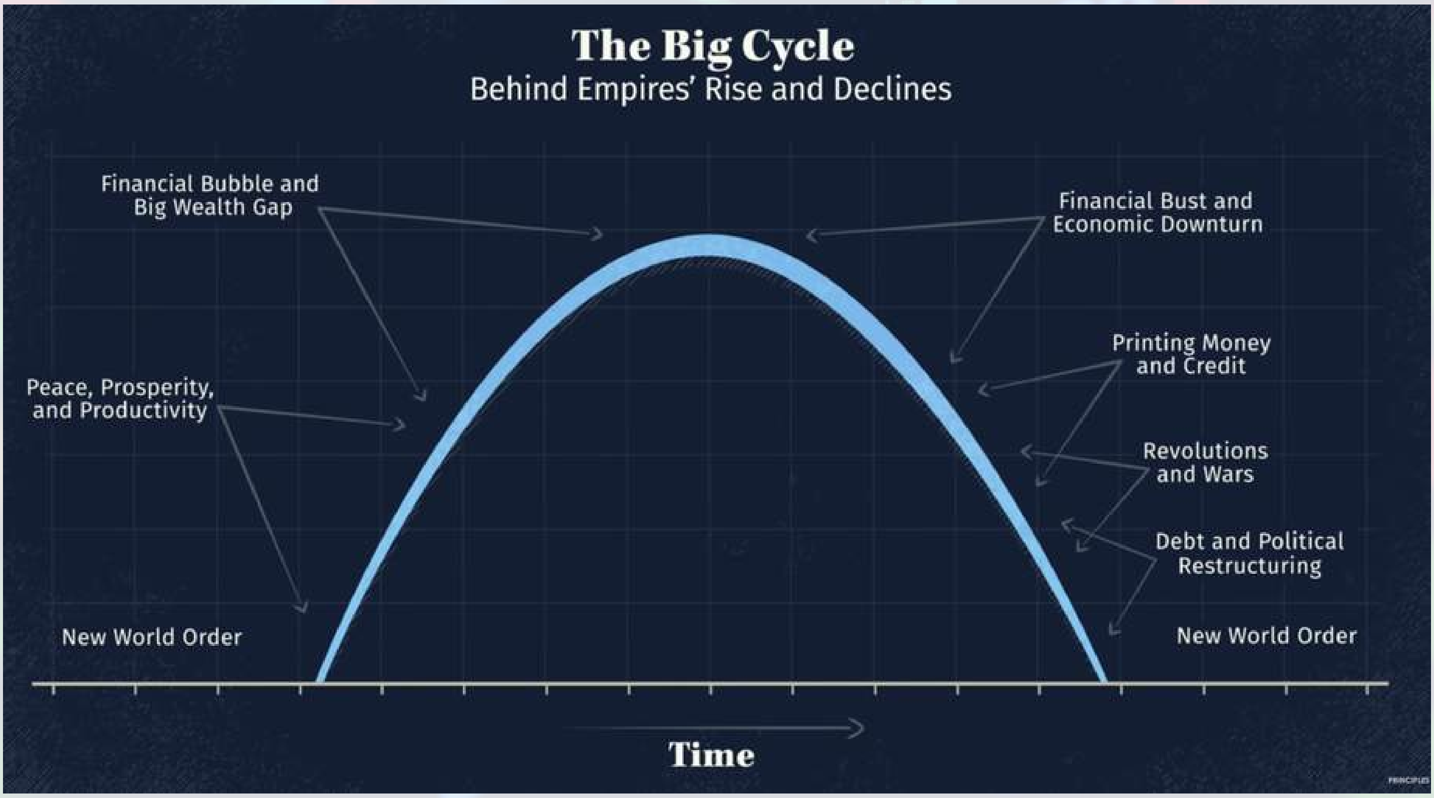
# *A view on DOLLAR*
## The Global Reserve Currency

The Indian economy is the fastest-growing in the world. The economy has demonstrated strong resilience to multiple challenges, including the global slowdown and recessionary pressures in developed markets. The country's demographic profile, with a large and growing working-age population, positions it well to meaningfully impact global markets in the coming decades. Visionary leadership from the government, focused on accelerating the pace of economic growth, is making strategic investments to expand India's manufacturing base and spur job creation.

