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The Palos Perspective

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The Dollar Debasement Question

Discussion surrounding whether dollar debasement is an immediate threat has so far been either theoretical or anecdotal, with little empirical evidence to justify its case. Nonetheless, the question itself has been the centre of attention in the media.

Last week, the Chinese President Xi Jinping made it public that he wants the renminbi, China's currency, to become "powerful" and ultimately replace the USD - the currency most held by central banks in the form of U.S. Treasuries. A few days later, China told its banks to cut back on buying those Treasuries, citing concerns over concentration risks and market volatility, and rhyming with a concern that the dollar is losing its status as the safest place in the world to park your money.

In my judgment, Xi may have hit a raw nerve, but his statement has more to do with geopolitical manoeuvering and the current negative narrative about the greenback - which has declined by about 12% since Trump returned to office as President - than a loss of confidence. A number of other countries, along with sovereign funds, financial institutions and retail investors, have turned away from the dollar to commodity trading and to hedging strategies.

This has been caused by: the implementation of Trump's tariffs, resulting in frequent threats; US foreign policy isolation, straining international relations; political polarization in America, causing domestic strife; and the weaponization of the dollar, all at a time when the national debt exceeds $38 trillion and 125% of N-GDP, with budget deficits worsening.

The situation begs four big questions:

First, is it remotely realistic that China can replace the dollar? No.
The renminbi accounts for only 2% of global currency reserves, versus 57% for the USD. In order for the renminbi to become eligible as a main international asset, China would have to open its capital

markets to the world, end limits on foreign investments, allow its people to move money abroad, make its currency convertible easily into gold and other currencies, and - above all - let it float freely. There is no indication that China is about to implement any of those pre-conditions to making its currency a safe and liquid alternative.

Second, is the US willing to lose its geopolitical advantage?
The U.S. government will not allow its currency to fall out of favour: the ramifications would be massive. It would decrease its chances to stop or curtail a currency crisis; eliminate or reduce its geopolitical power; remove its capability of enforcing sanctions; increase the cost of capital; hurt its ability to finance its budget and trade deficits; and lose its ability to block countries from trading and making international payments.

Third, will Americans readily accept a lower standard of living and stability? No.

Fourth, is there any empirical evidence that the world is selling off Treasuries? No.
As a matter of fact, the U.S. is not even quietly quitting Treasuries. Its government has $36 trillion of debt on issue, and its bonds are the bedrock of the global financial system, of which 24% are held by foreign investors. In November 2025, foreign holdings of U.S. Treasury securities reached a record high of $9.4 trillion, representing a 7.2% increase from a year earlier. Only China, Brazil and India shed some.

The bottom line is that the world demands short-term protection, which in turn has subjected the USD to an extraordinarily huge amount of various sorts of hedging strategies, which are tantamount to near-term short-selling. They are not outright naked sales, because investors, merchants, international borrowers, hedgers and financial traders cannot move away from them. Forex players rather use the swap markets, forwards, and over-the-counter contracts, which, according to the Bank for International Settlements (BIS), amount to no less than $155 trillion, to hedge themselves against currency movements. It also appears that recent activity in the over-the-counter market has occurred during off-trading hours, suggesting that most of the hedging has occurred in Asia.

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Conclusion:

Don't panic. Instead, it's better to stick with the exceptionalism of US productivity, which underscores its durability and will likely rescue the market from the pessimism surrounding the USD down the road. Eventually, the weight of the fall should trigger the "dollar smile" theory developed by Stephen Jen, a former Morgan Stanley currency strategist and founder of Evrizon SLJ Capital, whose thesis says that the US dollar tends to follow closely a defined cycle that is influenced by the relative performance of the economy and relative perception of risk. Moreover, investors should take note that interest rate differentials across the entire yield curve between the US and the rest of the world significantly favour U.S. Treasuries, thereby directly offering plenty of risk protection.

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