THE SINKING DOLLAR

PRESENTED TO

THE SINKING DOLLAR

The dollar has been losing value, weakening its status as the world's major currency and setting off jitters in the international financial system. The falling dollar is not just a technical matter for financial market experts: trillions of dollars in value have shifted in the course of about eighteen months, reducing the reserves of the world's central banks and knocking down the value of all US assets on the international marketplace. Analysts worry that a serious dollar selloff could create panic in the markets and lead to a global financial meltdown. Even if the worst-case is averted, a declining dollar may weaken the power of the United States, reorganize global markets and shift strategic power in the international system

Many financial analysts expected the dollar to weaken because of the growing US trade deficit on its "current account".

Soaring Trade Deficits

The biggest single factor in the dollar's fall has been the soaring deficit in US trade. The United States imports far more than it exports in goods and services. US companies are not able to export products and services of the same value.In 2002, imports of goods and services totaled $1,652 billion, while exports amounted to only $1,203 billion . The difference is made up by net foreign lending and investments.

The current account gap – and the foreign funds to pay for it – rose to a record $550 billion from $481 billion the previous year. Each business day, the US must attract about $2 billion in net lending and investments to pay for the trade gap and keep the economy afloat. Though some of the incoming investments promote long-term economic growth, most of the funds finance government deficits, contribute to stock speculation, or finance consumer credit lending. As global investors grew wary of the subsidy system and saw it as unsustainable, the dollar started its decline.

Beyond the Trade Deficit

Several other factors have influenced the fall of the dollar, magnifying the primary effect of the trade deficit. Firstly, the accounting scandals at Enron, Tyco, WorldCom and many other companies revealed serious weaknesses in the US reporting and regulatory system, leading to falling confidence in US stocks, bonds and other investments. Plunging values in these markets beginning in 2001, and the consequent enormous investment losses, further shook foreign investor confidence. As a result, foreign investors stopped sending a net inflow of investment funds into US markets. Instead, they began to liquidate their portfolios, causing a net funds outflow.

The sharp increase in US government budget deficits also undermined investor confidence. After several years of government budget surpluses, the Bush administration cut taxes dramatically and increased military spending, setting off a deficit that is estimated to reach $550 billion in 2004 (up from $481 billion in 2003), making the 2004 deficit by far the largest on record.

What Kept the Dollar High?

In spite of weak fundamentals, the dollar remained very strong in the 1990s. The strong dollar worsened the current account balance by pricing US goods out of world markets, but somehow that didn't dampen the enthusiasm of investors and currency traders.

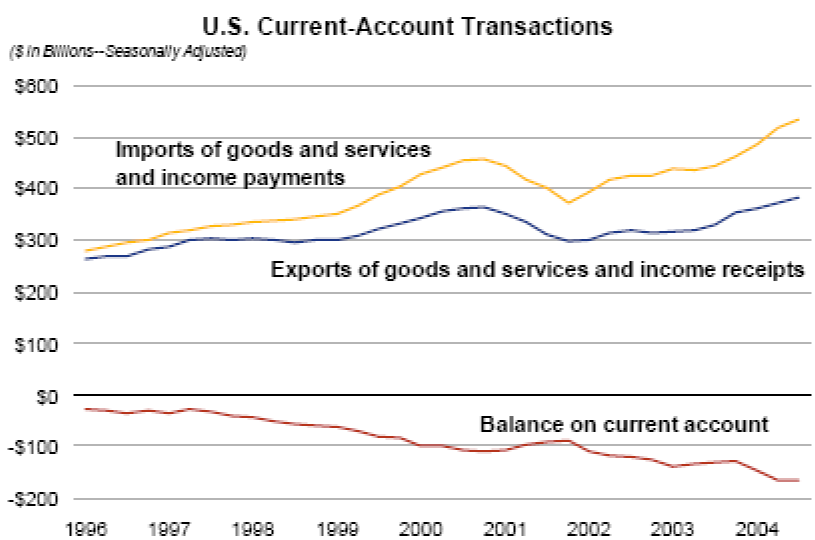
The US stock market bubble during the 1990s sucked in billions of dollars in foreign investments, as foreign companies and individuals hoped to ride rising stock prices to riches. Foreign investors preferred US investments because they saw them as exceptionally dependable, safe from political risk and financial uncertainty. With the Japanese economy weak, the yen did not offer a strong alternative to the dollar, in spite of sizeable trade surpluses. Further, the movement towards a European single currency encountered many pitfalls. When the Euro was first introduced in early 1999, investors were doubtful about its viability, forcing it down steadily. Meanwhile, the US dollar's role as the world's reserve currency strengthened. Central banks worldwide hold various currencies as reserve assets, but the US dollar climbed from 57% of total reserves in 1995 to 68% in 1999. Use as reserves created demand for dollar-denominated investments, mainly US government Treasury securities.

