

WEAKENED DOLLAR AND GLOBAL ECONOMIC RECOVERY

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For last two years, the world economy has been flying on a single engine, the United States. Still, the latest rebound in Japan, which is one of the main factors of the recent dollar's drop, could prove to be temporary, a short-term artificial gain from an unsustainable deficit-spending binge. Japanese officials fear that optimism could become self-defeating; the yen's strength could choke off a nascent recovery by slowing exports. Japan and Europe have yet to make the deep structural reforms which are required for long-term growth.

However, the general view is that global growth is improving, although not at explosive rates. After expanding by a sluggish, 2.1% last year, the world economy will grow by 2.8% this year and 3.5% next year. That's still below the heady 4% pace in the two years before Asia imploded, but a marked improvement. Attitudes about Europe also can shift wildly. July's German manufacturing orders rose much faster than expected in June. French car sales jumped in July, along with a broader recovery in French household spending. Overall, the outlook for economic activity in the euro area is more favorable now than it was a month ago. European growth now is being fueled, in part, by rising exports to Asia where economic situations are improving.

The brighter prospects for global growth are moving financial markets. The dollar has fallen against the yen as well as the euro, as investors shift their capital to increasingly attractive investment opportunities outside the U.S. Due to these outflows, some economists like Paul Krugman are even raising the possibility of a "dollar crisis" on the dollar's

recent dip. The virtuous cycle in which the strong dollar helped keep inflation and interest rates low and pushed investors toward the U.S. could turn into a vicious cycle of decline. A rapid dollar drop could result in higher inflation, higher interest rates, lower stock prices, and finally sluggish domestic demand, and it could cause economic growth to slow significantly, adding to downward pressure on the dollar.

In fact, a rebound in the overseas economy and following weak dollar would give some positive factors to the U.S. exporters and producers. They will get some benefits in the sense that the weak dollar will boost the U.S. export competitiveness. Also, those who have been battered by cheap imports would be among the beneficiaries.

However, since the 1990s, the Fed and U.S. Treasury have induced economic booming sequence with "low" interest rates, but it has been relatively higher than those of other developed countries. The continued capital inflow sustained the dollar's strength and made dollar-denominated assets more attractive. In other words, strong U.S. currency set a solid foundation for finance-led boom. Therefore, despite some positive factors in the export sector, the abandonment of strong dollar policy means new risks to the U.S. Considering that the dollar's weakness can cause contraction in the economy led by financial markets, the Treasury is cautious in publicly announcing the switchover of its monetary policy direction. The Treasury wants the dollar to be gradually weakened in the foreign exchange market without any policy change. **VIP**