Ambitious initiatives to boost capital expenditures on critical infrastructure like roads, ports, railways and power are laying the foundation for sustained long-term growth. India's inherent economic strengths, burgeoning consumer class, and growing clout on the world stage point to a bright future as a leading engine for global growth in long term though there are challenges currently. Further, the prevailing global scenario, India cannot grow smoothly while the world is undergoing multiple challenges. The world has shrunk and is well integrated. India will be impacted by crises and pain across the world on account of the economy, environment, and wars.

The history of the global reserve currency reflects shifts in global economic, political, and military power over centuries. A reserve currency is a currency held in significant quantities by governments and institutions as part of their foreign exchange reserves. It is widely used for international trade, investment, and as a store of value. The cycle of the global currency has been depicted in the below chart:

## अहंकार विनाश की जड़ है



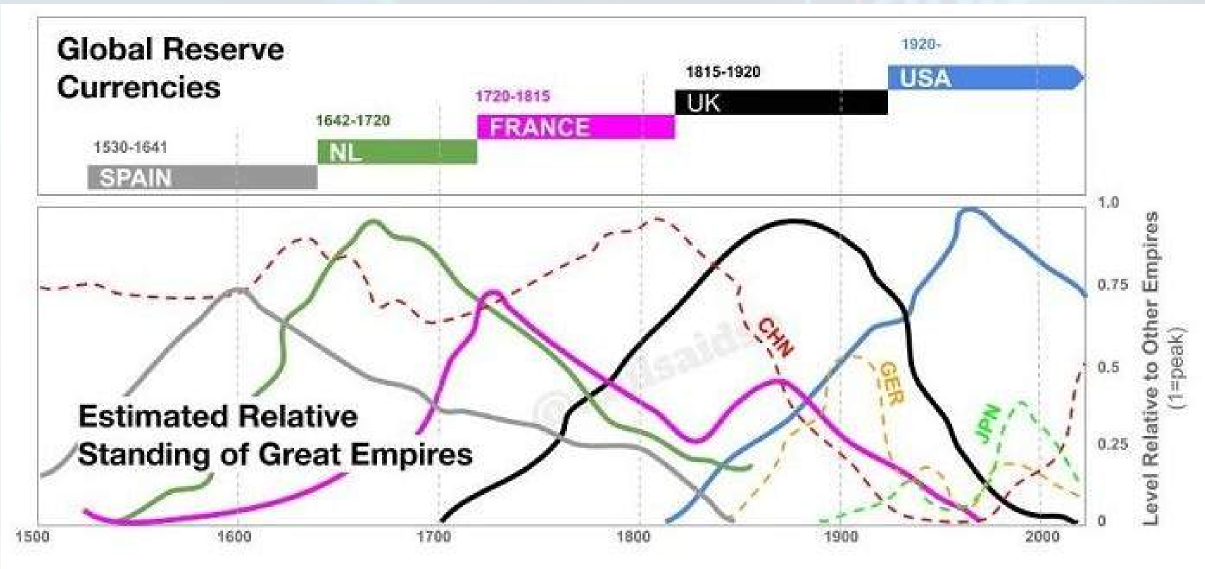

*SOURCE: SUBSTACK*

# How the *Global Reserve Currencies* behave?

The United States dollar's reign as the world's dominant reserve currency is facing an inevitable decline. The warning signs are clear — the U.S. has been abusing its privilege of printing the global reserve currency to finance ballooning government debt and persistently large trade deficits. This unchecked monetary expansion has eroded faith in the intrinsic value and stability of the dollar. Recognizing this unsustainable path, central banks around the world are wisely reducing their dollar reserves and bolstering their gold holdings as a more reliable store of value.

