ECONOMY

Inflation Keeps the U.S. From Stepping In to Slow Dollar's Rapid Rise

A strong greenback poses risks for global financial turmoil, but it helps fight domestic inflation

The Treasury, which oversees U.S. exchange-rate policies, isn't likely to take steps to reduce the value of the dollar.

PHOTO: AL DRAGO/BLOOMBERG NEWS

By Andrew Duehren Follow

Oct. 2, 2022 5:30 am ET

WASHINGTON—U.S. policy makers aren't likely to take action to slow the dollar's rapid rise despite rising risks of global financial turmoil, analysts say, largely because a strong greenback helps fight domestic inflation.

The U.S. dollar has soared in value as the Federal Reserve raises interest rates to fight the highest U.S. inflation in decades and investors move money into dollar-denominated assets. The WSJ Dollar Index, which measures the dollar against a basket of other currencies, is up roughly 16% so far this year.

The dollar's strengthening relative to other currencies puts pressure on many other countries around the world, boosting the costs of imports priced in dollars and servicing dollar-denominated debts. This is particularly difficult for many developing economies that struggle with large debts and import much of their fuels, food and other commodities.

Wealthier economies face troubles, too, as their import costs rise. Japan, the world's third-largest economy, recently intervened in currency markets to support the yen.

Treasury Secretary Janet Yellen says the U.S. supports market-determined exchange rates, adding that the strength of the dollar is largely the product of the Fed's policies and subsequent capital inflows to the U.S. The Fed manages monetary policy while the Treasury Department oversees U.S. exchange-rate policies.

Treasury Secretary Janet Yellen says the U.S. supports market-determined exchange rates.
PHOTO: KEVIN DIETSCH/GETTY IMAGES

Economists and former Treasury officials point to two reasons that the Treasury Department is unlikely to take steps any time soon to reduce the value of the dollar—or to slow its rise.

First, with the Fed on course to keep raising interest rates, any U.S. foreign-exchange intervention is likely to have limited impact on the dollar's value. Second, a strong dollar helps lower inflation, and the Treasury is unlikely to want to take steps that could undercut the Fed's efforts to tame inflation.

"Treasury may well fear that the dollar's strength will set the stage for complaints from abroad and protectionist pressures in the U.S. down the road, but for the near term their best strategy is to try and keep their mouths shut," said Mark Sobel, a former top Treasury career official who now is the U.S. chairman of the Official Monetary and Financial Institutions Forum.

The U.S. has only rarely moved to intervene in currency markets, notably in the 1985 Plaza Accord. Under that deal, the U.S., the U.K., Japan, West Germany and

France agreed on a joint currency intervention to depreciate the dollar. Over the next decade, the value of the dollar dropped and the yen rose.

But that intervention took place as the Fed had started to ease its rate increases, giving finance ministers and the Treasury room to intervene effectively.

"If they had tried to do a Plaza when [former Federal Reserve Chairman Paul] Volcker was vigorously hiking, I don't think it would have been as successful," said Nathan Sheets, who was Treasury's undersecretary for international affairs during the Obama administration. Given the market dynamics created by the Fed, Mr. Sheets said the Biden administration has no real choice but to accept the dollar's strength.

Fed Vice Chairwoman Lael Brainard in a speech Friday said the central bank was monitoring global financial developments while remaining committed to reducing inflation by raising rates high enough to slow U.S. economic growth.

"Monetary policy will need to be restrictive for some time to have confidence that inflation is moving back to target," she said. "We are committed to avoiding pulling back prematurely."

A strong dollar generally helps reduce U.S. inflation by reducing the prices of goods and services imported into the U.S. It also typically curbs U.S exports by making them more expensive in global markets, slowing economic growth, which also can ease price pressures.

These effects hurt the bottom line of U.S. exporters, but the Biden administration has made no effort to reverse the dollar's rise because it wants to see lower inflation, the former officials say. Meanwhile, the U.S. job market remains strong, mitigating the potential political blowback about the dollar's strength.

The risks that the strengthening dollar pose to the global economy could accelerate though. Central bankers around the world might feel they must raise interest rates more rapidly than anticipated to fight inflation in their own countries and to prevent further depreciation of their currencies.

Their combined efforts could worsen the global economic slowdown. Investors may increasingly choose to find a haven in U.S. dollars, increasing the greenback's value further and risking more market instability.

Even as those risks build, Eswar Prasad, an economist at Cornell University, said the U.S. won't take any actions to slow interest-rate increases or otherwise change the dollar's path until it poses a direct risk to the U.S. economy. So far, the risks to the U.S. are limited—while the benefits are tangible.

"I don't see the Treasury or the Fed doing anything significant to mitigate financial panics in other parts of the world," Mr. Prasad said.

Fed Vice Chairwoman Lael Brainard has said the central bank is monitoring global financial developments while remaining committed to reducing inflation.

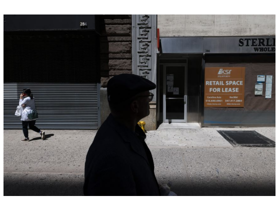
PHOTO: MANUEL BALCE CENETA/ASSOCIATED PRESS

Write to Andrew Duehren at andrew.duehren@wsj.com

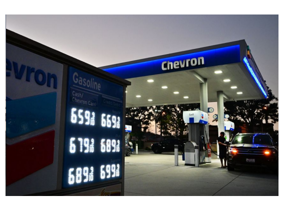
Inflation and the Economy

Analysis from The Wall Street Journal, selected by the editors

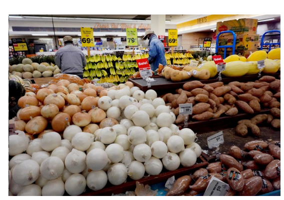
INFLATION PRICE TRACKER



Economists Now Expect Recession, Job Losses by Next Year



Core Inflation Hit Four-Decade High in September



People Are Spending Less on Gas, More on Food

Report Seals Case for 0.75-Point Hike in November