

US and Dollar Dominance in the International Monetary System

Implications for Global Spillovers

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PIIE, Floating Exchange Rates at Fifty, March 23, 2023

On the Surface: Popular View

- Increased awareness for pros/cons of the US Dollar hegemony in the light of the weaponization of the currency within the context of the war.
- **There is no alternative hegemonic currency** as neither the euro nor the renminbi are as important as USD in:
 - 50% + of **world trade** is invoiced in USD (payments)
 - 50% + of **world finance** is in USD (investment)
 - 60% of **world reserves** is in USD (store of value)

My focus today: Finance role

⇒ does not mean trade side, dollar pricing and pass-through to inflation are not important (Goldberg'08, Gopinath'14, Mann'89, Forbes'16)

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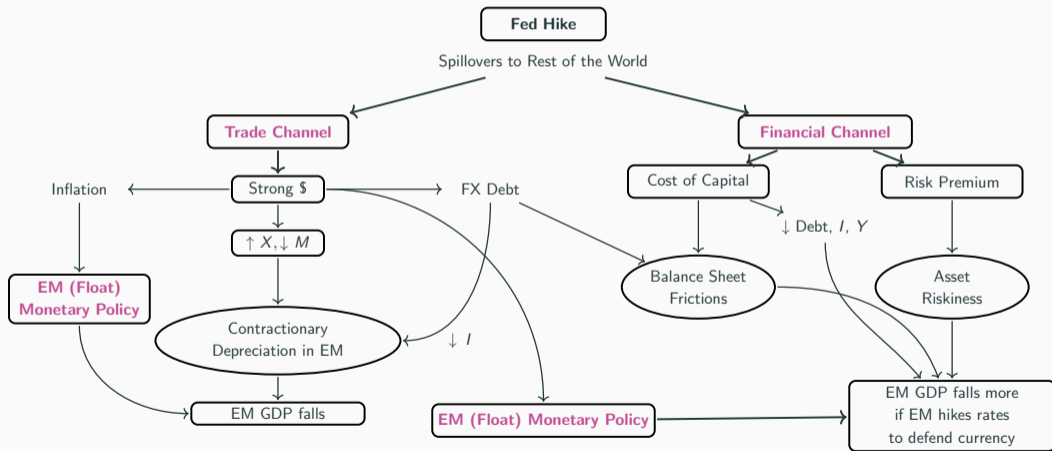
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Hard to separate: US dollar's international role from US monetary policy given the two key facts:

1. The US is the world's top provider of safe/liquid assets (Gourinchas and Rey, NBER 05)
2. Each time USD moves and/or US monetary policy moves (unexpectedly and/or significantly), EM risk-pricing changes (Longstaff et al., AEJ 11; Kalemli-Ozcan JH 19)

How US FED Hikes Transmit to the ROW?

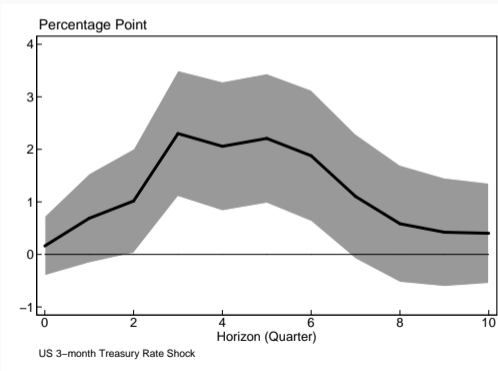


EM Spreads Response to US Tightening

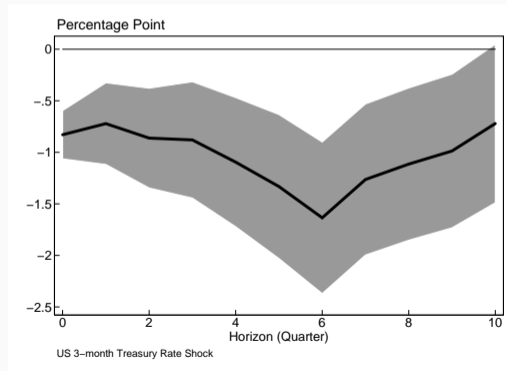
Using surprise \uparrow in US policy rate—1996-2018:

ST government bond spreads increase in EMs and decrease in AEs

Emerging Economies

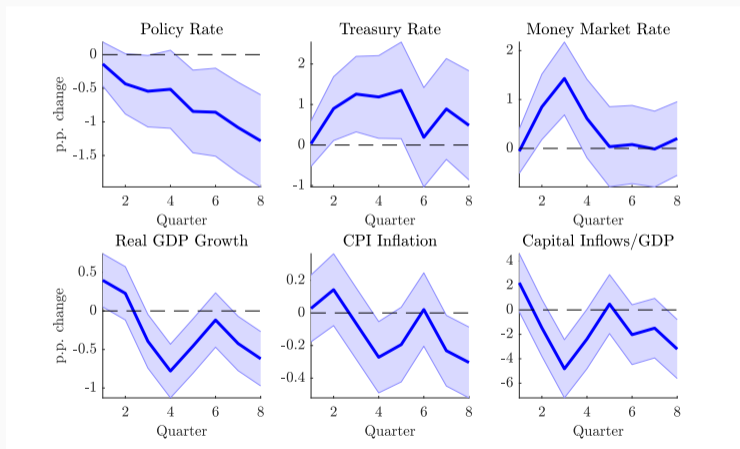


Advanced Economies

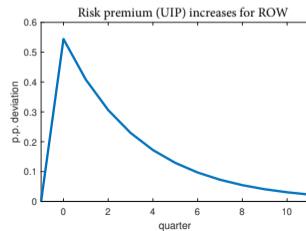
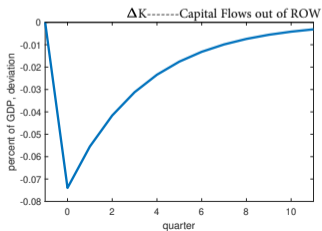
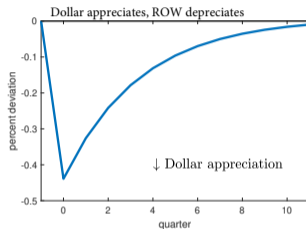
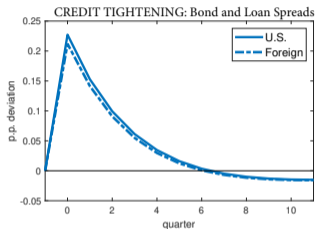


FED Hike: Dollar appreciates, EM currency depreciates, EM contracts

In spite of loose monetary policy in EM!



Uncertainty \uparrow : What might happen if FED action leads to higher financial volatility/uncertainty?



- In a world where financial channel of US dollar and US monetary policy dominates the international transmission, uncertainty shocks and financial market volatility become first order (for real sector transmission, output, employment)
- Flexible exchange rates help in that world as they absorb the risk premia shocks