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The Strong Dollar

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For decades, the U.S. stood out as the one nation that traditionally preferred its money superpower-strong. Investors flocked to it, enabling the U.S. to borrow lots of money at low interest rates. American consumers feasted on it, buying imported goodies for less. U.S. politicians touted it as evidence of the economy's eternal dynamism. Then under former President Donald Trump's "America First" manifesto, the so-called strong-dollar policy was shoved aside, as gains in the currency crimped U.S. exports and hurt the earnings of America's multinational companies. Janet Yellen, President Joe Biden's pick for Treasury secretary, signaled that she'd return stability and predictability to the \$6.6 trillion-a-day currency market.

The Situation

At a Jan. 19 confirmation hearing, Yellen didn't cite the benefits of a weaker dollar, as she did when she was chair of the Federal Reserve. Rather she said that the market should set exchange rates, though she didn't explicitly refer to the strong-dollar policy. She did assure markets that she would not seek a weaker dollar. Trump and Steven Mnuchin, his Treasury chief, broke with decades of tradition by repeatedly and openly acknowledging that a weaker greenback was good for U.S. trade, though their statements were sometimes conflicting and confusing. A less muscular greenback aligned with Trump's protectionist trade policies, including a desire for lower trade deficits and increased exports of American goods. In 2019, the Trump team didn't rule out intervening in currency markets to weaken the greenback, a move that would have violated G-20 commitments.

"The United States does not seek a weaker currency to gain competitive advantage and we should oppose attempts by other countries to do so." -- Janet Yellen (Jan. 19, 2021)

The Background

The U.S. economy became the world's largest in the 1870s, yet the British pound remained the dominant currency. That changed starting with the creation of the Federal Reserve in 1913. World War I helped too by forcing other nations to suspend convertibility of their money to gold. The Bretton Woods agreement made the dollar's preeminence official in 1945 as U.S. money became the standard used to fix exchange rates. That system collapsed in 1971, but the dollar's ascendancy continued. In 1985, the Plaza Accord reached by the U.S. and the other four richest economies pushed down the dollar's value for a while to slow Japanese exports. It didn't last. The dollar remains the dominant reserve currency, used by countries to pay international debts. In 1995, Treasury Secretary Robert Rubin asserted that a strong dollar is in the U.S. national interest, a mantra repeated by each of his successors until Mnuchin qualified it by saying that it was good in the long term, but not necessarily in the short term. Even the global financial crisis of 2008 strengthened the dollar, as investors sought safety in U.S. government debt. The flight to the dollar was repeated at the start of the pandemic in 2020. For the rest of the world, danger lurks in dollar-denominated debt sold in emerging markets such as Brazil and India; a stronger dollar makes those obligations harder to repay.

The Argument

There are always winners and losers when a nation's currency rises or falls. Yet U.S. Treasury secretaries have traditionally pledged allegiance to the strong dollar, mostly to signify U.S. strength, even if they sometimes mused openly about the benefits of a weaker currency on jobs and economic growth. While U.S. officials often criticize other countries that manipulate their currencies, they aren't blind to the benefits of a falling greenback. In 2016, the surging dollar weighed on the Fed's plans to raise interest rates, with Yellen, who was then the Fed chair, saying it had harmed U.S. exports. Former Treasury Secretary Lawrence Summers warned in early 2017 that a stronger dollar would hurt American workers who are competing with Mexico. In late 2020 he advised that under Biden, favoring a strong dollar again would be "prudent" for the new Treasury secretary and that it would be "unwise to appear actively devaluationist or indifferent to the dollar."

The Reference Shelf

- Why Yellen was pressed to back a strong dollar and reverse the Trump-era tone.
- A QuickTake on how difficult it is to replace the dollar as the cornerstone of the world economy and another on the so-called currency wars.

- A Bloomberg markets column on the sudden death of the strong-dollar policy under Trump and another column saying it ended years ago.
- Harvard University professor Jeffrey Frankel examines the Plaza Accord in a 2015 paper.
- Intercontinental Exchange, owner of the New York Stock Exchange, explains the ins and outs of the U.S. Dollar Index.
- The Cornell University economist Eswar Prasad argues in a 2014 book “The Dollar Trap” that the dollar will remain the cornerstone of global finance.

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