Bumps on the road to a weaker dollar

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AT LAST, Jean-Claude Trichet, the president of the European Central Bank (ECB), is letting the markets know that he is worried about a stronger euro. On January 12th he launched traders on a selling-spree of Europe's currency by describing the single currency's rise as “unwelcome” and “brutal”—which it obviously is for Europe, since a stronger currency threatens its budding economic recovery. Together with comments from others in Europe's financial hierarchy (a departure from the ECB's more relaxed stance), Mr Trichet's comments halted the euro's rapid march towards $1.30 and caused it to fall by about 4% a week later.

The disquiet of European policy-makers is understandable. Europe has shouldered much of the adjustment in the dollar, for Asian central banks have spent many billions of dollars in an attempt to halt their currencies' rise against the greenback. If Japan and China, whose currency is pegged to the dollar, continue their stubborn ways, the dollar will need to fall even more against the euro to cure America's imbalances. Mr Trichet's broadside suggests that Europe's central bankers are beginning to find this unacceptable.

Alas, currency markets rarely respond to words alone. Indeed, when European finance ministers joined Mr Trichet's rebuke to the markets, traders sent the currency soaring again. Though ministers wrung their hands over “volatility” in the markets, their half-hearted words failed to convince traders that any action was planned.

The ECB could, of course, cut interest rates, but it has seemed more concerned with fighting inflation—which to most economists seems like fighting the last war—than reducing pressure on the euro or spurring growth. The ECB could also intervene in the foreign-exchange markets, but in the long term, such efforts are likely to be fruitless unless the Americans are in favour. They aren't.

Still, Mr Trichet and his colleagues at least made the markets pause for thought in what had seemed a one-way bet. Almost everyone had been bearish about the dollar's prospects, for the logic behind its fall has seemed impeccable. America's oft-lamented twin deficits, those of its government budget and its current account, which need to be corrected by a weaker dollar, have shown every sign of getting worse, not better, and foreigners now need to lend America some $45 billion a month to allow the
country to maintain its spending habits. Ergo, the dollar must fall.

Two recent developments have, however, questioned this logic. The first was that on January 14th, the Commerce Department announced that America's trade deficit, at $38 billion in November, was better than expected. The fall in imports was especially welcome, given that the weaker dollar had previously failed to dent Americans' predilection for foreign goods. Europe's trade surplus also fell in November. America's current-account deficit, at 5% of GDP, is still huge, and one month's statistics scarcely constitute a trend, but it is at least possible that the fall in the dollar is finally having some effect.

The second factor that may sustain the dollar, at least for now, is that foreign investors seem to have been more enthusiastic about buying American assets. On January 16th, the government's flow-of-funds numbers showed that overseas investors had bought $83 billion-worth of American securities in November—nearly twice the monthly current-account deficit. The pleasing thing for that endangered species, the dollar bull, is that it was not just Asian central banks, the main foreign buyers in recent months, who been snaffling up Treasuries. Private investors were more eager buyers of Treasuries, shares and corporate debt than they had been in months, perhaps encouraged by robust economic growth.

But America still needs to attract a lot of money. And the ECB has precious few weapons in its armoury. Mr Trichet will be hoping that the G7 summit in early February will be sympathetic to his cause. But it is difficult to see why any of Europe's trading partners will be overly concerned.