The deteriorating fiscal position of the United States, coupled with slowing economic growth, has exposed the limits of relying on debt-fueled consumption to drive prosperity. Moreover, the U.S. has overplayed its hand by weaponizing the dollar in geopolitical disputes, prompting nations to accelerate efforts to conduct trade in local currencies and develop alternative payment systems outside of U.S. control. History has repeatedly shown that global economic leadership breeds arrogance and abuse of power, ultimately leading to the downfall of the dominant currency and widespread financial turmoil. The world is on the cusp of a seismic shift in the monetary order as dollar hegemony crumbles. A new era is dawning, one in which economic multi-polarity reshapes trade flows, financial markets, and the global balance of power. The only certainty is that the looming end of the dollar's run at the top will bring profound changes and challenges to the prevailing world order.

## *Figure: Historical Timeline of Global Reserve Currencies*




## *Duration of Global Currencies*

| Global Reserve Currencies | Years of Operations |
|---|---|
|  | 1450-1530 (80 Years) |
|  | 1530-1640 (110 Years) |
|  | 1640-1720 (80 Years) |

| Global Reserve Currencies | Years of Operations |
|---|---|
|  | 1720-1815 (95 Years) |
|  | 1815-1921 (115 Years) |
|  | 1944-Present (77 Years) |

? *WHO'S NEXT?*

# What is the future of the *Dollar?*

Dollar is appreciating against major currencies even in weak fiscal position. This will not sustain in prevailing global challenges. There are four key reasons which can trigger the collapse of Dollar. These are as follows:

- **Unsustainable & rising debt level currently stands at over $ 36 trillion.**
- **Weaponization of the Dollar.**
- **Expanding BRICS alliance.**
- **Rise of CBDCs & emergence of Blockchain.**

# Very High *debt of America and the world*

American debt has been growing consistently, and the pace has accelerated during COVID and thereafter. The same is the case with most countries. The oversupply of liquidity has triggered inflation and high interest rates, compounding the pressure of interest servicing. ***The dollar, the global reserve currency,*** has been growing in comparison to all currencies, irrespective of the shortfall in its intrinsic value and limitations in servicing repayments and interest. With this background and other global challenges, markets are not supported by fundamentals and cannot sustain the current valuations we are witnessing across all asset classes.

Learning from history, besides the pressure on markets and turmoil going ahead, we anticipate concerns about the global reserve currency as well. By human psychology, success and leadership give authority, which has been misused and leads to arrogance, ultimately ending in disaster. This has been the trend for centuries, and we don't expect it to be different this time.

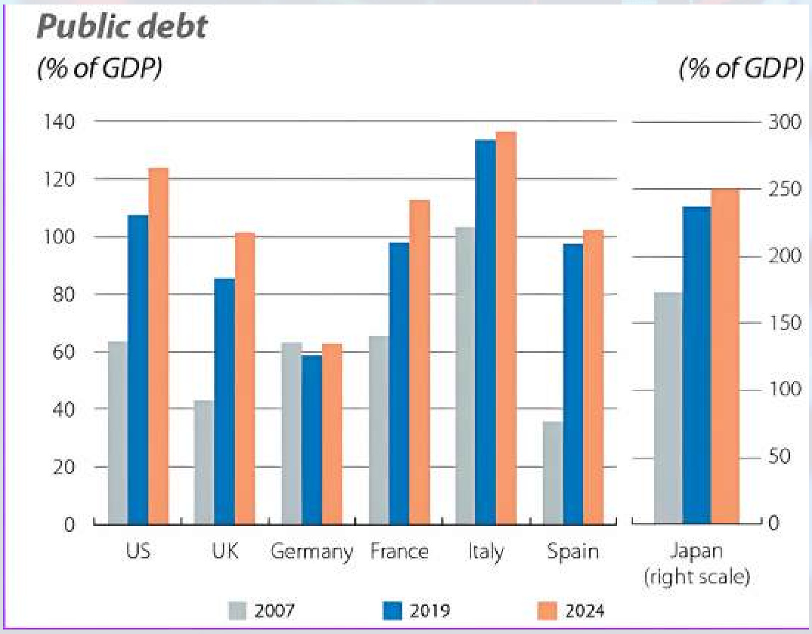
The launch of a BRICS currency has the potential to challenge the U.S. dollar’s dominance, particularly in trade settlement and reserve holdings. However, the magnitude of its impact depends on factors like the BRICS currency's design, stability, and adoption. While the dollar may face pressure, its deep markets and global trust are likely to ensure its continued relevance for the foreseeable future.