Current Account

The U.S. current-account deficit—the broadest measure of receipts and payments for trade in goods and services, income, and net unilateral current transfers, such as gifts—increased slightly to $164.7 billion (preliminary) in the third quarter of 2004 from $164.4 billion (revised) in the second quarter.

Balance on US Current Account

1996 - 2004



What a weak dollar could mean for the world economy

Growth : The world economy could slow down or stagnate, depending on how US consumption reacts to a weak dollar.More importantly,growth could get redistributed-away from those countries that let their currencies appreciate and towards the US.

Interest Rates: A falling dollar could mean that foreigners start pulling out their money from the US financial system.The most likely result will be higher interest rates,which could upset the solvency of deep-in-debt American families.

Capital Flows:It is likely that more capital could flow to markets where currencies are strong.Asia could be a big gainer,though past history shows that such sudden floods of capital can lift asset values to unsustainable levels.

Crisis:A lot depends on how orderly the decline of the dollar is.Some economists fear that matters could get out of hand and we could see a huge financial crisis.The coming months will test the strength of the global financial architecture.

Will currency trends affect U.S. growth?

Sizzling booming stock market attracted foreign investment to U.S. shores in the late 1990s. The influx of overseas capital drove the dollar higher. Now the dollar is trading near a record low vs. the euro and has fallen relative to other major currencies. With the economy rebounding, financial pundits have turned their focus to the declining dollar and its relation to the trade and budget deficits. Further currency slide may disrupt the U.S. recovery and stall other major economies across the globe.

Markets, not governments, drive exchange rates.

In the short term, governments can manipulate the dollar's value relative to their currencies. But long term, the dollar bows to market forces. Exchange rates essentially reflect the global forces of supply and demand. For instance, the dollar rises against another currency when there is a net inflow of dollars into the U.S. This occurs when foreign demand for American products, investments, debt instruments and tangible assets is high. The dollar weakens when there is a net outflow of dollars from U.S.This results from U.S. businesses, consumers and investors sending a disproportionate share of dollars overseas while foreign demand for U.S. currency and assets is falling.

Currency trends are hard to forecast.

Currencies move in cycles, following economic performance and trade activity. But these trends are often unpredictable and lagging. And different monetary policies between nations can briefly distort exchange rates. The dollar remained strong well into the recession, then began sinking in 2002. And now, despite a rebounding economy, the dollar has continued its downward slide. The U.S. capital markets are not attracting a large enough flow of foreign money to support the dollar. This suggests that the U.S. financial system is vulnerable to the whims of foreign investors and governments. But the dependency is a two-way street. About 80% of capital inflows come from countries that would experience major recessions without the U.S. as their primary export customer. A weak dollar works against their economic interests, so central banks buy dollars to support its value.

Currency views are mixed

Weak dollar proponents say that a falling currency makes U.S. goods cheaper and imports more expensive. This pricing disparity helps boost economic growth by raising demand for domestic goods (at the expense of foreign goods) while slowing the migration of factories and jobs to foreign sites. A cheaper dollar gives U.S. companies more room to raise prices while staying competitive with imports. Domestic companies gain market share while their foreign subsidiaries experience improved profits when sales are converted from higher local currency to dollars. Strong dollar proponents claim that a weakened currency hurts the business environment, raises prices for consumers and drains capital from the stock and bond markets. When foreign investors leave the U.S. markets, the Federal Reserve must eventually raise interest rates to attract more capital.

