



PIIE PETERSON INSTITUTE FOR
INTERNATIONAL ECONOMICS

Fifty Years of Floating Exchange Rates and the Future of the US Dollar

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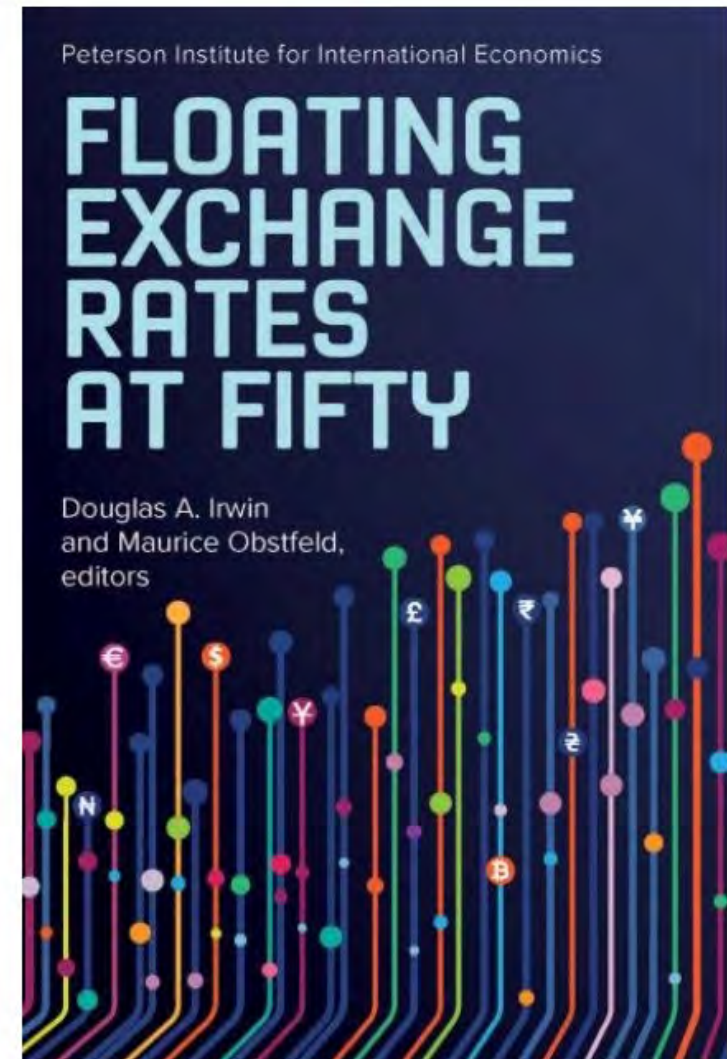
Expectations 50 years ago echo today's

- In the early 1970s, the Bretton Woods system anchored on the dollar unraveled
- By early 1973, major currencies were floating against the dollar – and continue to
- Inflation was rampant globally; then the Middle East exploded and OPEC reacted
- President Nixon's unilateral actions in 1971, severing the dollar-gold link and imposing 10% across-the-board tariffs, signaled for many a US regime change



But a durable “non-system” emerged

- A new PIIE book brings together 29 experts to assess how that happened and how the non-system (a term coined by the late John Williamson) has functioned and evolved
- Collectively, the included essays offer a comprehensive analysis of international money and financial markets and their impact on the world economy since 1973
- Several authors speculate on the future of the US dollar in the light of current tensions and threats

