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A SYMPOSIUM OF VIEWS

Is a *Dollar Crash* Coming?

Some argue (see "The end of the dollar's exorbitant privilege" by Stephen Roach, *Financial Times,* October 5, 2020) that America's plunging net domestic saving and ballooning current account deficit put the overvalued dollar at severe risk. As deficits and debt accumulate further and the current account imbalance deepens, the risk to the dollar will intensify. Do you agree?

The U.S. federal debt, now at $27 trillion, is scheduled to rise a lot further as presidential campaign promises are met and coronavirus-related costs escalate. What are the chances U.S. federal debt will ever be paid off? After all, the president of the World Bank has already proposed debt forgiveness for developing world economies. Is the next step global debt restructuring?

The entire developed world is bogged down in unprecedented levels of debt, the Covid-19 crisis is not over, and the major central banks' balance sheets have been massively expanded. What is the end game to this global situation in what is still a dollarized world?

Nearly thirty noted analysts share their views.

The dollar is on the cusp of an extended depreciation cycle.

SCOTT BESSENT
CIO and Founder, Key Square Capital Management

In a typical U.S. recession, the current account improves markedly as consumers restrain spending and imports contract. However, in this latest recession the current account has widened by nearly 1.5 percentage points, as consumers flush with stimulus have shifted consumption away from domestically produced services towards more import-intensive goods. Indeed, stories abound about a critical shortage of shipping containers needed to ship consumer goods from Asia to the United States amid surging demand.

Naturally, this backdrop has led observers to conclude that a dollar crash is imminent, as government debt expands and the balance of payments deteriorates in kind. Over the short to medium term, such a crash is unlikely. Rather, the currency is likely to face a steady but prolonged period of depreciation as the structural supports that have boosted the dollar begin to fade.

Broadly speaking, the most recent upcycle has been buoyed by three pillars. First, the shale revolution allowed the United States to achieve energy self-sufficiency in 2019. Mechanically, this generated a major improvement in the trade balance and led to a shortage of dollars abroad. However, the world is on the cusp of another energy revolution, a green one. Here, the leadership role of the United States is less clear, as Europe and China possess many of the key technologies. As these technologies are adopted over time, this will erode the relative energy advantage of the United States.

Second, U.S. growth outperformance following the global financial crisis allowed the Fed to normalize monetary policy as many other developed-market central banks remained stuck at the zero lower bound. Prior to Covid-19, this opened up wide interest rate differentials that encouraged U.S. inflows. However, these interest rate differentials have now contracted substantially. And with the Fed likely on hold for many years, they are unlikely to widen again soon.

The final factor boosting the dollar has been President Trump. While it is debatable whether his policies were good for the U.S. economy as a whole, they were undoubtedly good for the currency. In particular, the corporate tax rate was reduced from 35 percent to 21 percent, and there was a dramatic rollback of government regulations. Combined, this raised the after-tax return on capital and made the United States a very attractive place to invest.

Though Joseph Biden campaigned on a plan to raise the corporate tax rate to 28 percent, he is unlikely to be able to do so with a likely divided Congress. Equally, a divided Congress is unlikely to agree to large deficit spending. However, Biden will likely make extensive use of agency appointments and executive orders to restore some of the regulations unwound under President Trump. On the margin, this will dent the relative attractiveness of U.S. investment.

In addition to his explicit policies, President Trump's unpredictable behavior made it unattractive for investors to take short positions in the dollar. At any moment, Trump could issue a tweet imposing tariffs, leading to an abrupt depreciation of the target country's currency. As this unpredictability fades under a Biden presidency, so too will the reluctance to borrow or be short the U.S. currency.

In sum, while a dollar crash does not seem imminent, the primary factors which have boosted the dollar are slowly fading, making it likely that the dollar is on the cusp of an extended depreciation cycle.

Francis Browne contributed to this article. The views presented in this article are purely the opinions of the author and are not intended to constitute investment, tax, or legal advice of any nature and should not be relied on for any purpose.

What would make the dollar crash? Domestic political breakdown.

ADAM S. POSEN
President, Peterson Institute for International Economics

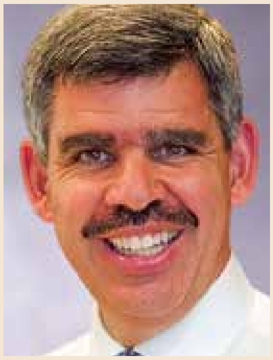
No, but a dollar downward adjustment is underway, and likely to be sustained. As I have said for some time, the relative values of the major global currencies are determined by a least-ugly contest. What matters is not the attractiveness of the currency or underlying economy on its own terms, but how that develops compared to the alternatives. This phenomenon particularly shows up in times of crisis or disruption, as in 2008–2010 when the U.S. economy was definitely ugly, but the alternatives, particularly the euro area, got uglier faster. So the flows then were towards dollar assets, even when the crisis hit the United States hard.

Right now we are seeing the reverse on average. For the first time since 1979–1980, it is the U.S. economy that is getting uglier faster than those of the other major currencies and even alternative assets (such as gold and cyber currencies). This reflects the political dysfunction of the United States and its substantial negative effects on pandemic policy response, which are worse than those in Europe, Japan, China, and some other mid-size market economies.

In particular, over the last six months, the European Union has created a unified fiscal policy response and validated the European Central Bank's approach. Whether or not you believe this is a Hamiltonian moment for Europe [see *TIE,* Summer 2020], whatever estimate you had for the risk of euro area break-up and redenomination of risk must be meaningfully lower. Even with the resurgence of the pandemic at the time of writing, Europe's public health response and results are better than those of the United States, and the failure of the U.S. Congress to pass an extension of the CARES Act will reinforce this divergence in outcomes.

The various ways in which the U.S. dollar is over-weighted in international finance—including its share of official foreign exchange reserves, of cross-border lending, of trade invoicing, and of private portfolios—are likely to be reduced as a result. This is not a dollar crash. The dollar is so overweight in all of these dimensions, from 40–80 percent or more shares on various measures, when U.S. GDP is less than quarter share of the global economy and shrinking (and trade with the United States is an even smaller share of the global total). Thus, there is plenty of room for substantial downward reduction in share without a rout. And none of these aspects require there to be one dominant currency—the network benefits can accrue to a few large currencies at once.

What would make the U.S. dollar crash beyond this downward adjustment in its international financial role is domestic political breakdown. Public debt levels and even current account deficits do not matter much for a large high-income democracy in and of themselves, so long as people believe that taxes can be raised if needed. That probability is what has kept the Japanese economy afloat even as public debt levels went above 200 percent of GDP. If due to a contested election or a divided partisan Congress the United States repeatedly cannot pass budgets in 2021, that portends badly for the dollar, just as it would for any other economy.



It is extremely challenging to replace something with nothing.

MOHAMED A. EL-ERIAN

President, Queens' College, Cambridge University, Chief Economic Adviser, Allianz, and author,* The Only Game in Town: Central Banks, Instability, and Avoiding the Next Collapse *(Random House, 2016)

Two basic concepts help anchor my views on the dollar's prospects: exchange rates are relative prices rather than absolute; and it is extremely challenging to replace something with nothing.

The future of the dollar depends not only on what is happening in the United States but also what is taking place elsewhere. Viewed through this first lens, the currency will not "crash"; and it will continue to retain its standing as the world's premier reserve currency, albeit in a world subject to higher fragmentation risk.

Undoubtedly, the United States faces a host of economic challenges. Growth is slowing at a time when additional Covid-related disruption remains a real and present danger. Already, fiscal deficits and debt have ballooned, as has the Federal Reserve's balance sheet. The inequality trifecta—of income, wealth, and opportunity—has worsened. Meanwhile, domestic political divisions are likely to hinder timely and decisive economic reforms, as well as slow the country's return to multilateralism leadership and a reversal in the recent weaponization of both trade and investment policies.

Yet the United States is by no means an outlier among advanced countries. Europe is under more immediate economic, institutional, and structural pressures. This hampers the ability of the euro to consistently out-perform the dollar and assume a predominant reserve currency role.

East Asian economies (China is particular) are in a better place, though sustaining this will require significant domestic reform to lower dependence on such an uncertain and uneven global economy. In such circumstances, the authorities may well have limited enthusiasm for sharp and sustained currency appreciations; and even less to see their currencies internationalize rapidly—preferring instead a more regional approach.

The bottom line may be illustrated by a simple analogy. Imagine your business trip (remember those?) is extended suddenly, you have run out of blouses/shirts, and you have no way to get to either a laundry or a dry cleaner. You will have little choice but to wear your "least dirty" clothes. That's the situation for the dollar. It is not squeaky clean but it's more desirable and feasible than the alternative.

This simple analogy illustrates why the dollar is likely to retain its relative role in a world where the "exorbitant privileges" that have traditionally come with this are gradually eroding.

The United States has been sabotaging its own privileged situation. Yet the dollar remains the most trusted and reliable option.

