Discussion of

The Dollar in an Era of International Retrenchment

by Ryan Chahrour and Rosen Valchev

Dmitry Mukhin
LSE

The Future of Macroeconomic Policy

June 15, 2023

Motivation

- **Will decoupling of global economy undermine USD dominance?**

Motivation

- **Will decoupling of global economy undermine USD dominance?**
  - USD retains its status? replaced by RMB? regional currencies?

Motivation

- **Will decoupling of global economy undermine USD dominance?**
  - USD retains its status? replaced by RMB? regional currencies?
  - welfare implications for the U.S., China, other economies

Motivation

- **Will decoupling of global economy undermine USD dominance?**
  - USD retains its status? replaced by RMB? regional currencies?
  - welfare implications for the U.S., China, other economies
- **Models of dominant currencies** (Gourinchas'2019):
  1. goods markets + sticky prices (Mukhin'22)
  2. financial markets + reputation (Clayton et al.'22)

Motivation

- **Will decoupling of global economy undermine USD dominance?**
  - USD retains its status? replaced by RMB? regional currencies?
  - welfare implications for the U.S., China, other economies
- **Models of dominant currencies** (Gourinchas'2019):
  1. goods markets + sticky prices (Mukhin'22)
  2. financial markets + reputation (Clayton et al.'22)
  3. goods + financial markets (Gopinath-Stein'21, Chahrour-Valchev'22)
     - search models (Matsuyama, Kiyotaki, Matsui'93, Rey'01...)

Summary

- **This paper**: Chahrour-Valchev (RES'22) + int'l trade
  - gravity and tariffs
  - transition dynamics
  - exorbitant privilege and welfare analysis

Summary

- **This paper**: Chahrour-Valchev (RES'22) + int'l trade
  - gravity and tariffs
  - transition dynamics
  - exorbitant privilege and welfare analysis
- **Main findings**:
  - USD is likely to survive trade fragmentation

