Breaking Up Is Hard To Do: Prospects for the Dollar

Dr. Catherine L. Mann

Senior Fellow, Institute for International Economics

(CLMann@IIE.com)

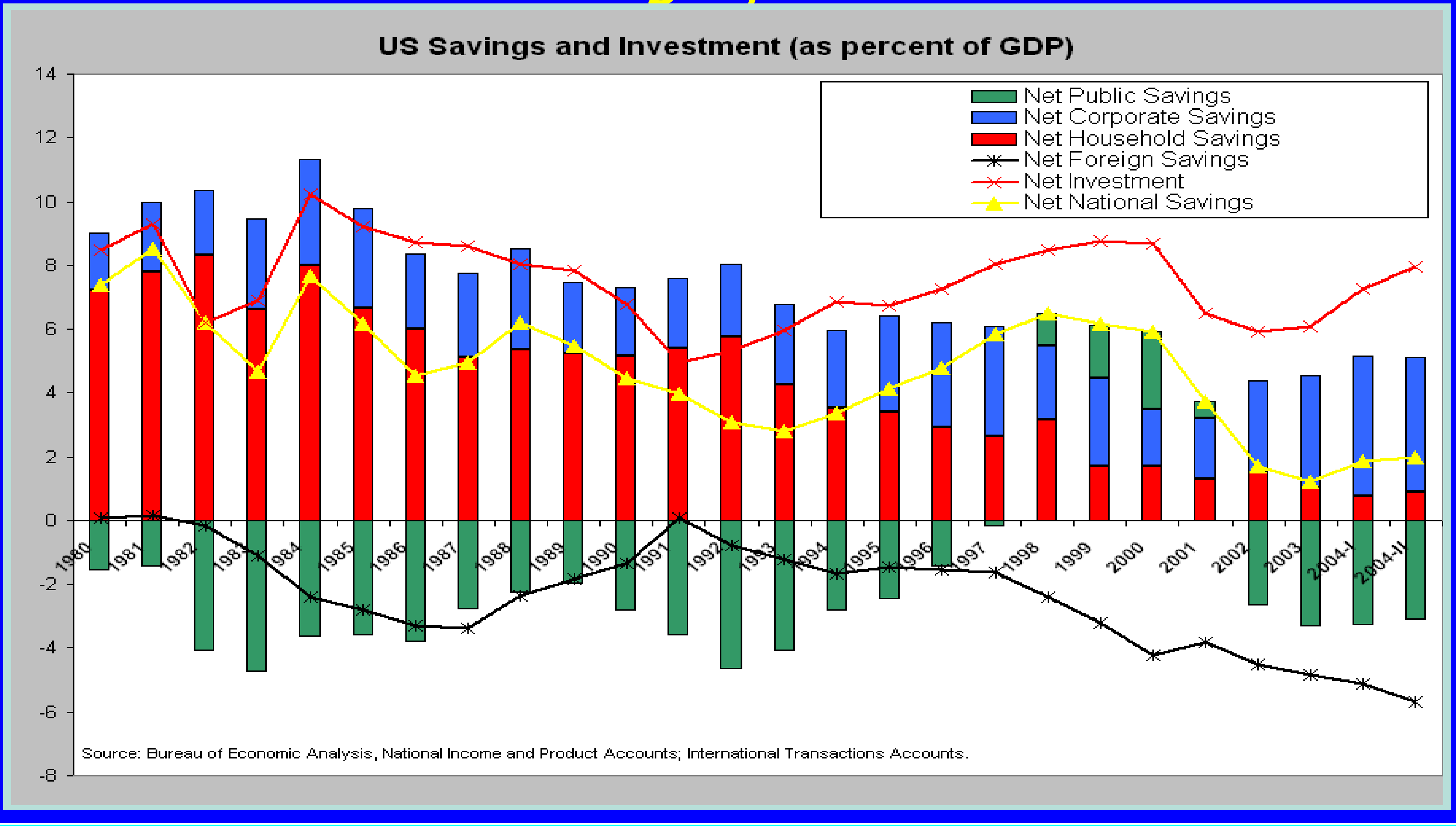
NABE Teleconference, December 17, 2004

Global Co-Dependency

Global Co-Dependency	How Does It End?
• US saving trends & import habits • Foreign saving trends & export habits • Foreign official purchases & exchange rate management	• Central Bank portfolio preference? • Change in structural savings? • Private market portfolio preferences?