JILL CARLSON

Investor in early stage companies, Slow Ventures, and Co-founder, Open Money Initiative

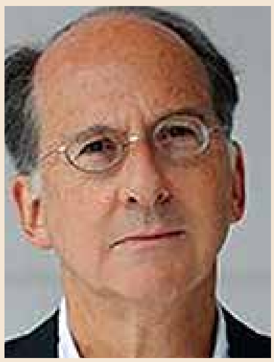
One need not be an economist in order to understand the esteem the U.S. dollar commands in countries around the world. Walk into a corner store in Bucharest or pay for a taxi in Buenos Aires and chances are, if you ask, your dollars will not only be accepted but be welcomed. The greenback remains a symbol of safety, stability, and access. People on every continent accept dollars as payment or tip, examining the bits of paper, feeling them in their hands, even kissing or smelling them. They are unaware of—or do not care about—the United States' debt burden and current account balance.

The emotional response of individuals around the world to the dollar is emblematic of the dollar's position in geopolitics as well. The enormity of the federal debt, the dampened growth expectations of the United States, the costs of the coronavirus lockdowns, and the Federal Reserve's easy monetary stance are all well-known at the state level, of course. Yet just as it is amongst people globally, the U.S. dollar persists as the perceived safe haven of countries around the globe. The dollar is still the reserve currency of almost every central bank. As long as it remains so, the dollar's dominance (and its value) will be unthreatened.

It is worth noting that the United States has not done itself many favors in terms of maintaining this position over the last several years. Fiscal policy, monetary decisions, and political moves have all combined to create an environment in which the position of the dollar is in question. Ballooning debt, an indefinite zero-interest rate environment, and liberal deployment of sanctions by the Trump administration have all undermined the dollar's position of hegemony. The United States has been sabotaging its own privileged situation.

And yet the dollar remains the most trusted and reliable option for central banks, corporations, and individuals around the world. There are, today, no viable alternatives. The euro area remains fiscally fragmented and is dealing with debt, growth, and interest rate dynamics similar to (if not worse than) those of the United States. Until China embraces increased openness, transparency, and respect for property rights, the renminbi will not be an option. Given this context, the dollar will maintain its status.

Global demand for dollars means that, at least in the short and medium terms, the United States will not need to pay off its debts. This, naturally, means that the country likely will not. Until the U.S. debt burden starts to threaten the perception of the U.S. dollar as the safest option out there, there will be no change in policy. Until then, to take a variation on Winston Churchill's words on democracy, the U.S. dollar will remain the worst performing currency in the world, except for all the others.



There are now no alternatives to the dollar.

MARK SOBEL

U.S. Chair, Official Monetary and Financial Institutions Forum, and former Deputy Assistant Secretary for International Monetary and Financial Policy, U.S. Treasury

Prophesies of dollar demise and crash are legion.

Recently, an oldie but goldie has resurfaced—the twin deficit dollar doom story.

Over past decades, there have been several massive dollar-led currency market swings. One was a late 1970s dollar collapse amid high inflation and little confidence in U.S. policy. Another was in the early 1980s when Fed Chair Paul Volcker tightened monetary policy and President Reagan further pressured rates with an expansionary fiscal policy and deficit. The dollar unsurprisingly soared and the current account deficit surged.

The third was the dollar's plunge between mid-2006 and mid-2008. This period encompassed a large external deficit and aggressive Fed cuts with the onset of financial crisis—which other central banks followed later. Turbulence persisted afterward.

Many commentators argue the dollar will fall sharply as post-pandemic risk appetite resumes and/or as twin deficits catch up with America. Early in my career, senior officials told me only a fool thinks he/she knows where foreign exchange rates are headed.

At the risk of being foolish, a range of offsetting factors could shape currency markets for coming years and limit prospects for large trade-weighted dollar swings, let alone crashes.

Movements in short-term rate differentials between the United States, Europe, and Japan are a key exchange rate driver. Rate differentials are compressed and will remain so for a long time.

The dollar's safe haven bid leads to risk-off appreciation pressures. While risk appetite may improve, bouts of volatility and risk-off behavior often pop up.

As the pandemic wanes, especially post-vaccine, the United States will be bailed out of its failed Covid-19 response—the U.S. growth outlook is better than that for Europe and Japan.

While Europe and Japan interminably lament the dollar's "exorbitant privilege," they immediately start hand-wringing the nanosecond their currencies strengthen. The Euroepan Central Bank and the Bank of Japan will step up accommodation if the dollar weakens.

America has an entrenched saving/investment gap. But America issues the world's best safe asset, and given rock bottom interest rates—plus Fed purchases—despite our large fiscal deficits, demand seems robust. That can't go on forever. But now is the time for fiscal support.

Some argue the EU Next Generation Fund is the harbinger of a safe euro asset. It's only a first step. When the crisis abates, Germany and the "frugals" may revert to business as usual.

The RMB is a good candidate for appreciation. But China has an extremely weak financial system and is increasingly authoritarian. Despite increased inflows into Chinese bonds and stocks, major capital account opening runs the risk of massive outflows, depreciation, and financial instability. Chinese property protections leave much to be desired.

A major U.S. policy mistake undermining macro stability or the dollar's reserve currency properties could sow the seeds of dollar demise. Excessive unilateral use of financial sanctions could weaken the dollar over the longer haul.

But there are now no alternatives. One day the soothsayers of doom may prove right. In the meantime, the repeated prophesies are tired.

Economists used to extrapolating the present into the future with their stationary models see deflation as the bigger risk. But they usually miss what lurks around the corner.

THOMAS MAYER

Founding Director, Flossbach von Storch Research Institute, and Professor, Witten/Herdecke University

Forecasts of a U.S. dollar crash have been inspired by the increase in the U.S. economy's foreign current account deficit from -2.1 percent of GDP in the first to -3.5 percent in the second quarter of this year, the highest deficit since 2008. The reason for the increase was the massive fiscal and monetary policy support for domestic demand, which raised imports, pushed the stock of money with zero maturity up almost 30 percent on the year, and will boost the general government budget deficit and debt (on International Monetary Fund forecasts) in 2020 to almost 19 percent and 131 percent of GDP, respectively.

However, these figures are less frightening when put into context. At -3.5 percent of GDP, the U.S. current account deficit is close to its average over the last two decades. The real effective exchange rate of the U.S. dollar stands about 8 percent above the average but remains well within the fluctuation margin of plus or minus 15 percent over this period. For the advanced countries, the IMF forecasts government deficits and debt of 14 percent and 124 percent of GDP, respectively, with deficits and debt rising significantly almost everywhere. And liquid money growth in the euro area and Japan is running at around 14 percent, although the euro and yen are less in demand globally than the dollar. All this suggests that if the dollar crashes, then it will crash probably not against other fiat currencies, but together with them.

In almost all advanced countries, the legacy of the Covid-19 pandemic will be a largely government-run economy, shattered public finances, and a huge money overhang created to finance the national debt. The similarities with a war economy are unmistakable. After the Napoleonic Wars, England was able to work its way out of its national debt with the Industrial Revolution; after the Second World War, the United States succeeded in doing so with the economic boom triggered by the reconstruction of war damage and pent-up consumer demand.

A comparable growth driver for the period after the epidemic is not in sight for the advanced economies.

Bankruptcy or inflation seem to be the only means of eliminating the debt and money overhang. But since policymakers will continue to do everything to avoid debt defaults, debasement of the fiat currencies is the more likely outcome. Economists used to extrapolating the present into the future with their stationary models see deflation as the bigger risk. But they usually miss what lurks around the corner in our non-stationary world.

Who will be the winners? China is coming through the pandemic better than most other countries, which could make the yuan a relative winner. But the return of inflation will affect all fiat currencies and could bring back the "barbaric relic" gold as the preferred means for transactions and the store of value.

The dollar could weaken, but a crash for now is unlikely.

JIM O'NEILL
Former Commercial Secretary to the Treasury, United Kingdom, and former Chairman, Asset Management, Goldman Sachs International

I probably spent far too many years of my professional life trying to answer this question. Since my first days in foreign exchange in 1982, it has been a reoccurring question, and often, superficially, seemed like a fair question. These days, as I have no such professional obligations, when I still get asked about what I think about the dollar or any other currency, I often answer, "I guarantee it will go up and down, although I am not sure whether it might go down and up, before it goes up and down!"

Before I get to the core issues of why this question has come up, I would also offer the following reflections. First, on one level it has often seemed over the course of my professional life that the natural tendency of the dollar has been to rise in value. It has often taken deliberate efforts by U.S. policymakers to actually weaken the dollar, the Plaza Accord in the mid-1980s being an especially good example. Also, it has often seemed to be quite easy for U.S. policymakers to halt a decline in the dollar when they choose.

Second, while many casual observers always link the two, it seems to me that there is a big difference between the cyclical performance of the dollar and the use of the dollar and its overall role in the global monetary system. At times, the two can even relate. Indeed, I think it is not inconceivable and maybe relevant to the current case that the period of a rising dollar in recent years partly reflects at times the strong dominance of the U.S. dollar in global financial transactions, and the United States flexing its muscle, so to speak. This has contributed to some countries choosing to deliberately reduce their dependency on the dollar in their own daily transactions.

As far as the cyclical outlook is concerned, I spent many years developing my own personal models, trying to estimate fair value for the dollar and other currencies. Notwithstanding earlier comments, I do generally believe these broad models had and still have great validity. In particular, models that build upon the basic concept of purchasing power parity (PPP) to those that accept real exchange rates themselves aren't stable, but will generally move and broadly reflect differential productivity performance.