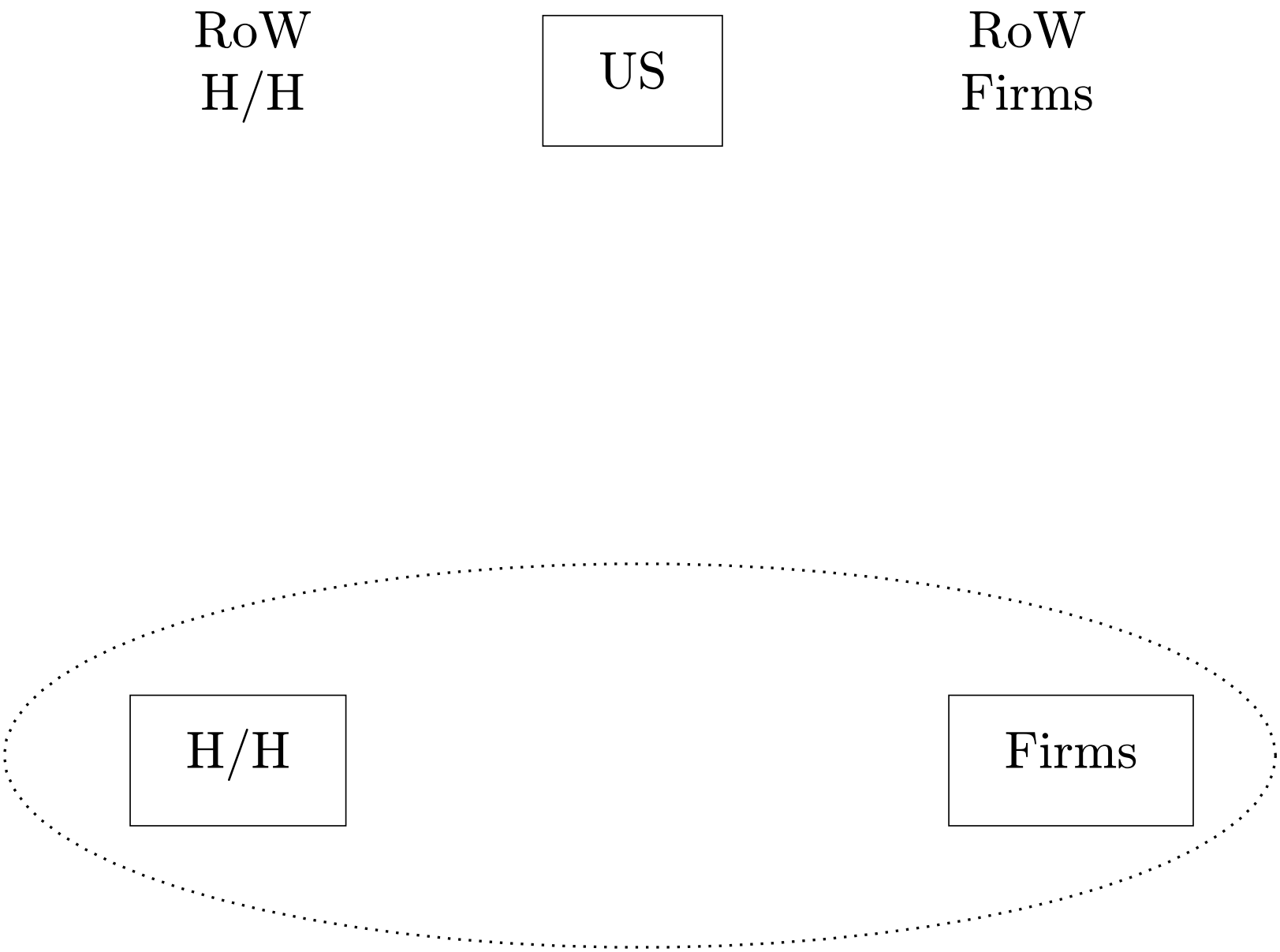
Summary

- **This paper**: Chahrour-Valchev (RES'22) + int'l trade
  - gravity and tariffs
  - transition dynamics
  - exorbitant privilege and welfare analysis
- **Main findings**:
  - USD is likely to survive trade fragmentation
  - RMB can replace USD if internationalized by China
  - potentially very slow transition