This, combined with higher prices, ignites an inflationary trend. These events curtail consumer spending, business investment and economic growth .A weakening dollar may point to deeper business problems such as low productivity, runaway costs and inferior products that are making U.S. companies uncompetitive in the world markets. Strong dollar also questions many of the assumed benefits of currency debasement. Exporters and retailers, who cannot immediately change their arrangements with foreign suppliers, must pay higher production costs, which are passed along to consumers. Also, some economists believe that America's trade gap results more from its economic growth rate than from the dollar's value.

The dollar affects fortunes and economies.

The dollar is the world's business currency. Most countries outside Europe use the dollar as their primary intervention currency. Asia, the Middle East and Latin America hold 90% of the world's international reserves. Most of which are dollar denominated. China and Japan also run the largest account surplus with the U.S. and are inclined to unofficially peg their currencies to the dollar. Export-driven economies cannot afford for the dollar to slip and American buying activity to stall. This is why Japan, China and other Asian economies regularly intervene in the markets to keep the dollar high against their own currencies. Europe is the largest foreign holder of U.S. equities. A massive sell-off would further drive down the dollar, raise the price of European goods and threaten the Continent's current export-driven recovery. Most countries have a continuing stake in the dollar's strength. During times of uncertainty, countries hold the dollar because it reflects the stabilizing influence of U.S. economic power, military strength and political balance. And during good economic times, the highly liquid dollar (along with dollar-denominated assets) serve as fuel for continuing expansion. This gives the U.S. a continual line of credit and gives other regions the stability of dollar denominated assets and a reliable export market.

Has dollar fallen at the right time?

A strong dollar helped the U.S. during the mid 1990s. It made imports cheaper, which held down inflation and satisfied consumer demand, which was growing beyond what U.S. companies could supply at full utilization. The situation reversed midway into the last recession.Inflation has been minimal, with consumer prices growing at only 1.3% in

2002. A weakened dollar has given manufacturers a break from low-price Asian goods and consumers have been shielded from price hikes.

Rising Oil Prices and a Weak Dollar Could Shatter the Global Economy

OPEC is worried about the weakening value of the dollar.Since OPEC sells oil for dollars, the oil-producing countries are losing precious revenue as the value of the dollar continues to erode. And because oil-producing countries then turn around and purchase much of their goods and services from the EU and must pay in euros, their purchasing power continues to deteriorate.

Deflation:

It Threatens the United States--and the World

Depression means an economy that is stuck in a ditch and cannot get out, unable to regain its normal energies for expansion.If the United States also undergoes Japan like depression then the global economy is imperiled, too, since America's market for imports and its huge trade deficits keep the global trading system afloat.

Taking strong measures would be messy and disruptive to regular order but in the present circumstances that would seem more prudent than a false optimism that lamely repeats that the "good times" are right around the corner.

A depression can be read as a "market signal" of a dysfunctional economy that requires fundamental restructuring.Such a signal may be flashing the need for deep changes both in the American economic system and the world's.

Declining prices create a vicious spiral of negatives--falling profits, more closed factories, shrinking employment and incomes, accompanied by waves of failing debtors, both corporations and families.

Dollar’s Fall Lands Hard in Europe

The sharp decline in the dollar against the euro may start to squeeze the nascent export-driven growth seen by Germany and some of the largest economies in Europe, where the high oil price is already starting to crimp consumer spending.

Over the past year, the dollar's weakness has reflected continuing unease at the "twin deficits" in the United States - the federal government's massive budgetary imbalance, and the current account deficit. These ballooning figures indicate the extent to which the

United States relies on other countries to finance its growth.The American trade deficit stems principally from its Asian trading partners, above all Japan and China, but China pegs its currency to the dollar.

Implications of the Dollar’s Decline

As the dollar has continued to fall, US authorities have not intervened to prop it up. Bush administration has said that it welcomes the decline of the dollar and has made it clear that it is abandoning the previous “strong dollar” policy. The dollar’s fall will reduce the huge international subsidy enjoyed for two decades by the US economy, ultimately shrinking the standard of living of US citizens. At the same time, falling US demand for imports will likely harm economies everywhere else and set off further currency devaluations, trade pressures and financial instabilities -- all with dangerous consequences.

