What a roaring dollar means to the global economy

By Komal Motwani

Amid the chaos of slowing economies and recession fears, volatile stock markets and increasing oil prices, the dollar is gaining popularity and momentum. So how much does the strong dollar impact price increases for commodities and products?

The dollar is continuing to hold its strength as investors flock to the safety of the currency amid global recession concerns. Another reason that has caused the dollar to advance is the hawkish Federal Reserve and their determination to bring the four-decade high inflation down by increasing the interest rates. Higher interest rates lead to an increase in investments. Where countries such as Japan still have a dovish stance on monetary policies, the U.S. is an attractive market for income/yield generators.

In contrast, the euro recently slumped to its lowest in 20 years due to concerns that the European Central Bank may not be able to raise the rates to tame inflation. (The annual inflation rate in Europe increased to 8.6% in June.). At its June meeting, the ECB confirmed its intention to hike its key interest rate by 25 bps by its July meeting.

The euro continues its decent toward parity with the dollar amid recession fears. The dollar is also continuing to rise against the Japanese yen and other currencies.

While a strong dollar stands positive for U.S. imports, it is not quite beneficial for the exports. Emerging market economies are adversely impacted as well due to dollar peg, higher foreign currency payments, and higher cost of goods and services. Commodities are usually priced in U.S.

dollars. Oil, wheat, corn, gold and other metals trade in U.S. dollars. A surge in the dollar makes commodities more expensive.

Today, we are facing unprecedented global issues around the globe. The war in Ukraine, the COVID-19 pandemic, supply chain disruptions, food shortages and climatic changes are a few to name. The global shortages and sanctions have led commodity prices to work in tandem with the increase in the dollar. In a normal scenario, the increase in the dollar should hurt the demand and commodity prices. Conventionally, the strengthening dollar must move commodity prices lower and increase the purchasing power (somewhat an inverse relationship). Technically, a strong dollar should be a problem for oil markets. Historically, a tightening cycle in the U.S. has likely resulted in strengthening the dollar.

In current market scenarios, gold, for example has not been able to provide a good inflation and recession hedge, one of the reasons being a strong dollar. Gold is priced in dollars, and gold is considered to be a safe haven during times of geopolitical turmoil.

The recent ban on Russian gold imports technically should have benefited gold prices. Gold is an asset and hence other factors such as demand also impact the intrinsic value of the commodity. However, compared to other commodities, gold is still not trading as volatile and can be perceived as a recession hedge with a small allocation in a diversified portfolio.

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