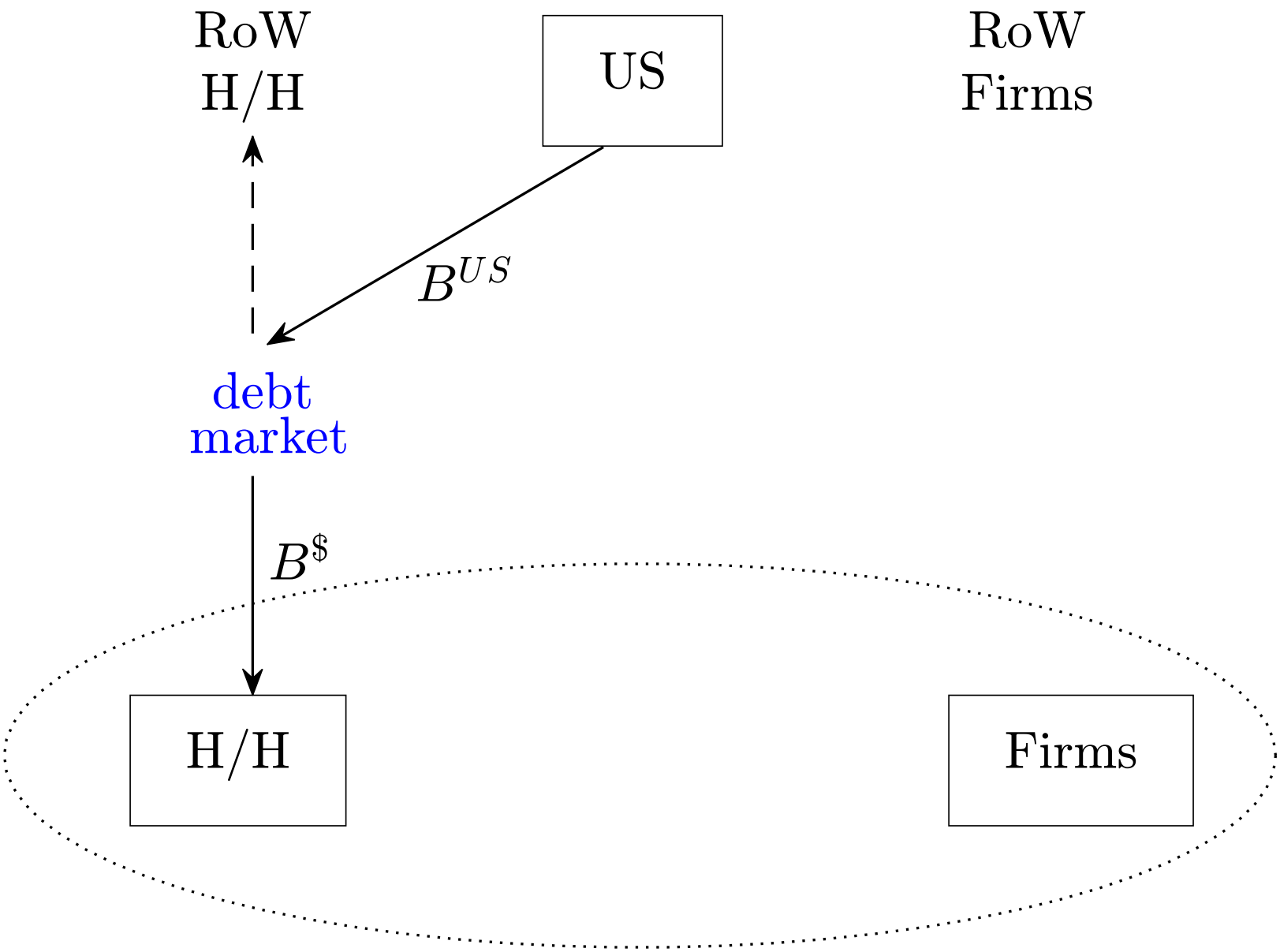
Summary

- **This paper**: Chahrour-Valchev (RES'22) + int'l trade
  - gravity and tariffs
  - transition dynamics
  - exorbitant privilege and welfare analysis
- **Main findings**:
  - USD is likely to survive trade fragmentation
  - RMB can replace USD if internationalized by China
  - potentially very slow transition
  - both China and U.S. loose in all scenarios

