

From the Desk of CIO

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It's a Matter of Trust

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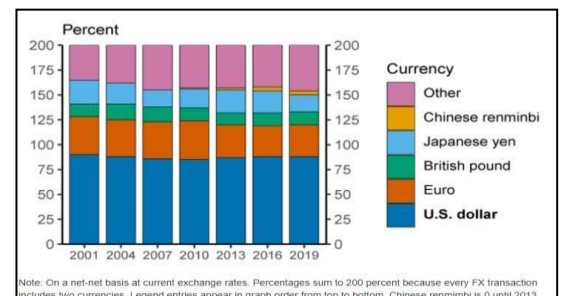
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US Reveals its Financial Weapon

The main reason why the world is able to continue to grow at low inflation rate for the past 30 years is due to the benefit of globalisation where each country specialises on goods and services, which they are more competitive at and delivering them at the cheapest price. The regular impositions of sanction by US on unfriendly countries and excluding a country from the SWIFT (Society for Worldwide Interbank Financial Telecommunication) financial settlement system such as on Russia recently may have forced many countries to review their reliance on other foreign countries for the provision of strategic goods and services. More countries may need to have a higher degree of self-reliance or at least reduce their foreign reliance on certain services/goods in case of international conflict. The use of SWIFT ban as a financial weapon sends fear in many country's heads who need to explore alternatives to diversify their financial risk.

Exhibit 1: Share of OTC foreign currency transactions

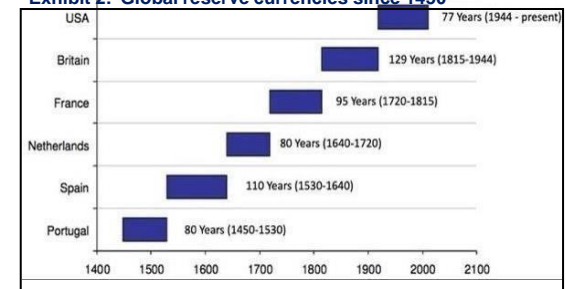
During the Iraq War, the US showed its military supremacy by launching its satellite-guided *Tomahawk* cruise missiles for the first time. For current Russia-Ukraine war, the US may have supplied Ukraine with *Javelin* missile, a portable anti-tank missile. Meanwhile, unconfirmed sources reported that Russia has deployed *Kinzhal* hypersonic aeroballistic missiles, which can travel at five times the speed of sound. In fact, war is the time when we see emergence of new weapons.



Source: BIS Triennial Central Bank Survey

Instead of using the traditional weapons, US has revealed a new weapon to checkmate an opponent by excluding a few Russian banks from using the SWIFT for trade settlements. This is a new financial weapon the US has deployed against its opponent. Prior to this, China has already developed its own SWIFT equivalent known as CIPS (Cross-Border Interbank Payments System). Similarly, Russia also has its own SPFS or System for Transfer of Financial Messages.

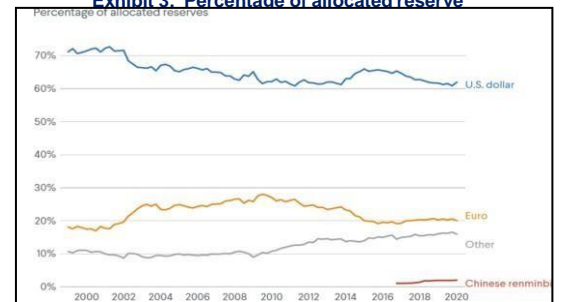
Exhibit 2: Global reserve currencies since 1450



Source: BMG Group

Presently, US dollar (USD) is still the most widely used currency for trade settlement (see Exhibit 1). USD replaced British pound as the global reserve currency after the World War II (see Exhibit 2). Nonetheless, USD position has deteriorated from 70% in 2000 to about 60% of the USD12.8tn global currency reserve in 2020 (see Exhibit 3). There is still a lot of trust in the USD either for trades or as a reserve currency. Unfortunately, the US abuses its supremacy by freezing half of USD630bn worth of Russian foreign exchange reserves in an attempt to pressure Russia to withdraw from Ukraine. To protect themselves from the same fate of Russia, other countries may have to reduce their holdings in USD assets and hold more on other currencies eg euro, Japanese yen and even Chinese yuan in their reserves. More and more countries may use non-USD currencies to settle trades.

Exhibit 3: Percentage of allocated reserve



Source: IMF

While USD will remain as the dominant global currency for many years to come, its position will continue to deteriorate and that will put a pressure on the strength of USD over the longer term.

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