ASIA'S PRAGMATIC CURRENCY PIVOT

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Diversification and digitalization are reshaping finance's future

Strictly speaking, it is far from a divorce, or even a serious breakup. But Asia's leading economies are edging away from their eight-decade relationship with the US dollar for international trade.

Two forces are driving this evolution of the international monetary system. Amid rising geopolitical and geoeconomic fragmentation, policymakers are weighing economic efficiency against national security and strategic resilience. And digital innovation is lowering the cost of conducting transactions directly across currencies and financial networks.

Although the dollar still dominates trade in Asia, the region's currency diversification promises to help shape the future of the world economy. The ASEAN+3 countries consist of 10 members of the Association of Southeast Asian Nations—Brunei Darussalam, Cambodia, Indonesia, Lao P.D.R., Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam—plus China, Japan, and Korea. Together, they encompass more than a quarter of the world's population and generate a quarter of global economic output.

Since World War II, the dollar has been Asia's dominant international currency. It still accounts for more than 80 percent of trade invoicing and nearly 85 percent of foreign exchange settlement in the ASEAN+3 bloc. More than half of regional banks' cross-border assets and liabilities are denominated in dollars, as are roughly two-thirds of official reserves.

Asia's unfolding currency pivot is not an ideological campaign against the dollar. Policymakers are simply pursuing a pragmatic strategy of diversification. Their objective is to create alternative pathways of clearing and settlement for trade and finance that can operate alongside existing global systems. In doing so, they are building resilience.

What will emerge is a more layered financial architecture. The dollar is likely to remain the region's dominant reserve asset and the ultimate liquidity backstop for financial markets. At the same time, local currency settlement arrangements and digital payment platforms will assume a larger role in trade and supply-chain integration.

The dollar's advantage

The dollar's historically dominant position in Asia is no accident. It is rooted in the postwar global order and reflects not only the weight of the US as the world's largest economy but also the credibility of its institutions over time.

Illustration by Jasu Hu

For central banks across the region, holding dollar reserves has ultimately been an expression of confidence in the Federal Reserve, the rule of law, and the transparency and predictability of the US monetary framework.

Yet this cannot be taken for granted. The dollar's central role depends on continued confidence in the US as an open economy and in America's ability to provide stable and predictable policy frameworks. To retain the dollar's central role, the US must continue to offer the world's largest and most dynamic economy, the deepest financial markets, and an independent central bank.

Recent strains in US institutions are testing that foundation. Market reactions over the past year—to events ranging from the tariffs imposed by the US administration to conflict in the Middle East—underscored a simple reality. When uncertainty originates elsewhere, investors seek safety in dollar-denominated assets. But when questions arise about the stability or predictability of US policies and institutions, concerns inevitably emerge about the dollar's reliability as the anchor of the international monetary system.

Asia's regional turn

Over the past two decades, Asia's economic structure has changed dramatically. The region is no longer just the world's factory, producing largely for Western consumption. Two decades ago, nearly a third of value-added exports from the ASEAN+3 group were destined for the US. Today, that share is down to a fifth. Meanwhile, China and ASEAN are each now absorbing a tenth of the region's production, up markedly from about 6 percent each two decades ago. Production networks across "Factory Asia" are now denser, more interconnected, and more firmly rooted within the region.

This structural transformation also changed the way economic shocks propagate. Analytical modeling by AMRO—the ASEAN+3 cooperation framework's macroeconomic research office—suggests that shifts in regional domestic demand now affect neighboring economies more strongly than demand shocks originating in the US.

Asia has traditionally been highly sensitive to global financial cycles driven by American monetary policy. When the Fed tightened policy, financial conditions across the region tightened as well. Capital flowed out, local currencies came under pressure, and domestic borrowing costs rose.

As the region's business cycles and production networks become more regionally anchored, monetary policy in Asia will respond more directly to domestic and regional conditions. While global factors remain important, there are early signs that financial conditions in ASEAN+3 economies are increasingly domestically driven.

DATA

80%

The dollar accounts for more than 80 percent of trade invoicing in Southeast Asia.

To consolidate this growing financial autonomy, the region needs to expand the use of regional currencies in trade. Invoicing and settling intra-regional trade in those currencies will help loosen the link between domestic credit conditions and US monetary policy. Greater use of local currencies will gradually reduce structural currency mismatches and allow central banks to calibrate monetary policy more closely to domestic conditions rather than reacting defensively to dollar shocks.

As Asia aligns its financial architecture more closely with changing economic structures, the region will be better positioned to safeguard macroeconomic stability and strengthen its resilience to external shocks, such as the debt-driven 1997 Asian financial crisis. In that case, the IMF stepped in with a $40 billion program to stabilize the region's collapsing currencies.