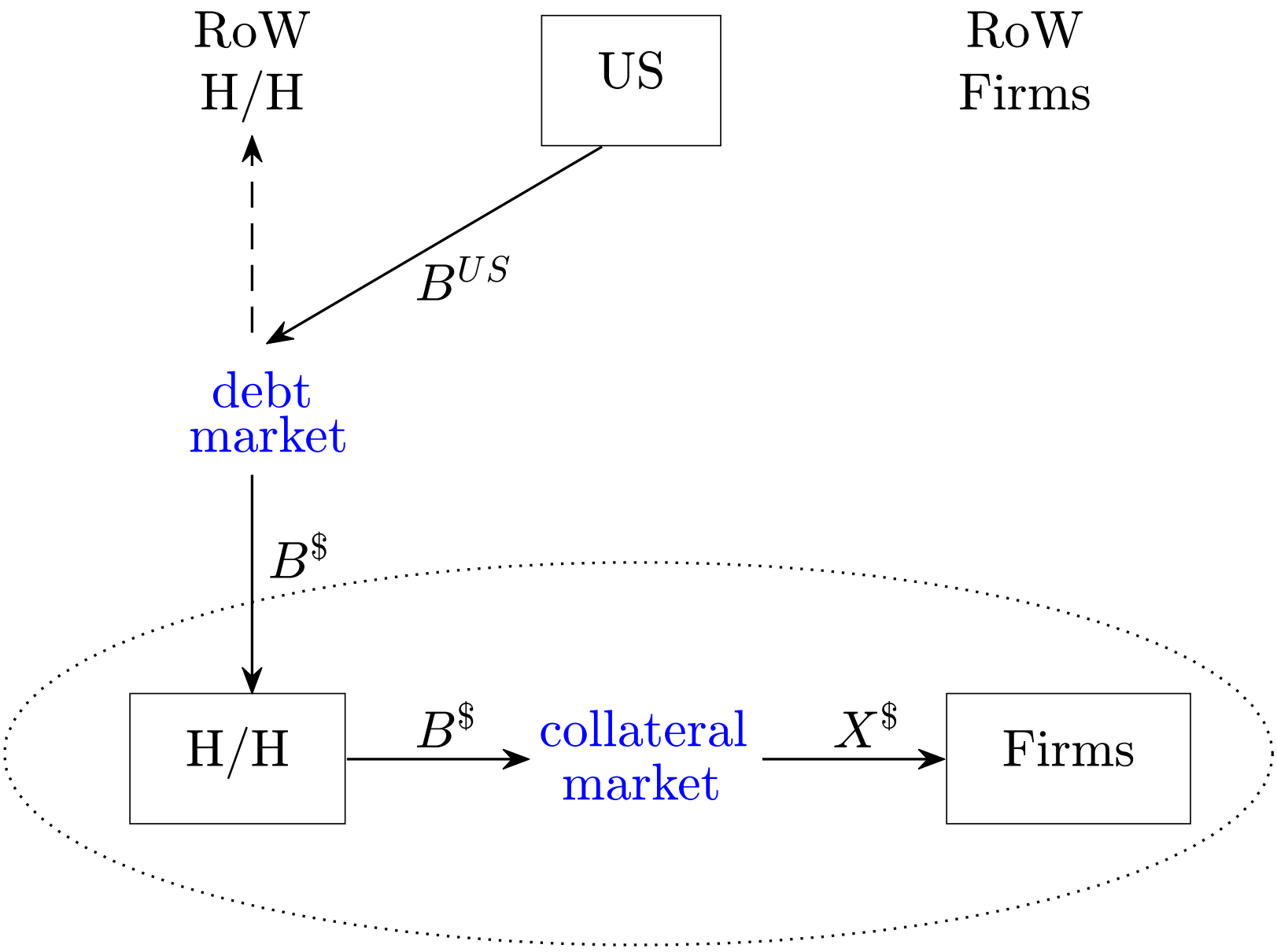
Model



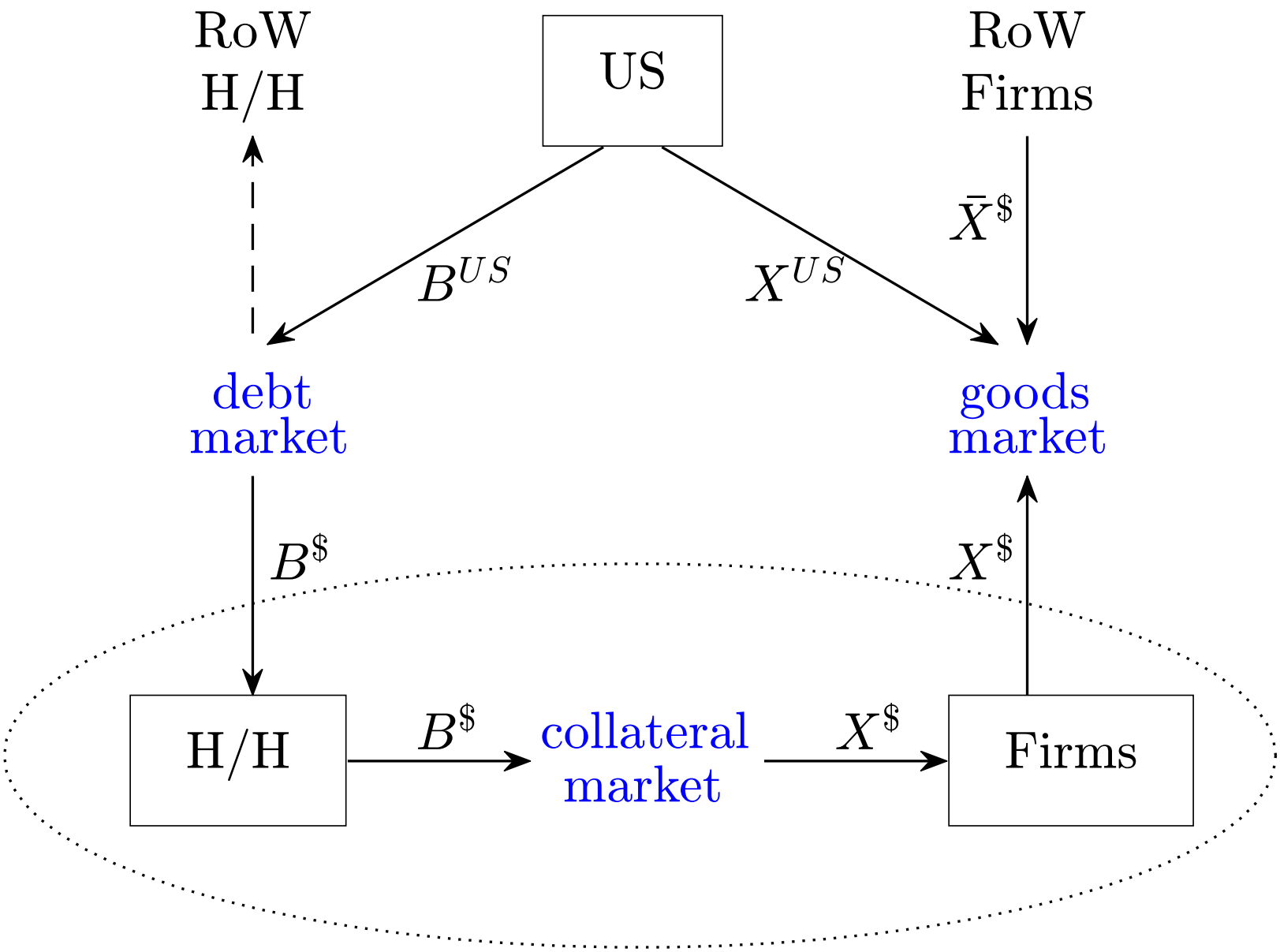
Model



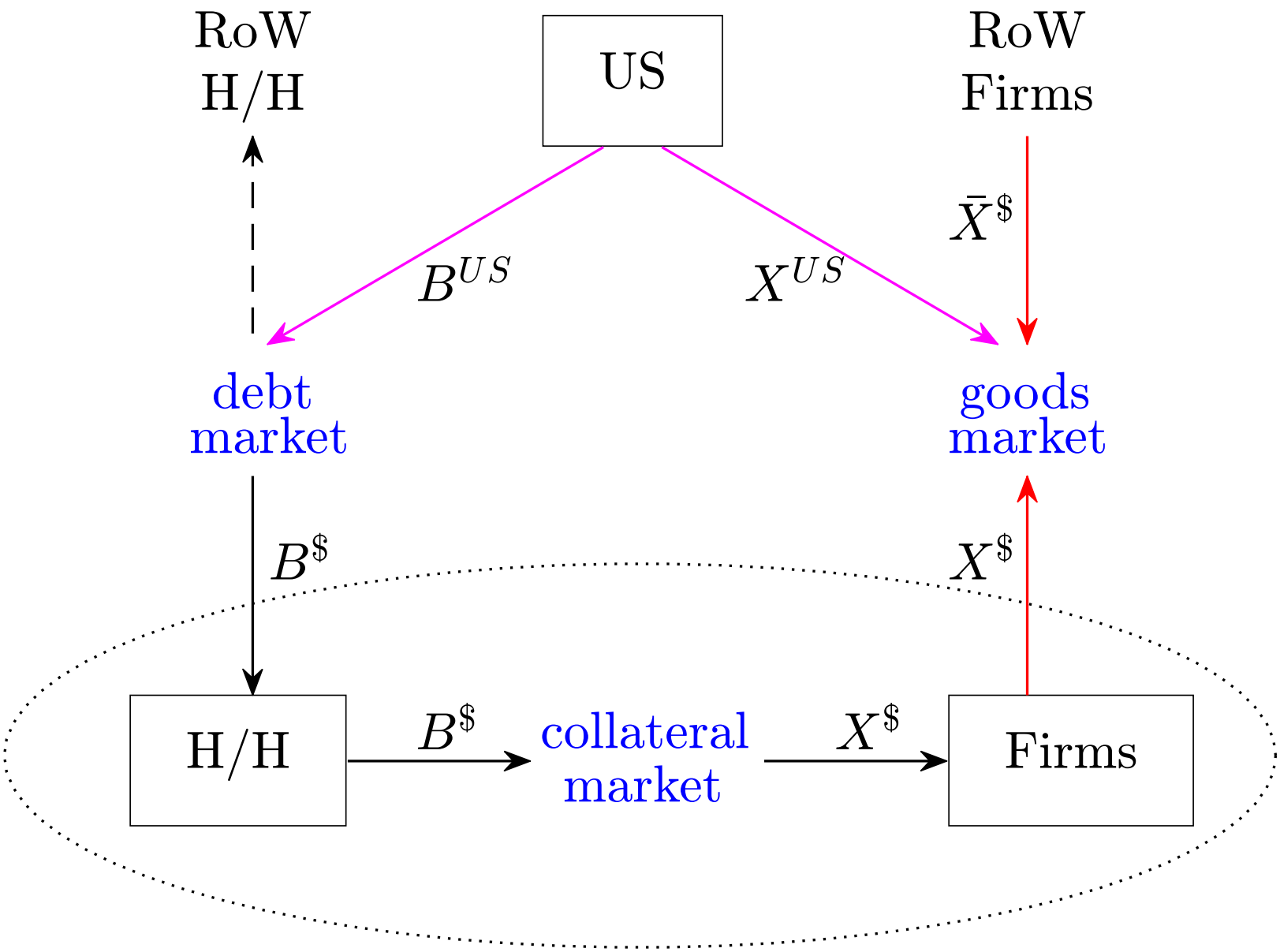
Model


RoW
H/H
US
RoW
Firms
B^{US}
debt
market
$B^{\$}$
H/H
$B^{\$}$
collateral
market
$X^{\$}$
Firms

Model


RoW
H/H
US
RoW
Firms
$\bar{X}^{\$}$
B^{US}
X^{US}
debt
market
goods
market
$B^{\$}$
$X^{\$}$
H/H
$B^{\$}$
collateral
market
$X^{\$}$
Firms

Model


RoW
H/H
US
RoW
Firms
$\bar{X}^{\$}$
B^{US}
X^{US}
debt
market
goods
market
$B^{\$}$
$X^{\$}$
H/H
$B^{\$}$
collateral
market
$X^{\$}$
Firms

Main Comments

1. **Role of RMB debt** (SS)

