Dollar Strongest Since 2010 Masking Competitiveness: Currencies
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By John Detrixhe

May 31 (Bloomberg) -- The surge that propelled the U.S. Dollar Index to its highest level since 2010 is masking the greenback's 30-year low versus emerging-market currencies, providing a boost for the Obama administration's export goals.

While the index tracking the dollar against the euro, yen, pound, Swiss franc, Canadian dollar and Swedish krona has risen 12 percent from its lows in 2009, America's currency is 18 percent weaker versus those in developing economies from its high that year as measured by the U.S. Trade Weighted Real Other Important Trading Partners Dollar Index.

The broad depreciation suggests a rebalancing in which nations from China to Chile with the world's fastest growing economies make up a bigger slice of global demand. That may help President Barack Obama meet his goal of doubling U.S. overseas sales by the end of next year even as export growth has slowed annually every year since he took office.

"The dollar is in fact on a trade-weighted, inflation- adjusted basis, near its most competitive levels in over 30 years," Robert Sinche, the global strategist at Pierpont Securities in Stamford, Connecticut, said in a telephone interview. "Where you want the U.S. to be competitive in the years ahead is in these emerging-market countries, where export potential is pretty significant, as they're growing faster than the developed world."

BRIC Output

Goldman Sachs Asset Management Chairman Jim O'Neill coined the term BRIC in 2001 to describe Brazil, Russia, India and China -- the four emerging powers he estimated would equal the U.S. in joint economic output by 2020. Those nations invited South Africa to join their ranks in December 2010.

Trade within the group surged to $282 billion last year from $27 billion in 2002, and may reach $500 billion by 2015, according to data from Brazil's government.

As the global reserve currency, the dollar has fallen against those of developing markets following the 2008 financial crisis as the Federal Reserve embarked on unprecedented economic-stimulus programs. That included printing dollars to buy bonds in a policy known as quantitative easing, or QE.

QE Byproduct

"I'm not surprised to see the U.S. on the weaker side because it's a byproduct of the QE," Win Thin, the global head of emerging-markets strategy at Brown Brothers Harriman & Co. in New York, said May 30 in a phone interview. "That's why you're having complaints about currency wars and money flowing into emerging markets from the zero interest rates."

Even as policy makers around the world have cut borrowing costs -- there have been more than 500 reductions since June 2007, based on Bank of America Merrill Lynch's count -- most benchmark interest rates are still higher than that of the world's largest economy.

The U.S. central bank's target rate for overnight loans between banks has been zero to 0.25 percent since December 2008.
The Bank of Korea's key rate is 2.5 percent, Mexico's is 4 percent and Poland's is 3 percent.

While the dollar has strengthened 29 percent against the yen in the past 12 months as Japan's government embarked on its own unprecedented stimulus plan, it has lost 10 percent to Mexico's peso, 5 percent to the baht and 3.7 percent to China's yuan.

Ineffective Anchor

The Fed’s programs have driven investors into higher- yielding debt of emerging-market countries, giving policy makers there the choice between allowing their currencies to appreciate, potentially making their exports less competitive, or to depreciate, which tends to drive up inflation, Sinche said.

“U.S. monetary policy isn’t exactly the virtuous anchor that it was for so many years,” Sinche said. For emerging markets, “you have to adopt very accommodative monetary policy, or else you need to break free and allow that appreciation to take place,” said Sinche, who has been a strategist at RBS Securities Inc. and at Bank of America Corp.

Obama has pledged to double exports to $3.14 trillion in goods and services by the end of 2014. Last year, they were a record $2.2 trillion, a 39 percent increase from 2009, when Obama took office, according to the Bureau of Economic Analysis.

U.S. exports advanced 17 percent in 2010 from the previous year as the economy began to recover from the global economic crisis. The rate fell to 14 percent the next year and was 4.3 percent in 2012 as growth slowed in Europe.

Mixed Dollar

Globally, trade growth eased to 2 percent in 2012 from 5.2 percent the previous year, the World Trade Organization said.

Intercontinental Exchange Inc.’s Dollar Index, which assigns the euro a 58 percent weighting and the yen 14 percent, has risen 4.2 percent this year and touched 84.498 on May 23.

The gauge, which stood at 83.090 as of 9:04 a.m. in London compared with 2009’s low of 74.17 that November, is forecast to rise to 86.1 by year-end, according to estimates of economists and strategist surveyed by Bloomberg.

The trade-weighted emerging-markets index, which includes China, Chile, Saudi Arabia, Israel and 15 other countries, has fallen 18 percent to 92.39 from 112.07 in February 2009. It reached a record 131 in December 1986, according to data going back to 1973.

Speculation that the Fed may reduce stimulus sparked declines in currencies ranging from Brazil’s real, which has weakened 2.8 percent versus the dollar in the past week, and the Indian rupee, which has lost 1.7 percent.

Fed Conundrum

The risk of a stronger dollar hurting the U.S. economy may keep the Fed from tightening policy as early as some investors expect, Eric Stein, a portfolio manager at Eaton Vance Corp. in Boston, said May 23 in a telephone interview.

“If you look at the dollar against a basket of emerging- market currencies, not even in inflation-adjusted terms, the dollar isn’t strong,” said Stein, who helps oversee $17.5 billion of fixed-income assets. “The stronger the dollar is, the less likely the Fed is to stop its easing any time soon.”

Stein, co-head of the Eaton Vance global fixed-income team, was previously an analyst and trader on the open-market desk at the Federal Reserve Bank of New York.

Faster inflation in developing economies is helping the U.S. regain some of its traction in manufacturing, Sinche said, as increasing prices and wages erode the competitiveness of a country’s workers. Prices in the BRICS economies climbed 3.7 percent in 2009, compared with a 0.4 percent decline in the U.S.

Last year the figures were 4.3 percent and 2.1 percent.

More Competitive

“Because of inflation differentials, the real effective rate has gone up even faster,” said Sinche. “This really bodes well for U.S. competitiveness and U.S. potential growth as we go forward, in particular in the globally competitive manufacturing sectors.”

That argument was made in 2011 by then U.S. Treasury Secretary Timothy F. Geithner, who said China’s inflation rate means the country’s currency is effectively appreciating against the dollar at a rate of “roughly 10 percent a year or more.”

The yuan has gained 1.5 percent this year and about 10 percent since 2010, when the Chinese began loosening the band in which the currency is allowed to float against the greenback.

“The real effective exchange-rate is really the one to look at,” said Thin at Brown Brothers, referring to the inflation-adjusted index of currencies. “China has been seeing real appreciation.”

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