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Trump's Return, De-Dollarization, and the Shifting Global Order

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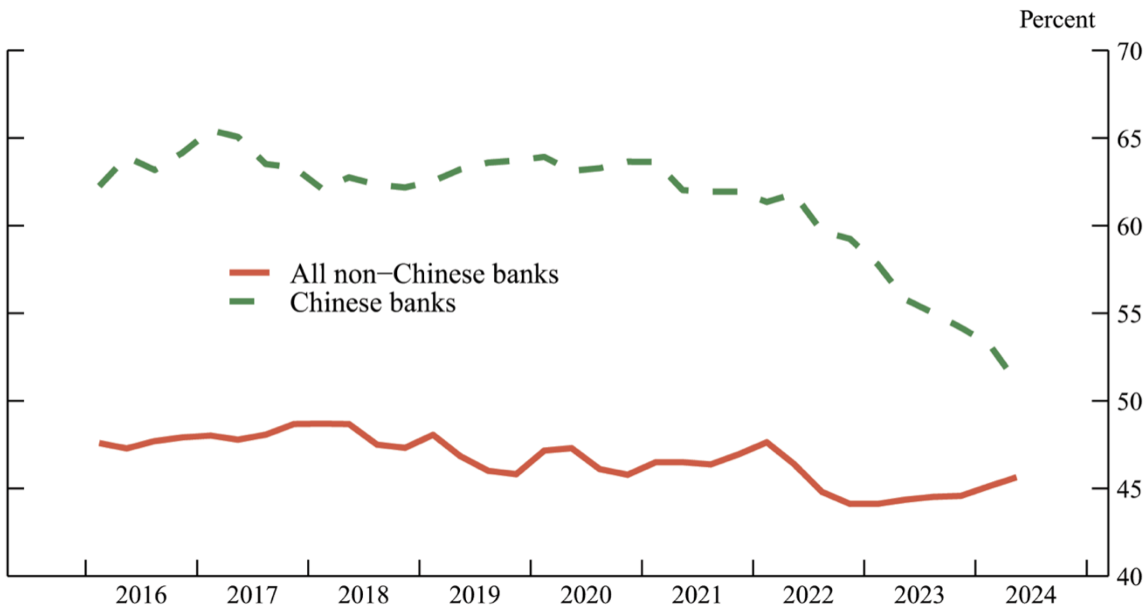
Executive Summary

- Investor confidence in the US is weakening as Donald Trump's return has triggered volatility through tariff threats, political interference, and rising fiscal risks. Stocks and Treasuries were sold simultaneously—an unusual signal of deep uncertainty.
- De-dollarization efforts are accelerating, led by China and BRICS nations, especially after Western sanctions on Russia and the proposed "Mar-a-Lago Accord," which would penalize foreign holders of US Treasuries.
- The US dollar has seen its sharpest fall in decades, down nearly 9% since Trump's return in January—its worst first 100 days performance since 1973, signaling investor concern over US economic and institutional stability.
- China is strategically reducing dollar exposure, cutting its Treasury holdings and reallocating to gold, agency bonds, private equity, and short-duration assets. It is also diversifying away from US asset managers.
- Chinese banks are shifting away from dollar lending, especially in emerging Asia, where the share of RMB-denominated loans has nearly doubled, accelerating regional financial decoupling.
- Emerging-market (EM) assets are showing resilience, with strong performance in local-currency debt as investors bet on falling global rates. Countries like Brazil, Mexico, and Turkey are benefiting from high yields and potential rate cuts.
- Trump's economic policies—tariffs, tax cuts, and immigration curbs—are seen as inflationary, limiting the Fed's ability to ease and increasing pressure on EM central banks to maintain rate differentials.
- US-China decoupling is intensifying, with EMs caught in the fallout. Countries closely tied to China or reexporting Chinese goods, like Vietnam or Malaysia, may face scrutiny and retaliatory tariffs.
- Central banks are turning to gold, with EM holdings growing fast. Since late 2022, gold purchases have surged as a hedge against de-dollarization risks and geopolitical instability.
- The global trade order is shifting, as US protectionism marks the decline of the open-market consensus. EMs now need to prioritize regional integration, policy autonomy, and resilience over US alignment.

