

Policy Brief

SCENARIOS FOR DE-DOLLARIZATION

Risks & Opportunities for the Gulf

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Geopolitical tensions, economic sanctions, tariff mechanisms, and selective trade settlement in non-dollar currencies have prompted renewed scrutiny of the United States (US) dollar's global role. Yet, despite gradual diversification trends, the dollar remains the dominant reserve, invoicing, and settlement currency worldwide. Rather than the imminent displacement of the US dollar, the resurgence of debates around de-dollarization reflects broader shifts in global economic governance. Recent geopolitical developments in the Gulf, including disruptions to key energy transit corridors in the Strait of Hormuz, have further sharpened these debates by linking monetary resilience to the stability of global supply chains.

Today, the US dollar accounts for roughly 56-57% of allocated foreign exchange reserves according to the International Monetary Fund's (IMF) currency composition of official foreign exchange reserves (COFER).¹ Analyses continue to underscore that dollar dominance is sustained by the US' deep capital markets, legal predictability, and powerful network effects due to the predominant use of the dollar, rather than by economic size alone.

For the Gulf Cooperation Council (GCC) states, the policy question is thus not whether the dollar will collapse but how dollar-anchored monetary systems can remain resilient amid incremental diversification and geoeconomic fragmentation. This Policy Brief argues that de-dollarization, in the Gulf context, should be understood as gradual hedging within a structurally dollar-centric system. The strategic objective is calibrated resilience and preserving the credibility of their exchange rate pegs while strengthening institutional capacity to manage monetary shocks.

WHAT DOES DE-DOLLARIZATION MEAN FOR THE GULF?

The term de-dollarization comprises several distinct trends. First, some economies have expanded bilateral trade settlement into alternative currencies. While hydrocarbon exports remain overwhelmingly priced in US dollars, occasional discussions of Renminbi (RMB) settlement, given China's status as the world's largest crude oil importer, reflect broader diversification conversations. However, recent currency research reports that the Renminbi's internationalization remains constrained by the Chinese government's capital account limitations and China's limited financial market depth.^{2,3}

Second, monetary authorities globally have incrementally diversified their portfolios over time. This diversification has been gradual and measured rather than disruptive. While the use of alternative currencies in trade invoicing and reserve allocation has modestly increased, the US dollar continues to anchor global liquidity provision, cross-border settlements, and sovereign reserve portfolios. The pattern reflects port-

folio adjustment at the margins rather than the systemic displacement of the dollar.

Third, alternative payment infrastructures have emerged alongside the US dollar-based Society for Worldwide Interbank Financial Telecommunication (SWIFT) network. While systems such as China's Cross-Border Interbank Payment System (CIPS) and Brazil's Pix digital payment system⁴ are frequently cited in discussions of financial fragmentation, global payment volumes remain heavily dollar-based, and the broader financial ecosystem continues to operate within a predominantly dollar-based architecture.

For the GCC states, therefore, de-dollarization does not imply abandoning pegs or realigning monetary anchors, but it does raise questions regarding the incremental diversification in trade settlements, reserve composition, and payment channels. These developments must be assessed through the lens of peg sustainability, reserve adequacy, and fiscal resilience.

THE STRUCTURAL FOUNDATIONS OF THE DOLLAR-GCC ALIGNMENT

The Gulf's monetary alignment with the US dollar is rooted in structural integration dating back to the 1970s. Oil exports consolidated around US dollar invoicing, embedding the currency into global energy trade. Simultaneously, US Treasury markets provided unparalleled depth and liquidity for recycling hydrocarbon revenues. Today, regional currencies, apart from Kuwait's basket arrangement, remain tightly pegged to the US dollar.⁵ By anchoring domestic currencies to the US dollar, policymakers import monetary credibility and reduce exchange-rate volatility in hydrocarbon-dependent economies.