Today, such models suggest that the dollar, despite its decline during recent months, is broadly overvalued against many currencies. This said, the degree of overvaluation doesn't appear to be especially dramatic, at least by the standards of eras such as the 1980s. Against the yen, pound sterling, and perhaps some important emerging market currencies such as the Brazilian real, the overvaluation of the dollar is more striking than against the euro or RMB. It is also true that notwithstanding the deterioration of the U.S. trade and current account deficit in 2020, the scale of U.S. external balances is much more manageable than in the past.

I often use to adjust these estimated real exchange rate equilibria for pure cyclical forces, especially relative interest rate differentials, and these adjusted equilibria should broadly correspond with how currencies are trading in the markets. If they aren't, either the models are of no use, or something odd is happening. If you do this today, because of higher relative interest rates in the United States than in many other places (at least bond yields), then this suggests some higher dollar value is cyclically justified (although not against the RMB).

All of this kind of analysis suggests that the dollar could weaken as and when relative cyclical forces change, but they do not suggest fears of a true dollar crash are especially warranted.

If some relative cyclical improvement in the economies of other major currency areas is observed, notably compared to that of the United States, especially in the unlikely event that their improvements occurred at the same time as the U.S. situation absolutely deteriorated, and if this either coincided with, or forced some significant attempts by, China, the euro area, and/or Japan to deliberately boost the use of their currencies and financial markets for major global transactions, then this would be a different story. But this could have been true at any point since I started thinking about these things in 1982, and will remain so. At some point in the future, it will turn out to be correct.

The short-term risk is low, but the longer-term risk is greater.

ANNE O. KRUEGER
Senior Research Professor of International Economics, Johns Hopkins School of Advanced International Studies, and former First Deputy Managing Director, International Monetary Fund

It is certainly true that the higher the debt burden, the greater the risk. The United States is positioned to incur large increases in that burden over the foreseeable future, as a result of the pandemic-induced expenditures and the prospective increase in entitlement expenditures for Medicare and Social Security.

Turn first to the last word in the question: "soon." It is unlikely that a dollar crash will take place in the near term. While the U.S. debt-to-GDP ratio is mounting, it is also increasing in many other countries. The United States is traditionally a safe harbor in circumstances such as these and will likely be so this time as well. Hence, capital inflows are likely to finance the current account deficit in the near future.

Moreover, as long as the interest rate remains near its low present level, the ratio of debt service to GDP will be manageable. Although the U.S. debt-to-GDP ratio is around 100 percent, the low interest rate makes interest payments low, which in turn means that rollover should not be an issue. With an interest rate of less than 1 percent now, the interest cost of debt relative to GDP is less than it was in 2000 when the debt-to-GDP ratio was half of what it is now and the interest rate was over 5 percent.

Over the longer term, the risk is greater. If inflationary pressures start to build, tightening monetary policy will increase the costs of debt service. Because it is difficult for politicians to cut expenditures or raise taxes, it is unlikely that those pressures would result in a sharp reduction in the prospective deficit. As further tightening is called for, political pressures against it because of the debt service cost would likely rise. At that point, the inflation rate would be rising and efforts (such as price and rent control) other than monetary tightening would be tempting and growth-reducing. The converse is also true. Given the already-elevated debt-to-GDP ratio, the ability to mount a fiscal response to a downturn in economic activity would also be limited.

The United States will never pay off all its debt and it need not do so. If the rate of growth of nominal GDP exceeds the rate of growth of the debt, the ratio can fall consistent with an increase in total indebtedness. The difficulty is that, with a fiscal deficit of 15 percent currently, there is little prospect that the rate of growth of debt will fall below that of nominal GDP any time soon. If the inflation rate is 2 percent, while the growth rate of nominal GDP is about that same level, the fiscal deficit would need to fall below 4 percent for debt-to-GDP to stay constant and below 3 percent to achieve any meaningful reduction in the debt-to-GDP ratio. With the prospective increase in entitlement costs, it is unlikely that politicians would have the political will to address the issue sufficiently until faced with a crisis.

Government debt can never be paid off.

HEINER FLASSBECK
Director, Flassbeck-Economics, and Former Director, Division on Globalization and Development Strategies, United Nations Conference on Trade and Development

The answer is no! Against whom should the U.S. dollar crash? Against a European currency that after twenty years of existence has not yet overcome its teething troubles? Against the Japanese yen backed by the biggest government debt of all countries on earth? Against a Chinese currency that is not even fully convertible? Against the Swiss franc that is kept artificially low by permanent intervention of the Swiss central bank?

To be sure, all countries of the world will see sharply rising government debt in the wake of the corona shock. But rising government debt is a normal feature of the new institutional arrangements inaugurated by the neoliberal counterrevolution since the 1970s. The attempt of the liberals to revitalize the market economy by deregulation and more labor market flexibility has brought about a fundamental shift concerning the role of companies—unfortunately, a shift in the wrong direction.

The original idea about market economies was based on the belief that private companies would do what has to be done in a world where private households are not spending the whole of the income that they receive from companies. For more than two hundred years, every good economist was sure that companies would be the natural counterpart to private households who are net savers. To deliver investment based on net debt was the role to be expected from the company sector. But this is no longer true.

The financial balances for the United States show companies moving consistently on the saving side along with private households over the last twenty years. This is true for many other countries. Without massive stimulus from fiscal policy, the U.S. economy could never have returned to full employment after the global financial crisis because the United States is suffering from a current account deficit (which is saving of foreign countries).

The fact that the United States was able to achieve rather high growth rates and a good employment performance after 2008 is only due to the fact that they have pursued a very pragmatic fiscal policy, accepting very high government deficits even when full employment was reached immediately before the corona crash.

According to serious estimates, even before the pandemic, overall government debt would have risen towards 110 percent of GDP. Now it will be much more. However, contrary to what the liberals believe, this is not a major problem. It just shows that in the modern times of saving companies, there can be no reasonable economic development without a permanently greater financial commitment on the part of the state. Japan learned that lesson long ago. The United States is learning by doing. Only Europe refuses to acknowledge that someone has to give if everyone wants to be a saver.

The paradox is that monetarism and neo-liberal labor market policies have created a world of diminished expectations on the private side so that only the state can provide a remedy. Through its own aggressive demand policy, the state can create growth rates that are sufficiently large to achieve ambitious employment goals. Given this, it is obvious that government debt can never be paid off. As one sector of the economy has to accept debt if everybody else is trying to save, only a full circle in terms of neoliberalism and inequality could bring a world back where companies are doing their job of providing booming investment and of accepting permanently higher debt. If you don't believe in such a miracle, you have to accept ever-rising government debt more or less in the whole world.

A dollar crash is not likely anytime soon, but unlikely events do happen.

JOSEPH E. GAGNON
Senior Fellow, Peterson Institute for International Economics

Predicting exchange rates is a fool's game. A dollar crash is not likely anytime soon, but unlikely events do happen. The U.S. net international investment position was -67 percent of GDP in the second quarter of 2020, a record net liability position and in the range where other countries have encountered problems. Some rebound is expected by year-end, but the trend is down and that bodes ill for the dollar's value. It makes no sense for the wealthiest large economy to have borrowed on a scale the world has never before seen. At some point, international investors will balk at further increases in their exposure to U.S. assets.

Studies find that the correction of unsustainable trade deficits and international borrowing tends to be orderly in countries with a sound policy framework and no currency mismatches. Low and stable inflation is key, and the United States certainly has that. Moreover, even in the event of a disorderly adjustment, most of the harm would fall on foreigners who would experience a sharp decline in the value of their U.S. investments.

Rising public debt is a global phenomenon, however, and not limited to the United States. The main drivers are longer lifespans, lower birth rates, and the rise of new technologies that produce output with little capital investment. All these factors depress desired investment and increase desired private saving, putting downward pressure on aggregate demand and interest rates and upward pressure on asset values. Most researchers do not expect a reversal of these trends for at least the next ten years.

The correct metric for excessive debt is not to compare the stock of debt to the flow of income but instead to compare the interest expense to the flow of income. Debts need never be paid down, but they do have to be serviced. On that metric, the advanced economies are in good shape. Government interest burdens, in particular, have fallen despite rising debt stocks. Indeed, a true inflation-adjusted accounting would show a negative burden, meaning that higher debt reduces a government's budget deficit. That is the market's way of saying "please borrow more."

Of course, this beneficent situation may not last forever. At some point, real interest rates may return to positive territory. That is why it is important to use the debt wisely and invest in human and physical capital (education and infrastructure) that will yield high returns to society for years to come. Any increase in real interest rates likely would be gradual and would result from good news for economic growth, making it easier to undertake the needed fiscal consolidation.

No crash for at least five years.

HOLGER SCHMIEDING
Chief Economist, Berenberg

The dollar is not heading for a crash, at least not for the foreseeable future of, say, five years. Despite the disaster called Trump and a potential swing of the pendulum to the progressive left once he is gone, the United States remains a fundamentally sound economy. No other country or region can match its capacity to innovate and reinvent itself. Under its red emperor for life, China has embarked on a dangerous path of repression at home and costly imperial pretensions abroad. As we cannot rule out that it may end in Mao-style hubris and turmoil, China's currency cannot replace the U.S. dollar as the world's ultimate safe haven.

