Click here for Full Issue of EIR Volume 29, Number 20, May 24, 2002

EIR Economics

Danger for the Dollar

by Lothar Komp

Big trouble is brewing on the foreign exchange markets. The soaring value of the American dollar against the European and Japanese currencies, maintained steadily since the mid-1990s, has come to a standstill since the beginning of this year. After an unbroken descent during April—when the leading American corporations presented, day after day, their generally catastrophic quarterly reports—the dollar fell at the beginning of May to its lowest level against the euro since October 2001.

Despite a warning by the Japanese government that it intended to intervene on the foreign exchange markets against its own currency, the dollar also slid downward against the yen, after the revelation that the U.S. unemployment rate had hit its highest in seven and a half years. In comparison to the Swiss franc, the dollar has already shed 7% of its value since the start of this year. On May 7, in its global currency markets report, the Bank of America spoke of outright "panic selling" of dollars in Asia.

Mirroring the dollar's fall, the gold price has continually risen, and for some time now has been hovering at well above $300 per ounce.

Think of Autumn 1998

A slight drop in the dollar's value would certainly come in handy for the U.S. government, in order to help its prostrate economy back on its feet. But as all experience with speculative bubbles shows, trying to let only a little air out of the bubble never works very well. It is quite probable that the bubble will burst with a loud splat, causing the dollar to lose one-quarter or even one-third of its value within a few weeks or months. Dramatic shifts and breakdowns in the financial markets would immediately follow. We are reminded of the global hedge-fund crisis in Autumn 1998, when the big funds had speculated against the Japanese yen with huge financial bets, and the dollar, in only four days, plunged by 18% against the yen.

This time, it may be much worse, because, from the mid-1990s proclamation of the American "economic miracle" onward, the U.S. economy has turned into a monster, which cannot survive without speculative bubbles to feed on. Along with this has come not only a bubble in the domestic U.S. financial markets—first on the stock markets, and now in real estate—which has enabled private households to take in ever-growing quantities of credit, thus forcing a still greater expansion of debt; but also an externally driven dollar bubble, which has been indispensable for maintaining the flow of considerable capital from abroad into the United States. The American economy is now just as addicted to both these speculative bubbles, as Count Dracula was addicted to the blood of his victims.

Trade Deficit Is Out of Control

Considering the spectacular decline in U.S. foreign trade, the question is not so much what the trigger will be for a full-scale dollar crash, but rather, why this crash hasn't already occurred long before now. It is worthwhile in this respect, to look at a few details from official U.S. statistics.

Last year, the United States exported goods valued at $721 billion, of which $322 billion were in capital goods, $160 billion in industrial materials and semi-finished products, $90 billion in consumer goods, $75 billion in automobiles and automotive parts, and $55 billion in agricultural products. But this export income fell far short of covering the bill for its much higher imports: In 2001, the United States imported $1.147 trillion in goods—$426 billion, or 59% higher than the volume of exports. The main components of these imports were capital goods ($298 billion), consumer goods ($284 billion), industrial materials and semi-finished products ($278

© 2002 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

billion), automobiles and automotive parts ($190 billion), and oil products ($104 billion). In the areas of consumer goods and automobiles alone, America had a foreign trade deficit of over $300 billion.

The question arises: How are they able to import $1.147 trillion in goods, and only export $721 million worth? The answer: on credit. While the U.S. corporate sector is, to a certain extent, directly indebted to foreign institutions via international loans, private households are only able to maintain a level of consumption beyond their actual income, by means of injections of credit from banks, credit card companies, and mortgage institutions. The U.S. financial sector, in turn, can only keep this debt machine running by ensuring—at least up until recently—that the markets in the United States continue to be inundated with flows of capital from abroad. In the process, the U.S. financial sector itself takes on massive quantities of foreign debt.