It is important to clarify that GCC currency pegs are not formal bilateral treaties or executive agreements with the US. The IMF classifies GCC arrangements as conventional peg regimes under domestic exchange-rate policy frameworks.⁶ While US-GCC relations are underpinned by extensive energy, security, and economic cooperation, publicly available policy and congressional reporting does not indicate the existence of any currency-peg treaty or expiration-based monetary agreements between the US and GCC states.⁷ Exchange rate pegs in the GCC are therefore unilateral monetary policy decisions undertaken by domestic central banks to preserve stability and credibility, rather than treaty-bound arrangements subject to renewal.

At the same time, participation in a dollar-anchored system entails structural alignment with US monetary conditions, including Federal Reserve interest-rate cycles and broader compliance with US financial regulations and sanctions frameworks, which shape global US dollar liquidity and cross-border settlement channels. A recent

strategic assessment describes this as the US dollar's ecosystem advantage.⁸ This describes a mutually reinforcing system linking trade, capital markets, and sovereign asset management. The scale and liquidity of the US Treasury markets, combined with institutional credibility, create a self-reinforcing monetary ecosystem. Sustained global demand for US dollar assets supports deep capital markets and underpins the currency's reserve appeal. For Gulf economies, this means continued participation in a financial system that still offers unmatched liquidity, institutional credibility, and global market reach.

COMPARATIVE LESSONS FOR CURRENCY-PEG RESILIENCE

Internationally, there are multiple examples of currency-peg regimes, ranging from single-currency pegs to basket arrangements where currencies are tied to an average of several weighted foreign currencies. While basket arrangements may provide incremental flexibility relative to single-currency anchoring, comparative experiences show that regime design alone does not determine resilience.

For example, Hong Kong's currency board maintains a US-dollar peg backed by foreign exchange reserves that exceed the monetary base. In this case, the credibility of the peg during periods of volatility depends primarily on reserve adequacy and institutional discipline. Panama's fully dollarized system offers another model, however, its deep integration into the US dollar ecosystem comes at the cost of independent monetary tools. Denmark's longstanding peg to the Euro (maintained through participation in the European Exchange Rate Mechanism II "ERM II") has kept the Danish Krone stable against the Euro since 1999, illustrating how policy consistency and institutional credibility support exchange-rate credibility. Finally, Singapore provides a different but instructive example. Though not US dollar-pegged, its managed exchange-rate regime is supported by active reserve management and liquidity discipline, with the exchange rate serving as the primary monetary policy instrument. This shows that currency exposure intersects with foreign policy considerations as much as with central banking practices. Ultimately, peg sustainability depends on maintaining adequate reserves, fiscal discipline, and institutional credibility during periods of external volatility. For the GCC, this suggests that strengthening institutional currency-risk monitoring and reserve discipline may enhance resilience more effectively than altering currency pegs alone.

ENERGY VOLATILITY & PEG SUSTAINABILITY

For hydrocarbon exporting states, monetary resilience is inseparable from the stability of energy revenue. Oil price volatility directly affects fiscal balances, which in turn

influence reserve accumulation and sovereign liquidity. When oil revenues are strong, fiscal surpluses reinforce the credibility of exchange rate pegs. When prices decline sharply, fiscal buffers narrow and reserve drawdowns may increase. Major oil-price downturns historically coincide with periods of fiscal stress and reserve pressure across hydrocarbon-dependent economies, making it harder to defend exchange rate pegs.

At the same time, historical patterns in global reserve composition suggest that periods of geopolitical and financial instability have generally reinforced, rather than weakened, the US dollar's systemic role within the international monetary order. Despite successive global crises over the last quarter century, including major wars, financial shocks, commodity downturns, and supply-chain disruptions, the dollar has remained the dominant reserve currency by a substantial margin. This reflects the continued depth, liquidity, and institutional credibility of the broader dollar-centered financial ecosystem, particularly during periods of heightened uncertainty. The sustainability of US-dollar pegs in the GCC therefore depends less on de-dollarization trends and more on maintaining sufficient reserves, prudent fiscal management, and credible monetary policy frameworks.