The U.S. Federal Reserve's monetary policy is aggressive, but so is that of all other major central banks. The European Central Bank and the Bank of Japan will not quite follow the Fed in actively striving for inflation above 2 percent. The Fed's pursuit of its new strategy can push the still-overvalued greenback to or slightly below its fair value of roughly $1.25 to the euro. Such modest differences in monetary policy do not make for a crash, though.

Of course, the United States faces serious long-run problems. The worst is the polarization of its society and the undermining of its institutions through policymakers such as Trump who worsen the rifts and exploit them for their narrow political ends. This makes it even harder for his successors to make the tough choices in the future needed to rein in the explosive rise of U.S. public debt eventually.

But for the next few years, this is not (yet) a grave risk to the dollar. As in other jurisdictions, the Fed absorbs most of the current rise in U.S. public debt. In times of heightened demand for liquidity by households, companies, and the financial system, these asset purchases are needed to expand the central bank's balance sheet accordingly. As the central bank is part of the public sector, the paper is—strictly speaking—not really public debt. Of course, once the central bank has to shrink its balance sheet again, no longer rolling over all maturing paper, the financing conditions for the U.S. Treasury will worsen—from extremely favorable to more normal. That need not trigger any crisis.

With its solid fundamentals and its unrivaled reserve currency status, the United States can get away with a starker rise in debt than other regions despite its reliance on foreign private and official investors to finance its twin deficits. If need be, modest changes in the returns which foreign investors expect from U.S. assets suffice to attract the needed capital from abroad. As a result, the dollar may fluctuate but will not crash for the foreseeable future. History shows that reigning currency kings are not dethroned easily. What happens in the longer term is a more open question. But if the United States finally rises to its challenges, as it has usually done throughout its history, the dollar will avoid a genuine crash for a long time to come.

I see any dollar weakness as cyclical in nature, nothing malignant.

CHEN ZHAO
Founding Partner and Chief Global Strategist, Alpine Macro

I totally disagree with this line of argument. There are several fallacies with regard to the argument of an imminent decline in the dollar. First, the foreign exchange rate is always relative and yes, when you look at the U.S. economy in isolation, there has been a large increase in both budgetary deficit and debt. However, this has been a global phenomenon. No high income-economy has escaped being hurt by the Covid-19 pandemic. I don't see the U.S. fiscal condition as particularly worse than others.

By the way, the U.S. current account deficit has averaged about 2 percent of GDP since 2018. This compares with an external deficit of 7 percent in 2005. The U.S. household sector savings rate rose to 6–8 percent after the 2008 financial crisis. It soared to 35 percent as a result of the pandemic, only to have fallen to 15 percent in recent months. The problem with the U.S. economy today is that the private sector saves way too much—a key reason why unprecedented fiscal stimulus has caused no financial stress or inflation.

Second, the U.S. economic recovery has proceeded more quickly than in most other major economies, excluding China. I simply cannot find a major currency that can afford to appreciate substantially. The eurozone already flirts with deflation and ECB President Christine Lagarde has tried to talk the euro down. Can the Japanese yen rise sharply against the dollar? Not very likely. Japanese inflation is going back to zero and any additional currency strength will send the economy right back to deflation.

The only currency that has stronger economic fundamentals than the dollar is the Chinese RMB, but it is not a fully convertible currency and is subject to a lot of regulatory controls. In this environment, how is a "dollar crash" possible? Against which currency?

Third, although the Fed has pressed rates at zero, they are negative in Europe and Japan. The long bond yield spread between U.S. ten-year Treasury notes and ten-year German bunds is close to 130 basis points, in America's favor, and the same spread between the United States and Japan is over 75 basis points. These bond yield spreads underscore strength in the U.S. economy relative to other high-income economies. This is another key reason why the dollar will not crash.

Fourth, will the U.S. government ever pay off its debt, given the escalating debt-to-GDP ratio? This question is flawed: Many strategists expressed similar concerns about Japanese debt in the mid-1990s when Japan's sovereign debt/GDP ratio climbed to 100 percent, with many economists projecting Japan hitting a "debt wall" leading to a collapse in Japanese government bonds and the Japanese yen. Today, Japan's debt-to-GDP ratio is 240 percent, Japanese government bond yields are zero, and the yen is strong.

The Japanese experience tells us that the government debt-to-GDP ratio has no bearing on financial stability whatsoever. The public sector debt-to-GDP ratio simply tells you how much private sector savings are being transferred into public sector spending. In a sense, it is nothing more than an accounting ledger documenting how savings have been redistributed. From an economic viewpoint, as long as the private sector saves more than it invests, as most high-income economies do, the government sector must borrow from the private sector by running budget deficits continuously. Otherwise, the nominal GDP will sink.

Of course, when the private sector starts to invest more than it saves, excess demand arises. The government sector must reduce its fiscal stimulus and cut down its borrowing. Otherwise, either bond yields will rise or the currency will fall, but make no mistake: debt repayment should never be an issue—a central bank can always be the "buyer of the last resort" for its own government bonds. In other words, the question of whether a government can ever repay its debt is conceptually flawed—because it always can.

Finally, the dollar is a counter-cyclical currency and tends to weaken during a global economic recovery. As such, it is possible that the dollar will continue to show some limited weakness against the euro and Japanese yen, but no crash whatsoever. In the meantime, the dollar could weaken more against the RMB because the Chinese economy will likely continue to lead the rest of the world in economic recovery. A range of emerging market currencies were destroyed during the pandemic. A rebound in these currencies is very possible, but this is a realignment from their very oversold and undervalued position. In other words, I see any dollar weakness as cyclical in nature, nothing malignant.

The predominance of the dollar will continue for the foreseeable future.

MAKOTO UTSUMI

Chairman of Global Advisory Board, Tokai Tokyo Financial Holdings, Inc., and former Vice Minister of Finance for International Affairs, Japan

For almost four decades, the argument has been made that the double deficit (current account and budget) and the low saving rate in the United States will cause a dollar crash.

The dollar's predominance in the global economy, however, has never been shaken. The value of a currency reflects the fundamental economic and geopolitical strength of its country. The United States has its unique strengths, including a still-increasing working population, a flexible labor market, innovation and entrepreneurship in the corporate sector, deep financial markets, increasing energy autonomy, and needless to say, its outstanding military strength.

Because of the necessity to cope with the deep recession due to the pandemic, the budget deficit is rapidly increasing. But the ratio of the accumulated public debts *vis-à-vis* GDP is 130 percent in the United States, which ranks between Japan (266 percent) and the European Union (101 percent).

And most important, there is not a single currency nor currencies yet which can replace the dollar as a predominant key currency.

Some argue that the Chinese renminbi might someday replace the dollar, but it is not yet a convertible currency. So it is out of the question at this point.

Although the euro is rapidly developing as a global key currency, still, from the viewpoint of its role as a unit of account, a medium of exchange, and a store of value, there is a long way to go before the euro catches up with the dollar.

While the yen's role as an international currency is gradually advancing, it still remains a local currency with some international functions. The predominance of the dollar will continue for the foreseeable future, assuming that the U.S. administration and the Federal Reserve system do not engage in "benign neglect" in maintaining the value of their currency.

I see a dollar crash as extraordinarily unlikely.

STEPHEN G. CECCHETTI

Rosen Family Chair in International Finance, Brandeis International Business School

Forecasting exchange rates is a fool's errand.

That said, I see a dollar crash as extraordinarily unlikely. First and foremost, the dollar is the world's reserve currency today and for the foreseeable future.

It is efficient to have a single numeraire for global trade and finance. This is the reason that something like 40 percent of global trade in goods and services is denominated in dollars. Quoting prices in dollars leads immediately to bank accounts and securities denominated in dollars. The direct result is that nearly 90 percent of foreign exchange transactions have the dollar as one leg; dollar liabilities of banks located outside the United States are on the order of $20 trillion; and foreigners hold $7 trillion worth of U.S. Treasury securities, $4.5 trillion worth of U.S. corporate bonds, and $9.6 trillion worth of U.S. equities.

Changing this—shifting away from dollar invoicing, converting foreign exchange markets to another currency, and replacing dollar-denominated financial assets with something else—would be not only very costly, but extremely disruptive. In other words, I do not see how it can change any time soon. Instead, as the Covid-19 shock fades and the global economy returns to growth, the use of the dollar outside the United States is likely to increase even further.

The consequences of this global structure are profound. As President Nixon's Treasury Secretary John Connolly famously said in 1971: "The dollar is our currency, but your problem." What was true then is even more true now. Put differently, a severe depreciation would wreak havoc on the entire global financial system. It gives rise to the balance of financial terror—a phrase coined by Larry Summers when he was Treasury secretary. This means that if there were a decline in the private demand for dollars, then foreign governments are likely to step into the breach, stabilizing the value of the dollar. It seems inconceivable that the Japanese and Chinese governments would act implicitly or explicitly to undermine the current system.

So, as debt of the U.S. federal government climbs over 100 percent of GDP, and nonfinancial corporate debt securities and loans climb to 60 percent of GDP, it is almost surely the case that foreigners will continue to maintain their holdings, supporting the role and the value of the U.S. dollar.

