

A euro rally but talk of a U.S. dollar bubble is wide of the mark.

The so-called "U.S. trade deficit" is the result of erroneous data - You can't pick up a serious newspaper these days without reading about "an overvalued dollar" or even "the U.S. dollar bubble". Stephen Roach of Morgan Stanley Dean Witter cited "Risks of a Growing Balance of Payments Deficit" as the reason, in a paper delivered on 25th July to the US Congressional Subcommittee on Economic Policy, no less. I think Roach is dead wrong on the deficit, which I have described in recent years as the most misleading economic statistic available. Subscribers interested in a well researched article on this subject may wish to read "The U.S. Trade Deficit: A Dangerous Obsession", published in the May/June 2001 issue of Foreign Affairs and co-authored, ironically, by Roach's colleague Joseph Quinlan and Marc Chandler of Mellon Financial Corporation. While there are huge time lags in collecting accurate data, they point out that "in 1998, U.S. foreign-affiliate sales topped a staggering \$2.4 trillion, while U.S. exports - the common but spurious yardstick of U.S. global sales - totalled just \$933 billion, or less than 40 percent of affiliate sales". I'll wager that this disparity has only increased in recent years. Additionally, U.S. foreign affiliates produce a great deal of what the U.S. imports. Net it out and the deficit all but disappears. Consequently, while the dollar is dependent on U.S. foreign affiliates and U.S. nationals for support, reasonably enough, comments that foreigners could pull the greenback's plug at any moment are risible.

Comparisons between the trade-weighted dollar in 1985 and 2001 are misleading - A currently fashionable chart shown by "dollar bubble" advocates depicts "the real trade-weighted dollar" approaching its 1985 peak, which these pages certainly cited as a bubble against the mark and other reserve currencies at the time. I've reproduced this graph from The Bank Credit Analyst which, incidentally, questions the significantly overvalued hypothesis. The problem with a trade-weighted chart, which I have not seen anyone else mention, is that it does not compare like with like. Trade is a moveable feast. Compared to 1985, the US has much more trade with Mexico and South American countries today. These have notoriously weak currencies. Against the mark and yen, the dollar peaked at DM3.453 and ¥262.8 in February 1985. Today, at DM2.221 and ¥123.8 talk of a bubble is absurd. Moreover, unlike 1985, it is not suggested by comparative economic performance. This does not mean that the greenback will go on appreciating, without some significant corrections against the mark and euro, and other arguably undervalued currencies such as the Canadian, Australian and New Zealand dollars. There are technical reasons for assuming that these will rally from current levels against the U.S. currency over the medium term. Also, just as mud sticks, repeated talk of overvaluation and

a bubble, plus rumours that the U.S. is reconsidering Robert Rubin's mantra, "a strong dollar is in our interests", however fanciful this may be, will inevitably have some effect on sentiment. As for a really overvalued currency, I maintain we should look at the yen. Please note: I will be away from the office during the week of 6th August.

Best regards - David Fuller

Trade-Weighted Dollar Since 1978



US Dollar/German Mark: Monthly (2.221)



US Dollar/Japanese Yen: Monthly (123.8)



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