Key Picture: Dollar share of global cross–border lending (to all borrowing countries), by lender



Source: Federal Reserve

Introduction

As Donald Trump's return to the global stage fuels policy unpredictability, countries and investors alike are accelerating efforts to hedge against US instability. EM markets are reassessing their dollar exposure, while capital flows shift in response to tariffs, sanctions, and political interference in institutions once seen as anchors of global stability.

The Dollar's Decline as Investor Confidence Erodes

De-dollarization has been underway for over a decade, taking multiple forms most visible led by BRICS countries and major commodity exporters. But analysts argue it gained fresh momentum after the war in Ukraine started, when sweeping Western sanctions triggered alarm among non-Western powers – above all China. The response has bee steady: a gradual shift away from Western financial infrastructure, including banks, currencies and payment systems. More recently, Trump-era tariffs and the political fallout surrounding Moody's US debt downgrade have added to the urgency for emerging economies to hedge against dollar dominance.

The proposed Mar-A-Lago Accord represents a dramatic attempt to tackle both the US's chronic trade imbalance and fiscal fragility, by weakening the dollar and limiting foreign appetite for US assets. The plan envisions discouraging overseas demand for Treasuries through ultra-long-term bonds and imposing "user fees" on foreign-held Treasuries to penalize dollar accumulation, which was eventually included in the so-called Big, Beautiful Bill.

In the meantime, Trump's erratic tariff threats have sent markets into a tailspin. Investors are not seeking safety in Treasuries, as they typically would during a selloff, but are instead dumping both equities and sovereign bonds. In a standard crisis, falling stock market would drive a rally in bonds. However, because of the extreme uncertainty, Treasury securities were also being sold. The simultaneous decline in the dollar and Treasury prices in April signals not just volatility, but a deep erosion of investor confidence – reminiscent of the UK's reaction to Liz Truss's ill-fated mini-budget.

Compounding the loss of investor confidence is a deeper unease about institutional erosion at home. The rule of law appears increasingly politicised, and the Federal Reserve's independence—once considered sacrosanct—is now under open question. That, too, has rattled markets.

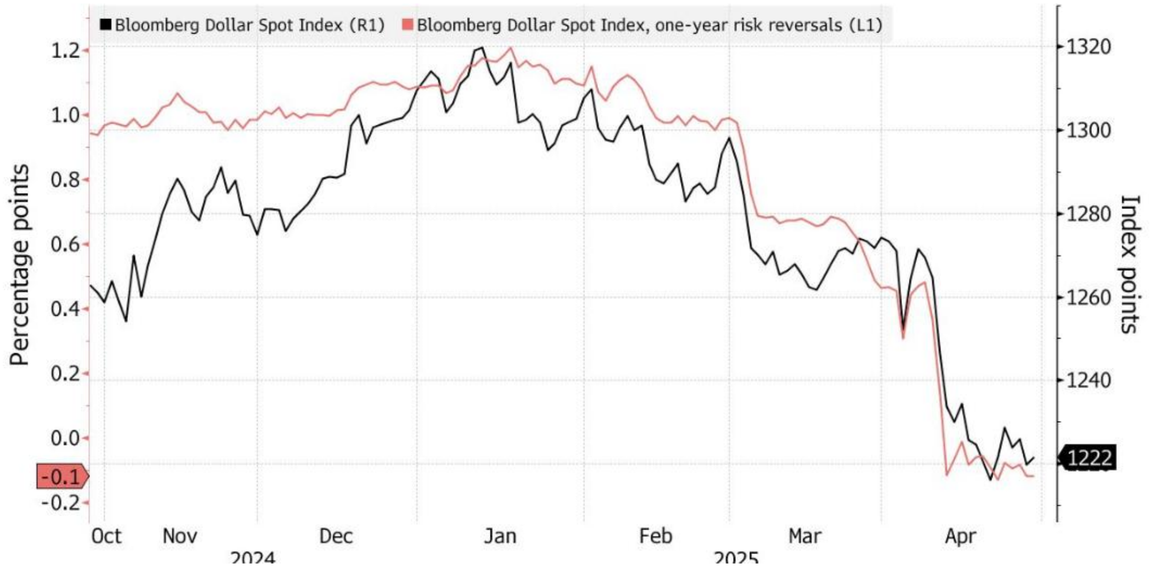
April has been the worst week for the dollar since 2022. As of the end of May, the dollar index was down about 4% amid a selloff in US stocks and Treasuries triggered by Trump's chaotic tariff rollout (**Figure 1**). Options markets reflect the most bearish dollar sentiment since 2020, with strong demand for downside protection. The US dollar index has fallen nearly 9% between Trump's return on Jan. 20 and April 25—its steepest drop over a president's first 100 days since at least 1973 (**Figure 2**). Historically, the dollar has averaged a 0.9% gain during this period. The last major exception was the 1971 "Nixon shock," which led to the collapse of Bretton Woods and a sharp dollar decline.

