

Dollar has lost its safe-haven shine?

The pandemic seems to have piled all sorts of pressures on the position of the US dollar as the global reserve currency and central banks across the world are beginning to wonder, and very rightly so, about what would happen to the financial universe if that special status were to really slip away one day. The Fed's obsession with quantitative easing and ultra-low interest rates to prevent a post-Lehman (2008) like credit squeeze that crippled the Wall Street and sent a deflationary spiral across the world, massive injections by the government, and a clear disregard for inflationary tendencies are now clearly weighing down on the dollar. The dollar index (DXY), which measures the performance of the reserve currency against a basket of its most actively traded partners, has fallen about 10 percent from its March high, when the pandemic triggered risk aversion in capital markets and safe haven inflows drove the index past its previous peak in last October. US interest rates are no longer higher than those of other G20 heavyweights, which has effectively killed the so-called carry trade which gave the dollar a premium over German and Japanese money market rates.

Even the world's biggest and most influential investment banks like Goldman Sachs and JP Morgan, which handle Big Money and know their way about the markets, have warned that these policies are debasing the dollar and expressed "real concerns about the longevity of the US dollar as a reserve currency." Fed Chairman Jerome Powell, no less, has repeatedly called for more action from the Congress to prevent, among other things, more dilution of the dollar. The central bank can print the money but it's the House that must ensure that it gets to the right places and people. That explains the higher-than-anticipated rush into gold and the completely unexpected rally in crypto currencies. Investors are clearly diversifying out of the dollar in terms of long term store of value. That, more than the EU area fundamentals, explains the general uptrend in the euro; to the point that the European Central Bank (ECB) has repeatedly hinted that it would not allow such a bulge in the common currency to undermine fragile export growth and the nascent economic recovery. It seems the only thing still keeping the dollar on the throne is just a lack of an alternative. It forms the largest part of central bank holdings, facilitates international trade, is used to measure the value of all commodities, and all that. But in a world where the market tends to dictate how and where money flows more than academic theories, how will the dollar continue to be so central if serious money loses faith in it? Often the financial world has had to look for alternatives after epic collapses. Perhaps this is another one in the making.

All this ought to make countries like Pakistan particularly concerned about what the future might hold. A number of them are already conducting very serious research on the matter. If the dollar is really stripped of the reserve currency status at some point in time, global markets would have to brace for cataclysmic shockwaves as an unprecedented readjustment would take place. This paper has it on good authority that the State Bank of Pakistan (SBP) also began work on preparing for just such a scenario some years back. But it seems that the initiative was not properly followed through, if it was at all. The Bank which has clearly become a lot more autonomous and proactive than before, should take that old file off the shelf and restart work on it immediately.

The second wave of the coronavirus is threatening a double-dip recession in America, and the recent presidential election there exposed flaws in its political and electoral systems, which is eroding trust in its economy as well as its authority like never before. And now that President Trump is disputing the outcome and markets are pricing in increased volatility around mid-December, the currency could come under more pressure more quickly than markets might be prepared for. It could well be the end of the road sooner rather than later for "King Dollar" and countries like Pakistan should do what they can to prepare for it.