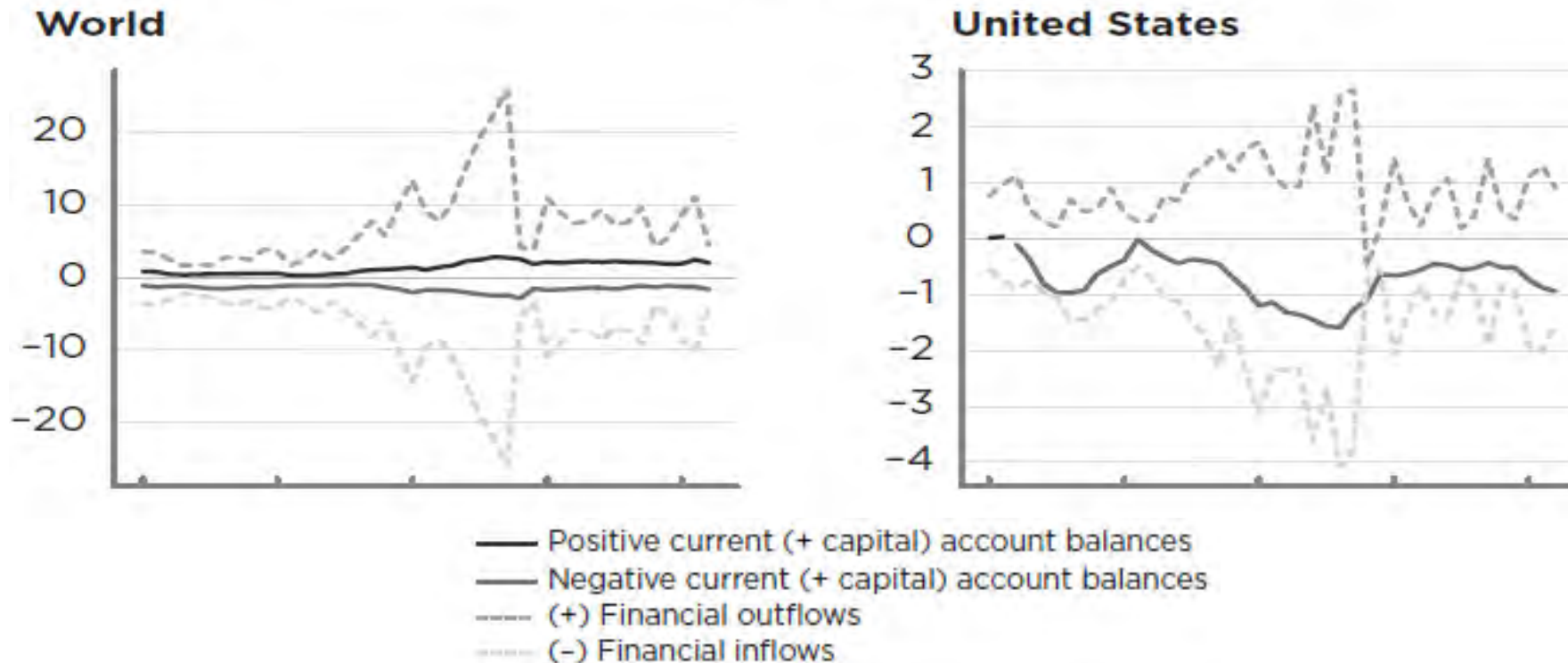


Several major themes stand out

- Financial shocks are main drivers of short-run exchange rate movements
 - A massive expansion of global financial markets occurred since the 1970s
 - This allows for liquidity and diversification but is also a source of shocks
- Domestic and international politics influence the system's functioning
 - Exchange-rate flexibility gives an extra degree of monetary freedom
 - But even freely floating rates cannot insulate completely from foreign shocks
 - They do not prevent trade and technology from driving intra-economy sectoral reallocations
 - Interdependence creates a need for international governmental cooperation, which continued, e.g., Basel process, the Plaza Accord, FX swap facilities
- Many problems of Bretton Woods are inherent in international finance and remain (often in different forms) under floating – *for example ...*

