



Managing the Risks of a Rising Dollar

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Some may view the US dollar's appreciation as consistent with a longer-term rebalancing of the global economy. But, as Argentina's recent request for IMF financing starkly demonstrates, a sharp and sudden dollar appreciation risks unbalancing things elsewhere.

NEWPORT BEACH – Argentinian President Mauricio Macri's government has asked the International Monetary Fund for a loan that it hopes can stem a peso rout that has driven up interest rates, will slow the economy, and threatens the reform program. This reversal of fortune for the economy partly, though far from fully, reflects broader pressure created by the US dollar's recent appreciation – a process that is set to accelerate, because both monetary policy and growth differentials are now favoring the United States.

For a while now, the US Federal Reserve has been well ahead of other systemically important central banks in normalizing monetary policy – that is, raising interest rates, eliminating large-scale asset purchases, and starting the multi-year process of shrinking its balance sheet. This was amplified this year by another catalyst of the dollar's recent appreciation; a growing, and less favorable, divergence between economic data and expectations in the rest of the world.

During most of 2017, markets were scrambling to catch up to indications of growth outside the US that were markedly more favorable than anticipated. As a result, the most widely followed measure of a trade-weighted dollar index depreciated by 10% last year. Capital flows into Europe and major emerging economies picked up, as investors sought to benefit from the expansion, while enjoying both higher yields and the possibility of capital gains from currency moves.

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