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**Il Sole 24 ORE**

# **THE DOLLAR IS TOO STRONG: GLOBAL FINANCIAL STABILITY AT RISK\***

By Marcello Minenna

These are difficult weeks for the international financial system. The steady hike in interest rates by 90% of central banks - and especially the speed of the rises - are starting to have visible negative effects on the financial stability of banks, businesses and governments. The driving force behind the restrictive effects of the US interest rates hikes is the rapid strengthening of the dollar on the Foreign exchange markets: since the beginning of 2022, the greenback has appreciated by almost 25% compared to an average of a basket of selected currencies.

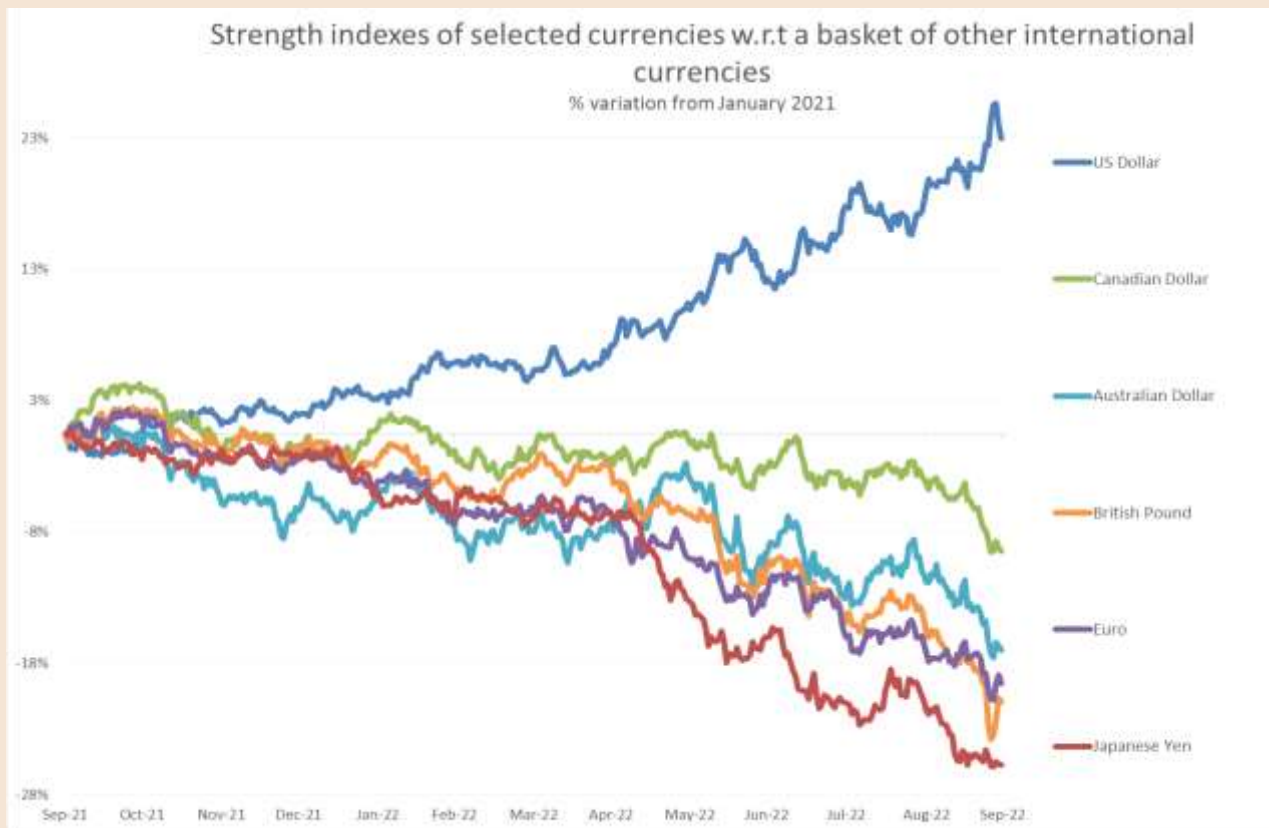
Conversely, the currencies of the other main industrialized economies underwent devaluations of 10% -25%.

In recent days, calls have increased to moderate the pace of monetary policy tightening by leading international institutions such as the United Nations and the International Monetary Fund. Unpredictable consequences are feared: the negative market response to the UK government's tax reform or the rising risk of insolvency of systemically important banks in Europe are signs of mounting stress in the global financial system.

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\* The complete version (in Italian) has been published on the website:

<https://www.ilsole24ore.com/art/il-dollaro-e-troppo-forte-rischio-stabilita-finanziaria-globale-AEsxA06B>



Source: TradingView

The phase we are experiencing shows us the hidden costs in the current "dollar-centric" structure of the international monetary system. The US currency is involved in 90% of global foreign exchange transactions. More than 50% of global export invoicing, cross-border bank credits and international debt securities are denominated in dollars, as well as about 60% of central banks' official foreign exchange reserves.

The dollar plays the same role in the global financial system as oil in the real economy. When a significant percentage of assets (bonds, derivatives) and liabilities (bank and corporate loans) issued and traded by national financial intermediaries are denominated in dollars, there is a more stable demand for greenbacks in the financial system.

If the relative price of the dollar in local currency rises too quickly, demand cannot fall as fast. A weakening of the exchange rate against the dollar translates into higher inflation because energy goods are priced in dollars along with much

of the volumes of goods traded on international markets. Furthermore, debt service costs increase and can cause generalized solvency crises with chain default of banks and enterprises, as already happened in the 1980s in Latin America and in the 1990s in Southeast Asia.

What can be done? It is technically possible to coordinate open markets operations between central banks in the perspective of stabilizing exchange rates. It has already happened: in the early 1980s, following the 1979 oil shock, a strong inflationary wave hit the global economy.

In September 1985, the *Federal Reserve* and the central banks of other industrialized countries agreed to pilot a gradual weakening of the dollar (the *Plaza Accord*). In about 2 years, the British pound, the German mark and the Japanese yen appreciated by 20-40%.

In 2022, however, there are other actors on the international scene that are hostile to the USA (Russia, China, Saudi Arabia), which are rapidly looking for alternatives to the current monetary system.

The global recession is gaining quickly traction thanks to financial warfare.

*Marcello Minenna, Economist*

[@MarcelloMinenna](#)

*The views and opinions expressed are strictly personal*