Current accounts grew but finance dominated

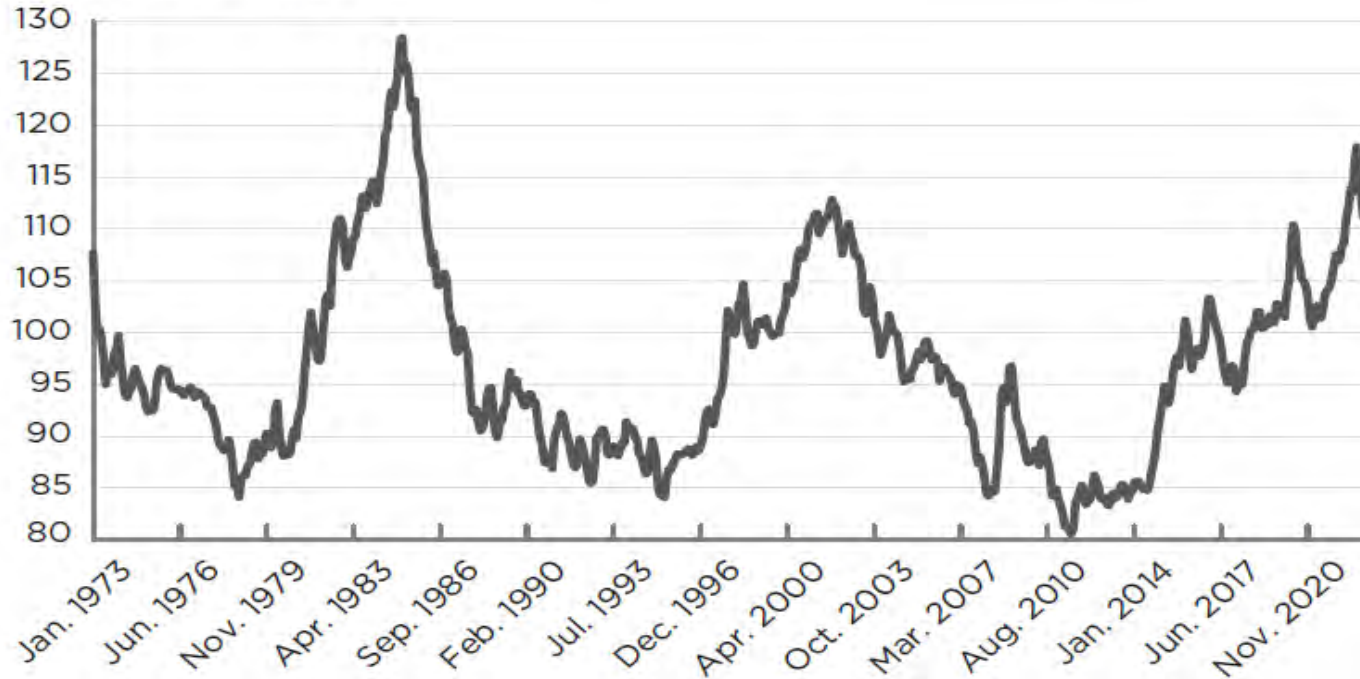
Dispersion of global current account balances and financial flows as percent of world GDP, 1980-2022



Currency moves didn't prevent trade deficits

US dollar real effective exchange rate, 1973-2023

index (March 1973 = 100)



Source: FRED

Currencies often strengthened as deficits grew, while depreciation didn't always eliminate them