China's Strategic De-Dollarization

China's heavy exposure to US dollar assets is rooted in its decades-long export-driven growth. As the country accumulated large trade surpluses with the West, it recycled much of the inflow of dollars into US Treasuries—supporting Washington's budget while building up China's foreign exchange reserves, which peaked at nearly $4 trillion in 2014 and have remained above $3 trillion since.

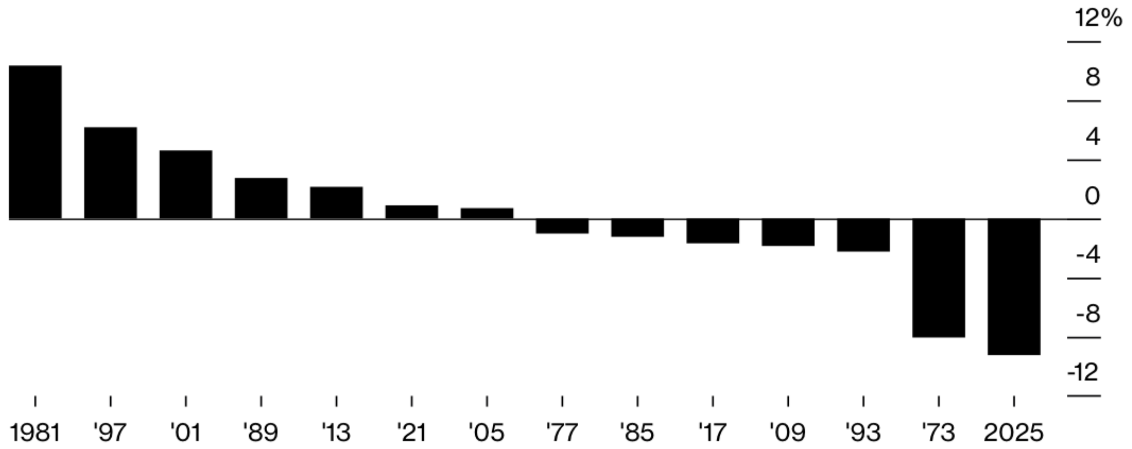
China is accelerating efforts to de-dollarize its $3.2 trillion in reserves, cutting its US Treasury holdings by 17% from 2015–22 and a further 27% since 2022. Fearing asset freezes like those imposed on Russia and viewing Trump's proposed "Mar-a-Lago Accord" as a potential default, Beijing is exploring alternatives—ranging from currency diversification and sovereign debt of other advanced economies to increased gold purchases.

Figure 1: Traders Sell the Dollar



Source: Bloomberg

Figure 2: Dollar Tumbles



Source: Bloomberg

While massive dumping of Treasuries is seen as impractical, Safe (China's foreign exchange regulator) is pursuing a strategy of "tengnuo"—cautious maneuvering—by shortening portfolio durations and reallocating maturing Treasuries to MBS and non-Western assets, including those in Hong Kong. Yet the global shortage of safe, liquid alternatives limits how far China can go.

To mitigate growing financial and geopolitical risks, China has quietly diversified the composition of its vast foreign reserves through a series of deliberate strategic moves. One major shift has been into US agency bonds. Between 2018 and 2020, China increased its holdings of debt issued by government-sponsored entities like Fannie Mae by 60%, reaching $261 billion. These bonds offer returns slightly above US Treasuries while maintaining similar credit ratings, making them an attractive alternative within the American financial system.

