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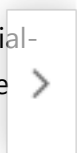
Dire Dollar Shortage Shows World Failed to Fix Key Crisis Flaw

Christopher Anstey and Enda Curran 5 hrs ago

(Bloomberg) --



The global rush for dollars that's been roiling the \$6.6 trillion a day foreign-exchange market has showcased a missing piece of financial-safety architecture that world policy makers never addressed in the aftermath of the 2008 crisis.

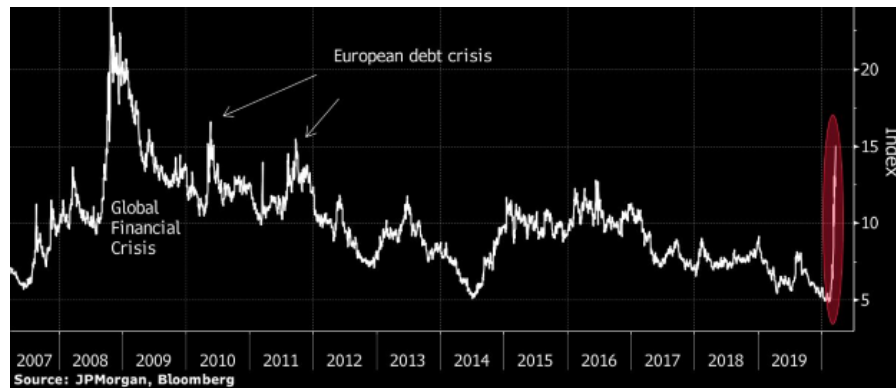


The financial system's reliance on one keystone currency proved to be an amplifier of shocks more than a decade ago. Yet since then, the greenback's role has climbed even further as borrowers outside of America ramped up dollar-denominated debt. That's again adding an enormous layer of stress on markets.

"It's precisely what the global economy does not need at this moment," Alexander Wolf, head of Asia investment strategy at JPMorgan Private Bank and a former U.S. diplomat in China, said of a strong dollar. "It tightens financial conditions, make servicing dollar debt more expensive, and can cause pass-through inflation just when that is not needed."

As often occurs during bouts of extreme currency fluctuation, there's been speculation about something akin to the 1985 Plaza Accord that sought to rein in a runaway dollar. Observers discount that possibility now. But one of the key takeaways from the current episode may be that one important currency finds itself burnished: China's yuan.

Volatility Surge
 Currency volatility leapt up from a record low in February
 ■ J.P. Morgan G7 Volatility Index



© Bloomberg Currency volatility leapt up from a record low in February

The salve for emergency dollar demand that the Federal Reserve came up with during the global financial crisis -- giving other central banks the power to deploy greenbacks abroad via swaps with the U.S. -- has been applied again. The Fed broadened the group of counterparts on Thursday, including some emerging economies, though not China or India.

Any Intervention to Weaken Dollar Seen Futile Amid Funding Woes

That decision came after an explosion in volatility in the foreign-exchange market. Traders stampeded into the dollar this month in a mass liquidation of positions triggered by the intensifying economic shutdowns associated with battling the coronavirus.

Some moves have hinted at markets veering toward dysfunction:

At one point Thursday, Britain's pound registered its deepest eight-day slide since 1992, when it was infamously ejected from the European exchange rate mechanism. Australia's dollar hit its weakest since 2002, suffering its biggest two-week decline since the aftermath of Lehman. The Japanese yen, Swiss franc and gold, which usually gain when fear grips markets -- and did so until recently -- have been sliding the past two weeks as the dollar stood alone as a haven. Mexico's peso and India's rupee hit record lows. The Korean won slid the most in a decade on Thursday.

"The dollar's surge will renew calls for a shift from a dollar-centric global financial system," said Eswar Prasad, who once led the International Monetary Fund's China team, and is now at Cornell University. "But the pandemic has also fractured global governance, making it harder to envision the G-20 devising a viable alternative."

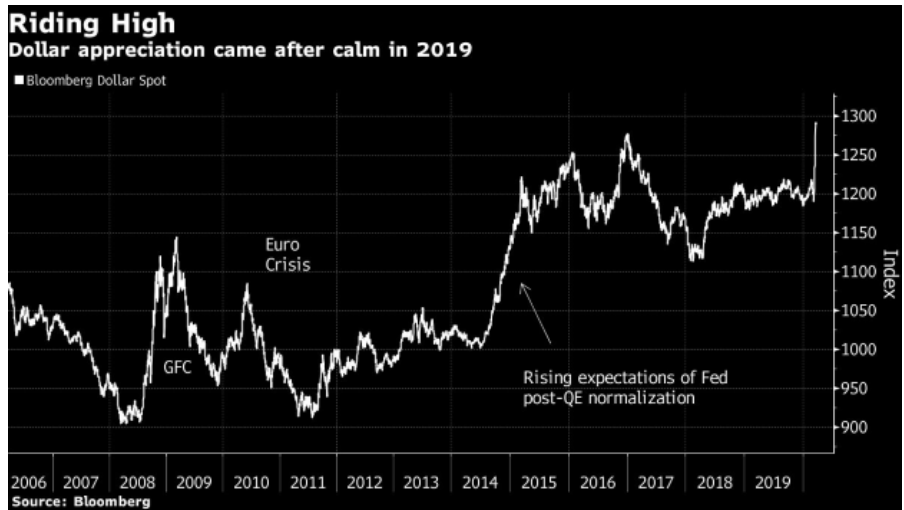
A similar surge in the dollar occurred back in 2008, prompting China's then-central bank chief, Zhou Xiaochuan, to call for a super-sovereign reserve currency in early 2009. The following year, South Korean officials tried to get the Group of 20 to consider permanent exchange-market architecture to address vulnerabilities.