Nonetheless world trade grew fast until GFC

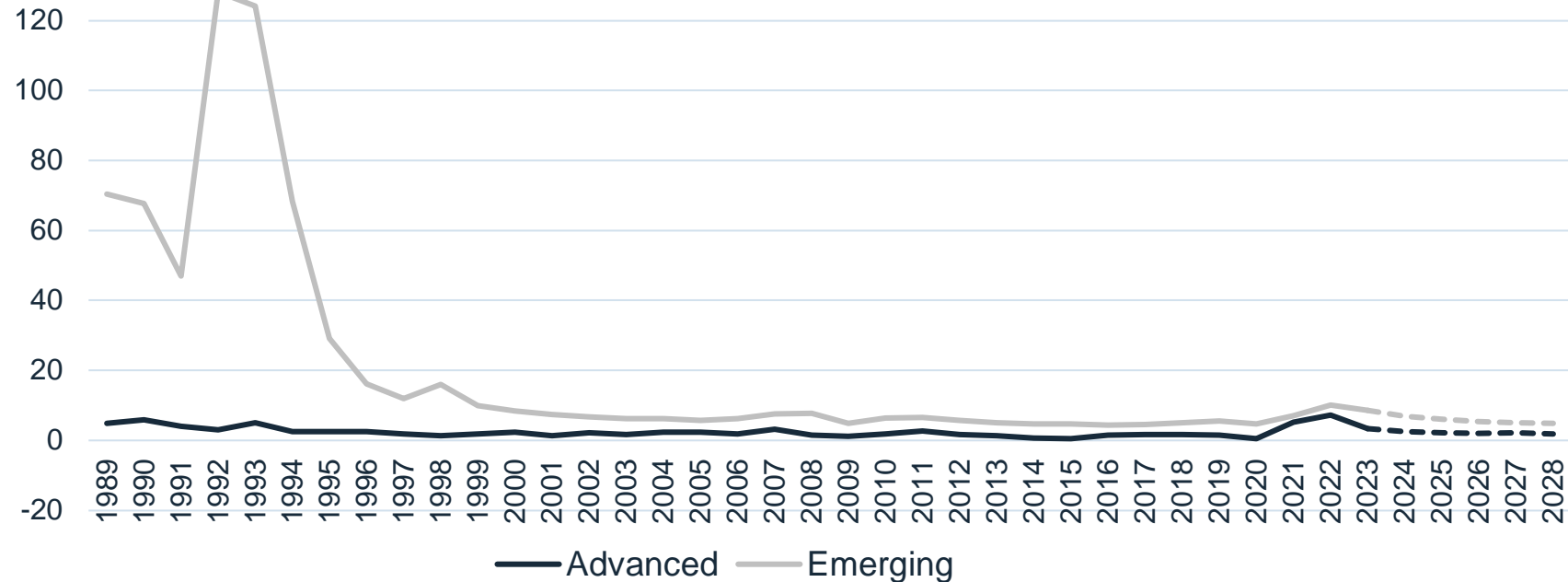


Source: World Bank

Until recently, protection pressure generally was limited despite exchange rate swings; indeed, the first 20 years saw ongoing trade liberalization and the formation of the WTO

