

Could the USA default on the dollar?

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The world's financial system depends on the dollar, and the man in charge of it is mad, bad, or both. Where are we with the management of the world's reserve currency need in that case?

https://www.youtube.com/watch?v=V4Skn_0INaM?si=zR8KL_1EWaNMv1BW

This is the audio version:

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This is the transcript:

Could the USA default on the dollar? It's a good question and one that needs to be asked because a recent downgrade by Moody's rating agency suggests that they have doubts about the credibility of the dollar now.

Leading economists in the USA, like Paul Krugman, are asking whether Trump is actually trying to destroy the dollar as a reserve currency for the world.

And Martin Wolf, a noted commentator in the UK's Financial Times, has asked the same question.

The thing is, nobody can be sure what Trump is doing.

As Martin Wolf has noted, the US has 26% of world GDP at present. In other words, it's got the clout to supply the world with a reserve currency. And as a consequence, 58% of all the world's global reserves are denominated in dollars right now, ahead of the Euro's 20%, with everybody else lagging behind.

81% of trade finance at the moment, and 48% of international bonds, as well as 47% of cross-border banking claims, are all denominated in dollars.

We have a dollar hegemony. It dominates world trade, world finance and world reserves.

Now, that's important, but first of all, we do need to understand precisely what a reserve currency is.

There have only ever been two reserve currencies in the world. One was the UK pound sterling, and that diminished in power after the First World War, and ever since then, for near enough a century, the dollar has acted as the world's reserve currency. It is the currency which the world wants to save in. This is an immensely important point, which I don't think that Donald Trump understands in the slightest.

To provide a reserve currency, a nation has to have a number of characteristics.

First of all, it has to be a major trading nation, and as I've just explained, the USA is that. It provides a quarter of the world's GDP and a lot of its trade as a consequence.

It also has to be the creator of a stable currency, and let's be clear about it, the dollar has, broadly speaking, fulfilled that role, although there were times when you might wonder about that, particularly during the Paul Volcker era of the 1980s, when US interest rates were incredibly high.

But perhaps most importantly, the country that is going to supply the world's reserve currency has to be willing to act as the borrower of last resort in the world.

In other words, when everybody else wants to flee to safety, when they want to get out of the currencies they're in because they no longer trust them, that country has to be willing to borrow the funds that other people want to deposit with it. And that is exactly why, at present, the US has \$36 trillion of borrowing. It's not just because it wants to run a deficit; it's because the world wants to save with it.

And that is a vital thing to understand. If someone is going to replace the US as a world currency, not only have people got to trust them to deposit funds with, but they've got to be willing to use them, and it's not clear at the moment that anybody else has that power. And nor have they got the major financial services centre to back up the trading that running a reserve currency requires.

The UK has, but hasn't got the economic clout.

The dollar has got the economic clout. It has got the financial services centre. But, is Trump willing to actually play the game of running a reserve currency anymore?

No one knows what Trump will do with regard to letting the Federal Reserve manage the dollar in the future. He's in dispute with it. Is it going to have the power that Jay Powell wants to still set interest rates, or is Trump going to demand that back?

No one knows what he's actually going to do with regard to debt. The current bill before the House of Representatives, his Big Beautiful Act, will increase federal debt by \$3 trillion. But is that his real plan? Is it sufficient? Will it meet the world's needs for running a reserve currency? Who knows?

And no one also knows what Trump's plans are with regard to deflating the value of the dollar. His tariffs are meant to achieve that goal, but will they, and what will the consequence be, particularly for the dollar as a reserve currency? We just don't know.

And that is the problem that we face.

No one knows.

No one knows who they can trust.

When no one knows who they can trust, no one knows where they can put their money.

And no one knows where to put money when the world has a crisis.

And the crisis the world now has is that money wants to pile into a reserve currency, but nobody is sure that the dollar is really that reserve currency anymore, or if there's any alternative to it.

That is the crisis that we now face.

The crisis we have is that the world's reserve currency is at the epicentre of the financial crisis we might face.

So what can be done about this?

In the short term, my suggestion is precisely nothing. Whatever Trump decides will happen. There is quite simply no alternative at this moment to the dollar. That is the only game in town.

What we do know is that some countries might increase their reserve holdings of Euros or sterling or Chinese currency, but they're going to be insignificant changes in comparison to the amount still held in the dollar.

in the longer term, many of the BRICS countries - those are the southern developed countries like Brazil, and India, and China, and South Africa, and maybe Russia - have been in discussion about creating a new reserve currency, and that would be based on a basket of their currencies from multiple states. But although the idea looks good, there are several problems.

The first one is very obvious. Who will run it? Would it be the World Bank, or someone else? It's unlikely to be the World Bank. That is too associated, first of all, with the USA, and secondly, with the post-war consensus, which was heavily dominated by Europe and the USA, and the countries who want this reserve currency are rejecting that colonial model of economic management.

So, who will it be? Nobody knows. It will take years to resolve just that one question.

And then, who would trust this currency? Because the question would be, who is really behind it and who is really managing it?

And, anyway, the third critical question is, who actually is the borrower of last resort in such a system? When you've got a bundle of currencies, it's not one country that can act as the borrower of last resort, as the USA does now, but a whole host of countries. And yet what we know is that some of the countries who might be involved in this do, in fact, run significant surpluses. China does, for example. It wants no part in playing a role as a reserve borrower of currency when it's actually looking for a place to deposit its excess funds. So, there's real confusion here.

And, anyway, who sets the rates for this currency? Both the exchange rate, at least as regards to target, and the interest rate, which of course does have an implication for that exchange rate, and how are they going to do it?

The point is, the problems in setting up such an alternative reserve currency are massive, and nobody really knows what the solutions are.

What we can all say with ease is that the solutions would be easier to find if the US was involved, the EU was involved, China was involved, and the UK were involved, because either they've got the experience, or the financial clout to bring to the game to help give such a currency credibility. But at the moment, they aren't playing ball. So, at the moment, the backstop that is required to make an alternative world reserve currency work isn't really available.

And in particular, note that China cannot provide this. That's because, as I've already noted, it runs a massive surplus of savings inside its economy, so it is actually looking to save money outside its economy, rather than take deposits from elsewhere. But also, there's a simple question of trust. Around the world, there is a lack of political trust in China still, and frankly, there's also a lack of trust in the strength of its domestic economy and the data that is produced about that economy, which still has the feeling

that, on occasions, it may not be wholly reliable. So China isn't in the game for actually offering this role.

And nor, I would suggest, is Europe or the Eurozone, not least because the Eurozone is of course dominated by Germany. But Germany cannot play this role single-handedly.

So, where are we?

We are in trouble.

The result is that we are dependent on Trump.

Our fate lies in the hands of a madman and the idiots around him, sitting in the White House.

Trump could cause a default on the dollar. Don't doubt it. It's possible that he might either push Congress to this situation at some time in the future, or his policies could simply produce this outcome. His tariffs could, for example, cause such a revaluation of the dollar that an effective default might take place.

And he could still crash the US economy. That is entirely plausible. What he's doing is by no means certain to work. And there could be a meltdown in the US when things like his cuts to social security in that country create such a backlash, or such a lack of employment, and a crisis with regard to capacity to spend, that it could go into recession very easily, whatever the rest of the world might do.

So Trump could cause the value of the dollar to fall creating a global financial crisis.

Don't rule it out.

But there again, he might not.

The future hangs by a very thin thread right now, and at the top of that thread is Donald Trump. It's not a comfortable place to be.