At the same time, China expanded into higher-yield private investments. Using its discreet New York-based arm, Rosewood Investment Corp, Safe has explored opportunities in private equity, commercial real estate, and infrastructure assets such as data centers—assets that can provide more robust returns than traditional government bonds.

China has also turned to gold. After years of minimal movement, the central bank began steadily increasing its gold reserves in late 2022, with holdings rising by 18%. Gold now comprises around 6% of the portfolio, up from just 2% a few years prior—a signal of Beijing's intent to hold more crisis-resilient and politically neutral assets.

In tandem, Safe has shortened the duration of its US government bond holdings. By favoring shorter-term debt, China has increased the liquidity of its portfolio and reduced its exposure to long-term interest rate risk—a prudent adjustment in today's volatile macroeconomic environment. Finally, Safe has diversified its asset management structure, shifting more funds to non-US institutions. This reduces the risk that Chinese assets could be frozen by Western governments, as geopolitical tensions continue to rise.

In particular, Chinese banks, major lenders in emerging Asia, have already sharply reduced their dollar-denominated lending since early 2022, accelerating the region's shift away from the dollar. While direct data is limited, Chinese banks account for about 35% of cross-border lending to emerging Asia, and their global shift from dollar to RMB lending closely tracks regional trends (**Key Picture**). Since Q1 2022, dollar lending by Chinese banks has dropped significantly, offset by a rise in RMB loans—doubling RMB's share in their overseas lending to nearly 40%. Even when excluding related jurisdictions like Hong Kong, data confirms a clear move toward RMB lending across emerging Asia.

Resilient Emerging Markets Amid Global Turmoil

Emerging-market assets have held up well amid recent market turmoil. As US stocks plunged—wiping out $5 trillion and marking the steepest two-day S&P 500 drop since March 2020—EM local debt posted its best week in a month, with rates swaps in Brazil and Chile seeing their biggest weekly declines since 2022.

Inflation Risks and Policy Divergence

Trump's key policies—tax cuts, higher tariffs, and reduced immigration—are likely to be inflationary, limiting the Fed's room to cut rates. Risks are skewed toward an even slower easing cycle, which would constrain emerging markets central banks that only began cutting rates broadly in September. Thad said, As Fed-sensitive central banks like Mexico's and Indonesia's will likely proceed cautiously to preserve yield differentials.

Betting on Lower Rates in EM

Amid the market volatility triggered by Trump's trade war, investors are increasingly betting on falling global interest rates. Especially given that, interest rates in EMs remain historically high, offering room for cuts and creating attractive entry points. Many are turning to local-currency bonds in emerging markets, where yields remain attractive and central banks have ample room to cut rates. Others are expressing this strategy through swap "receivers," or bets that the floating leg of interest-rate swaps will decline.

A key driver for emerging-market local debt is the Dollar. A softer dollar boosts returns for US investors in EM local bonds, as they convert proceeds back into dollars. Expectations of further dollar weakness are lifting the appeal of local bonds in countries like Turkey, Brazil, and Mexico. Turkey's central bank may resume rate cuts as dollarization fears ease, with 10-year bond yields still near 32%. Brazil and Mexico offer similarly high yields.

On May 15, the Bank of Mexico (Banxico) cut its benchmark interest rate by 50 basis points to 8.50%, reflecting concerns over a potential recession fueled largely by Trump's trade policies. Bank Indonesia cut its benchmark interest rate by 25 basis points to 5.50%, resuming its easing cycle after three holds. The move was driven by easing inflation, slower growth, and a more stable rupiah, giving the central bank room to support the economy. Governor Perry Warjiyo said stronger policy action is needed to boost growth, which slowed to its weakest pace in over three years in Q1. The bank slightly lowered its 2025 growth forecast to 4.6–5.4%, citing global uncertainty and US tariffs as headwinds. Despite recent fiscal measures raising concerns, the rupiah has rebounded over 2% since April and is up 1.13% month-to-date, aided by bank's stabilization efforts. Analysts expect further easing, forecasting an additional 50 basis points of rate cuts this year.

