

Opinion **US Dollar**

Dangers of dollar nationalism hang over the world economy

Even more serious than Fed rate rises would be a politically driven devaluation of the US currency

ADAM TOOZE



Easy access to the currency stokes economic activity around the world but high interest rates are undermining this © AFP via Getty Images

Adam Tooze YESTERDAY

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The dollar is both America's and the world's currency. While the US accounts for roughly 15.5 per cent of global GDP (PPP), the dollar is involved in 88 per cent of all international currency transactions. Some 58 per cent of global reserves are held in the US currency.

The economics of this lopsided situation are ambiguous. The dollar's reserve status supports a US current account deficit that favours US importers and creates markets for the rest of the world, but also skews the US economy away from traded goods. The global spread of the dollar makes the Federal Reserve willy-nilly into the world's central bank. The dollar's ubiquity also confers huge power on the American state. US financial sanctions are a commercial death sentence.

In an increasingly multipolar and antagonistic world, how long can this weird hybrid of punitive confrontation and commercial co-operation continue?

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Some in Washington fear that the US will overuse its sanctions weapon, eroding confidence in the dollar and thus ultimately America's own source of power. A far more encompassing threat to the status quo, however, comes from the working of the currency system itself.

The global dollar system works best when dollars are abundant, when the US interest rates are low and other currencies are riding high. Easy access to dollars stokes economic activity around the world. Right now, we are in the opposite configuration. The bullish recovery of the US economy has forced the Fed to raise rates, sending the dollar sky high and putting stress on dollar business all over the world.

This is uncomfortable but not in itself cause for systemic concern. Financial elites around the world know how to react to the pressure of the strong dollar. The European Central Bank and the Bank of Japan will calibrate their interest rate setting. Major emerging market central banks have the firepower to intervene to manage depreciation.

But if the exchange rate swings are large enough and American rates remain higher for longer, this veneer of calm may shatter. The dollar question may be driven into the political realm. It is not for nothing that President Luiz Inácio Lula da Silva's government in Brazil continues to talk about the Brics setting up an alternative to the dollar. On the margins of the world economy, the damage done by the recent increase in interest rates is profound. As a recent stock take commissioned by the G20 has shown, lending to the world's poorest countries went into reverse in 2023. The IMF and World Bank failed to compensate. The need for structural reform is glaring.

But the place where the politics of the strong dollar matter most is in the heart of the system, in the US itself.

The Biden administration has chosen not to make an issue out of the dollar's surge, viewing it as a symptom of America's strong economic recovery. Donald Trump shows no such restraint.

As a man shaped by America's era of crisis in the 1970s and early 1980s, Trump has a crudely nationalist view of trade and exchange rates. For him, a strong dollar "kills" America, to the benefit of China. Trump's close adviser Robert Lighthizer favours the use of tariffs to force a co-ordinated dollar devaluation. In Trump's circle there is even talk of subordinating the Federal Reserve to the Oval Office, so as to force through lower interest rates.

First under Trump and then Biden, US policymakers have blended industrial policy, trade policy, green energy and geopolitics into a potent nationalist formula. Adding the currency system into the mix would make for a truly explosive cocktail. A comprehensive push to devalue the dollar for the sake of reviving US manufacturing would politicise the global currency system in a way that goes far beyond the surgical strikes delivered by financial sanctions.

Of course, Trump may not win. And even if he does, who knows whether he is serious about any of his economic policy. In his first term he was restrained by the so-called adults in the room. But the general lesson is this: the deciding factors in the future of the dollar system are not China and Russia but the politics and the economics of the US itself.

The US established the dollar system in 1944 at Bretton Woods. President Richard Nixon broke it for the first time in the early 1970s. In the wake of the 2008 financial crisis, the US led the way into a new era of quantitative easing. The question in 2024 is whether the ongoing crisis of American democracy is about to spill over into the world economy at large.

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