# Here are the *key global challenges* and the factors driving the same:

| Challenge | Key Factors |
|---|---|
| **Geopolitical Tensions** | - Conflicts in Eastern Europe and the Middle East affecting energy and food supplies<br>- Risk of escalating oil prices due to disruptions in energy markets |
| **Economic Inequality** | - Billionaires' wealth growing significantly faster than the rest<br>- Persistent poverty levels and rising income disparities |
| **Climate Change** | - Economic impacts of aggressive climate policies debated<br>- Need for balancing environmental goals with economic growth |
| **Trade Uncertainties** | - Potential for increased tariffs under new U.S. policies<br>- Concerns about trade deficits and strained international relations |
| **China's Economic Slowdown** | - Slowest growth rate since 1990 (4.5% in 2024)<br>- Impact on global trade and supply of key commodities |
| **Rising Financial Stress** | - High levels of public and private debt constraining growth<br>- Challenges in maintaining fiscal discipline and borrowing practices |

The graph highlights a significant increase in public debt ratios over the years, particularly since the 2007 financial crisis and the subsequent economic challenges, including the COVID-19 pandemic. Among the countries, Japan consistently shows the highest public debt-to-GDP ratio, exceeding 250% in 2024. The trend underscores the growing fiscal challenges faced by advanced economies which is an alarming geopolitical factor.