All of that was to no avail: even before the advent of the America-first Trump administration, the U.S. government and Federal Reserve weren't prepared either for a broad pledge to supply of dollars in an emergency or to abandon having the dollar as the world's main currency.

While the euro has increasingly become a funding currency in its own right, the dollar's outsized role continues. Total dollar credit extended to borrowers, excluding banks, climbed to a record \$12.1 trillion by last September, Bank for International Settlements data show. That's more than double the level a decade before. It amounted to almost 14% of global GDP; the ratio back in 2009 was under 10%.

Read here why dollar strength is a bid headache for the global economy.

While the dollar snapped an eight-day rally in Asian trading Friday, the continued spread of the coronavirus threatens to keep roiling markets. In theory, global policy makers could coordinate actions to stem any renewed and destabilizing dollar surge. The U.S. and four other key developed nations agreed to do that in 1985, with the Plaza Accord.



© Bloomberg Dollar appreciation came after calm in 2019

But such notions may be unrealistic nowadays, with top officials criticizing each other over the epidemic response. China for its part has looked poorly on the Plaza Accord's history, viewing it as a contributor to Japan's subsequent economic stagnation.

In any case, the dollar's recent appreciation still pales in comparison to the scale of the early 1980s strengthening. One element that's held the U.S. currency back some has been the relative resilience of China's yuan.

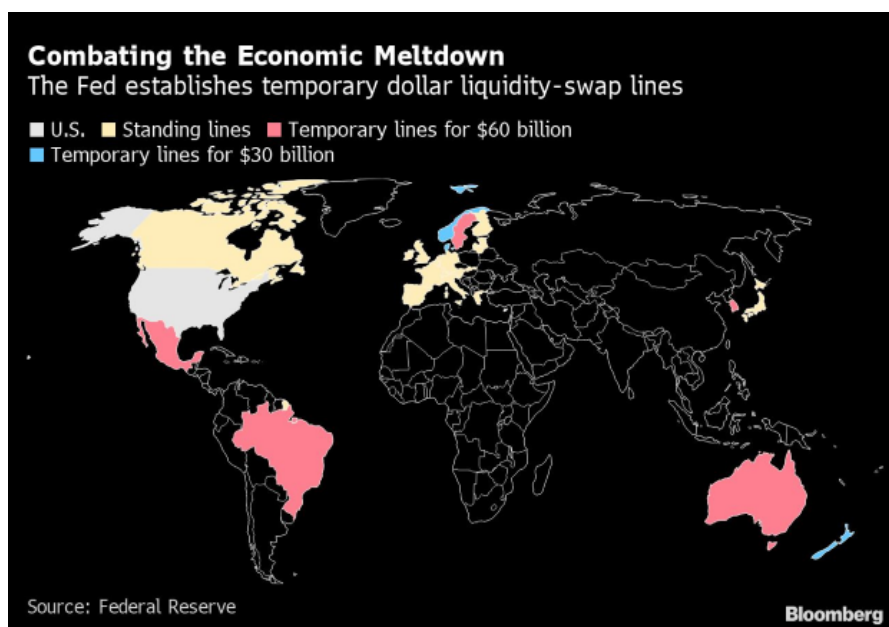
Currency March 6-19 change versus dollar

Yuan offshore	-3.2%
Japanese yen	-4.8%
Euro	-5.3%
British pound	-12%

China's stock and credit markets have also not been hit as hard as others this month, thanks in part to seeing its coronavirus cases crest earlier

Concerns about ready convertibility and the legacy of a messy devaluation in 2015 have held back the yuan, also known as the renminbi, from being a universally regarded reserve currency. But the current period of turmoil suggests something of a return to its role as an anchor of relative stability during the 1990s Asian financial crisis, as well as in 2007-09.

“Normally, by this stage of a bear market, these currencies would have blown out already,” Stephen Jen, who runs hedge fund and advisory firm Eurizon SLJ Capital, said of emerging market exchange rates including the Indonesian rupiah. “A key reason is the stability of the renminbi.”



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