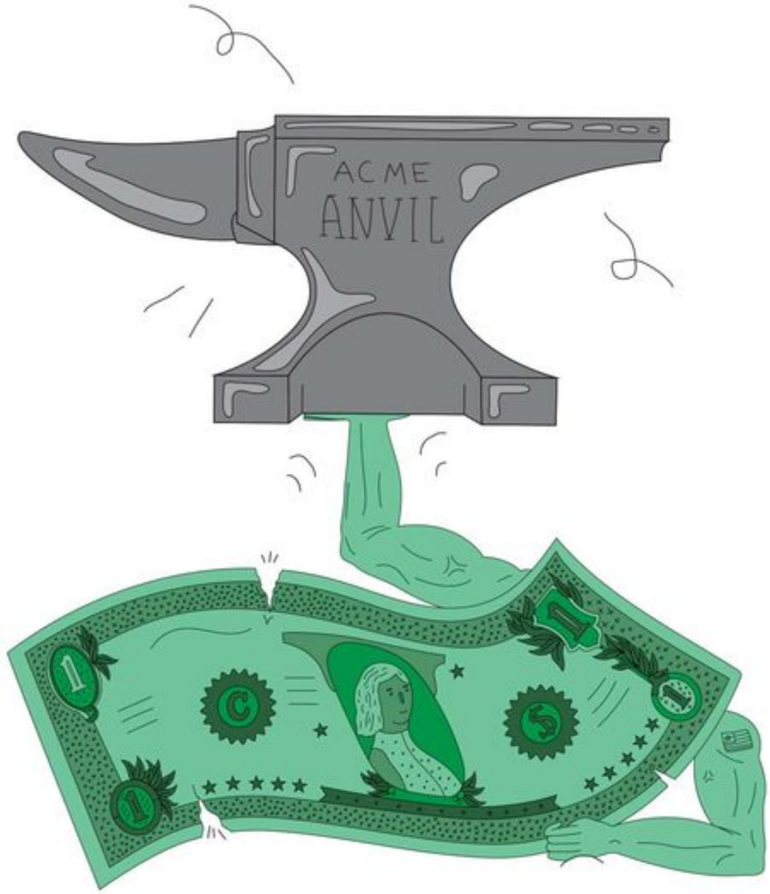
The Strong Dollar Could Bash the Economy—and It's Just Getting Started

The surging greenback could slam U.S. manufacturing and trigger capital flight from emerging markets.

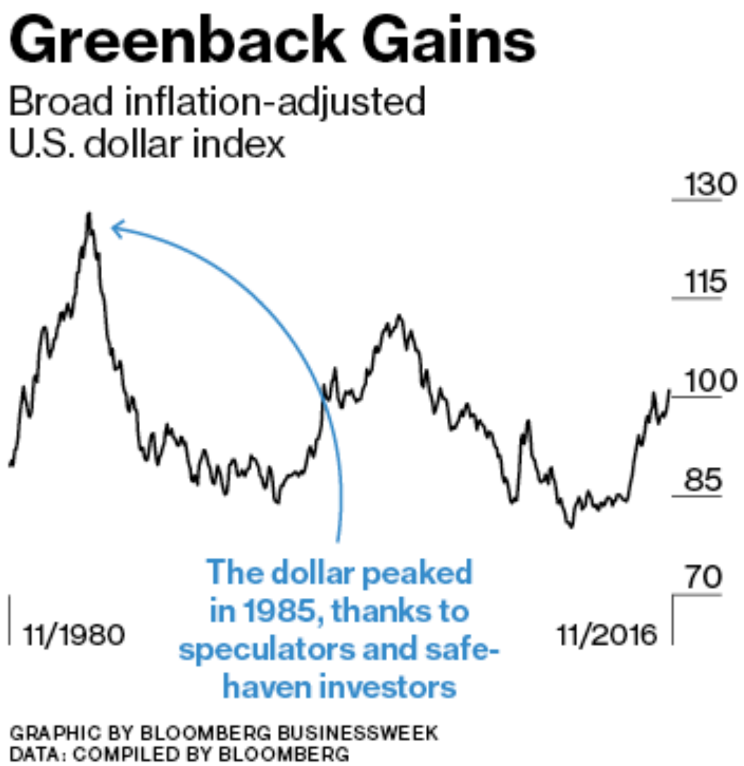
by **Peter Coy**

2017年1月6日 GMT+8 上午2:00:04
From | Subscribe | Reprints



The headlines are full of scary reports about the dollar’s rise to a 14-year high against a basket of six major currencies. Its strength will hurt U.S. manufacturing while triggering capital flight from emerging markets, economists say. The appreciation “is a real serious noose around the neck of the global economy,” David Beckworth, a senior research fellow at the Mercatus Center at George Mason University in Arlington, Va., said in November.

