Tea Leaf

…weekly since 1976

Your guide to understanding today's economy and financial markets

November 25, 2009

view previous issues

Dollar Rambling

Written by Jeff Thredgold, CSP, President, Thredgold Economic Associates

One of the first critical tests a potential candidate to serve as Secretary of the U.S. Treasury must pass is the ability to say "the U.S. supports a strong dollar" with a straight face….no smirking…no snickering…no giggles. The current U.S. Treasury Secretary Tim Geithner serving under President Obama, as well as his predecessor Henry Paulson who served under George Bush, both have/had such an ability, as did most former occupants of this powerful position.

"It is very important to the United States that we have a strong dollar," stated Geithner at a news conference last week in Singapore. *"We recognize, of course, that given the very important role of the U.S. in the global economy, the important role the dollar plays in the system, that we bear a special responsibility for being a source of stability and strength for the global economy."*

All that is well and good, and as it should be stated. At the same time, however, Obama and Geithner and others in positions of authority know that reasonable weakness of the U.S. dollar, at times, is a beneficial economic development, one that is useful in helping the economy escape the brutal winds of recession.

Good News…

- Current moderate weakness of the American dollar versus other major global currencies, particularly versus the euro and the yen, leads prices of U.S. exports to the world to be lower when compared against other currencies…hence greater U.S. exports and stronger U.S. manufacturing performance than if the dollar was stable

- A weaker dollar pushes U.S. import prices higher, hence we as American consumers are more apt to buy U.S.-made equivalent products (if possible), again helping the U.S. economy

- A weaker dollar makes it more expensive for Americans to visit other parts of the world on vacation (remember vacations?)…hence we find it more attractive to vacation within the U.S.

- And a weaker U.S. dollar makes it more affordable for Europeans, Asians and many others to visit the U.S. on vacation, as well as take advantage of bargain-priced American real estate or perhaps even get Holiday shopping done at U.S. stores where bargains are aplenty

Yes, there are limits as to how weak the dollar "should" get in the eyes of this Administration and many of its predecessors. The national media notes that the U.S. dollar has fallen to a 15-month low versus other major currencies during the past two weeks.

In recent days, a euro was worth roughly $1.49.

jeff thredgold, CSP
ECONOMIC FUTURIST

THREDGOLD ECONOMIC ASSOCIATES

The TEA Company
A Professional Speaking and Economic Consulting Company
1366 S Legend Hills Drive, Suite 150
Clearfield, Utah 84015
801-614-0403
www.thredgold.com

Note that a euro was worth $1.61 when the dollar reached its low point during the summer of 2008. I was in Europe during that time and everything…everything was very expensive.

The U.S. dollar was stronger a year ago as global anxiety about another possible Depression was sky-high. Scared money at that time went in search of the world's strongest, most liquid (marketable) currency and securities…yes, the dollar and U.S. Treasury debt securities.

…and Bad

How 'bout the flipside? Given current weakness of the U.S. dollar, how do the Europeans, the Japanese, the Canadians, etc. feel about their "strong" currencies? They are scared to death.

A strong currency leads to just the opposite of those "benefits" noted above…a more difficult time selling, for example, German manufactured goods…attractively priced imports in France or Canada, making it more difficult for "local" producers of similar goods to survive…more attractive for the "locals" to travel overseas, hurting local restaurants, shopping malls, etc. And more expensive for Americans to visit foreign tourist destinations, hurting hotels, restaurants, etc. in other nations.

Not So Good

This is NOT to say that a weak dollar is a positive development over a longer period of time. A weak dollar can effectively shift wealth between nations.

In addition, current weakness of the U.S. dollar has led global commodity prices higher, as most are priced in dollars. One could argue that oil prices are 15-20% higher today, in dollars, than such prices might be if the dollar had held its ground over the past 15 months. One could also argue that current gold prices near $1,150 per ounce are higher than such prices were a few months ago because of 1) weakness of the U.S. dollar, and 2) global anxiety that U.S. inflation pressures, in part tied to the weak currency, will be higher in coming years.

The Reserve Currency

Dollar weakness has led to major frustration within those nations, including China, Saudi Arabia, and Russia, who currently run large trade surpluses with the world. These nations have invested tens of billions of excess funds (dollars) into enormous amounts of dollar-denominated U.S. Treasury bills, notes, and bonds, as well as other securities. Such investments (believe it or not!) remain the most secure and the most marketable on the planet.

Declining values of such investments have led each of these nations to profess a desire for an alternative to the U.S. dollar as the primary reserve currency…don't hold your breath.

The enormous size of the American economy, combined with the enormous size and depth of U.S. financial markets, suggest that while other major currencies will make inroads as to being one of numerous global reserve currencies, the dollar will not be replaced anytime soon.

Too Strong

We have short memories. A major concern in global currency markets just a decade ago was that the U.S. dollar was noooooo strong. U.S. manufacturers were screaming bloody murder as to how the strong dollar was limiting their ability to sell U.S.-produced goods around the world.

U.S. travel industry executives were complaining that the strong dollar was limiting the number of Europeans and Asians and South Americans, etc. who were willing to travel to "expensive" America. A global agreement at that time did help lead the dollar somewhat lower versus other major currencies.

Low Rates

One current factor that has led to dollar weakness is the incredibly low level of short-term interest rates within the U.S. The Federal Reserve has maintained a 0.00%-0.25% federal funds target rate since mid-December 2008, the lowest level in the Fed's 96-year history. As a result, U.S. Treasury bill yields (investment returns) of 0.01% (annually) for three months and 0.11% (annually) for six months don't exactly see global investors racing to place money in the U.S.

The dollar is a commodity, like so many others. Sometimes up…and sometimes down.

Jeff

"TEA"ser

Virus is a Latin word used by doctors to mean "your guess is as good as mine."

—Bob Hope

jeff thredgold, CSP
ECONOMIC FUTURIST

THREDGOLD
ECONOMIC
ASSOCIATES

To receive the *Tea Leaf* free via email, sign up at
www.thredgold.com

Thredgold Economic Associates
1366 S Legend Hills Drive, Suite 150
Clearfield, Utah 84015
www.thredgold.com

Graphics and layout by Kendall Oliphant
Research assistance by Shawn Thredgold