Monetary freedom led to inflation stability

Inflation, percent, y-o-y

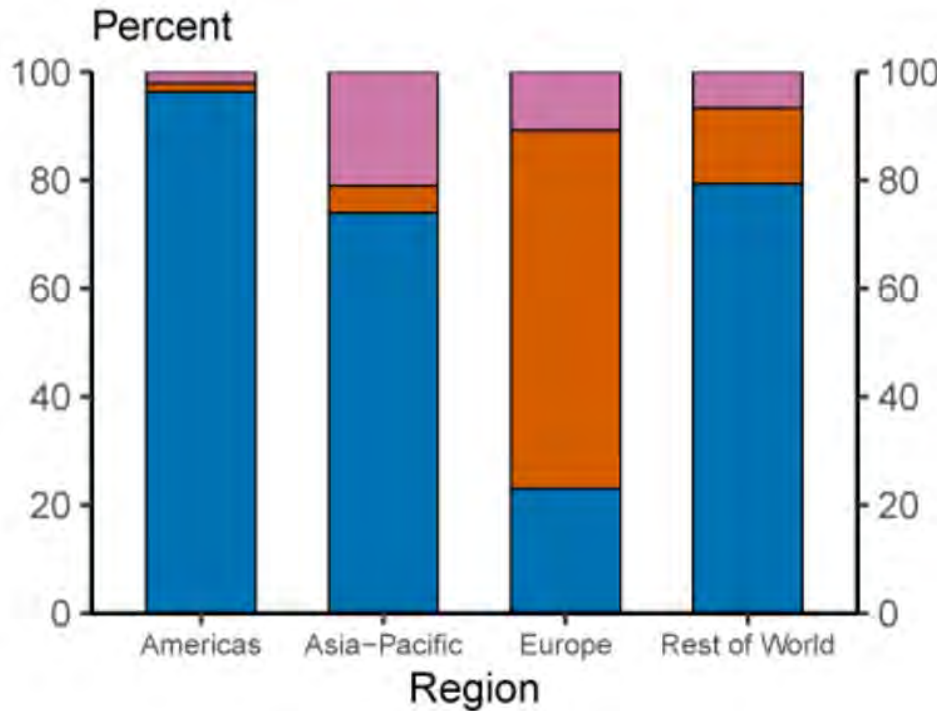


Source: IMF WEO Database, October 2023; projections start 2023

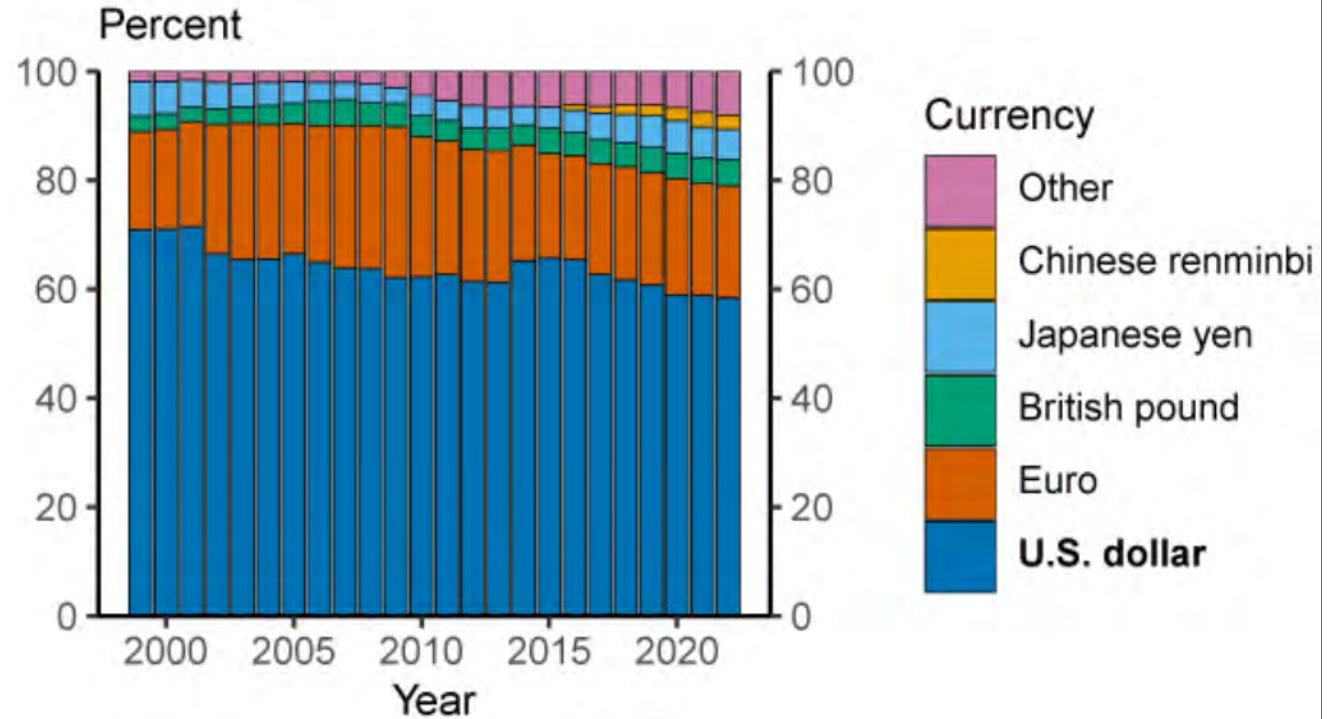
Many had predicted in 1973 that freeing monetary policies from the anchors of the dollar or gold would inevitably lead to price instability – but experience has been different under inflation targets

The dollar's central role remained and grew

Share of dollar invoicing, 1999-2019 average



Share of dollar in FX reserves



Bertaut, Carol, Bastian von Beschwitz, Stephanie Curcuru (2023). "The International Role of the U.S. Dollar" Post-COVID Edition," FEDS Notes. Washington: Board of Governors of the Federal Reserve System, June 23, 2023, <https://doi.org/10.17016/2380-7172.3334>.

Is the US dollar's reign ending?

- Most contemporaries felt that the end of Bretton Woods would topple the dollar
- Several factors prevented this and *strengthened* the dollar's role and influence:
 - Conquest of US inflation (now largely reaffirmed)
 - Financial liberalization and US financial primacy
 - Network externalities and need for a global benchmark currency
 - US rule of law and political stability – which may not be a given
 - Alternatives?
- Most authors felt these factors would continue to support the dollar medium term
- Even the threat from digital currencies is overhyped
- However, continuing trade and geopolitical frictions leading to (more) currency weaponization and financial segmentation could lead to rival currency blocs
- Many countries in the Global South could participate in more than one of these



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