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## **A Rising Dollar Lifts the U.S. but Adds to the Crisis Abroad**

By [PETER S. GOODMAN](#)

As the world is seized with anxiety in the face of a spreading [financial crisis](#), the one place having a considerably easier time attracting money is, perversely enough, the same place that started much of the trouble: the United States.

American investors are ditching foreign ventures and bringing their dollars home, entrusting them to the supposed bedrock safety of United States government [bonds](#). And China continues to buy staggering quantities of American debt.

These actions are lifting the value of [the dollar](#) and providing the Obama administration with a crucial infusion of financing as it directs trillions of dollars toward rescuing banks and stimulating the economy, enabling the government to pay for these efforts without lifting interest rates.

And yet in a global economy crippled by a lack of confidence and capital, with lending and investment mechanisms dysfunctional from Milan to Manila, the tilt of money toward the United States appears to be exacerbating the crisis elsewhere.

The pursuit of capital suddenly seems like a zero sum game. A dollar invested by foreign central banks and investors in American government bonds is a dollar that is not available to Eastern European countries desperately seeking to refinance debt. It is a dollar that cannot reach Africa, where many countries are struggling with the loss of aid and foreign investment.

“Virtually all of the low-income countries are in very serious trouble,” said Eswar Prasad, a former official at the [International Monetary Fund](#) and a senior fellow at the [Brookings Institution](#), the liberal-leaning research organization in Washington.

He went on: “This is the third wave of the financial crisis. Low-income countries are getting hit very hard. The flow of private capital to the emerging market has dried up.”

Private money invested in so-called emerging countries plunged from \$928 billion in 2007 to \$466 billion last year and is likely to fall to \$165 billion this year, according to the Institute of International Finance.

Not that the United States is enjoying a great influx of money. Globally, investors are holding tight to cash and extracting it as quickly as they can from risky ventures.

In the United States, investments by foreigners have slowed markedly. But as Americans eschew foreign deals and keep their dollars at home, and as foreign central banks — especially China — buy [Treasury](#) bills, the United States is absorbing money that used to be scattered around the globe. And that is making money tighter elsewhere in the world.

The most immediate crisis appears to be in Eastern Europe, where investors borrowed exuberantly in foreign currencies — notably [the euro](#) and the Swiss franc — using those funds to build office towers and factories. Their debts are growing as their currencies decline in value, leading to bank losses and requiring government bailouts along with aid from the I.M.F..

Economists liken this episode to the financial crisis that assaulted much of Asia in the late 1990s. Then, as now, investors borrowed in foreign currencies. When investment left the region, local currencies plummeted, particularly in Thailand and Indonesia, setting off defaults and sowing job losses and poverty.

“Eastern Europe looks incredibly similar to Asia in the 1990s,” said Brad Setser, an economist at the [Council on Foreign Relations](#) in New York.

In one key regard, this crisis is more problematic: In the 1990s, the rest of the global economy was growing vigorously. Once danger abated, Asian countries were able to resume growth by selling goods to the United States, Europe, Japan and China.

Indeed, the very plunge in currencies that precipitated the crisis also provided a fix, making Thai, Malaysian, Indonesian and Korean goods that much cheaper on world markets.

This time, as many low-income countries again see their currencies fall, they are confronting a world beset by recession, in which demand for their products is weak and falling.

In a report released Sunday, the [World Bank](#) predicted that the global economy would shrink in 2009 for the first time in more than half a century and forecast that global trade would decline for the first time since the early 1980s.

“Depreciation isn’t enough now to offset the global contraction,” said Mr. Setser, noting that export powers like Japan, Korea, Taiwan and Brazil have had rapid declines in sales in recent months. “Everybody’s looking vulnerable. All commodity exporters are potentially subject to currency crises.”

Fears are growing that a much broader group of countries will plunge into trouble. Mr. Prasad’s list of potential danger zones includes Vietnam, the Philippines, Malaysia and Indonesia, as well as Pakistan and Ecuador.

In the Asian financial crisis, countries at the center of the storm were particularly vulnerable because the values of their currencies were mostly pegged to the dollar. Once central banks ran out of dollars to exchange for their own currencies, they lost their ability to influence the exchange rate. As a result, their currencies fell, turning already large debts into impossible debts.

Many more countries now allow their currencies to float with the whims of the market, removing this grim chain of events. Still, as economic activity slows and banks are stuck with larger losses, the damage could swell beyond the ability of governments to finance bailouts, said Kenneth S. Rogoff, a former chief economist at the I.M.F. and now a professor at Harvard.

“Debt collapses are going to wreak havoc with exchange rates,” Mr. Rogoff predicted. “A lot of countries in Europe are already on the brink of default.”

Only two years ago, many analysts were suggesting that the I.M.F. — created more than 60 years ago to rescue countries in financial distress — no longer had a clear reason to exist. Now, the fund is scrambling

for contributions from developed nations to bolster its \$350 billion war chest. Mr. Setser suggested it needed \$1 trillion for all that might yet unfold.

Because worries are deeper nearly everywhere else, the United States and the dollar have essentially benefited from the worldwide panic. In the last year, the dollar has risen 13 percent against major foreign currencies after adjusting for inflation, according to [Federal Reserve](#) data. Foreign holdings of Treasury bills rose by \$456 billion in 2008.

“It’s a huge safe haven effect,” said William R. Cline, a senior fellow at the Peterson Institute for International Economics in Washington. “The basic assumption that people are making is that the U.S. government will never default on its debt.”

As the dominant flavor of money used in business worldwide, the dollar has once again been affirmed as the global reserve currency.

Only last year, some analysts said that as the American economy sagged, foreign central banks would be reluctant to sink national savings into the dollar. That has been soundly debunked.

In ordinary times, the rise of the dollar would provoke American worries that it would crimp exports by making goods more expensive on world markets. But for American policy makers, what matters now is attracting enough buyers of American debt to finance the rescue plans, and if the dollar must rise along the way, that is a cost worth paying.

“The fact that we can still borrow at lower interest rates is saving us from much more severe adjustments,” Mr. Rogoff said. “We’re really still staring down an abyss.”

*Julia Werdigier contributed reporting.*

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