

MACROCOSM

Is Saudi About to Ditch the Dollar?

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Even if it's true that a 50-year US/Saudi agreement is about die, does it make any difference?

It's not unusual in client conversations, after we take a victory lap for our long-standing no-recession call, to be asked, "OK, fine, but what can go terribly, terribly wrong *now*? Surely we are facing *both* a US government debt crisis and a trend away from the US dollar's status as the world's reserve currency."

We share concerns about the level of US government debt, but observe that *markets are giving no indication at all that it is at critical levels*, and that properly contextualized the raw level of it isn't as fearsome as it seems (see ["Video: What you're not hearing about the crisis in federal spending, debt and debt service"](#) May 6, 2024).

There's similarly little market evidence of a move away from USD – if there were, we'd see a weak USD when in fact we see what is arguably a too-strong one (see ["Video: What you're not hearing about foreign holders selling US Treasuries"](#) April 15, 2024).

Last week there was an interesting new development. [It was widely reported](#), especially in the [FX, crypto and precious metals communities](#), that *a multi-decade agreement between the US and Saudi Arabia for the Kingdom to trade its oil only for dollars, and to reinvest surpluses in US Treasury securities, had lapsed*. Some are reporting it as a deliberate and pro-active ["exit,"](#) with Saudi ["ditching the dollar."](#)

This would seem to be the beginning of the end of the "petrodollar" era that began in the 1970s. Indeed it could be the beginning of the end of the dollar standard that has reigned since the 1940s – potentially to be replaced by [a "BRICS currency" standard](#), led by China.

But, as always with geopolitical developments, there's more than a little truth to it, but there's not much transparency on what's really happening, and certainly no context. ...so where shall we begin?

- *We should start by noting that the US itself potentially ended the petrodollar regime*, indeed the dollar standard itself, more than two years ago when, jointly with Europe, it banned purchases of Russian crude oil and refined products and [kicked Russia's banks out of the SWIFT global dollar payment system](#) as punishment for

Update to strategic view

FX, US BONDS, US MACRO, ASIA MACRO, OIL: There are reports that a 1974 agreement between the US and Saudi Arabia requiring the Kingdom to trade oil exclusively in USD, and reinvest surpluses in US Treasuries, is about to expire without renewal. It's not clear such an agreement actually exists. The actual history of Saudi holdings of US Treasuries is not consistent with such an agreement. Saudi has been threatening the Biden administration with abrogating USD-exclusivity for two years, will Biden has vilified the Saudi crown prince and accommodated Iran. After the October 2023 Hamas attacks, Biden has reversed course and is working with Saudi on military assistance. Even Saudi's total abandonment of USD-based trade would be a drop in the bucket in the context of total USD trade. USD remains the most reliable and stable currency. Reports that China is developing a gold-backed RMB appear to be baseless. Such backing would have to include exchange-rate fixity and the market's...

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the invasion of Ukraine. This left China and India as the only major markets willing to buy Russian petroleum exports and required them to remit in RMB or INR – in a stroke, de-dollarizing about 10% of global cross-border oil trade. *The US may regret giving China and India the idea – but it's not exactly as though those major oil counterparties are fleeing USD by choice.*

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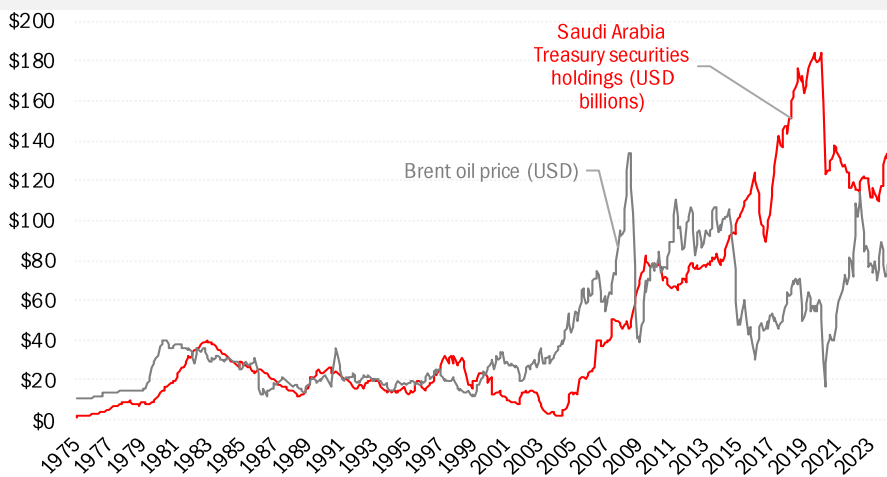
...belief that a communist dictatorship would honor it. Without that, RMB cannot compete with USD as a store of value, which is the important dimension of USD dominance, far outweighing USD's transaction role.

Now about that 1974 agreement for Saudi Arabia to trade oil exclusively in dollars and buy Treasuries for fifty years.

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- It seems that there were two agreements, one in June and another in July.
- The June agreement was a pact set up between US Secretary of State Henry Kissinger and Saudi Prince Faud Ibn Abdel Aziz. As far as we have been able to discover as of this writing, the text of the agreement has never been made public. According to reporting at the time, the pact established commissions to explore various forms of cooperation – but if there was anything about the dollar or Treasury securities holdings in it, [the New York Times front-page story](#) didn't think it was important enough to mention. The closest it gets is to say the US and Saudi “will consider cooperation in the field of finance.”
- [A 1979 General Accounting Office report](#) on the June agreement mentions only that one of its intentions was to facilitate “recycling petrodollars” through Saudi commitments to buy US exports, and to establish various funding accounts with the US Treasury. *That's all folks, for references to USD or Treasuries.* More attention is paid to joint US/Saudi efforts to develop solar energy.
- [A lengthy 2016 Bloomberg story](#) that purports to be a “now it can be told” narrative history seems to describe a separate agreement in July, negotiated by US Treasury Secretary William Simon and Saudi King Faisal bin Abdulaziz Al Saud. The story never mentions

Saudi holdings of US Treasury securities since 1974 agreement



Source: [US Treasury TICS](#), [FRED](#), TrendMacro calculations

anything about Saudi's commitment to trade exclusively in USD. But it does speak of a commitment for Saudi to "plow billions of their petrodollar revenue back into Treasuries and finance America's spending." The June agreement anticipated Saudi Treasury holdings as a rest-stop on the road to *Saudi's spending* on American goods and services.

