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Perils of the Dollar Weakness

About mid-1977 the exchange rate of the dollar was still approximately D-mark 2.40 per \$. After a rapid descent setting in the dollar reached its hitherto lowest level of D-mark 2.06 per \$ at the beginning of January. Although it recovered temporarily after an announcement of the United States to participate in the interventions for the support of the dollar on the foreign exchange markets its value has declined again since then. American bankers are even anticipating that it will fall still further and Perex Corporation, a private consulting company, in November 1977 caused a sensation with its forecast that by the end of 1979 the dollar will be worth only D-mark 1.84 still.

The reasons for this decline are to begin with of a psychological nature. The currency dealers give little credit to Mr Blumenthal's, the US Secretary of the Treasury, occasional protestations that his country requires a strong currency. For, just as frequently Mr Blumenthal precipitated the Dollar-collapse by his public conjectures about the future dollar exchange rate. In addition there is the change in the management of the Federal Reserve Bank. Arthur Burns who, as the representative of America's conscience in the field of currency policy, reminded the USA time and again of its great responsibility also for the external value of its currency in the interest of the stability of the international currency system, was replaced by Mr G. William Miller. That all these events could not exactly influence positively the currency dealers' assessments of the further development of the dollar exchange rate is evident. With this constellation also dramatic support purchases of dollars by Tokio and Bonn – in December the Deutsche Bundesbank alone bought up dollars for D-mark 6 bn – could not prevent the sharp fall of the dollar. It was shown once more that such interventions can effect nothing against the dominating market forces and the speculators, even if responsible politicians frequently stated in public that the dollar is undervalued.

Disregarding however these psychological reasons, also the economic factors do not exactly seem to indicate a stable dollar for the future. In the first instance last year's enormous American current account deficit of \$ 20 bn is to be mentioned which has to be anticipated to the same tune for 1978. Walter H. Heller, the chief economist of the former Kennedy and Johnson administrations has therefore already predicted that the descent of the dollar will continue until the American balance of payments will not be in the red anymore. The enormous current account deficit is to be attributed mainly to the tremendous mineral oil imports from the OPEC-countries. In 1977 the USA purchased oil for \$ 45.5 bn, in 1975 it had spent only \$ 26.5 bn for this purpose. Without these immense amounts the balance of trade that in 1977 registered a deficit of \$ 30 bn, to which Japan alone contributed \$ 8 bn, would have shown even a surplus. Therefore the fact is not to be denied that the USA consumes too much energy at too low prices. And as long as no serious steps are taken to reduce this huge energy consumption, nothing will change regarding the deficit in the balance of trade and the shakiness of the dollar.

At present the USA attempts to solve its balance of payments problems by simply abandoning the dollar to the market forces. This fact should also not be glossed over by the foreign currency loans of \$ 20.16 bn made available to the US Central Bank by the Bank for International Settlements, and which are to be

employed for interventions in case of erratic, i.e. wild fluctuations of the dollar rate. This supposition is also supported by the fact that the American monetary policy did not give the necessary support. The increase of the discount rate by 0.5 % is much too moderate for justifying the expectation of a changing trend regarding the dollar rate.

At a first glance this American policy of a weak dollar seems very advantageous for the USA. To begin with exports will rise and imports will be kept down. Besides, foreign capital for direct investment flows to the USA and this also creates new jobs. The current account will improve again and thus in the longer term restore the dollar somewhat. This policy is therefore certainly more comfortable than enforcing a rigorous programme for energy saving. The Americans however do not seem to realise the manifold dangers inherent in this policy.

First, a declining dollar means an appreciation of the other currencies. Thus during the first ten months of 1977 the yen registered a de-facto revaluation of 22 % compared with the dollar, and the rate of the D-mark has risen vis-à-vis the dollar by 16 % from the beginning of 1976 until November 1977. In both instances this is exceeding the differing cost and price developments in these countries, i.e. the American economy's improved competitiveness was purchased with an encumbrance of other countries' competitive position via an exaggerated increase in their export prices. In the case of Japan this may be countenanced because this country produces immense current account surpluses vis-à-vis the USA and apparently is not willing to reduce them through adequate economic policy measures.

Vis-à-vis the Federal Republic and Western Europe however the USA registers a large surplus in its balances of trade and payments. Although a large part of German industry is invoicing its exports in D-mark, highly export oriented trades as e.g. mechanical engineering, the chemical industry, the fabrication of automobiles and maritime shipping are affected strongly. In general the Americans with the small contribution of their exports of goods to their GNP of 7 % in 1976 do not seem to realise to what extent other smaller Western countries are depending on goods exports, the Federal Republic for instance to the tune of about 23 % in 1976. Thus every revaluation is hurting due to the deteriorating competitive position.

The question of how long the OPEC-countries will be prepared to tolerate payments in weak dollars constitutes also a major risk of the US-monetary policy. That these states sooner or later will react with price increases if the dollar is not being stabilised is a severe risk. This would hurt the entire world economy, and here again the smaller states and the developing countries.

The international monetary system and world trade are however jeopardised most. The dollar is the world's most important currency. A permanently distrusted dollar could exercise an extremely distorting influence on the trade flows and in particular the capital flows. The American exchange rate policy is also undermining the world monetary system. According to the new articles of Jamaica signed also by the USA, the IMF would even be obliged to ask the USA to abstain from distorting manipulations. The American attitude encourages the violation of the rules of the game of the "controlled floating" and prejudices the international monetary order because it contributes to its erosion. If the American version of "exporting" employment problems via the exchange rate policy were imitated, not only the international monetary order but also free trade would suffer damage. Due to the counter measures to be anticipated from the partner countries the trade protectionism existing anyway would be strengthened. This would entail disadvantages to all – also to the United States. It should therefore remember that as the Western leading nation the USA has to take not only political and military but also economic responsibility.

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