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Last Resort to Prevent Financial Crunch

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Around the world, economic catastrophe has shaken up governments and they have resorted on economists to flip through the pages of the 2008 global financial crisis playbook. To keep afloat the sinking economies amid the coronavirus pandemic, governments are pumping liquidity into the banking system to prevent the stock market from crashing. It is unclear whether these measures may lessen the panic, but the shock has grappled the corporate giants globally and requires a quick response.

For the world, witnessing the acute shortage of dollars for the second time in a century is a threat to global financial activity, which depends on the use of dollars. To contain the fallout from the crisis, America's central bank, with the world's biggest dollar reserves, must step forward to lend money, not just to its financial institutions, but to act as a spine for the entire world.

With uncertainties hovering over, the Federal Reserve ("the Fed") has stepped forward to funnel trillions of dollars to the central banks around the world. For many, the question remains "How long will the Fed continue to feed other economies?" In 2008, the dollar shortage was only limited to banks in Europe and America, but the present crisis requires the Fed to leave its comfort cushion, since it has to supply dollar liquidity to a polycentric world economy, amid the coronavirus crisis.

To pump dollars into the global financial systems, the Fed utilize "liquidity swap lines" to improve liquidity conditions in dollar funding markets in the US and abroad. This is done by providing the foreign central banks with US dollars and deliver them to the financial institutions in their jurisdiction, during times of market stress. In 1960, this system was deployed to circulate funds between the central banks wresting with upholding the exchange rates of the Bretton Woods system. economic gap, the Fed has widened the swap network to include all the 14 banks it supported in the 2008 financial crisis. The news brought back the skyrocketed exchange rate of the dollar in Brazil and South Korea.

The swap lines reflect the influence that America's central bank exerts on controlling the economies trading in the dollar-based financial system, while also serving as a tool of geopolitics. To many, this system of trading network provides financial stability and security to countries allied with American banks. However, no swap lines were ever extended to Russia and China, which was the reason that they never fall prey to American politics.

Countries, which were once a marginal part of the world's economy are now the emerging economies and key drivers of global growth, which includes China in the main lead and Indonesia, Malaysia, Thailand, and Turkey are also on the forefront. But China was already a main driver of global growth and today its economy is larger than ever, along with its holdings of American assets.

As of now, the foreign debt on Chinese business has surged to $1.3 trillion and is less sustainable with the increase in the dollar value.

Relations between the US and China are strained over trade issues, which was further deteriorated after President Trump's recent characterizing of the coronavirus as the "Chinese Virus," in an era when the US Treasury market is shaking badly. With the prevailing conflicts, the Fed should manage good relations with China's central bank by extending its swap line to China.

To avoid further losses, the White House and Congress should set aside their political motives and adjust their political discourse to join hands with the emerging economies in this crucial time to people. Especially, when the pandemic has wreaked havoc due to the dollar-based financial system.