Rewiring international payments

In the aftermath of that crisis, some policymakers and academics advocated a European-style monetary union. Asia did not pursue that idea. The region is simply too diverse. Political systems, economic structures, income levels, and financial market development vary widely across the region, making a common currency impractical.

Instead, regional cooperation evolved in a more pragmatic direction, focusing on financial integration and stronger safety nets. Modernizing cross-border payment infrastructure became a central pillar of this strategy.

In the past decade, Asian central banks have pioneered local currency settlement frameworks. These are bilateral arrangements between two countries that use local currencies for cross-border settlement via financial institutions authorized by central banks. Although still modest in scale, such arrangements now operate between many ASEAN+3 economies.

At the same time, the region has become a leader in retail cross-border payment linkages. Central banks have integrated interoperable, QR code–based fast payment systems, enabling consumers, tourists, and businesses to transfer funds across borders quickly and cheaply using their domestic currencies. One prominent example is the linkage between Singapore's PayNow and Thailand's PromptPay. Such efforts are also expanding through various multilateral initiatives, including Project Nexus.

These developments reflect a broader structural shift. As production networks become increasingly regional and supply chains deepen across Factory Asia, there is a growing economic rationale for regional currencies to take on a larger role in trade invoicing and settlement. As Asia's economic geography becomes more regional, its payment infrastructure is gradually adapting to support that reality.

China's renminbi is at the forefront of this shift, reflecting the country's critical role in regional trade and investment. Investments by China in cross-border financial infrastructure have supported the renminbi's growing international use. These include the expansion of the Chinese central bank's Cross-Border Interbank Payment System and the rollout of the digital yuan. China has also increased foreign access to its government bond market, providing a deeper pool of sovereign assets for use in diversifying regional central banks' reserve portfolios.

Digital finance's promise

The next frontier calls for the extension of gains in retail payment systems to the wholesale financial system, supporting large-scale trade and investment.

Several initiatives are underway. Project mBridge connects the central banks of China, Hong Kong SAR, Thailand, and the United Arab Emirates through a shared distributed ledger platform for wholesale transactions with central bank digital currencies. Project Guardian, coordinated by the Monetary Authority of Singapore, is exploring the potential of tokenized assets and open digital infrastructure.

These projects take advantage of progress in digital technology such as tokenization. This process converts diverse assets—such as gold, dollars, and stocks—into digital "tokens" that computers can recognize and transfer. It amounts to labeling everything using a common language.

Under the traditional model, transactions between two currencies often require conversion through the dollar. Tokenization may eliminate the need for such an intermediary currency. Just as Google Translate enables people to communicate directly without a common language, tokenized financial infrastructure could facilitate direct interaction between different currencies.

Tokenization thus has the potential to enhance direct liquidity on shared digital platforms. Liquidity pools on these platforms can broaden participation and eliminate the need for long chains of dealer banks operating across different time zones.

The benefits extend beyond efficiency. The risk of one party delivering payment and the other failing to do so has long been a challenge in global foreign exchange markets. Existing arrangements, such as the 24-year-old Continuous Linked Settlement System, have helped reduce these risks for major currencies, but many emerging market and developing economy currencies are still excluded.

Tokenized foreign exchange transactions could help address this gap through something known as "atomic settlement," in which both sides of a transaction are completed simultaneously. By reducing settlement risk, such arrangements could improve liquidity in foreign exchange markets.

Much work remains before these innovations become part of the financial mainstream. Interoperable digital financial infrastructures must be built and regulatory standards and cross-border compliance rules harmonized.

Through digital platforms, Asian policymakers are opening up additional channels for trade and finance. If traditional financial systems become disrupted, alternative digital networks could help ensure that economic activity continues uninterrupted.

Building resilience

Asia's evolving financial architecture is taking the form of a sophisticated, multilayered system. It seeks to balance technological innovation with institutional realities, promoting economic efficiency while enhancing resilience in an increasingly uncertain world.

The dollar continues to anchor one track. The currency serves as the indispensable liquidity backstop for global financial markets and large-scale international transactions. The depth of US financial markets and the unparalleled availability of dollar-denominated safe assets underpin this role. For the foreseeable future, no alternative is likely to match these advantages.

Alongside this dollar-based system, regional platforms are assuming a larger role in facilitating trade and investment in Asian supply chains. These platforms draw on advances in cross-border payment connectivity, tokenization, and the growing use of regional currencies, including China's renminbi and Japan's yen.

This emerging architecture offers a practical framework for managing risk in a fragmented world while creating a more balanced and resilient monetary ecosystem.

Over time, these developments should bring Asia's financial architecture more closely in line with the region's growing economic weight. Success will depend not only on technological innovation but also on maintaining the institutional trust, policy credibility, and international cooperation that underpin a stable monetary system. F&D

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