Figure 1: Global Composition of Official Foreign Exchange Reserves (2001-2025)

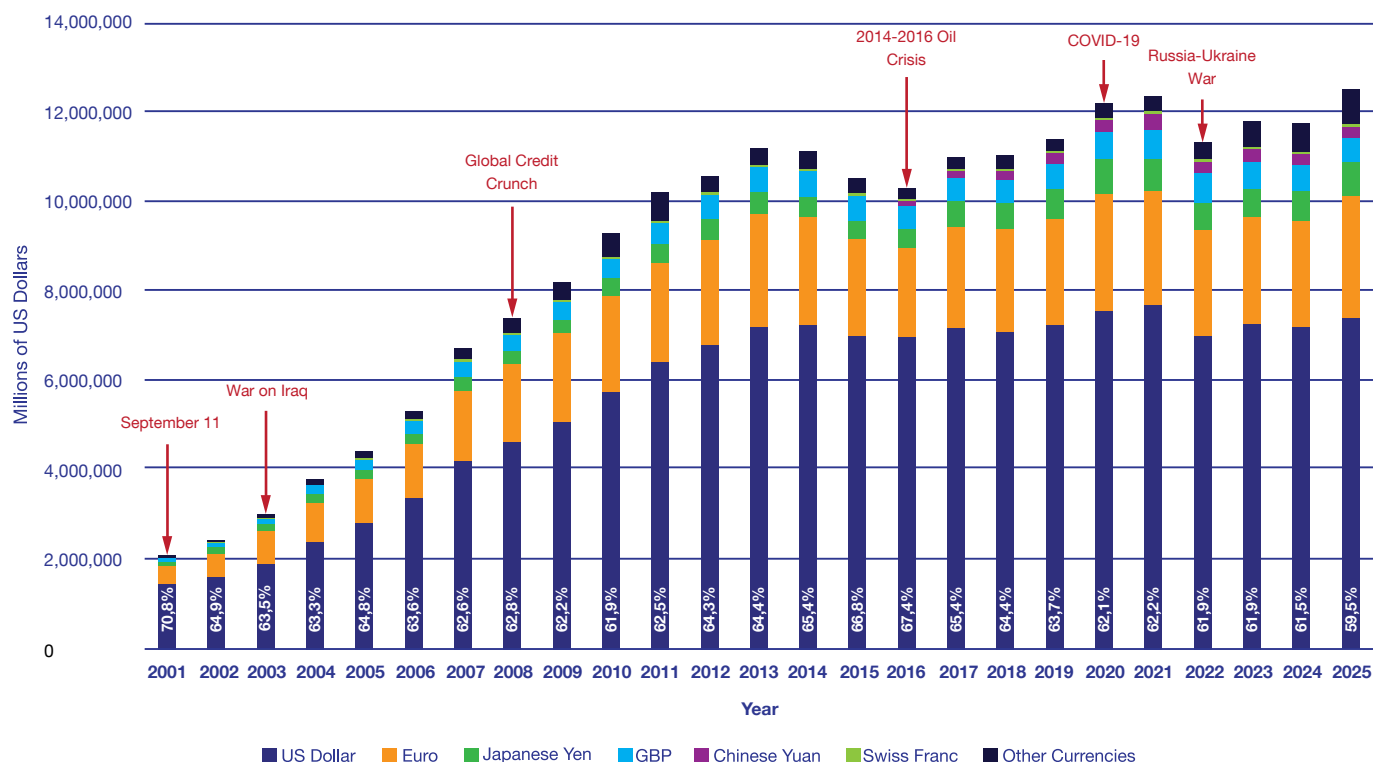


Figure 1: This figure was created by the author based on accumulated IMF's COFER data. It illustrates long-term trends in the composition of global foreign exchange reserves. While the share of US dollar-denominated reserves has gradually declined over time, the dollar continues to remain the dominant global reserve currency by a substantial margin despite geopolitical and economic shocks.⁹

THE IRAN WAR & ITS SYSTEMIC IMPLICATIONS

The Iran War has provided a real-time stress test of both global energy markets and the financial architecture underpinning them. The disruption of maritime flows through the Strait of Hormuz, whether through physical constraints, heightened risk conditions, or temporary closures, has underscored the extent to which financial stability in the Gulf remains inseparable from geopolitical developments.