What do we interpret?

The US can scarcely prevail as the global superpower if its economic fundamentals are weak. Britain’s two hundred years of global supremacy were based on a strong currency, a large trade surplus and growing foreign investments. Trade decline in the late nineteenth and early twentieth century gave a clear sign that Britain’s empire was on the wane. Today’s trade and payments deficits, and the falling dollar, may point in the very same direction for the global order based on US dominance.

Economic relations between Europe and developing countries

Trade between the European Union and developing countries is important. About 22 percent of the European Union's exports go to, and 20 percent of its imports come from, developing countries. Over the past two decades, Latin America's exports to the European Union have tripled, to $38 billion a year. Imports from the European Union have quadrupled since 1977 and continue to climb, rising from $27 billion to $54 billion a year between 1990 and 1997.

How will the introduction of the euro affect trade between the two regions?

One advantage is that Latin Americans will be able to invoice in a single currency when trading with different European partners. A more important—although less certain—effect is that if European economic growth picks up as a consequence of increased efficiency and competition in Europe, demand in the euro area for imports from Latin America and the Caribbean will increase.

The decline in risk premiums is, in turn, reflected in lower interest rates and should therefore boost growth rates in these countries. Furthermore, the euro reinforces financial deregulation. As a result, it should spur the development of broader, deeper capital markets in Europe that would more closely resemble U.S. capital markets, thereby contributing to improved corporate governance and better performance by European companies. However, the euro's direct contribution to European growth and employment will probably not be very significant, because the gains in competition and efficiency are likely to be small. The elimination of exchange rate risk and transaction costs within Europe could result in trade diversion and a reduction of imports from non-European countries. The only exports from Latin America and the Caribbean that would be negatively affected, however, would be the small number that are in direct competition with goods produced in Europe. Thus, both the expansionary influence from possibly faster European growth and any dampening impact from trade diversion are likely to be relatively slight.

Value and volatility of the euro

The financial challenges facing EMU are real. Exchange rate volatility could lead to portfolio shifts both into and out of the euro. Uncertainty about the ECB, and especially about European politics, weakened the euro in the early days of EMU. A weaker euro would probably stimulate demand for labor in a region where high unemployment levels have been a source of grave concern for more than a decade.

What implications will the euro's introduction have for banking systems, foreign debt, and reserve management in Developing countries?

Banking systems. The introduction of the euro worked as a catalyst for the development of integrated money and bond markets in Europe. It has spurred competition among banks and between banks and other sources of funds. Furthermore, the increased competitiveness of banks and financial systems in general will lead to more efficient resource allocation and ultimately stimulate investment and job creation. In recent years, the involvement of European banks in Latin America has expanded considerably.In the longer term as competition within Europe heats up and margins narrow, banks may find the prospect of expansion into non-European markets attractive.

Management of foreign debt. As trade between Europe and Latin America and the Caribbean grows, euro-denominated debt may well account for a larger share of the latter's total foreign debt. Hence, countries in the region need to reassess their hedging strategies. In the longer term, a shift in euro interest rates will have an effect on the foreign debt service of countries in Latin America and the Caribbean because part of their debt will be denominated in euros. Furthermore, countries in Latin America and the Caribbean could offset the adverse effects of economic shocks by changing their debt-management policies. This will be easier to do with a single European currency.

Reserves. The European Union's intention is that the euro will become a major reserve currency competitive with the U.S. dollar. Will countries in Latin America and the Caribbean substantially diversify their reserve holdings? If Europe succeeds in making the euro competitive, the euro could cut into the seigniorage currently accruing to the United States.

China's economy is overheated, its banks are shaky, and hot money continues to pour in

China is not a 100% market economy. China's banking system is really insolvent, and all the monetary tools they have to fix things are blunt. China's current prosperity is adding fat to the fire. Since the country joined the World Trade Organization, the economy's links with the outside world have accelerated. The result is a collision of global capital with a still-primitive financial system.Much of the extra yuan ends up in the money supply and banking system, where a good chunk of it is lent.The weaker dollar's impact on stock prices could go in either direction. The higher bond yields will hurt price-earnings ratios, but profits will be buoyed by a lower dollar. The effect on earnings is twofold: First, the cheaper greenback makes U.S. outfits more competitive, allowing higher volumes and fatter margins. Second, the earnings from overseas operations will be translated at a higher exchange rate. With the greenback expected to keep sinking in 2005, the impact may be mixed for the U.S., but the rest of the world will probably dislike the experience.