Moments	US	USD Coord. CN	A	B
Dollar Share	0.90	0.10	0.80	0.80
$100\times(i^{\$} - i^{¥})$	1.08	-	-	-
100×Implied rev./GDP	0.88	0.22	-	-
NFA/GDP	-0.48	-0.34	0.21	0.21
Gross For. Assets/GDP	0.03	0.01	0.21	0.21
100×Trade bal./GDP	1.12	1.20	-0.61	-0.61

Main Comments

1. **Role of RMB debt** (SS)
   - can RMB replace USD if China gov't debt is low?
   - dominant currency in goods vs. asset markets

Main Comments

1. **Role of RMB debt** (SS)
   - can RMB replace USD if China gov't debt is low?
   - dominant currency in goods vs. asset markets
2. **Valuation effects** (transition)
   - tariffs $\rightarrow$ demand for CHN/USD $\rightarrow$ NFA
   - potential solution: calibrate initial positions

Main Comments

1. **Role of RMB debt** (SS)
   - can RMB replace USD if China gov't debt is low?
   - dominant currency in goods vs. asset markets
2. **Valuation effects** (transition)
   - tariffs $\rightarrow$ demand for CHN/USD $\rightarrow$ NFA
   - potential solution: calibrate initial positions
3. **Decoupling in financial markets** (counterfactuals)
   - freeze of Russian FX reserves
   - China holdings of U.S. debt