All other statutory currencies will weaken but the least weak currency will survive. That is the key currency—the U.S. dollar.

TAKESHI FUJIMAKI

Former Member, House of Councillors, Japan, and former Tokyo Branch Manager, Morgan Guaranty Trust Company of New York

No, I do not think a dollar crash is coming soon.

As almost all of the major central banks are monetizing government debt, all statutory currencies will weaken because there will be too much money in circulation. It means that we will have inflation worldwide.

However, an exchange rate is a relative value and will be determined by the relative strength of each currency.

As long as a barter economy does not come back, at least one statutory currency will survive. It means that all other statutory currencies will weaken but the least weak currency will survive. That is the key currency—the U.S. dollar. The United States dominates both the oil and information industries today. These are the two most important resources for the economy in the future decades.

Many factors such as current account deficit, interest rate differential, trade surplus, and so forth will determine the exchange rate. In general, national strength determines the exchange rate.

We can, however, say the above rule is true as long as the central bank is sound and has credibility.

If a central bank loses its credibility, the currency it issues also loses its credibility and will crash in value, even if national power is strong.

After World War II, Germany's Reichsbank was abolished and the Deutsche Bundesbank was established. It was only then that Germany was able to control hyperinflation. The German currency regained its credibility even though other factors did not change. It proves the central bank's credibility is the fundamental factor underlying the value of a currency. Even if national power is strong, without central bank credibility, the country's currency will crash.

The easiest way for a central bank to lose its credibility is to have negative net worth on its balance sheet.

The U.S. Federal Reserve, the European Central Bank, and the Bank of England are still far from having a negative net worth. But the Bank of Japan is in a different situation. Its balance sheet is completely different from the old days. Traditionally, central banks never purchased assets whose prices fluctuated in order to prevent a deterioration of their balance sheets. But the Bank of Japan now holds tons of stocks, real estate (REITs), and long-dated government bonds whose prices fluctuate a great deal.

The Bank of Japan holds almost 50 percent of outstanding Japanese government bonds today. And the average yield on its JGB holdings is only 0.247 percent for the period from April 2019 to March 2020. It may be much lower now because the Bank of Japan bought a huge amount of bonds at zero percent in the last year.

The duration of such JGBs is around six to seven years, so if the ten-year JGB yield goes up to around 0.2 percent from the current level of zero percent, the Bank of Japan's net worth will become negative.

If the following three conditions are met, a crisis can be averted:

- Negative net worth continues only for a short period;
- Negative net worth is caused by a financial system problem, but monetary policy is properly operated; and
- The nation's fiscal deficit is shrinking.

Currently, none of these conditions apply to the Bank of Japan. So the Bank of Japan will lose its credibility and the yen will crash once her net worth becomes negative, and we will see hyperinflation in Japan.

In comparison, the average yield on bonds held by the Federal Reserve was 2.6 percent (January–June 2018). The Fed's net worth will not become negative for the foreseeable future.

The Bank of Japan is like a canary in a coal mine. The U.S. government and the Federal Reserve may change their policies immediately after they see the failure of the Bank of Japan. The U.S. government may increase taxes to reduce the Fed's balance sheet. People will not oppose the idea of increasing taxes because they will see the miserable result of government debt monetization in Japan.

All statutory currencies will weaken and we will see hyperinflation worldwide if central banks continue government debt monetization

But the U.S. government and the Fed may cease monetizing government debt after witnessing the Japanese tragedy, and the U.S. dollar at that time may be relatively strong against other currencies because it is the key currency. At least, the U.S. dollar will appreciate substantially against the yen after the Japanese tragedy.

A strong U.S. dollar will also help prevent a malignant inflation. Unlike the Bank of Japan, the Fed will still have the ability to control the inflation rate by raising interest rates.

If the Fed can control the inflation rate at around 7 percent for ten years, fiscal debt will effectively be cut in half in real terms, even though the nominal debt amount remains at the same level. So I think every penny will be paid off under 7 percent inflation in the United States because the government has to pay off only half of the current level in real terms.

But if the Fed continues monetizing government debt and has a negative net worth, people will suffer hyperinflation like in Japan.

In that case, the current Fed will be abolished and a new Federal Reserve Bank will be established.

Even then, every penny will be paid off, but citizens will not be able to buy anything with the money they are paid in as the price of goods and services will have become too expensive.

American policy was worrisome, now it's frightening.

DEREK SCISSORS
Resident Scholar, American Enterprise Institute

The end of the dollar's time as reserve currency is now visible, but most likely remains well in the distance.

The world economy is borrowing heavily against the future, calling it "stimulus" despite Covid-driven prohibitions on economic activity that are likely to tighten during Northern Hemisphere winter. The result, following the immediate post-Covid recovery, will be considerably slower global growth for at least three years.

A longer period of comparative weakness is possible if policymakers continue to pretend they can borrow their way to growth. The obvious comparison is Japan since the 1990s (though few face the same demographic contraction). Japan's choice of continued leveraging over painful structural reform resulted in a lost generation of growth. The large majority of countries do not have Japan's domestic savings and will face a more acute reckoning.

American policy in particular was worrisome, now it's frightening. The United States was irresponsible prior to Covid, borrowing increasing amounts at the federal level and maintaining historically loose monetary policy despite a quite reasonable output and employment performance. Then the fiscal year 2020 federal deficit more than doubled that after the global financial crisis and the Fed loudly pledged to pin monetary policy indefinitely.

The two sets of mistakes, however, work at odds to each other to some extent. In a dynamic global economy, holders of foreign currency assets would actively seek alternatives to dollar denomination, speeding up erosion of its status as reserve currency. The more likely scenario of poor global growth, with all of the attendant problems, means generally slower abandonment of the dollar. This is tied to the obvious question of alternatives.

I don't know enough to properly address the euro, but the yuan faces severe challenges. For a decade prior to Covid, China's leveraging was worse than America's. Its own aging problem is unprecedented in nature and scope. Even more important, opening the capital account and creating a genuinely independent currency requires accepting uncontrolled capital outflow. The Communist Party is terrified by such instability. The current interest rate differential means little in comparison.

A wild card is U.S. politics. Gradually declining foreign willingness to hold dollars will raise true borrowing costs. Today's mutters about magically defaulting only on debt owed to China will become more expansive. American unwillingness to lead the global economy could predate inability to lead the global economy caused by poor policy. And dollar decline starting at home in that sense could proceed swiftly.

The risk to debt sustainability emerges when the central bank loses control of inflation.

LORENZO BINI SMAGHI
Former Member of the Executive Board, European Central Bank

According to the latest International Monetary Fund forecasts, the U.S. public debt, including both the federal and local debt, is expected to rise from around 109 percent of GDP in 2019 to about 137 percent by 2025, which may look worrying. It is nevertheless interesting to note that the so-called burden of the debt, which is the interest rate that U.S. taxpayers would have to pay annually on the debt, is expected to fall over the same period, from 2.2 percent to 1.5 percent. The effective burden may in fact be even smaller, given the rising share of public debt held by the Federal Reserve system, which would be transferred back to the government in the form of seignorage.

The lower interest burden derives from the fact that the world demand for U.S. Treasuries has increased more than the supply, as a result of the savings glut and the demand for safe assets at the global level, which is likely to persist for some time as a result of the Covid-19 crisis.

The question is whether the scenario may change abruptly, in particular if interest rates rise over time, putting at risk the sustainability of the debt. The key factor to assess debt sustainability is the relationship between the rate of interest paid on the debt and the rate of growth of the economy. As long as the economy grows faster than the rate of interest, sustainability is not at risk. If the opposite holds, fiscal policy will have to tighten in order to generate primary surpluses to ensure debt sustainability.

Interest rates can rise for two main reasons. The first is higher long-term economic growth. In that case, both sides of the equation go up, and the debt can remain sustainable.

The second, more worrying case, is when interest rates increase because of higher inflation. This scenario is not very likely over the next few years, as the economy recovers from the crisis, but could materialize in the medium term, especially if demographic factors lead to a trend fall in global output compared to demand. In that case, a rise in inflation could lead to higher interest payments on the debt. The main risk is that interest rates rise more than inflation because of expectations of even higher inflation in the future. This may happen if inflation expectations are dis-anchored, rising above the 2 percent target set by the central bank.

In summary, the risk to debt sustainability emerges when the central bank loses control of inflation. This happens if the central bank does not act sufficiently rapidly to prevent inflation from rising above target, either because it underestimates inflationary pressures, or if it is not sufficiently independent to take the appropriate decisions.

Under these circumstances, the demand for government bonds could fall, triggering further rises in interest rates and jeopardizing the credibility of the U.S. currency in the eyes of international investors. This is similar to what happened in the second half of the 1970s, before Paul Volcker was appointed as Fed chairman.

A moderation is expected, but no crash.

