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The Rising Dollar Is Bringing the World Closer to Recession

By Uriel Araujo
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The US dollar's real effective exchange rate (its value against a trade-weighted basket of currencies, adjusted for inflation) is up 18% this year and in September it hit a 20-year high, according to the benchmark ICE US Dollar Index. The truth is that it remains overvalued and it has been pulled up mostly by US interest rates – not by other countries' currency manipulation. Moreover, the overvalued dollar hurts financial markets and damages global capital flows and trades.

In Europe, for the first time in two decades, one euro is worth less than one dollar, and the British pound also has plunged 18% from the previous year. In the current scenario, countries worldwide cannot really benefit from falling currencies (which does make their products cheaper and more competitive) because economic growth is faltering globally. Analysts Paul Wiseman, Kelvin Chan, Samy Magdy, and Ayse Wieting write that the rising US dollar is squeezing governments and companies which borrowed in dollars. It is making other countries' imports more expensive and thereby adding inflationary pressures, they argue. It is also forcing central banks everywhere to raise interest rates too (to keep money from leaving the country), which, they add, damages economic growth and generates unemployment.

By September, American interest rates had already risen overnight by 300 basis points over the previous 12 months, which is the fastest increase since 1989 (and before that 1981). Moreover, yields on benchmark 10-year U.S. Treasuries rose to 3.80% (which is the highest level in over 12 years) – it is expected rates will need to remain higher to control inflation. And traders estimate that by April 2023 the US central bank will lift its target for the federal funds rate by another 150 basis.

The American central bank lifts interest rates faster as part of an effort to control price increases. In any case, by rising interest rates in the core of the financial system and by its fastly appreciating currency, the US is basically exporting its inflation worldwide, according

to John Kemp, senior market analyst and Reuters journalist. The US central bank aims to control domestic inflation (as do other central banks), but it also happens to be the interest rate “setter” for the world’s reserve currency, according to this analyst. This reality puts the supposed “sovereignty” of monetary policies around the world into perspective, as these cannot “deviate” too much from the Fed – or they risk running into debt and currency crises. In other words, monetary policies in the “core” impact the “periphery”, as the global system is still dollar-based (the dollar remains the main reserve currency globally).

Moreover, the surging dollar is increasing the cost of living internationally amid a global food crisis. Cornell University trade policy professor Eswar Prasad sums it up thusly: “A strong dollar makes a bad situation worse in the rest of the world.”

Kemp argues that the rapidly rising US interest rates have been among the primary triggers of global financial instability for the last four decades, as exemplified by the 1998 Russia’s default, the 1997 Asia’s financial crisis and the 1994 Mexico’s default and devaluation (all triggered by rising American rates).

Although facing inflation, the US still has high employment, while the UK and the EU are very close to depression and recession driven by the high cost of energy amid the Ukrainian conflict. In fact, the World Bank has warned that “central banks around the world have been raising interest rates this year with a degree of synchronicity not seen over the past five decades”, and this brings the risk of a global recession in 2023.

I have written before on how Washington weaponizes its currency, which has been described as the “dollar bomb”: in 1972, the US broke the Bretton Woods treaty by reneging its issuance rules. As Brazilian politologist Cesar Benjamin remarks, a national state which is a highly deficit economy issues a fiat currency, which is the world’s currency – “without anything to back it up” and without emission rules.

Moreover, the dollar system and international energy policies are intertwined in a complex geopolitical-geoeconomic game, as the petrodollar has been a pillar of the Western financial system. But there are signs the times are changing. Of course, the April Russian ruble payment for gas decision was a game changer. And, following the trend, more countries are using local currencies for settlement of trade payments.

The Reserve Bank of India’s (RBI) decision to permit the rupee in global trade, for instance, could be a precursor to making it an international currency. The recent OPEC+ decision to cut oil output has marked the possible end of the US-Saudi relationship, which had been so far the clearest materialization of Washington’s “oil-for-security” policy. Saudi Arabia has also advanced the de-dollarization process through its cooperation with Beijing and its willingness to trade oil in Chinese Yuan.

To sum it up, real monetary and energy sovereignty for Europe and for emerging powers everywhere can only come about with the end of the petrodollar and the dollar system. This will require international coordination by bilateral and multilateral currency agreements. The BRICS reserve currency proposal is promising, but it faces severe challenges, as many emerging countries lack economic sovereignty and it is hard to break the cycle. In any case, de-dollarization is a pre-condition for stability in the emerging polycentric world, whose painful birth we are now witnessing.

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Uriel Araujo *is a researcher with a focus on international and ethnic conflicts.*

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