

Dollar is sinking as deficit mounts

The US dollar hit a record level of 1.3007 against the euro last Wednesday and is now hovering at around 1.2970. It is amazing that the greenback slumped to the all-time low soon after Washington released its monthly statistics on jobs creation.

The report suggested that the country had created 337,000 jobs in October, which it felt was "good".

If that was the case, then why did the markets react so badly?

Probably it is sending a message. That is, American consumers will spend more and save less, thereby pushing the trade deficit further into the red. It now represents 5.5 per cent of the Gross Domestic Product (GDP), a figure of \$ 415 billion over the past 12 months.

With the exception of the Wall Street Journal's George Melloan, who feels that "the American economy runs well", an increasing number of economists all around the world, including the US, are issuing more and more warnings.

The facts are clear. The US current account deficit that is the excess of what Americans spend on goods, services and funds transferred abroad over which the US earns from the rest of the world now exceeds \$500 billion, which amounts to five per cent of the GDP.

That is the result of the above mentioned trade deficit, in spite of a currency having already lost nearly 30 per cent of its value against the euro over one year, an excessive consumption saving ratio in the US is two per cent compared to an average 10-15 per cent in the rest of the developed world- and a bad fiscal policy (budget deficit alone represents three per cent of the GDP).

The results are as clear as well. Just to take the position of the Asian Central Banks, their US financial assets now exceed \$ 124 billion. The US has to find \$2 billion per day just to close the balance. How long will that last?

As usual for economic issues, the theories are conflicting. "America's current account deficit is not only sustainable, it is perfectly logical given the world's hunger for investment returns and dollar reserves", writes Richard Cooper, former US undersecretary of state for economic affairs in Britain's Financial Times.

His main argument is that this situation can go on for years he cites a 15 year-period as long as the growth continues.

Opposite side

Considering that the US economy accounts for more than one quarter of the global economy and provides higher return on investment than any other developed countries, other savers will continue to invest in the US whatever the front value of the dollar.

On the opposite side, two university professors from Berkeley and Harvard answer Cooper and ask: "Should the US administration worry that the US is single-handedly eating up more than 70 per cent of the combined current account surpluses of China, Japan, Germany and all other surplus countries in the world? Our answer is a resounding 'Yes'."

In the theoretical fields, it happens often that when a situation moves towards a predicted catastrophe that, however, has not yet occurred, new theories explain that

since it did not occur, the underlying conditions for it may go on for years with nothing to fear. This, of course, until the catastrophe actually happens.

A fair analysis of the American economy can only lead to some basic evidence.

Americans do not pay enough taxes to cover the cost of their public spending. They import much more than what they sell abroad. They do not save enough and consume too much.

As a result, the rest of the world finances the US consumers so that they can go on consuming, importing and incidentally, creating new jobs related to their own spending.

But are these "good" jobs? Is this a "real" growth based upon intangible wealth-creating economic realities? It is true to say that this is made possible because the US itself prints the currency that it borrows; or that the US pays in dollars the energy it needs to import?

But in concrete treasury terms, the US must place \$2 billion every day with foreign financial institutions, the reserves of which are not without limits.

For the time being, it works as it also does for those investors who enjoy the benefits of an over performing market and only decide to leave it or diversify their holdings once it is too late.

Actually, it looks like something such as a perfusion: The day it stops un-avertedly, the sick man doesn't progressively get bad. He collapses. It is why no soft-landing can be likely expected from a decreasing dollar (just imagine that bringing down the trade deficit to 3.5 per cent of GDP would already cost the dollar another 35 per cent in value).

The currency actually will fall abruptly and sharply. US authorities will then have no other choice, but to raise interest rates, quickly and significantly, creating as a result of it recession in America and all over the world.

This is what will happen unless corrective measures are taken, immediately.

New request

"A sober US president-elect ought to worry a lot about his country's foreign borrowing addiction", the two professors wrote.

But it is not sure that George W. Bush will care. His new programme, besides "promoting freedom and democracy in the world" the way we know, also provides for new fiscal policies that, on the contrary, will increase the public deficit.

A war in Iraq costing one billion per week a new request for \$70 billion is now reaching the US Congress, will not help either. In the ferocious environment of the US capitalism and its shady financial markets (MCI, Enron and others), this is not what is needed by America. Nor by the rest of the world.

Luc Debieuvre, 14/11/2004