MENZIE D. CHINN
Professor of Public Affairs and Economics, University of Wisconsin

Over a decade and a half ago, Jeff Frankel and I ("Will the Euro Eventually Surpass the Dollar as Leading International Reserve Currency?") speculated about the dollar's future as the world's key international currency. We argued that only if U.S. economic policy went disastrously wrong—for example, extreme fiscal laxity combined with a subservient central bank—would the dollar be at risk of being dethroned. While we never envisaged a policy mix and implementation as catastrophically terrible as that associated with the Trump administration, it seems likely that with the presidential election's outcome, coherence will be restored to fiscal and trade policy in time to salvage confidence in U.S. economic leadership. Perhaps most importantly, the assault on the Fed's autonomy also appears to have been successfully fended off. Hence, while to some, burgeoning U.S. government debt threatens an inflationary spiral (after all, government debt is never fully paid off), the fact that safe assets remain in demand, real U.S. borrowing costs remain low if not negative, and sovereign debt ratios are rising all over the world, means that the prospect for a massive flight from dollar-denominated assets is unlikely. The likelihood of a split between the executive and legislative branches further reduces the possibility of a large increase in federal debt.

The foregoing does not mean the dollar's role might not be eroded by the rise of regional currencies. In fact, that outcome seems inevitable, eventually. Nor does it mean that the value of the U.S. dollar might not decline as macro factors wax and wane—risk appetite increases, or U.S. interest rates fall relative to foreign interest rates—but in the absence of one that is sharp and persistent, that's not a crash. In fact, a moderation in the dollar's value is to be expected, and would encourage net exports, thereby boosting U.S. economic growth and employment.

The dollar will continue to dominate and there is still no alternative.

MICHAEL HÜTHER
Director, German Economic Institute

It's true: the U.S. national debt and current account deficit continue to rise—the domestic savings rate was -1.2 percent in the second quarter of 2020. The dollar's share in global foreign exchange reserves has fallen by over 10 percentage points since 2000 to below 60 percent. But it is also true that the dollar is an attractive investment currency. Eighty-eight percent of global foreign exchange market transactions take place in dollars, with only 31 percent in euros and 4 percent in renminbi. The dollar's real effective exchange rate is nearly 30 percent above its 2011 low.

A massive dollar devaluation would not be historical news and there is no reason to write off the dollar as the dominant global reserve currency. However, this time is different and not so easy to characterize. Not only are the economic criteria decisive for the continued existence of a reserve currency, but no less the political position and the hegemonic claim. In addition, a currency's value is always a relative consideration. The changes in the United States must be put in relation to the political and economic dynamics in the European Union (more precisely, the eurozone) on the one hand and in China on the other. The situation here is anything but clear.

An exchange rate as a relative price is ultimately and in the long term an expression of political and economic considerations between two economic areas. Currency competition today is embedded in the newly sparked global power competition. The United States has long had a double budget deficit and current account deficit. If the United States were a small economy, this would cause massive confidence problems and a continued devaluation of the currency. But as a large nation with hegemonic claims, military power, and diplomatic assertiveness, things look different. This has changed for the United States under President Trump. The strategic alliances of NATO and the transatlantic West in general are dispensed with. The current annual Asia Power Index compiled by the Lowy Institute that measures resources and influence to assess the relative power of states shows that the United States has lost its lead over China, especially due the bad Covid-19 crisis management of Trump.

The European Union got together in the Covid-19 crisis after initial disorganization, and thanks to the Next Generation EU, it did not experience its "Hamiltonian moment" but has taken a big step towards an investment union. In this respect, despite Brexit, which naturally weakens Europe politically and economically, there are new prospects for European integration. If these prospects turn into veritable political approaches, then this would, together with economic modernization—climate, energy, digitalization—as well as a stability-oriented monetary policy, strengthen the chances for the euro as a reserve currency.

China is trying everything to strengthen its global political role and is increasingly formulating hegemonic claims. This is what various projects are about—One Belt, One Road, China 2025, China Standards 2035—as well as military advances. But China has just as massive problems as it has ambitions, including state terror against the Uyghurs, enormous aging, investment control, high indebtedness of the private sector, fragile financial markets, and more, which are increasingly having an impact on foreign policy.

All in all, the relative weights of geopolitics are shifting, but it is not clear how this will turn out and thus whether the different economic arguments for and against the various world currencies would cause a either a substantial depreciation or appreciation. In the medium term, Europe and the euro have a good chance of increasing their importance, while without democratization and fair foreign trade policy, China's chances are less. For the time being, however, the dollar will continue to dominate and there is still no alternative. A return to global responsibility under President Biden will stabilize this arrangement. A dollar crash is not in sight.

The unprecedented levels of debt are bogging down the entire developed world.

LORENZO CODOGNO

Visiting Professor in Practice, London School of Economics and Political Science, and Founder and Chief Economist, Lorenzo Codogno Macro Advisors Ltd.

There is no obvious overvaluation for the U.S. dollar.

The jump in U.S. private domestic saving may well be temporary and more than compensated by public dissaving. At the same time, investment activity will likely collapse in the near term. The net effect on the current account balance is difficult to grasp, especially as the same phenomenon will happen in most other developed economies around the world. It is, nevertheless, reasonable to expect an additional deterioration in the U.S. trade and current account balances, although only a gradual one. A prospective worsening in the external position may also be seen as a reflection of a still-positive medium-term outlook for domestic investment relative to saving.

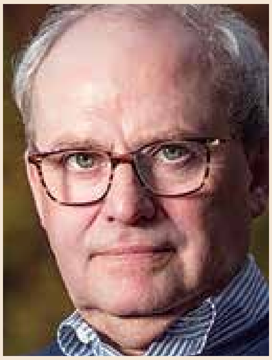
Short-term and long-term interest rates are already close to zero in the United States but also elsewhere. Even the term structure of interest rates has flattened substantially in all major countries. Given the current signaling by most central banks, it is unlikely that the monetary policy stance will change significantly any time soon, and this is equally true for the United States and other major countries.

Central banks have helped credit growth, but cannot guarantee related spending. Monetary policy tools are exhausted or about to become exhausted almost everywhere, including the United States, and the bulk of the support must inevitably come from the fiscal side. It is not obvious what will happen in relative terms. For sure, the U.S. government can productively counter the shortfall in aggregate demand with a substantial fiscal stimulus following U.S. elections. U.S. public debt is due to increase to levels associated with sustainability concerns. However, it can enjoy the advantages of a still-unchallenged global reserve currency, expectations for nominal growth stronger than in most other advanced economies, a positive prospective differential between nominal growth and the cost of borrowing, and asset purchases by the Federal Reserve.

The unprecedented levels of debt are bogging down the entire developed world. If we rule out restructuring, the way out could only come from the buying and keeping of the stock of debt in the central banks' books for the foreseeable future, or some inflation over the medium term, or both.

In the current global liquidity trap, there is a greater risk of currency wars. The tectonic changes caused by the pandemic crisis may convince some policymakers that a weaker currency must become part of the solution.

However, a currency war would be a zero-sum game for the global community. With the pandemic already testing the limits of multilateralism, the world can ill-afford the escalation of tensions that competitive devaluations are likely to generate. A newly found U.S. commitment to a multilateral approach to global governance should prevent such a risk.



How large can the monetary supply, the budget deficit, and the public debt be before a country ends up in a financial crisis? We don't have any answer.

ANDERS ÅSLUND
Senior Fellow, Atlantic Council, and Adjunct Professor, Georgetown University

After the U.S. dollar slumped by about 10 percent in relation to the euro from March until July 2020, a broad sense took hold that the U.S. dollar would just continue sinking, but we have been there earlier and it has rarely happened.

The U.S. federal debt is large, but so is the public debt of almost all big, developed countries. U.S. savings are low, but so is U.S. investment, and that has not hindered the United States from achieving higher growth than most developed countries with much higher investment rates.

These measures do not appear all too relevant. The fundamental truth is that no other country is actually financially significantly better off than the United States, save tiny Switzerland and even smaller states.

Possibly even more important is that no other country wants to hold the dominant reserve currency. You cannot beat something with nothing.

The United Kingdom intentionally abandoned its position as the prior reserve currency holder in the 1970s because the British government realized that providing a major reserve currency implied that it had to maintain a large current account deficit, which led to the overvaluation of the pound, which in turn rendered much of British industry uncompetitive. Japan and Switzerland have avoided becoming reserve currencies by all means. The eurozone shows no interest, either.

While the U.S. economy looks frail in this first year of the coronavirus, nobody else, apart from China, looks better, and China doesn't even have a convertible currency. After China, the United States is likely to have the best economic growth among big economies in 2020, because the United States has most big high-tech companies that benefit from the coronavirus. The U.S. high-tech lead has starkly increased during this recession.

Another aspect that has lost prominence in recent years is that a few countries—the United States, the United Kingdom, Switzerland, and Sweden—have better corporate governance than most other countries, and good governance including the rule of law is a major attraction for foreign funds. Recessions always reveal financial crimes and as international monetary flows speed up, investors also become more vulnerable and become all the more concerned about the legal security.

The ultimate question is how large can the monetary supply, the budget deficit, and the public debt be before a country ends up in a financial crisis with inflation and depreciation.

At present, we don't have any answer, but Japan has shown that a developed country with its own currency can move much further in that direction than anybody had anticipated. Admittedly, it led to the development of a multitude of zombie enterprises, leading to low growth, but its currency stayed stable.

We know there is also a limit also for the United States, but we can claim no knowledge about how far it can go until it reaches that limit.

A prolonged phase of dollar weakness is a very likely sequel.