Going Down With the Dollar: The Cost to Developing Countries of a Declining Dollar

In the years since the East Asian financial crisis in 1997, many developing countries have sought to increase their holdings of foreign reserves, as a way to protect their currencies against financial instability. Since most countries hold most of their reserves in dollars, this build-up in reserves has led to a large accumulation of dollar holdings.

These large holdings of dollars could lead to substantial losses in wealth for developing countries with the decline in the dollar.

THE FUTURE OF THE DOLLAR

The big question is whether the dollar—the world's reserve currency—can survive a steep fall in its value without the active support of the major central banks. Is an orderly retreat for the dollar possible today?

The recent stock market bubble led to overinvestment. Now that the bubble has burst, there is overcapacity throughout the economy. Underutilized capacity, combined with a high level of indebtedness in the U.S. corporate sector, implies that business investment will be depressed for a long time to come. Despite falling stock prices and contraction of business investment, a consumption boom has continued, kept alive by a bond market bubble underwriting a housing boom, along with a high dose of fiscal stimulus. By exporting deflation to the rest of the world, a weak dollar would allow the U.S. economy to expand at the expense of the Asian and European economies. A weak dollar would also make more difficult the maintenance of the private consumption boom in the United States. A gradual weakening of the dollar would be particularly harmful, since it would dampen the attractiveness of U.S. assets—stocks as well as bonds—for foreign buyers. If foreign investment slackened, then U.S. interest rates would rise sharply. A sharp and steep dollar devaluation, rather than a slow downward drift, is preferable for the United States: it would wipe out the asset devaluation risk in one fell swoop and make U.S. assets cheap and attractive to foreign buyers once again. Furthermore, foreign currency-denominated assets owned by Americans overseas and the investment income that these assets generate would rise in value (in dollar terms), while dollar denominated U.S. liabilities to foreigners would remain unchanged. The U.S. economy would benefit from a substantial improvement in its negative net investment with the rest of the world.

Then What?

If neither an orderly retreat of the dollar nor the emergence of a new source of global demand to replace the U.S. economy is likely, then what?The Fed is trying to prevent the bond market bubble from bursting, which would depress the real estate market and the private consumption boom, before the business outlook improves in the corporate sector. It hopes that, once investment comes back to life, the economy will then easily grow out of its budget deficit, and the current account deficit, whatever its size, will be equity financed by foreigners and cease to be a problem. As confidence in this rosy scenario subsides around the world, the likely outcome is a gradual fragmentation of the world currency markets: the dollar and other major currencies will cease to be the magnets they have been during the era of financial liberalization. While this outcome makes the U.S. economy increasingly vulnerable, it may prove to be beneficial for developing countries by making it easier for them to stimulate their own internal demand. Many of the soft currencies, such as the Indian rupee and the Turkish lira, are already showing an amazing degree of resilience. This welcome respite from foreign exchange constraints is happening not only because hot money is returning, as expected, to the emerging markets, but also because people with wealth are buying assets denominated in local currencies. The greater the expectation of a weak dollar and the greater the uncertainty about the euro and the yen, the greater the ability of developing countries to reflate their economies. This may also prove to be an opportune time to experiment in setting up regional networks and to rehash ideas such as the Asian Monetary Fund, which was shot down by the United States and the International Monetary Fund after the Asian crisis—especially if the newfound assertiveness of the southern hemisphere at the last ministerial meeting of the World Trade Organization in Cancun proves to be some sign of a sea change in the developing world.