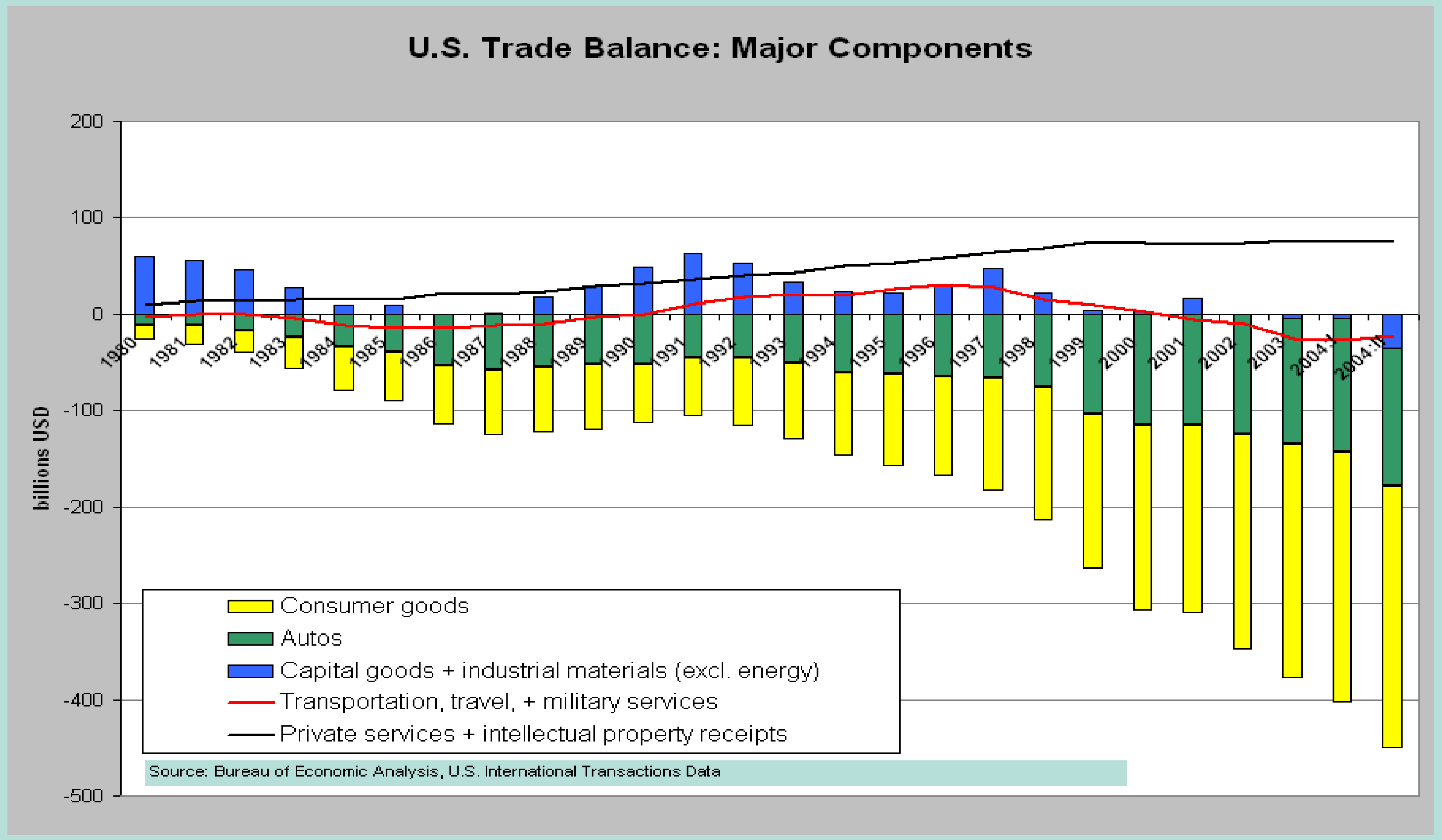
Global Co-Dependency: US side

The Big Spender…



Household savings trend spans fiscal surplus and fiscal deficit.
In surplus, consumers spend out of the wealth generated from fiscal discipline.
In deficit, consumers spend out of consumption-favored tax cuts.