- Bloomberg claims in the story that its Freedom of Information Act request forced the Treasury to break out Saudi holdings of Treasury securities in its monthly [Treasury International Capital System report](#) (please see the chart on the previous page). Prior to that, according to Bloomberg, Treasury had been honoring a commitment to King Faisal that Saudi's "Treasury purchases stay 'strictly secret.'"
- Well... they are such a secret that, according to the data that Bloomberg claims it forced into the light, Saudi holdings of Treasury securities were the same in 2005 as they were thirty years earlier at the time of the agreement (please see the chart on the previous page). Over half a century, there's been basically random variability in those holdings. They don't even track oil prices in any consistent way.

Setting aside the matter of the agreement or agreements, what would happen if for whatever reason Saudi starts taking currencies other than USD in exchange for oil?

- For one thing, it's not a new idea. *Saudi has been brandishing this possibility for more than two years* – [talking about accepting RMB](#) in payment for its substantial exports to China. It's part of a feud with President Joseph R. Biden, Jr. in the wake of [his vilification of Saudi Crown Prince Mohammed bin Salman](#), and his tacit relaxation of sanctions against Iran in a so far vain attempt to restart the Obama-era nuclear deal abrogated by President Donald J. Trump.
- But now, after the Hamas terrorist attacks against Israel last year, the Biden administration has had to change tack. [Reportedly](#), the US is on the cusp of a deal with Saudi for military assistance in exchange for the Kingdom's normalization of relations with Israel.
- But still... what if?
- If all that happens is Saudi accepts non-USD payments – and if every buyer of Saudi oil, including the US, pays in some other currency – then that, and that alone, is a drop of about \$77 billion in annual USD trade flows. To put that in context, [total global import/export trade in 2022 was \\$31 trillion](#), of which [something like 61%](#), or \$19 trillion, was settled in USD).
- It's easy for us to imagine Saudi accepting EUR, JPY or GBP instead of USD. Those are stable and freely convertible currencies issued by wealthy democratic nations that (mostly) honor the rule of law and the sanctity of contract. Would Saudi accept RMB – a non-convertible currency issued by a kleptocratic communist dictatorship? Highly doubtful.
- And even if they did accept it in trade, would they hold it? Or would they get out of it immediately and just store their wealth in USD to

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the same extent they are doing so now? If not, the volume of FX transactions in USD would remain the same as it is now (it's just that Saudi would make the conversion, not its customers). And the USD role as a store of value would not change.

- The store of value role could change if RMB were convertible into gold – indeed, in an important sense, such convertibility would make the RMB the world's most attractive currency as a store of value. Indeed, if RMB were truly gold-backed, it would not just be Saudi that would start using it, and it wouldn't just be for the oil trade.
- A very widely read 2017 [article in Nikkei Asia](#) claimed that China was setting up a futures market in oil, whose contracts would settle in RMB that would be freely convertible to gold. Indeed, the next year, the [Shanghai International Energy Exchange started trading oil contracts](#) denominated in RMB – but [there is nothing](#) that makes the cash settlement of deliveries against them convertible into gold in any special way. By which we mean that any currency can be used to buy gold at the market price, although doing so is more difficult in China (as most financial transactions are). As far as we can tell, there is nothing here that provides for conversion of RMB into gold at all, and certainly not a fixed quantity of gold – and without that fixity, there is no gold standard.
- And fundamentally, it seems most out of character for China's totalitarian regime to cede control of currency policy to markets – which is what such a gold standard would necessarily entail.
- To be sure, the People's Bank of China has been accumulating gold (although it seems to be on pause [at this exact moment](#)). But we don't see how its doing so constitutes any kind of reliable promise to the international community that RMB holdings would ever be convertible in a crisis.
- We'll take Jerome Powell's implicit commitment to settle up in gold if worse comes to worse over Xi Jinping's.
- Without some other currency becoming vastly more reliable and attractive as a store of value, we don't see how there could be any substantial shift away from USD as the world's go-to trade and reserve currency. Why would there be? There is a vast investment in the status quo. There would have to be a real reason to change it. Right now there is no reason.

Bottom line

There are reports that a 1974 agreement between the US and Saudi Arabia requiring the Kingdom to trade oil exclusively in USD, and reinvest surpluses in US Treasuries, is about to expire without renewal. It's not clear such an agreement actually exists. The actual history of Saudi holdings of US Treasuries is not consistent with such an agreement. Saudi has been threatening the Biden administration with abrogating USD-exclusivity for two years, while Biden has vilified the Saudi crown prince and accommodated Iran. After the October 2023 Hamas attacks, Biden has reversed course and is working with Saudi on military assistance. Even Saudi's total abandonment of USD-based trade would be a drop in the bucket in the context of total USD trade. USD remains the most reliable

and stable currency. Reports that China is developing a gold-backed RMB appear to be baseless. Such backing would have to include exchange-rate fixity and the market's belief that a communist dictatorship would honor it. Without that, RMB cannot compete with USD as a store of value, which is the important dimension of USD dominance, far outweighing USD's transaction role. ▶