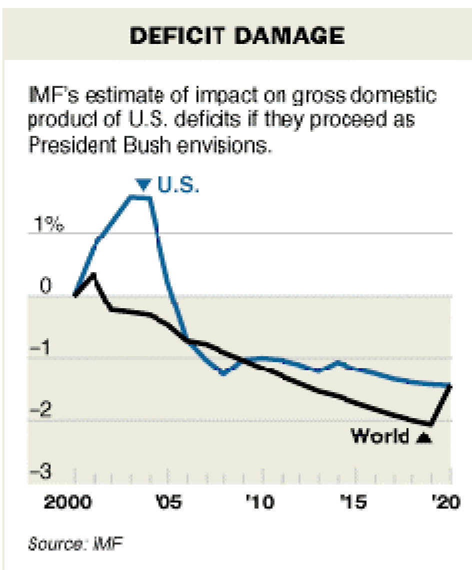
LIKELY RESPONSE TOWARDS THE FALL OF DOLLAR

U.S. ADMINISTRATION

Cheapening the Dollar

U.S. administration has abandoned longstanding support for a strong dollar in favor of a weak dollar that is getting weaker.By encouraging a cheap dollar, the administration is providing a big push to American exporters by making their products less expensive in foreign markets. That should encourage more hiring and lower unemployment leading up to the election. The only immediate losers are exporters in Europe and Asia who have to choose between cutting prices or losing market share in the United States.

INTERNATIONAL MONETARY FUND (IMF)



The IMF estimates that even if the budget deficit is cut in half from $521 billion by 2009, as the Bush Administration projects, U.S. gross domestic product would be 1.4% lower by 2020 and 1.9% lower by 2050 than if surpluses had continued, as had been expected in 2000. The IMF predicts that for many poor countries, the effects could be even worse as they pay even higher interest rates to compete with the U.S. for the world's spare savings. Those that borrow in U.S. dollars would also find it costlier to pay off those debts as the inflow of foreign capital to finance the U.S. deficit initially pushes the dollar's value.IMF worries about a collapse in the dollar that would send shock waves through the global economy. IMF argues that the dollar needs to depreciate another 20 percent against the other major currencies but warns about a run on the dollar that could reduce its value by 40 percent. A collapse of that size would severely affect Europe and Asia, which have relied heavily on exports to the United States for their growth.

FEDERAL RESERVE

Federal Reserve chairman Alan Greenspan contends that global financial markets are awash in so much money that the United States can borrow much more than seemed possible 20 years ago. The dollar may well decline in value but the decline would be gradual and would help reduce American trade imbalances by making exports cheaper and imports more expensive.

FOREIGN GOVERNMENTS

Foreign governments like China and Japan will continue to finance American borrowing and keep the dollar strong because they are determined to sustain their exports and create jobs.

STRATEGIES FOR U.S. ADMINISTRATION AND OTHER GOVERNMENTS

- As long as the US and global economy are increasingly dependent on an ever-dwindling supply of oil from the Middle East, the conditions for a perfect economic storm will continue to haunt. The solution, in the long run, is to wean the world off its dependency on oil. That would require much tougher fuel efficiency standards, greater energy conservation measures, support of hybrid vehicles and a switch to renewable sources of energy.
- The US could raise interest rates, making it more attractive for foreign investors, but that would mean higher interest rates for US companies and consumers, which could dampen the already weak recovery and send us back into a recession in the US and around the world.
- Congress and the White House can simultaneously launch a major stimulus program composed of public spending and quick-acting tax cuts, thus running up far larger budget deficits than the Bush Administration has engineered. Whether

the money builds schools and highways or hires more schoolteachers, it creates new jobs, incomes and business activity.

- The government may have to intervene more directly and manage a substantial liquidation of debt burdens--either arrange ways to write off failed loans (as it did in the savings-and-loan crisis of the 1980s) or create more lenient terms for the indebted companies and households, much like a banker's "workout" for a financially troubled business.
- Government could create a "resolution trust corporation" for people--an agency that supervises debt workouts for households, gives them more time to catch up with mortgage and credit card payments, and imposes these relaxed terms on the financial industry, with government guarantees against failure. That would represent stimulus with a democratic bottom line.
- First, leading nations must join to launch worldwide stimulative policies and persuade rising nations like China not to bring down the system by overwhelming rival producers. The fundamental solution, however, involves the kind of moderating reforms advocated by antiglobalization activists worldwide--rules to rebalance the system and genuinely promote wages as well as output, financial terms that give developing countries more time and space to seek their own distinctive economic plans, plus new institutions of governance that are truly equitable and democratic, instead of corporatized lawmaking. That's a very tall order for statesmanship in a world presently governed by small-minded men.
- Invest in the smaller, more nimble firms ready to do things differently. Invest in people--the human development that begins with children at a very early age. These and other investment opportunities are where the future jobs and higher returns are most likely to be found.
- Introduce Tax cuts-central to spurring growth –boost growth by encouraging people to work and invest.
- Policymakers should avoid playing the blame game, which is a recipe for inaction: global imbalances are a problem of global disequilibrium, and it is unproductive to point to one or other localised variable - saving here or investment there - and pin the entire blame on it. It is actions that matter.

