EFFICIENT GROUP

ECONOMIC COMMENTARY

Dr. Francois Stofberg

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THE DOLLAR'S GLOBAL DANCE: STABILITY AND STRAIN

In this week's exploration of economic narratives, we look at the almost omnipresent influence of the United States (US) dollar: A currency that wields unparalleled sway over the international financial landscape. While the US accounts for a modest 15.5% of global gross domestic product (based on purchasing power parity), its currency forms the backbone of global reserves and dominates international transactions. The implications of this scenario are profound, both economically and geopolitically.

The dollar's double-edged sword

The boon and bane of the dollar's double-edged sword lies in its global influence and economic skews. The dollar's role in 88% of international currency transactions is a testament to its global acceptance. Countries around the world hold 58% of their reserves in US dollars, facilitating trade and investment across borders. This reserve status helps finance the US current account deficit, allowing the country to consume more than it produces and to invest beyond its domestic savings.

However, the dominance of the dollar also channels US economic policies directly into the heart of global finance. The Federal Reserve's decisions ripple worldwide, affecting monetary policies and economic conditions in countries far removed from American shores. This outsized role often complicates economic management in other regions, forcing them to adjust their own policies in response to actions taken in Washington. This even happens in South Africa contrary to what the South African Reserve Bank will tell you.

The burden of dominance

The burden of the dollar's dominance is two-fold, namely economic distortions and global dependency. As noted by financial analysts, the strong dollar complicates life for US exporters by making their goods more expensive overseas, potentially widening the US trade deficit. This phenomenon pressures domestic industries that compete with imports, affecting employment and business growth within these sectors.

The dependency on the dollar injects a layer of external vulnerability into other economies, particularly emerging markets. These countries must manage their currencies meticulously to maintain stability, often at the expense of their own economic autonomy.

Rising calls for alternatives

Amid these dynamics, some global leaders advocate for decreased reliance on the dollar. For instance, Brazil's President Luiz Inácio Lula da Silva has discussed creating a BRICS currency as an alternative, highlighting the growing discomfort with the dollar's dominance. Such movements underscore a broader reckoning with the vulnerabilities inherent in the current financial system.

The US political landscape and the dollar's fate

Domestically, the political response of the US to the dollar's strength varies. The Biden administration perceives the robust dollar as a sign of economic health, while figures like Trump criticise it as harmful to American manufacturing competitiveness. Trump's advisors have even suggested aggressive measures, like tariffs and manipulating dollar valuation, to support domestic industries - a strategy that could have far-reaching consequences for global trade and economic stability.

What lies ahead?

The history of the dollar's dominance is marked by pivotal changes, from the creation of the Bretton Woods System in 1944 to its transformation in the early 1970s. Today, as geopolitical tensions reshape global alliances and economic practices, the dollar's future as the cornerstone of global finance is debatable. That being said, it is worthwhile to note that a change will not happen overnight or even any time soon.

As we continue to navigate the current complex financial landscape, the evolving role of the dollar will be crucial in shaping economic strategies, both in the US and internationally. The decisions made now will determine the global economic landscape of tomorrow, influencing trade, monetary policies, and international relations.

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