

OPINION

Bush and the Dollar

By David Malpass

When President George W. Bush addresses the Economic Club of New York on Friday, his comments on the dollar crisis will be the crucial issue for markets and the economy. The best thing he could do would be to state clearly that he wants a stronger dollar. That would draw liquidity back to the U.S., lower inflation risks, and head off the growing calls for government bailouts and support programs.

Absent administration support for the dollar, recent Fed rate cuts have simply sped up the flood of capital away from the U.S. without providing enough domestic stimulus. The rest of the world is already full of cheap dollars, pushing gold and oil to new highs, European tourists onto Madison Avenue, and petro-dollar sovereign wealth funds into building islands to use up their excess.

A clear presidential preference for a stronger dollar could cause an immediate leap in financial markets. U.S. stocks and corporate bonds are attractively priced—except for the dollar risk. No matter how high a bond yield or how strong the track record of a U.S. private-equity manager, the threat of continued dollar weakness holds global liquidity at bay. The prospect of a stronger dollar would reverse that.

This week, Mr. Bush may well use the same inadequate mantras that the administration has repeated since 2001: A strong dollar is in the “national interest,” and the dollar should reflect U.S. economic “fundamentals.” U.S. Treasury Secretary Hank Paulson used these standard phrases, now taken to be code words for a weaker dollar, on March 3, with predictable results—the dollar hit new lows last week. Jean-Claude Trichet, the hard-money head of the European Central Bank,

perhaps holding his nose, voiced similar encouragement for the dollar on March 3 (and yesterday): “I consider it very important what has been affirmed and reaffirmed by the U.S. authorities . . . according to whom a strong dollar is in the interest of America.”

Damned by faint praise. The officials are not saying they want a stronger dollar, or that they will do something to stop the dollar’s plunge. In fact, the U.S. has repeatedly prevented the G-7 group of finance ministers and central bankers from discussing ways to strengthen the dollar, most recently by imposing a dollar-lite agenda at the February G-7 meeting.

When it comes to currency strength, words can work magic.

The current dollar mantra, coined in the 1990s, never made sense. Saying a strong dollar is in our “national interest” ignored the need for dollar stability. It set no upper bound on the dollar’s strength, causing a destructive global deflation cycle from 1997 to 2001.

The dollar is now weaker than the loonie, the Canadian dollar, yet the same hollow 1990s phrases are being mouthed. If a strong dollar is in the “national interest,” then the seven-year dollar collapse is clearly in need of a remedy. There’s an equally deep logical flaw in claiming that the dollar should depend on economic “fundamentals.” A strong, stable currency is itself one of a country’s most valuable fundamentals, not a byproduct of other fundamentals. Our fundamentals haven’t been nearly as bad as the dollar’s seven-year slide. More likely, the weak dollar trend is itself a bad economic fundamental, mask-

ing health elsewhere.

The policy shift to a stronger dollar is as critical for national security as it is for economic health. Oil would cost less if the dollar were stronger, slowing the transfers to our antagonists in Venezuela, Iran and Russia. A stronger dollar would allow U.S. wealth to grow as fast as foreign wealth, adding to our strength and independence.

Though many economists still support the theory of unlimited free-floating exchange rates, no weak-currency country has had a healthy economy. Momentum takes over and pushes currencies to extremes that can’t be hedged. Many also think current interest rates control currencies. But 1% more or less in annual interest won’t make up for a country’s longer term intentions for its currency. Markets have labeled the U.S. a weak-currency country. That’s an albatross that the president should dump.

An administration decision to support a stronger dollar would be dramatic, and probably so unexpected that it would break the dollar’s downward momentum, and with it the defeatism now dragging us down. If the dollar started up, the vicious cycle—dollar weakness causing economic weakness and more dollar weakness—could be reversed.

The president’s dollar preferences matter even in the short run, setting expectations that become self-fulfilling. The many speculators now short-selling the dollar, or betting against the U.S. in favor of commodities and other currencies, would have to reduce their positions. This would immediately add to U.S. liquidity, and improve the outlook. Treasury would begin working to achieve a stronger dollar, opening the possibility, anathema to dollar shorts, of a G-7 preference for a stronger dollar or even coordinated currency intervention.



There’s more at stake in the dollar debate than a recession, inflation and a bear market. In the economic confusion created by the weak-dollar policy, presidential campaigners are blaming Nafta and free trade, not the weak-and-weaker dollar, for hard times.

The president should state a preference for a stronger and stable dollar. It has a good chance of stopping the credit crunch. It’s free and easy. And let’s face it: Other measures aren’t working.

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