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US Dollar:
Past, Present & Future

(a discussion paper released by Proletarian Power)

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Prepared by
Chandra Sekhar Gupta Boggarapu
Founder, Proletarian Power
(proletarianpower.org)
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Introduction

US Dollar is a unique currency because it is both world's reserve currency as well as it is domestic currency to USA. Since it became world's reserve currency after World War II it came a long way. During this period of about 75 years it transformed into a totally different animal. While it is still 'THE CURRENCY' of the world , its power seems to be waning of late.

This paper is an attempt to look at its past briefly, look at its present status closely and predict its future analytically. This discussion became necessary because USD affects every country, corporate and even individuals directly or indirectly.

Before getting into the subject technically a small story. The story goes like this:

There was a town somewhere where there used to live a very influential guy. He owned a dog, a ferocious one. Owner of this dog never bothered about its maintenance. Out of love or fear or both entire town used to feed it, groom it and practically used to take care of it completely. But the dog takes commands from its master only though he never bothered about its upkeep. After sometime the town started to feel tired and weary. The story ends here for now.

PAST:

1. Distant past:

a.1944-45 :
- End of Second World War
- Bretton Woods Agreement

b.1970-75:
- US Dollar is taken off ‘gold standard’ by Nixon, the then US President.
- US agreement with Saudi & other middle east oil producers to trade crude in dollar denominated price.

2. Recent Past:

a. 1990-2008:
- Emergence of China, ASEAN countries as manufacturing power houses.
- Decline is US domestic production, decrease in exports and increase in imports.
- Collapse of Lehman Brothers and Global financial crisis.

3. Latest:

a. 2008-2015:
- Ultra loose money policies by Fed.
- Expansion of US balance sheet rather quickly.

b. 2016
- Sedate GDP growth.
- Attempts to rebalance US balance sheet.
- Increase in Fed rate slowly.
- Pick up in growth marginally.

PRESENT: (Overview)

We believe US has been suffering for the past two, three decades - more acutely of late - from the following problems:

1. Aging population.
2. Declining population growth.
3. High levels of household debt.
4. Income inequality - worsening progressively.

All the above lead to contraction of demand resulting in sedate GDP growth leading to more unemployment, pulling down demand even further. (unemployment figures released by US government are contested by some experts).

To improve the situation US Fed has taken series of (mis)steps. It injected liquidity into the system under various schemes like QE thereby bloating its balance sheet many folds. One may call its actions reckless and irresponsible considering the status of US Dollar.

In the absence of demand as already stated this extra liquidity lead to following developments:

a. Increase in asset prices. (size of Manhattan do not increase just because US balance sheet size has increased).
b. Dollars overflowing into emerging economies world over with its own consequences.

In 2016, finally, Fed has declared its intention to rebalance by increasing the fed rate slowly and by withdrawing extra liquidity gradually.

FUTURE:

We see following situations developing:

a) Withdrawing extra liquidity from the system: This is going to be tricky. When easy money policies were followed excess Dollars flown into emerging economies. But tightening now do not exactly reverse the flow. First, those dollars that left US shores are owned by HNIs directly or indirectly. Second, they did not go out for a picnic. They went out chasing profits. So these Dollars do not come back to US unless attractive investment opportunities are available back home. There are not many such opportunities in US right now. So they won't return, no matter how much ever pressure Fed applies. So tightening effectively leads to sucking out liquidity from the domestic market. This will lead to further fall in already weak demand and may even lead to recession. So the Fed may be forced to give up this exercise midway helplessly.

b) Raising interest rate: Fed has started raising interest rates from 2016 and raised four times so far at the rate of 25 basis points each time. Again, we guess, this can not go too far. Even at zero percent, practically, not many US industries could compete globally. So substantial hike in interest rate would hurt the domestic industry seriously. This would force the Fed to abandon rate hike too.

In sum Fed seems to have painted itself into a corner. So it may either maintain status quo or may even revert to easy money policy once again.

While entire world, willingly or grudgingly, was accommodating US excesses so far, a day may come, sooner or later, when other countries may show less interest in accumulating further dollars. This shall lead to fall in Dollar rate vis-a-vis respective local currencies. This may in turn giver further incentive to US investors to take out more dollars from US and invest abroad. This cycle may continue making Fed's job more difficult.

At the end US Dollar may depreciate against all major currencies across the world. Is this good for US? We don't think so. Theoretically this will make US more competitive but we are not convinced. For many decades US is accustomed to 'exporting' mainly dollars without any resistance. Exporting goods and services is a different ball game. Competing with Europe, China and other Asian, Southeast Asian countries may not be easy. At best it may revive some local industry to cater to local consumption. We do not expect them of any great significance.

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CONCLUSION:

To conclude we believe that USD would depreciate , in long run, against all major currencies. Effectively it may lose its 'world's reserve currency' status explicitly or implicitly. With this the concept of 'world reserve currency' may come to an end. Countries like China may try to step in but unlikely to succeed. What follows thereafter is an unchartered territory. There are many possibilities.

Further big shift in geo political alignment of countries might take place. After all Dollar is the most lethal weapon US possess in its armour till now. Once it becomes blunt US is expected to lose great deal of power and its 'superpower' status would be challenged. US clout over the world would reduce considerably as a consequence.

Key takeaways:

a. USD may be either nearing its peak or already peaked against all major currencies (after adjusting for country specific issues like easy money policies of Bank of Japan and European Central Bank)
b. US 'Superpower' status may come under cloud.
c. US citizens may have to gear up to lower their standards of living.
d. World's GDP is expected to shrink.
e. Prices of precious metals, alternate investments etc., are likely to shoot up.
f. EU & UK which are already facing political, economic and social problems may get adversely affected.

Postscript:

- The above paper is prepared based on publicly available information.
- Since this paper is meant for well informed people we kept it very brief and crisp.
- Between NOW and FUTURE many things can happen which may prove us wrong.
- Our objective is to engage everyone concerned in discussion and try to understand what may be coming our way so that everyone is better prepared for impending disruptions, if any.

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