TIM CONGDON
Chairman, Institute of International Monetary Research, University of Buckingham

Nowadays, top economists do not like to be reminded of the quantity theory of money. References to the growth of the money supply at leading academic conferences are met by coughs, splutters, and looks of embarrassment, as if the attendees suffered from an allergic condition. At any rate, in the year to June, the M3 concept of money—estimated by the Shadow Government Statistics consultancy—increased by over 25 percent, the highest figure since the Second World War and well above the sort of numbers seen in the inflationary 1970s. Is a big rise in American inflation inevitable? And what does the answer to that question mean for the dollar?

At the time of writing, analysis and commentary are beset by a huge new uncertainty: the outcome of the U.S. presidential election. But whatever the eventual result, a large new fiscal package is widely expected. Let us assume that the expectations are correct and that the package amounts to $2,000 billion, with all of the extra budget deficit to affect the economy in the 2021 calendar year. Let us further assume that, like the first pandemic-related $2,200 billion fiscal package back in March, the second is financed largely from the banking system. Then the impact on the M3 quantity of money (which stands at about $25,000 billion) will be an increase of 8 percent in a few months. On that basis, the rate of annual money growth will remain over 20 percent in early 2021 and may even reach a new post-war peak above that seen in June.

Despite the coughs, splutters, and looks of embarrassment at academic conferences, evidence from all countries establishes a relationship in the long run between changes in the quantity of money and changes in nominal GDP. As Nobel economist Milton Friedman brilliantly forecast in his 1959 Millar lectures, in future decades the broadly defined quantity of money would rise in the United States by about 1 percent a year more than nominal GDP. That has been almost exactly correct. In the ensuing sixty years, the average annual rates of increase in M3 and nominal GDP were 7.4 percent and 6.5 percent respectively.

Anyone can see that, on this basis, a permanent and sustained rate of annual money growth of over 20 percent would lead to American inflation well into the double digits. (Even New Keynesians and real business cycle theorists in central bank research departments might appreciate the point.) An associated dollar collapse would be inevitable. Of course, the money growth surges of spring 2020 and probably early 2021 are temporary and exceptional, and do not signal an irreversible slide into currency debauchery. All the same, the United States' macroeconomic response to Covid-19 has been more generous and hence more irresponsible than that of the eurozone or China. A prolonged phase of dollar weakness is a very likely sequel.

The national debt of the United States will grow until the Republic falls.

JAMES K. GALBRAITH
Lloyd M. Bentsen, Jr., Chair in Government/Business Relations, LBJ School of Public Affairs, University of Texas at Austin

Let's begin with a maxim: debts that cannot be paid will not be paid. Many third world debts, contracted largely in dollars, will be written down or written off. The only questions are when, by how much, and after how much pain.

The case is similar for the first world debts of private households—mortgages, rents, student loans, health care debts, and credit card debts—and the collateralized loan obligations of many corporations, especially in the United States, as the Covid catastrophe lingers on.

The public debts of the rich countries, outside the southern tier of the misbegotten eurozone, are not like that. They can and will be paid as they always have been, in the coin in which they were promised. The United States pays interest and principal on its bonds because the Fourteenth Amendment to the Constitution says it must—and because in a world of fiat money to do so costs no real resources. The principle is that bowling alleys do not run out of points; green cheese factories do not run out of green cheese.

Paid does not mean "paid off." Government debts almost never are. The national debt of the United States will grow until the Republic falls; serious efforts to reduce it will end as they always have, since the time of Andrew Jackson, in a slump that cuts tax revenues and therefore keeps the debt growing. This is a good thing; the public debt is, dollar for dollar, penny for penny, the net wealth of the private sector. And as Stephen Hawking observed of the universe, the debt to the gravitational field that powered the Big Bang will not come due … until the end of the universe.

Will the dollar depreciate? It's possible. It already has fallen, about 7 percent, since April. As Eurasia consolidates and creates its own settlement zone—a process that we almost surely cannot stop in the long run—the dollar may well fall some more.

Will the dollar "crash" in some vague, frightening, catastrophic way? That too is unlikely. Europe did not create a money that punctured the reserve status of the dollar. A unit that might be concocted by Russia, China, and Iran may be useful for their purposes, but hardly lethal for ours.

Here a final principle applies, attributed, though possibly apocryphal, to the Iron Chancellor, Otto von Bismarck: Almighty Providence takes special care of drunks, fools, and the United States of America.

The grim U.S. fiscal picture is not likely to lead to a dollar crash.

JAMES E. GLASSMAN

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Every penny of U.S. federal debt will be paid off.

The surge in the deficit and debt burden unleashed by the response to the Covid-19 crisis is eyepopping for sure. However, the current fiscal situation is not likely to lead to a dollar crash. The principal fiscal challenge is the growing projected revenue shortfall, visible prior to the health crisis, that reflects a demographic drag on the U.S. economy's growth potential. This development, which the Congressional Budget Office has been warning about for years, is expected to worsen in coming years. Nonetheless, the grim U.S. fiscal picture is not likely to lead to a currency crisis and dollar crash for a number of reasons.

For one, the United States is not alone in deploying its fiscal tools to address the upheaval caused by the Covid-19 pandemic and national lockdowns. After all, the value of the dollar is a measure of relative performance. And notably, others have not hesitated to use their fiscal policy tools in the face of an economic crisis, despite unfavorable fiscal balance outlooks. That theme likely accounts for the relative stability of the real trade-weighted value of the dollar amid this year's pandemic. At the same time, the Federal Reserve's commitment to a 2 percent longer-run inflation target, an important anchor for financial markets, implies that a devaluation of outstanding debt through higher inflation is unlikely as well.

For another, confidence in the ability of the U.S. government to honor its financial obligations is a key anchor for the dollar and stability of the international financial system. For that reason, debt forgiveness for developed world economies would dash investor confidence and undermine the stability of the international financial system that for the past seventy-five years has contributed so much to the rising global prosperity.

Even more important, expansion of debt caused by the fiscal measures taken to address the 2020 economic crisis isn't the central fiscal issue, thanks in part to the Federal Reserve's balance sheet policies. Record low bond yields underscore that point. For sure, the surge in this year's U.S. Treasury debt burden to 100 percent of GDP turns the fiscal clock back to a similar situation at the end of World War II.

The fundamental fiscal challenge centers around the growing imbalance between steady-state revenue growth and spending. This imbalance has been building steadily as the baby boom generation has been retiring. For some time, this has been a key factor in the Congressional Budget Office's long-term budget projections. For the past century, the U.S. economy expanded at a 3.5 percent average annual rate, through business cycle ups and downs—that performance surely shaped perceptions about the affordability of the national safety net. However, if the U.S. economy's growth potential slows to half that pace, as the CBO currently assumes, public sector revenues will not be able to keep up with government spending. That imbalance will not trigger a currency crisis but will require actions to counter the slowdown in the nation's underlying growth.

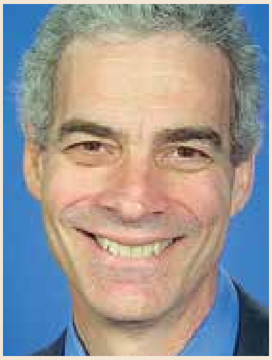
The indebtedness of the United States to others, public debt as well as private, is often incorrectly portrayed as a sign that America is living beyond its means, relying on outsiders for a shortfall in its domestic saving. Currency crises often are rooted in such circumstances when investors become reluctant to accumulate claims on a country suffering from a shortfall of domestic saving.

But the U.S. story is fundamentally different. The proof of that is in the investment flows. The United States has run outsized current account deficits for several decades. This has led to an $11.1 trillion gap between foreign claims on the United States ($40.2 trillion currently) compared with $29.2 trillion U.S. claims on others.

Yet despite this large and growing U.S. indebtedness to the rest of the world, the United States earns $230 billion more than it pays to outsiders in investment income. That's because U.S. claims on others are investments in growth (direct investment) compared with foreign claims on the United States that are concentrated in recycling of trade surpluses into lower-earning Treasury securities.

The international indebtedness reflected in the U.S. financial accounts is more accurately viewed as an investment in global development and global growth. The rise of the value of the U.S. stock market over the past two decades to an unprecedented multiple of one-and-a-half times the size of the economy likely is a reflection of that important development.

Budget deficits do matter. But just as the economic boom of the 1950s and 1960s brought the World War II debt burden down from similar levels seen today by the late 1960s, pro-growth initiatives can do the same for the U.S. fiscal picture. America's fiscal imbalance will be a political challenge but is not likely to lead to a currency crisis.



There is a world of difference between a currency depreciation and a dollar crash.

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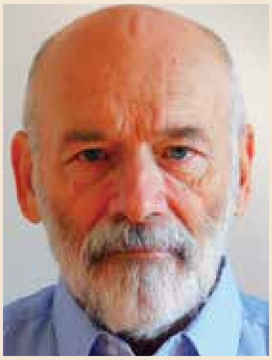
I do expect the dollar exchange rate will depreciate, but there is a world of difference between a currency depreciation and a dollar crash or crisis. Past crises have been rare, and when they occur, they involve widespread loss of confidence for good reason, like in 1978 when U.S. inflation was rising toward 10 percent and the Fed (pre-Volcker) and the Carter administration did not have a credible anti-inflation strategy.