While the global monetary system is often analyzed in abstraction, recent events highlight a critical linkage. Energy flow and currency stability are mutually reinforcing. Periods of disruption in Hormuz have contributed to heightened oil price volatility, increased insurance and transaction costs, and uncertainty in global supply chains. These developments, in turn, affect fiscal balances, reserve accumulation, and ultimately the credibility of exchange rate pegs across hydrocarbon-dependent economies.

At the same time, the crisis illustrates the persistence of the US dollar's central role. Even under conditions of geopolitical fragmentation, global energy markets continue to be priced, settled, and hedged predominantly in US dollars. Rather than accelerating systemic displacement, the recent instability has reinforced the dollar's function as a liquidity anchor during periods of stress. While alternative financial infrastructures and non-dollar settlement mechanisms promoted by states such as China and Russia continue to expand incrementally, the crisis did not produce a meaningful operational shift away from the US dollar in global energy trade. No alternative currency has demonstrated sufficient scale, convertibility, liquidity depth, or institutional capacity to emerge as a systemic substitute during this period of heightened volatility. Indeed, recent discussions surrounding potential US dollar swap arrangements with Gulf economies highlight this broader paradox within the evolving global monetary system. The Iran War and disruptions affecting energy flows through the Strait of Hormuz appear to have strengthened, rather than weakened, the Gulf's dependence on dollar-based financial architecture during periods of stress.

However, the long-term implications are more complex. Sustained geopolitical risk may accelerate incremental diversification strategies, including the expansion of non-dollar settlement mechanisms and alternative financial infrastructures. In this sense, geopolitical fragmentation does not immediately displace the dollar, but it does contribute to a gradual reconfiguration of the global monetary system at the margins.

TESTING DIFFERENT SCENARIO FRAMEWORKS

Historical experience across major geopolitical and financial disruptions suggests that systemic shocks tend to reinforce US dollar centrality in the short-term, even as they contribute to diversification pressures over the longer term. This dual dynamic

is critical for understanding how current geopolitical developments may shape future monetary trajectories.

Scenario 1: Continued dollar centrality

Under the baseline scenario, the dollar retains structural dominance. While its share of global reserves declines incrementally, no alternative currency replicates the scale, openness, and liquidity of US capital markets. This trajectory aligns with multiple [analyses](#) emphasizing the continued structural advantages of the US dollar-centered financial system.

For the GCC states, exchange rate pegs remain stable, hydrocarbon trade continues to be US dollar-dominated, and reserve diversification occurs only at the margin. Incremental hedging through modest reserve adjustments does not materially alter the underlying US dollar-centric architecture. This remains the most probable trajectory.

Scenario 2: Managed multipolarity

In this scenario, global currency usage becomes more distributed. Bilateral trade settlement in alternative currencies increases selectively, and monetary authorities and sovereign reserve institutions expand allocations beyond the US dollar. The US dollar remains central but shares space within a more diversified global system.

For GCC states, peg regimes remain intact but require more active liquidity management and diversified reserve strategies. Under such conditions, the key variable is not the denomination shift, but rather reserve adequacy and the institutional capacity to absorb volatility. Participation in a US dollar-anchored framework could continue to provide liquidity depth and financial integration, yet it would also require ongoing alignment with US monetary cycles and exposure to broader US financial regulatory decisions.

Scenario 3: A divided financial order

This low-probability, high-impact scenario involves intensified geopolitical fragmentation in which economic sanctions expand, financial systems partially diverge, and capital flows become more volatile.