- U.S. Treasury can work closely with EU to manage the dollar's fall.

IMF ADVICE

- In the US, credible measures of fiscal consolidation are needed, together with measures to boost private saving. The eurozone and Japan must concentrate on structural reforms to increase flexibility and to boost domestic demand and growth, especially in the relatively inefficient non-traded sectors.
- Meanwhile, emerging Asia should allow greater exchange rate flexibility and focus on reforming the financial sector. The first will help to cool overheating economies; the second will increase the level and quality of investment while reducing the need for saving.

STRATEGIES PURSUED BY FEDERAL RESERVE

- Fed can deliberately induce price inflation to counter the deflationary forces and excite what Keynes called the "animal spirits" of business leaders. Rising prices will also automatically ease the debt burdens of borrowers by diluting money's real value.
- Take corrective action that may be required of **monetary policy:** Pump up the money supply and deliberately induce rising prices- foster a renewal of inflation. Rising prices provide an essential lubricant for any sustained recovery because a dose of inflation helps businesses get well and takes some of the depressive pressures off wages and debtors of every kind.
- Fed can keep interest rates low to maintain economic expansion.
- Fed can propose for fixing exchange rates between yen,dollar and euro-currency union.

STRATEGIES PURSUED BY EUROPEAN CENTRAL BANK (ECB)

- Introduce euro denominated bonds & stocks to stimulate the economy
- Besides inflation, should also focus on jobs and growth.
- Instead of buying only short-term Treasury notes to inject new money into the economy, ECB may purchase long-term US bonds or foreign bonds. It may accept corporate debt, private bank loans and mortgage securities as collateral for the Fed's direct lending to banks--a way of pushing bankers to lend more generously to business.
- Pursue policy of price stability to have an important influence on the euro's international value.
- Adopt sound financial structural policies including reforms of both labor markets and public spending.

STRATEGIES ADOPTED BY ASIAN CENTRAL BANKS

- Develop a deep and liquid foreign market for price-exchange rate-discovery and determination.
- Increasing market information on the sources and uses of foreign exchange.
- Phasing out regulations that stifle market activity
- Unifying and simplifying foreign exchange legislation and avoiding ad hoc and frequent changes.
- Facilitate the development of risk hedging instruments.
- Develop policies to guide the objectives,timing,and amounts of foreign exchange intervention.
- Establish a new nominal anchor and redesign the monetary policy framework to accommodate it.
- Contain exchange rate risks in all sectors of the economy.

- Diversify holdings and currency options

CONCLUSION

The dollar will rebound.

The U.S. is now importing 1.5 times more than it exports and analysts expect imports to increase substantially in 2004 as U.S. manufacturers replenish inventories and move operations overseas in response to rising global competition.So, the dollar may drop further in the short term. The larger question is how the capital markets will respond. Many fear that foreign investors, who now hold over $9 trillion of U.S. assets, will lose confidence in the dollar and start a massive sell-off, which could spark a currency crash. Interest rates would have to rise to attract more capital, which could smother the U.S. recovery. Falling U.S. imports would stall regional economies across the globe.And as long as the inflation rate stays low, an outflow of capital from U.S. financial markets will be offset by foreign central banks buying up dollars to preserve market share .In the long run, America's commanding lead in new technology, combined with a pro-growth, low-regulation environment, suggests that the dollar will remain the currency of choice. High productivity,robust economic growth and attractive investment returns are magnets for global capital. The stage is being set for another round of prosperity. The dollar should rise again.