## *Figure: Public debt (% of GDP)*




*SOURCE: CAIXABANK RESEARCH*

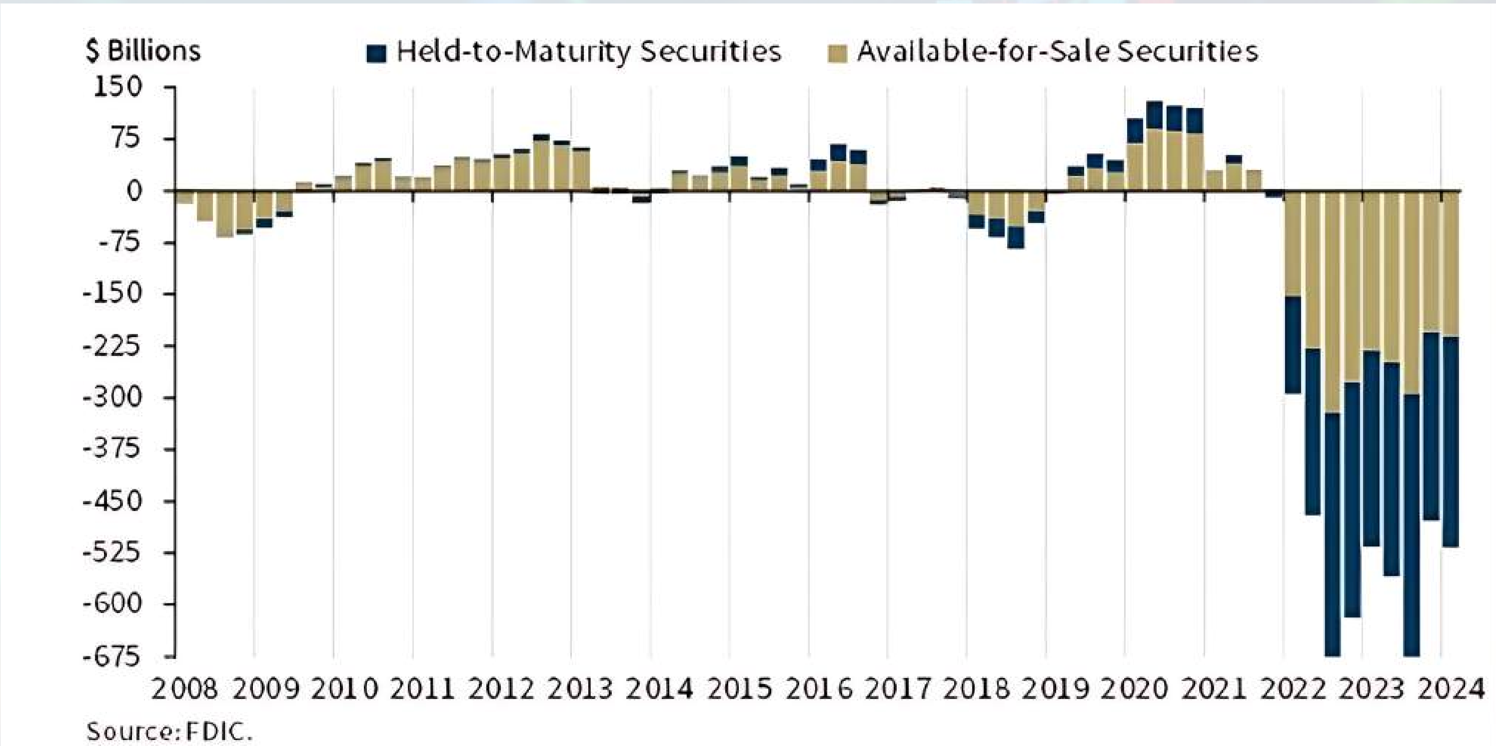
# Is *America* getting *great again?*

The United States is navigating several significant economic challenges, which will also have social implications. Debt levels have ballooned to over $36 trillion. The U.S. is confronted with a significant volume of debt maturing in the near term, necessitating effective rollover strategies amidst a landscape of rising interest rates and projected increases in overall debt levels.

- **Short-Term Debt:** Approximately ***31% of U.S. government debt***, equating to ***$7.6 trillion,*** is scheduled to mature within the next 12 months.
- **Debt Projections:** The Congressional Budget Office (CBO) projects an increase in the national debt by $23.9 trillion over the next decade, which is likely to be revised and enhanced.
- **Interest Rates Impact:** Interest costs, currently 18% of federal revenue (versus 9% in 2021), are expected to reach over 35% by 2034. Rising interest rates have led to increased yields on Treasury securities, which has elevated borrowing costs for the government, adding pressure to fiscal sustainability.

Unrealized losses on investment securities are not accounted for in Hold to Maturity (HTM) securities of banks and institutions. This could potentially add pressure on institutions and could trigger a major financial crisis.

## *Figure: Banks Unrealized Gains/Losses on Investments*




*SOURCE: REDDIT*

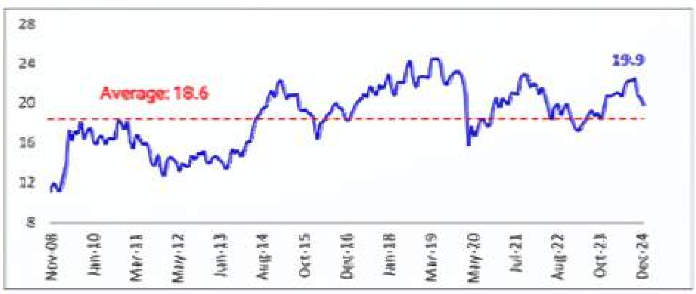
# Is staying invested in *INDIAN EQUITIES* the best option?

India's long-term economic growth story remains intact. Historically, Indian stocks have delivered good returns for long duration investments, outpacing other asset classes. India's economy continues to expand at an impressive clip, cementing its place as one of the fastest growing major economies in the world.

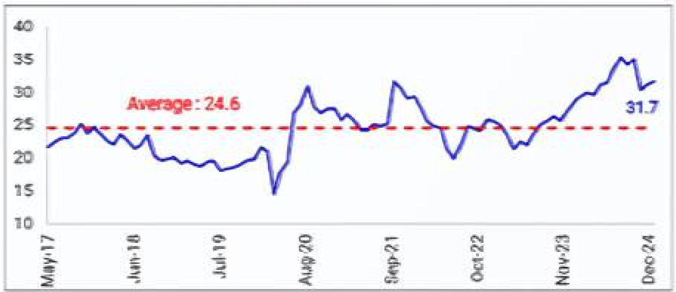
The recent correction in Indian equities can be attributed to several interrelated factors:

- **Unreasonable High Valuations :** Indian equity valuations currently stand at relatively expensive levels compared to historical norms, warranting a measure of caution in the near-term. The fragile global macroeconomic environment could present more attractive entry points for investors to partake in India's promising long-term trajectory.