There is no crisis brewing now, although rising debt poses a longer-run problem. The United States is recovering strongly from the pandemic—faster than other advanced nations—and its potential growth is above that of other advanced nations. Inflation is low. Real rates of return on dollar-denominated assets exceed those in other currencies and risks of holding dollars are relatively low. U.S. capital markets are functioning smoothly, the Federal Reserve is credible and transparent, and capital flows freely across borders. The dollar is widely perceived to be a safe haven. The U.S. current account has widened but remains well within its historic range. These factors are not symptomatic of crisis or collapse.

Several factors suggest the dollar may weaken. A widening current account deficit reflecting persistently high government deficits (dissaving) may exert downward pressures on the dollar. The current account deficit has risen from 2.25 percent of GDP in 2019 to 3.5 percent, but it remains far below the imbalance that averaged 4.9 percent during the 2002–2007 expansion. The Fed's new strategic tilt toward higher inflation and inflationary expectations through sustaining ultra-monetary ease increases the risks of higher inflation beginning in 2022. The economic policies of the Biden administration will add to U.S. dollar pressures. Fortunately, Biden's campaign proposals of massive increases in taxes and deficit spending would have been a big dollar negative, but the Republican-controlled Senate will block the magnitudes of the proposals. However, Biden's anti-business regulations will introduce business inefficiencies and lower productivity, which will lower the expected after-tax rates of return on investment in dollar-denominated assets. These downward pressures on the dollar would be partially mitigated by the United States re-engaging in diplomatic relations with global allies and less confrontational strategies toward China.

Looking forward, the United States' demographics, mounting costs of entitlement programs, and the political impetus toward high deficit spending will push up debt. This inevitable path poses potential problems for economic performance and financial sustainability. A large and rising share of government spending is for income support and financing current consumption (including health services) which does not add to productive capacity but raises debt for future generations. This will gradually erode potential real growth. For now, nominal GDP growth is above the level of interest rates, which makes the debt service costs manageable. But interest rates will eventually rise to reflect post-pandemic economic growth and higher inflationary expectations, raising government debt service costs. The mounting debt also raises the risks of financial instability. Among other concerns, fiscal dominance over monetary policy may exert pressure on the Fed to sustain low rates and purchases of Treasuries longer than is appropriate, heightening the fragile balance and raising risks of financial instability.



Even if a sovereign debt crisis is avoided, the public debt burden will negatively impact growth.

MAREK DABROWSKI

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The dominant role of the U.S. dollar can be traced back to the end of World War II or even earlier—to the interwar period when it gradually dethroned the British pound. Since the collapse of the Bretton Woods system in 1971 (in fact, this was a crisis of the U.S. currency), there has been continuous speculation about the imminent fall of the dollar in its global role. However, this has not happened yet despite numerous macroeconomic and financial shocks, including the global financial crisis in 2007–2009, and the mixed fortunes of the U.S. economy and politics. Most likely, the current crisis also will not undermine the dollar's dominance, at least in the short-term.

The dollar's resilience can be explained by private sector preferences, the strength of network externalities (I trade or save in the same currency as my trade and financial partners do to minimize transaction costs), and inertia of past choices. Changing the transaction currency would be too costly for each market participant alone unless other participants do the same (a typical collective action problem).

The lack of an alternative to the dollar is another obstacle to its "dethroning." In the foreseeable future, the second most important world currency—the euro—does not have the chance to challenge the dollar's dominant position because of the much smaller and less liquid market of euro-denominated financial instruments.

Regarding the fiscal prospects of advanced economies, they raise a deep concern. The United States, Japan, and several European countries entered the Covid-19 crisis with record-high debt levels. They missed the good times (in the early and mid-2000s and the second half of 2010s) to rebuild fiscal space for the countercyclical intervention against unexpected shocks.

The current crisis will further increase debt burdens as a result of recession, pandemic-related spending, and fiscal stimulus launched by many governments. The frequently expressed opinion that there is still room for debt to increase because of historically low interest rates may be a dangerous illusion. Interest rates are low because of the forced saving caused by containment measures and pandemic-related uncertainty, low enterprise demand for credit, and an aggressive policy of quantitative easing. None of these factors will last forever and interest rates will start growing at some point.

Eventually, the growing debt burden and debt service costs may trigger sovereign defaults with devastating consequences for global financial stability. High inflation is an alternative scenario if central banks are forced to monetize government debt. Even if a sovereign debt crisis is avoided, the public debt burden will negatively impact economic growth because it will absorb a growing share of private saving, destabilize the financial sector, and push governments to increase taxes.

Intertemporal fiscal constraints do not stop working and elementary fiscal arithmetic cannot be ignored.

The end-game for such debt issuance across the developed world is unclear. Certainly, it will never be paid off.

RICHARD JERRAM

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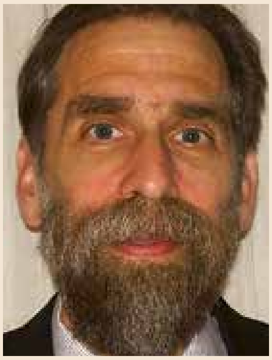
We should be wary of believing that the U.S. dollar's role as the dominant reserve currency insulates it from the risk of a crash. After all, it has long been preeminent, yet it collapsed in the second half of the 1980s and again from 2002 to 2008. However, the current risk of a crash is lower simply because the dollar is not as over-valued as it was before those two periods. Moreover, America's current account deficit is reasonably contained, stable at just over 2 percent of GDP, so it is not overly reliant on inflows of foreign capital. Certainly, the U.S. government is issuing eye-watering amounts of public debt, but that is mostly being absorbed by domestic buyers.

In any case, the link between domestic debt levels and the exchange rate is unclear, especially post-Covid. Even pre-Covid, we had seen Japan rack up a huge amount of public borrowing with little prospect of stabilizing, let alone reducing, its indebtedness. Yet the impact on the Japanese yen was indeterminate—it certainly didn't crash. Similarly, the Trump administration's tax cuts had already pushed America towards a $1 trillion budget deficit and abruptly shifted its debt trajectory, while the U.S. dollar remained strong.

Post-Covid, the situation is even more complex. All major developed nations have thrown fiscal support at the economy, backed by central bank bond-buying schemes and zero interest rates. As the exchange rate is a relative price, can we say the United States is being more reckless than Europe or Japan? And perhaps one currency trader's "reckless" is another's "decisive," and a reason to be positive.

In fact, currency stability has been a curious feature of 2020, considering the violent moves in most asset prices. Interest rates have converged and are giving no clear signals to investors. It seems that everything that matters in determining exchange rates is either too uncertain or too far in the future to be relevant to the current situation. As a result, there is little to drive flows. We might expect some mean reversion toward neutral levels, which would be marginally negative for the U.S. dollar, but that is a long way from being a crash.

The end-game for such debt issuance across the developed world is unclear. Certainly, it will never be paid off, but it does not need to be. Perhaps the bigger problem is that we keep borrowing from the future with emergency fiscal and monetary policy responses, so each new crisis is progressively more dangerous.



The dollar's privilege will not be as exorbitant as multiple rising denominations begin to enjoy that semi-luxury.

GARY KLEIMAN
Senior Partner, Kleiman International Consultants

A dollar crumble at least is on the horizon, not so much against the background of traditional debt and current account indicators, but with the negative international investment position veering deeper into the red as emerging market competitors are on the upswing. The once-vaunted BRICs outside India enjoyed this status before Covid as well, accounting for over half of global output even if their currency share of daily trading and debt issuance lagged in single digits, as dollar-denominated cross-border credit activity was half outside the United States.

The initial outbreak period highlighted other regions' greenback overdependence, and only four emerging economies—Brazil, Mexico, Korea, and Singapore—had access to Federal Reserve swap lines. Eastern European members of the European Union had the same constraints with the European Central Bank until recently, as select Asian countries tapped Chinese renminbi bilateral pools.

Twenty developing-economy central banks joined advanced ones in launching quantitative easing programs to steady and loosen monetary policy through government and corporate bond purchases, with Chile, Poland, and the Philippines the largest as a portion of GDP. As a universe, average debt and deficit levels were well below the U.S. double-digit and 100 percent respective levels, and defaults and restructurings underway in Argentina and Ecuador were hangovers from previous over-borrowing and commodity price correction. Quantitative easing was an improvised measure to address a sudden shock, and central bank buying is supposed to taper over time and be limited to secondary markets, but it represents an overlooked structural shift in terms of deepening the local institutional investor base to act as counterparty and compensate for foreign investor safe haven position paring. These changes act just like the U.S. Treasury market in promoting currency use, and dozens of markets acting simultaneously constitute the equivalent of hundreds of billions of dollars alternative unit volume as a rival bloc.

This search was long underway for diplomatic/geopolitical reasons, and also mainly to avoid financial sanctions and entanglement in U.S.-China trade disputes, and central bank reserve and private fund managers increasingly diversified into second-tier currencies before the latest more profound evolution. The heavier emerging market exposure is clear in Bank for International Settlements statistics and new GDP-adjusted industry indices which weight them collectively more than the dollar and euro. Even as the United States likely holds on to its top credit rating and repays its debt although not without rescheduling in a higher rate era, the dollar's privilege will not be as exorbitant as multiple rising denominations begin to enjoy that semi-luxury. ◆