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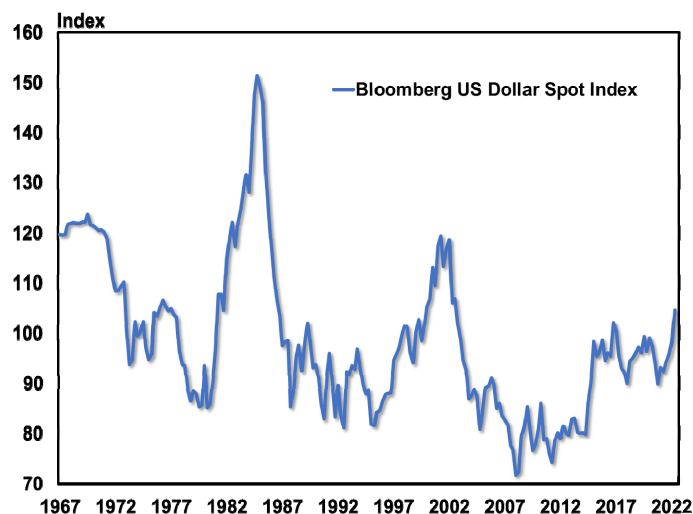
Dollar Remains World Reserve Currency

How many times have you heard that the US dollar will collapse because of Fed and fiscal policy? According to the pessimists, this will bring the loss of reserve currency status, and possibly the rise of China.

Replace China with Russia, and it sounds like the 1970s. Inflation is out of control, energy prices have surged, geopolitical tensions are rising, and Presidents (then Nixon, lately Trump) were replaced by widely perceived weak leaders from the opposite side of the aisle.

Though all these pessimistic forecasts are related, there is one very important distinction. The dollar is not weakening, as it did in the 1970s, the dollar is surging.

Yes, in *absolute* terms your dollars are worth less every day due to rising prices. However, when comparing the dollar to other major currencies (in other words looking at the *relative* value of the dollar) the story is the exact opposite. The dollar has soared over the past twelve months and currently sits at a 20-year high according to the Bloomberg US Dollar Index. The Euro just fell below parity with the US dollar for the first time since 2002. Sure, you may not be able to buy baby formula, but at least it's a good time to start planning that European vacation.



This is the opposite of what happened in years leading up to Paul Volcker's tenure at the Federal Reserve. From the late 1960s to the early 1980s, the dollar was collapsing in international markets, falling roughly 30% peak to trough. The dollar was at risk of losing its reserve currency status.

Why? The US Government decided to use the dollar's strength to monetize the debt from Vietnam War spending and President Johnson's huge expansion of the welfare state through the Great Society programs. (They called it "Guns and Butter").

These dollars started accumulating abroad, and the Europeans (and others) saw the writing on the wall and asked for gold. At the time, the global financial system still operated under a gold standard. This led President Nixon to close the gold window and devalue the dollar. And, voila, the fiat currency era was standardized. The bottom line is that this was terrible for the dollar's reputation internationally, precipitating its collapse in foreign exchange markets and creating even more inflation.

Inflation clearly played a role in the Volcker Fed's decision to send short-term interest rates to a record high of nearly 20% in the early 80s. However, saving the US dollar's reputation and reserve currency status was also a priority, even if it meant sacrificing the real economy to do it.

Today, while the US is dealing with plenty of economic problems, bailing out the dollar's reputation thankfully isn't one of them. Moreover, there is no potential shock like the end of the gold standard that could happen today. You can only go to fiat once.

So, why has the dollar performed so well recently? First, the US economic recovery has been stronger than pretty much anywhere else in the world, owing to the ability of states to manage much of the response to COVID which allowed certain regions to remain relatively open. Second, the war in Ukraine has caused a flight into US currency. We are the security umbrella for Europe and have the best defense companies in the world, a resource that now seems to be carrying a much bigger priority abroad. The US energy sector also looks set to displace Russia's market share in Europe as well. Finally, the Federal Reserve is raising rates while our biggest competitors in the currency space, Japan and Europe, continue to be remarkably dovish despite the global nature of the inflation problem.

While there is plenty of negative news to focus on, the collapse of the US dollar thankfully isn't on that list. If anything, reserve currency status looks stronger than ever. Once again the US is coming out of a global crisis as the cleanest dirty shirt in the laundry.