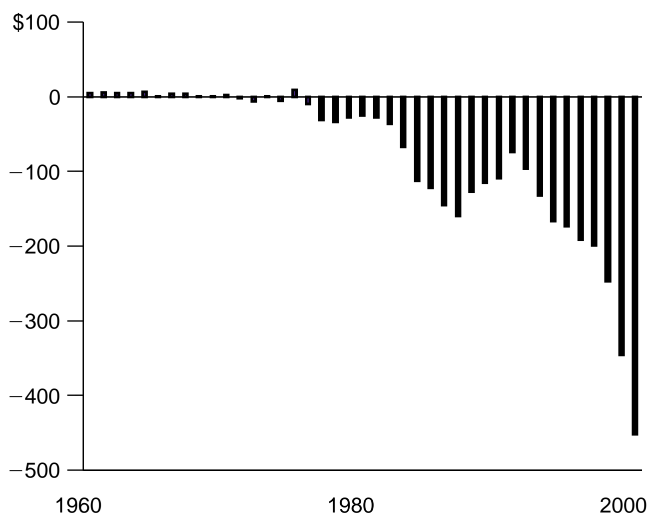
To be specific: Last year, U.S. purchases of foreign securities and businesses stood at $440 billion, whereas capital flows of the same kind into the United States from abroad, were more than twice that—$896 billion, or $2.5 billion per day. This represents a total net influx of $456 billion into the United States during 2001—which pretty closely matches up with the figure given for the U.S. trade deficit.

In a nutshell, Americans are receiving $400 billion worth of consumer goods, automobiles, crude oil, steel, and other hard commodities every year, above and beyond what they pay for with their exports; and they are covering this deficit with an equal sum of stocks, securities, and other financial paper, bought by foreigners sending capital into the United States.

Nothing Works Any More

During 2001, however, the world experienced tectonic changes in the composition of capital flows—changes which are extremely disruptive to the U.S. economy. As a result of the collapse in the stock markets, foreign investors' appetite for U.S. stocks has waned considerably. Such purchases declined from $193 billion in the previous year, to only $127 billion. The heady times of the late 1990s are also over for foreign direct investment (FDI) into the United States: In 2001, it collapsed from $288 billion to $156 billion. What saved total capital influx—and thus the U.S. dollar—from collapsing, was the massive expansion of foreign purchases of U.S. corporate bonds, which went from $293 billion in 2000—already a record high—to $371 billion in 2001.

Since the collapse of Enron in December 2001 at the very latest, and the subsequent revelation of systematic falsification of the balance sheets of the big U.S. high-tech firms, not only have foreign investors lost their urge to buy U.S. stocks or to buy up U.S. firms, but now this same malaise has spread to loans to U.S. corporations.



The dollar's problem, in a nutshell: this huge and growing trade deficit has been financed by equally large foreign capital inflows. The inflows fell in 2001, and fell much more sharply in the first quarter of 2002.

The record rates of defaults on corporate debt has only made matters worse. In the first quarter of this year, corporations defaulted on a total of $34 billion in loans. The current quarter has seen the biggest single default so far: the cable firm NTL, which defaulted on $10.6 billion. Bonds issued by many U.S. telecommunications firms, which up to a few months ago were considered "bomb-proof," have in the meantime been downgraded to "junk" status—including loans to the second-largest telephone company WorldCom, which has $30 billion in debt.

This, in turn, has serious consequences for the future of capital flows into the United States. Only the figures for January and Febrary 2002 are available, but they show a grim picture: Purchases of both U.S. stocks and U.S. corporate bonds by foreign investors have dropped to their lowest levels since Autumn 1998. Total foreign purchases of U.S. securities have collapsed to 25% of what they were in January and February 2001. And to top it all off, this year's trade deficit is threatening to veer even further off course, and could well reach the $500 billion mark.

Outside of stocks, takeovers, and bonds, there isn't much else left to serve as a magnet for foreign capital. The U.S. economy has blown its wad, and the impending crash of the dollar can no longer be averted by peaceful means.