What’s really alarming, though, is that even though the dollar has jumped 6 percent against the euro and 12 percent against the yen since the U.S. presidential election, it remains well below its historic highs. If its rise to date is causing trouble, imagine how much worse things could get if it went on a serious upward run.



The included chart shows how much headroom remains for the greenback. It's the Federal Reserve's index of the value of the dollar against a basket of currencies of 26 trading partners, with each one's value adjusted for that nation's inflation rate. This is a better indicator of the dollar's strength than the frequently cited U.S. Dollar Index, which covers just six currencies and isn't adjusted for inflation. The Fed's index remains 10 percent below its 2002 high and fully 19 percent below the lofty high of 1985, which led to an emergency international accord to lower the greenback's value through official, coordinated sales of dollar reserves.

Fundamental factors are driving the dollar upward. Because U.S. growth is strong and unemployment low, Fed policymakers are projecting three more quarter-point increases in short-term rates in 2017. That will tend to push up the dollar by making U.S. Treasuries and other fixed-income investments more lucrative. Investors are also betting President-elect Donald Trump will touch off a growth spurt through tax cuts and infrastructure investment.

Meanwhile, "The euro zone debt crisis and the travails of the Chinese renminbi have weakened the dollar's main rivals and cemented its dominance as a key benchmark for other currencies," Cornell University economist Eswar Prasad wrote in an e-mail. ABN Amro, a Dutch bank with a more extreme forecast than most, projects that the euro, worth $1.15 as recently as May, will be only 95¢ for most of 2017. *Trump Gives the Dollar Wings*, it headlined a November research report.

A strong dollar is bad for U.S. growth, making American goods and services less competitive in world markets. A rule of thumb says that a 10 percent rise in the dollar increases the trade deficit by 1 percent of gross domestic product, and that translates into the loss of hundreds of thousands of jobs, says Brad Setser, a senior fellow at the Council on Foreign Relations in New York. Warnings about the damage from dollar strength have come recently from U.S. companies including Boeing, Emerson Electric, 3M, and United Technologies.

The greenback’s strength could cause problems in emerging markets such as Mexico and Turkey, because it increases how much of the local currency borrowers need to spend to make payments on bonds they issued in dollars. And bond issuers in those countries must pay higher interest to attract buyers when the Fed raises rates. Petróleos Mexicanos pointed to the peso’s depreciation as a factor in a 23 percent increase in the peso value of its debt in the first three quarters of 2016. In China, debt-laden builders are suddenly having trouble selling dollar-denominated bonds.

At the end of 2015 there was $9.7 trillion in nonfinancial debt outside the U.S. issued in dollars, and one-third of it was owed by issuers in emerging markets, according to the Bank for International Settlements (BIS), which is run jointly by the central banks of several countries. “If the current trend of dollar strength persists, it is very likely that we will see emerging market currency crises,” Variant Perception, a London-based research firm, wrote to clients in December.

Whatever gains in trade competitiveness that emerging-market economies get when the dollar rises against their currencies can be outweighed by the rise in their borrowing costs, says a December research report by BIS economists Nikola Tarashev, Stefan Avdjiev, and Ben Cohen. That's true mostly for countries whose finances are already fragile.

Plenty of analysts see little reason for concern about the dollar's rise. "We think the dollar has pretty much run its course," says Gorky Urquieta, co-head of emerging-markets debt for Neuberger Berman, an asset management firm. Most emerging-market issuers of dollar debt are protected against a big dollar rise, either because they have offsetting financial hedges or because they receive a steady income of dollars from trade, says Joe Kogan, co-head of Latin America strategy at Scotia Capital Markets in New York. Emerging-market economies are in better shape than they were in 1997, when rising rates caused a financial crisis in Asia, says Mark Follett, managing director for emerging Asia debt capital markets at JPMorgan Chase in Hong Kong.

Then again, Follett doesn't know where the dollar is headed from here. "No one," he says, "has any idea at the end of the day."

—With Isabella Cota, Craig Torres, and Carrie Hong

The bottom line: *Several factors, from higher interest rates to a hoped-for Trump tax cut, are making the dollar stronger.*