Riding High With the Greenback

The dollar has been hovering near a 20-year high against major world currencies, offering a mixed blessing for American consumers and businesses, while posing a potentially destabilizing element in the global economy.

On July 13, the dollar hit parity with the euro, the first time since 2002.

Anyone who has traveled internationally lately may have noticed that their money goes a lot further than it used to. In fact, the U.S. dollar has been hovering near 20-year highs against a whole basket of currencies. The U.S. Dollar Index, a measure of the dollar's value against six major currencies (the euro, Swiss franc, Japanese yen, Canadian dollar, British pound, and Swedish krona), has risen over 10% since the start of the year. In mid-July, the Japanese yen fell to a 24-year low against the dollar, and the euro hit parity -- a one-for-one exchange rate. Many other currencies have also lost value against the dollar, though not all. The Russian ruble, the Brazilian real, and currencies of other energy and agricultural exporting countries have fared well in the face of rising prices.

What's behind the strong dollar? Essentially, high inflation and rising interest rates. Inflation in the U.S. is at a 40-year high, sparking the Federal Reserve to aggressively raise interest rates. Rates are now higher in the U.S. than they are in many other countries, prompting investors to flock to Treasury bonds and other U.S. securities.

The U.S. economy has also bounced back from the pandemic better than most other economies around the world. What's more, higher energy and agricultural prices are hitting many areas -- especially Western Europe -- much harder than the United States, which is less reliant on imports from abroad.

What a Strong Dollar Means

For consumers, the stronger dollar results in cheaper imports -- theoretically at least. In reality, global inflation and soaring energy prices have tempered or outweighed the effects of a stronger dollar for many imported products. But international travelers have certainly benefited.

For U.S. businesses, a stronger dollar makes exported goods and services more expensive, giving companies outside the U.S. a competitive advantage. American multinationals such as IBM, Netflix, Johnson & Johnson, and Philip Morris, which generate a sizable portion of their earnings abroad, are already feeling the pain since they must convert foreign sales back into dollars. Others, including tech giants like Microsoft and Apple, are expected to follow suit.

The strong dollar also impacts companies and governments around the world. Because the U.S. dollar is the favored reserve currency across the globe, many foreign entities borrow money denominated in U.S. dollars. That means they must pay interest on such debt in dollars. The higher debt payments are especially onerous for poorer countries, where dollar-denominated debt represents a significant portion of their GNP.

What You Can Do

While there is nothing an individual can do to change the exchange rate, you can take advantage of the strong dollar in several ways.

Vacation where the dollar is strong. Japan, Britain, and many European countries have seen their currencies drop over 10% against the dollar since year-end. That means your dollar can buy 10% more. That said, you'll want to factor in transportation costs, which have risen as a result of the higher cost of fuel.

Shop around for imports. Some imported products may be less expensive than their domestic counterparts. Japanese electronics, for instance, may offer a less expensive alternative in some cases.

Be aware of any currency exposure of companies you invest in. Many companies earn a large portion of their income abroad, or buy major components of their products overseas. Currency shifts can impact them positively and negatively, ultimately affecting their valuations and stock price.