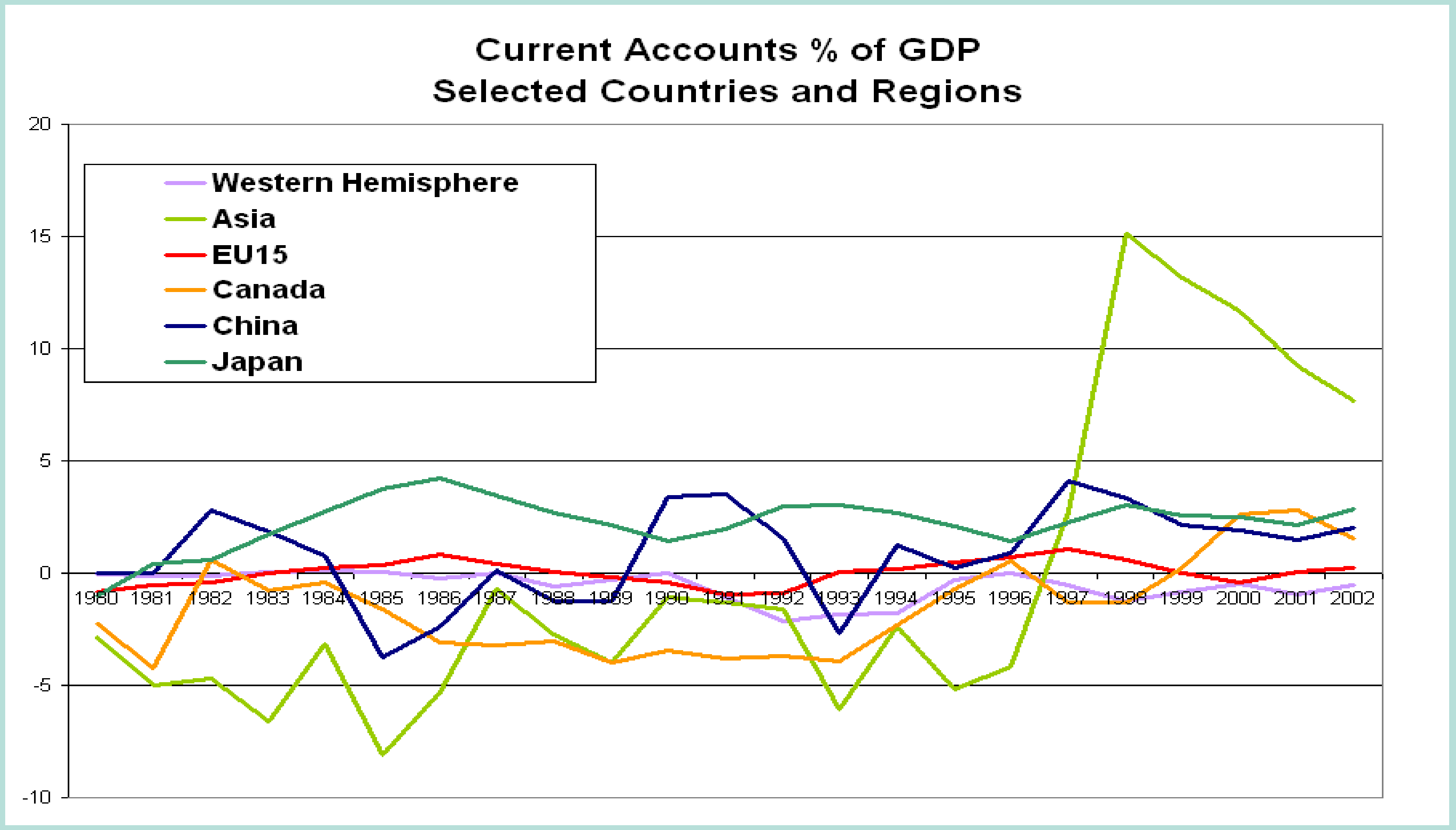
With a taste for the import high-life



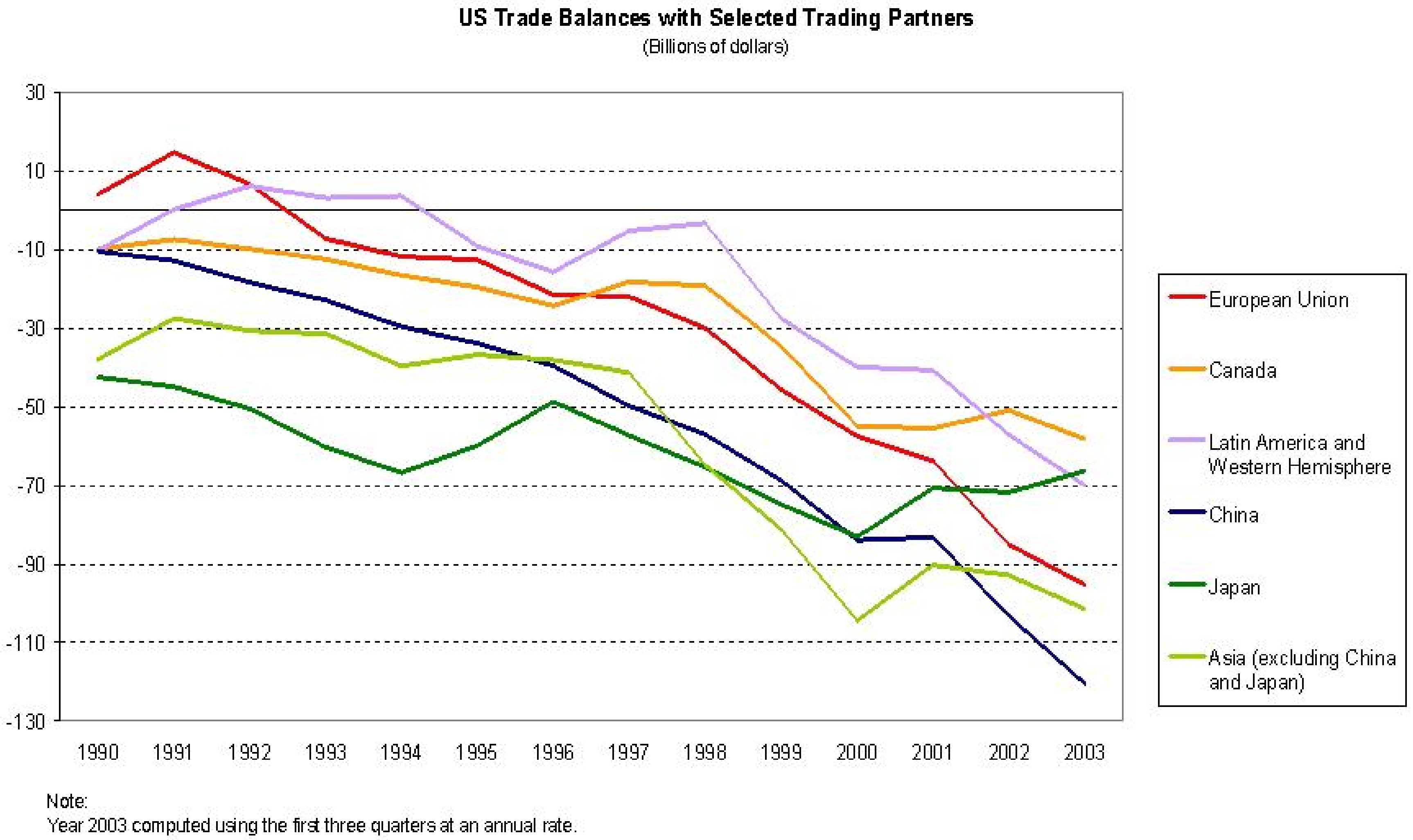
Consumption leads widening deficit: HH saving trends; recent tax cuts add impetus
Capital goods surplus disappears: Appreciated $, weak foreign growth stall exports
Services: Private Services increasing surplus;Travel, transportation, gov't services into deficit