Main Comments

1. **Role of RMB debt** (SS)
   - can RMB replace USD if China gov't debt is low?
   - dominant currency in goods vs. asset markets
2. **Valuation effects** (transition)
   - tariffs $\rightarrow$ demand for CHN/USD $\rightarrow$ NFA
   - potential solution: calibrate initial positions
3. **Decoupling in financial markets** (counterfactuals)
   - freeze of Russian FX reserves
   - China holdings of U.S. debt
4. **Decomposition of welfare losses/gains**
   - static gains from trade vs. use of currencies

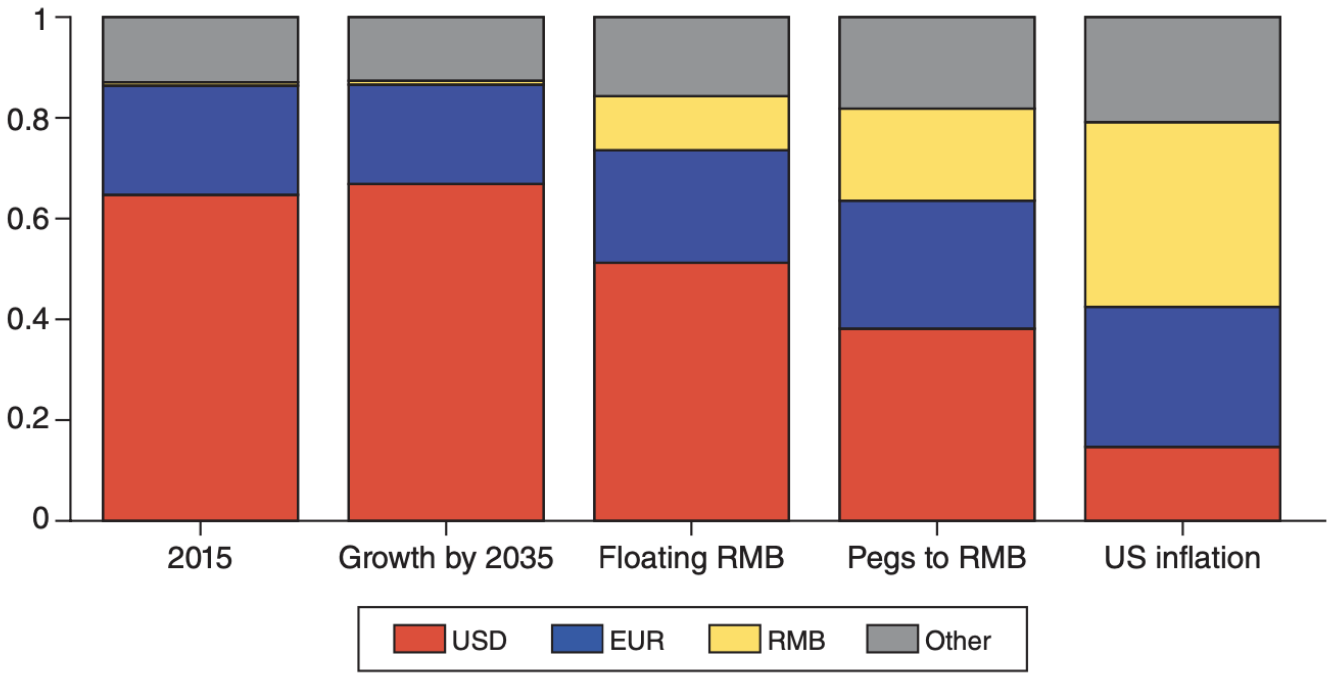
Complementary Mechanisms

1. **USD as reserve currency** (Clayton et al.'22)
   — arguably the main threat to USD dominance

Complementary Mechanisms

1. **USD as reserve currency** (Clayton et al.'22)
   - arguably the main threat to USD dominance

2. **DCP ⇔ Monetary policy**



   - peg to USD → DCP (Mukhin'22)
   - DCP → peg to USD (Egorov-Mukhin'23)