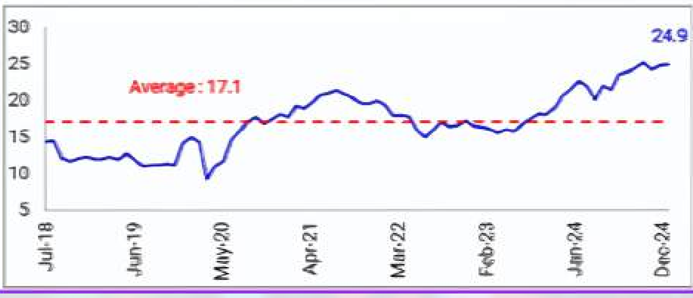
NIFTY P/E (x) - 1 Year Forward




NIFTY Midcap 150 P/E (x) - 1 Year Forward




NIFTY Smallcap 250 P/E (x) - 1 Year Forward




| Valuation | |
|---|---|
| Largecap | 7% premium to historical average |
| Midcap | 29% premium to historical average |
| Smallcap | 45% premium to historical average |

- **Rising U.S. Bond Yields:** A significant increase in U.S. bond yields has led to a contraction in equity valuations globally. Vinod Karki, Equity Strategist at ICICI Securities, notes that the surge in U.S. bond yields is a fundamental reason for the market correction, as higher yields make equities less attractive.
- **Foreign Institutional Investor (FII) Outflows:** Elevated U.S. bond yields have prompted foreign investors to withdraw from emerging markets, including India. In January 2025 alone, FIIs sold over ₹213.57 billion worth of Indian stocks and bonds, exerting downward pressure on the equity markets.
- **Asset Quality Concerns in the Banking Sector:** Indian private banks are experiencing a rise in bad loans, particularly in personal loans and micro-credit sectors. For instance, RBL Bank reported a 28% increase in quarterly slippages, primarily from credit cards and microfinance, signaling potential stress in asset quality.

- **Macroeconomic Factors:** Inflation and Interest Rates: Persistent inflation and high interest rates have contributed to economic slowdown concerns, affecting investor sentiment.
- **Currency Depreciation:** The Indian rupee has experienced rapid depreciation, falling from 85 to 86 per U.S. dollar in less than a month, indicating potential economic challenges.
- **Geopolitical Risks:** Ongoing geopolitical tensions have added to market volatility, leading to cautious investor behavior and contributing to the equity market correction.

# Conclusion

Given the convergence of global financial headwinds, domestic economic challenges, and underwhelming corporate earnings, maintaining a cautious stance towards Indian equities appears to be the most prudent approach in the current market environment. The correction in Indian stocks reflects the broader concerns emanating from the global financial landscape, as tightening monetary policies, geopolitical uncertainties, and recessionary fears weigh heavily on investor sentiment. Domestically, India faces its own set of economic hurdles, with slowing growth, inflationary pressures, and fiscal constraints hampering the country's near-term prospects. As the United States grapples with economic pain and a potential banking crisis, the spillover effects on India could be significant.

In light of these multifaceted challenges, staying on the sidelines of Indian equities may be the most judicious strategy for investors seeking to preserve capital and mitigate downside risks until the economic and financial landscape shows signs of stabilization and renewed growth potential. Investors would be wise to maintain ***balanced and prudent asset allocation approach***. Furthermore, a staggered and patient deployment of capital into Indian stocks over time can be considered. This will help navigate intermittent volatility and tap into India's enduring growth potential.

# Addendum (28th January 2025)

**Global markets remain volatile** amidst changes in policy stance with the change in leadership in the US regarding **trade tariffs, America First, immigration rules, etc., which can escalate geopolitical tensions. Indian markets** face additional challenges of high valuations, slowing growth, and macroeconomic concerns, which will lead to an **extended correction. With Union Budget expectations** of measures to stimulate growth and consumption, **a temporary market upswing is likely.** Investors can use this opportunity by **realigning the asset allocation of portfolios based on their investment horizons and risk tolerance.**

*Happy Investing!*

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