Under such conditions, the sustainability of GCC states' currency pegs depends heavily on sufficient foreign exchange reserves and fiscal discipline. Liquidity management, rather than currency denomination alone, would become the central challenge. In this environment, exposure to sanctions regimes, cross-border payment restrictions, and shifts in global settlement infrastructure could increase transaction costs and heighten liquidity stress. However, even in a fragmented system, no single alternative presently replicates the depth of US dollar capital markets.

STRATEGIC RESILIENCE OPTIONS

A cautious resilience strategy for the GCC states should be grounded in maintaining confidence in the US dollar-anchored system while simultaneously building calibrated hedging mechanisms to manage exposure to external shocks. Strengthening sovereign debt management frameworks and reinforcing fiscal buffers remain central to sustaining peg credibility, particularly during periods of commodity price volatility. Expanding bilateral currency swap arrangements and enhancing payment infrastructure interoperability can further support liquidity resilience without altering the core monetary anchor. Equally important is the institutionalization of dedicated currency-risk monitoring capacity within monetary authorities and relevant economic and diplomatic institutions. In an era of heightened financial interdependence, currency exposure should be approached not only as a monetary consideration, but also as a broader dimension of economic and foreign policy coordination.

Resilience, however, does not require disengagement from the US dollar system. Rather, it requires strategic foresight within it, recognizing both its structural advantages, including liquidity depth and market access, and its systemic implications, such as alignment with US monetary cycles and exposure to executive financial measures. Crucially, recent geopolitical stress reinforces that reliance on the US dollar is not solely a function of alignment, but of systemic functionality. During periods of instability, the dollar continues to provide unmatched liquidity and settlement capacity. For GCC states, this suggests that resilience lies not in disengagement from the dollar system, but in managing its risk through diversification at the margins while preserving core monetary stability.

CONCLUSION

The global monetary system is evolving, but the centrality of the US dollar remains structurally resilient. Abrupt de-dollarization remains improbable under the current structural conditions. The recent Iran War and disruptions affecting the Strait of Hormuz further reinforce this dynamic. Despite growing discussions surrounding alternative financial infrastructures and non-dollar settlement mechanisms, the crisis did not produce a meaningful operational shift away from the US dollar in global energy markets. The crisis further illustrated the distinction between strategic diversification and systemic substitution. While some Gulf states had expanded economic, security, and diplomatic engagement with multiple global powers in recent years, the operational foundations of regional monetary and security stability remained closely tied to US-centered financial and security structures during periods of acute instability.

For the GCC, the strategic objective is not currency realignment but disciplined risk

management. Energy revenues, fiscal buffers, and reserve adequacy form the foundation of peg sustainability. By strengthening institutional foresight and pursuing calibrated diversification, Gulf states can navigate incremental global shifts while safeguarding monetary credibility. In a period of geoeconomic complexity and geopolitical stress, where energy corridors and financial systems are increasingly interlinked, resilience lies not in rupture, but in strategic hedging. The same forces that encourage diversification also reinforce reliance on established monetary anchors during periods of crisis. For the GCC states, the challenge is therefore not to replace the dollar, but to navigate its continued centrality with foresight, discipline, and institutional depth.

About the Author



Ahmed Buhejji is a current Bahraini diplomat and researcher with experience in bilateral and multilateral affairs. He is an inaugural Fellow of Fiker's Al-Khaleej program. From 2018 to 2023, he served in the Minister's office at Bahrain's Ministry of Foreign Affairs, overseeing political affairs, speechwriting, public diplomacy, and contributing to policy planning and development. Ahmed holds an MA in International Relations from Queen Mary, University of London, and an MSc in Business Administration from DePaul University. His research interests include geopolitical foresight, nation-branding, Gulf Cooperation Council (GCC) foreign policy, and the intersection of energy markets and diplomacy.

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