradual reduction in the use of the dollar by an undoubtedly growing number of emerging economies around the BRICS will necessarily lead to a decrease in the influence of the United States as exercised to date. Marco Rubio, Republican Senator from Florida and potential next President of the United States, recently commented on recent developments by pointing out that China is creating a new form of economic relationship away from the dollar, which will prevent the United States in the next five years from implementing economic sanctions against countries as it is able to do today.

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BBGI Group
Place de Longemalle 1
1204 Geneva
Switzerland
T: +41225959611
reception@bbgi.ch
www.bbgi.ch