Dollar Decline: What Me Worry?

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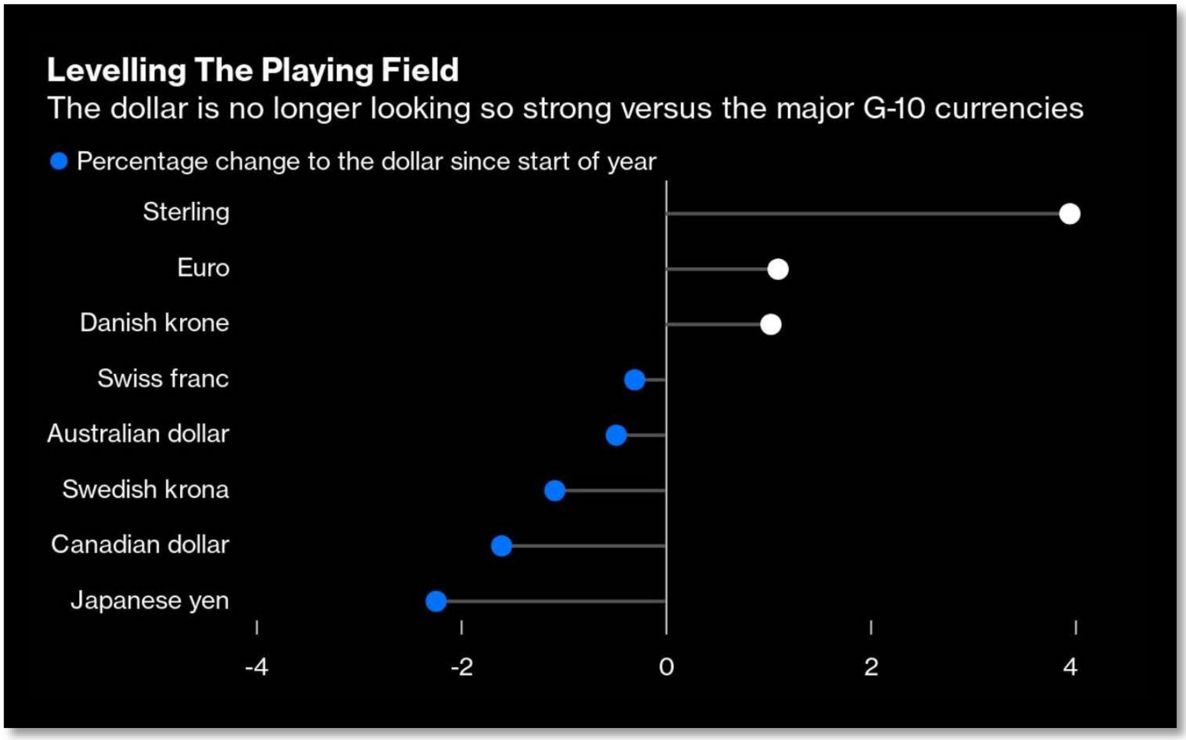
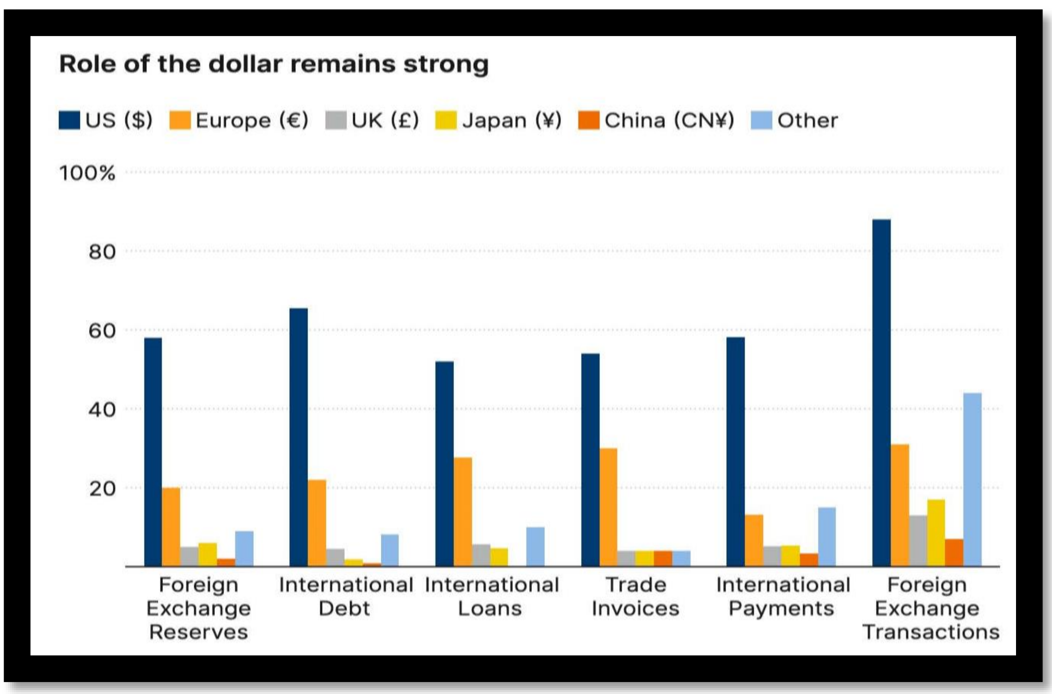
The U.S. dollar is declining in value compared with a basket of international currencies. The greenback has fallen 5% in the last two months, and now sits at a 13-month low.

Should we be alarmed? Probably not. In fact the other nations go to economic war over trying to devalue their currencies compared with the others around the world. A strong currency means that the products of companies based in that country will be priced higher in the countries they are exporting to—making them generally less competitive versus local brands. Japan and China exploited the value differences in their currencies to great advantage by helping their exporters sell their goods cheaply in the U.S. markets. American exports will benefit from the current trend, which could lead to higher profits for U.S. farmers and larger manufacturing firms.

On the other end of the spectrum, the dollar's weakening against the euro has not been kind to export-oriented Germany, whose GDP recently turned negative for the third time in the last five quarters. The Japanese yen, meanwhile, has weakened against the dollar since the start of the year (see chart) although it has actually gained strength from a greatly oversold position, and now sits at roughly where the Japanese government wants it.



You might read speculation in the press that the dollar's recent doldrums threatens its status as the world's reserve currency. But those fears are overblown. Dollar assets currently make up 59% of the total foreign central bank reserves, well ahead of the euro's 20% share. 64% of world debt is denominated in dollars, and the dollar is used for 54% of cross-border international payments among countries and companies involved in global trade. The dollar isn't going to be replaced any time soon.



The dollar's value tends to fluctuate with U.S. interest rates, which means that the next interest rate easing by the Federal Reserve Board will probably add to the downward trend. The downside is that a less-valuable dollar means that foreign stocks and goods and services manufactured abroad are more expensive to Americans, and your next vacation trip overseas will cost more in dollar terms.

But most of these shifts will be felt only at the margins, and there is not likely to be a global restructuring around the euro or the Chinese renminbi. The U.S. economy makes up 26% of the world's GDP, its economic rule of law is the strongest in the world, and for the near future, at least, the 'ol greenback is the world's most trusted currency.

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