

## Is the dollar strong by default?

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The strength of the greenback is one of the major economic developments of 2022. The US dollar index, which measures the value of the dollar against other major world currencies, is at its highest level in twenty years. The appreciation of the dollar is certainly fueled by the Fed's monetary policy. But it is probably even more important to look outside the United States to understand this trend that is in fact largely the result of other major currencies' weakness, first and foremost the euro.

The Eurozone has seen its share of upheavals and crises over the past 15 years, but the context of 2022 is of unprecedented magnitude. The impact of the global rise in commodity prices is amplified by the heavy dependence on Russian oil and gas imports, which have been brought to a brutal halt because of the sanctions related to the war in Ukraine. The resulting cocktail of high inflation, a sudden deterioration in the trade balance and a growing risk of recession is poisonous for the value of the euro. Not to mention that it puts the central bank in a dilemma, split between the need to curb inflation on the one hand, and the risk of recession and sovereign debt tensions on the other.

The situation is similar in the UK, where double-digit inflation, a ballooning external deficit and the prospect of a massive fiscal stimulus package have recently sent the pound plummeting. The Bank of England's acceleration of rate hikes is not sufficient to address the scale of the inflationary crisis and fears about the financing of public debt.

In Japan, although the inflationary shock is softer and the external balance remains in surplus for the moment, it is the attitude of the central bank that has caused the yen to plunge. Perhaps intoxicated by the prospect of finally breaking out of decades of deflation, the Bank of Japan decided to stick to its policy of negative rates and long-term rate controls, against the trend of most other central banks. The widening interest rate differential with other currencies is a strong headwind for the Japanese currency, which has weakened significantly in 2022.

In China, the strict anti-Covid policy and the sharp slowdown in growth contributed to the weakening of the yuan, which was also dragged down by the decline in the yen. The rate cuts only amplified the decline of the Chinese currency, as did the growing mistrust of Western investors in a context of geopolitical tensions and increased state interventionism.

Thus, the major currencies all face a particularly adverse set of conditions in 2022. In the relative value game that is the nature of the foreign exchange market, the dollar appears to be the safe haven currency 'par excellence', buoyed by rising rates, a resilient economy and the privilege of being the settlement currency for most commodities. But it should be noted that, against other currencies with robust fundamentals such as the Swiss franc, or certain currencies of commodity-producing countries (Australian or Canadian dollar, Brazilian real), the performance of the greenback this year has been less spectacular. If the dollar is therefore so strong this year, it is primarily in comparison with currencies undermined by a particularly challenging economic situation. A strength of the dollar by default, so to speak, which does not necessarily predict a sustainable outlook for the greenback.



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