The impact, however, depends on the version of Trump that emerges. A market-friendly Trump 2.0—focused on tax cuts and deregulation—could support risk appetite and global trade, easing pressure on EM currencies. Conversely, if Trump returns with full Republican control and pushes aggressive changes on trade, immigration, and onshoring, inflation could surge. A larger fiscal deficit and reduced labor supply from deportations would weigh on growth and raise risk premia, keeping EM investment and sentiment subdued.

US-China Decoupling and EM Spillovers

This escalation would deepen US-China economic decoupling, aiming to reduce the trade deficit and reliance on Chinese goods. The impact on China—and its EM trading partners—could be severe, with average bilateral tariffs potentially doubling. China is expected to respond with stimulus, though we have downgraded its 2025–26 growth forecasts by 0.2%.

Countries with close trade ties to China or those accused of re-exporting Chinese goods—like Vietnam and Malaysia—may come under pressure. FX depreciation could cushion the blow, but US accusations of currency manipulation might limit this option. Other exporters, such as Thailand or emerging Europe, could also be adversely affected.

Some EMs, however, could benefit. Mexico—now the top exporter to the US—is well-positioned. While Trump may threaten to renegotiate USMCA, a full reversal appears unlikely. These threats likely aim to extract concessions on migration or border issues. Other EMs may also secure bilateral trade deals with the US, even if China remains excluded.

Gold's Comeback

Gold's rally, up 19% in 2025 and 71% since late 2022, is being fueled by central banks diversifying away from the US dollar amid growing uncertainty over Trump's trade and foreign policies. Since Russia's invasion of Ukraine in 2022, central banks have doubled their annual gold purchases to over 1,000 metric tons. In Q4 2024, following Trump's election win, central bank gold buying surged 54% year-on-year. Emerging market central banks could significantly increase holdings—currently just 10% of their assets—up to 30%, requiring an additional 11,000 tons.

With Trump's tariffs, global tensions, and inflation concerns rising, gold is gaining favor over US Treasuries as a safe-haven asset. Central banks now account for 23% of global gold demand, and despite high prices, they are unlikely to slow purchases. Some may avoid public disclosure, fearing retaliation from a Trump administration wary of de-dollarisation

Trump's Tariffs and A Turning Point in Global Trade

As the US, the world's largest importer, erects sweeping trade barriers, Trump's 2025 tariff regime may signify the formal end of the preferential global trade order. What this shift reveals is that the path to economic emergence is no longer paved with trade access. Instead, it will require political alignment, security cooperation, and economic resilience in an era defined by protectionism.

In Asia, the ripple effects are sharpest. Southeast Asian economies like Vietnam, Malaysia, and Thailand have emerged as early beneficiaries of supply chain realignments, attracting FDI and boosting exports to the US. Yet this reorientation is not without risks. Sectors such as chips, autos, and pharmaceuticals are particularly vulnerable, and countries like India and Malaysia face challenges from sector-specific and reciprocal tariffs. Still, the narrative that Vietnam's export growth is merely Chinese rerouting is overstated—its rising trade is backed by a strong foundation of regional supply chain integration and surging North Asian investment.

Latin America, meanwhile, is caught between dependency and resilience. Mexico—deeply entwined with the US industrial base—stands to lose the most. However, Mexican Economy Minister Marcelo Ebrard said that cars assembled in Mexico and exported to the US will face an average tariff of 15%, not 25%, due to additional discounts on local products. Brazil, Chile, Peru, and Colombia are also vulnerable due to their reliance on commodity exports, which are sensitive to falling Chinese demand and global price shifts.

Conclusion

The world is entering a new phase—one where the US no longer guarantees market stability or open trade. For emerging markets, success will no longer hinge on proximity to the US dollar or access to American consumers. It will require strategic neutrality, institutional resilience, and regional integration.

Yet, it is important to recognize that diversification and de-dollarization at the margins do not spell the end of the dollar's reserve currency dominance. The greenback continues to benefit from powerful network effects, deep capital markets, and unparalleled liquidity—keeping it at the heart of global finance and trade.

Still, the shift is real. As Singapore's foreign minister recently observed, the dismantling of the rules-based economic order by its own founder is prompting governments and investors to reduce their reliance on the US This trend is accelerating not only due to Trump-era disruptions but as part of a broader global departure from the ideology of hyper-globalization.