Global Co-Dependency: ROW side

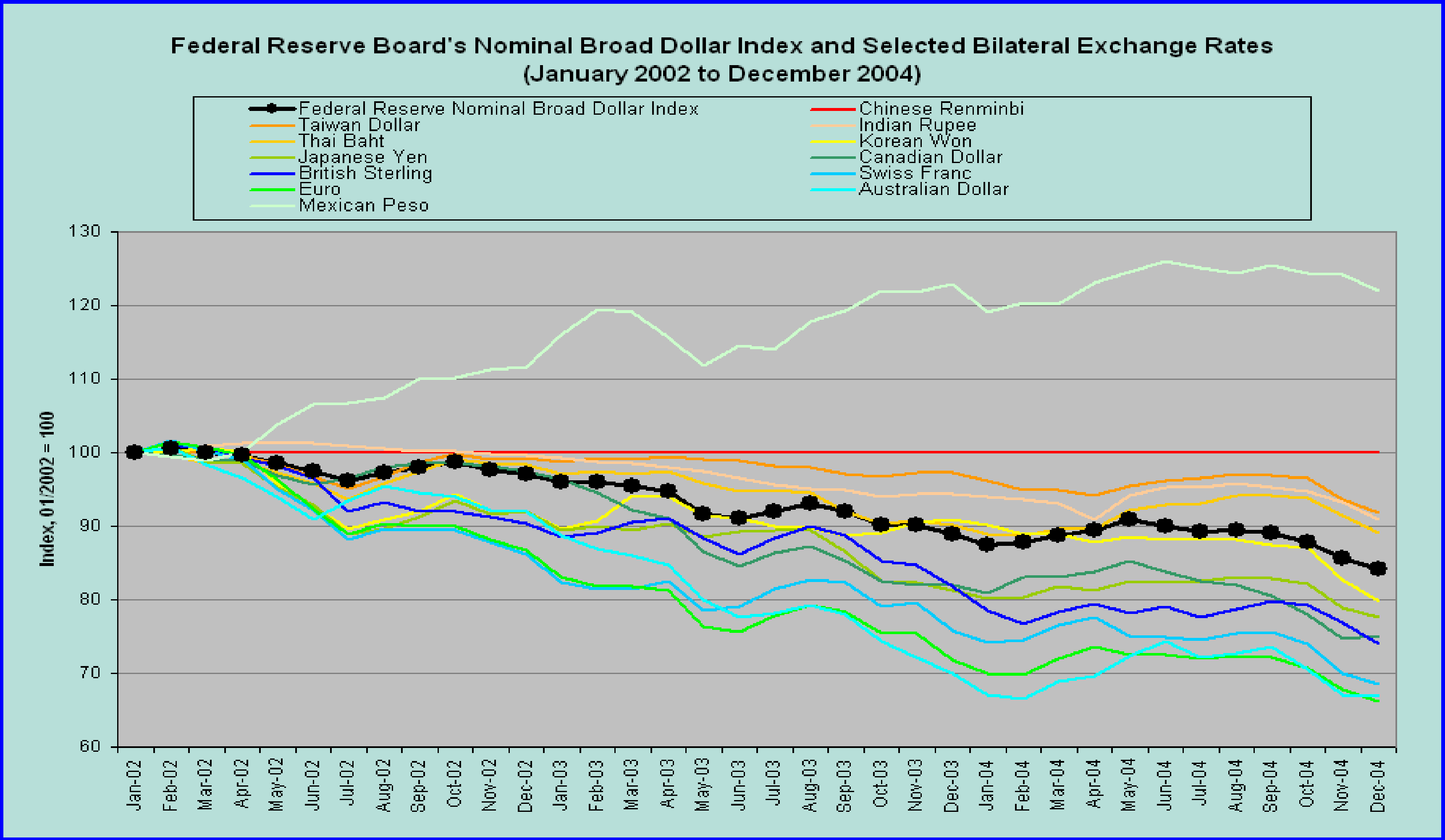
Although not everyone is a big net saver



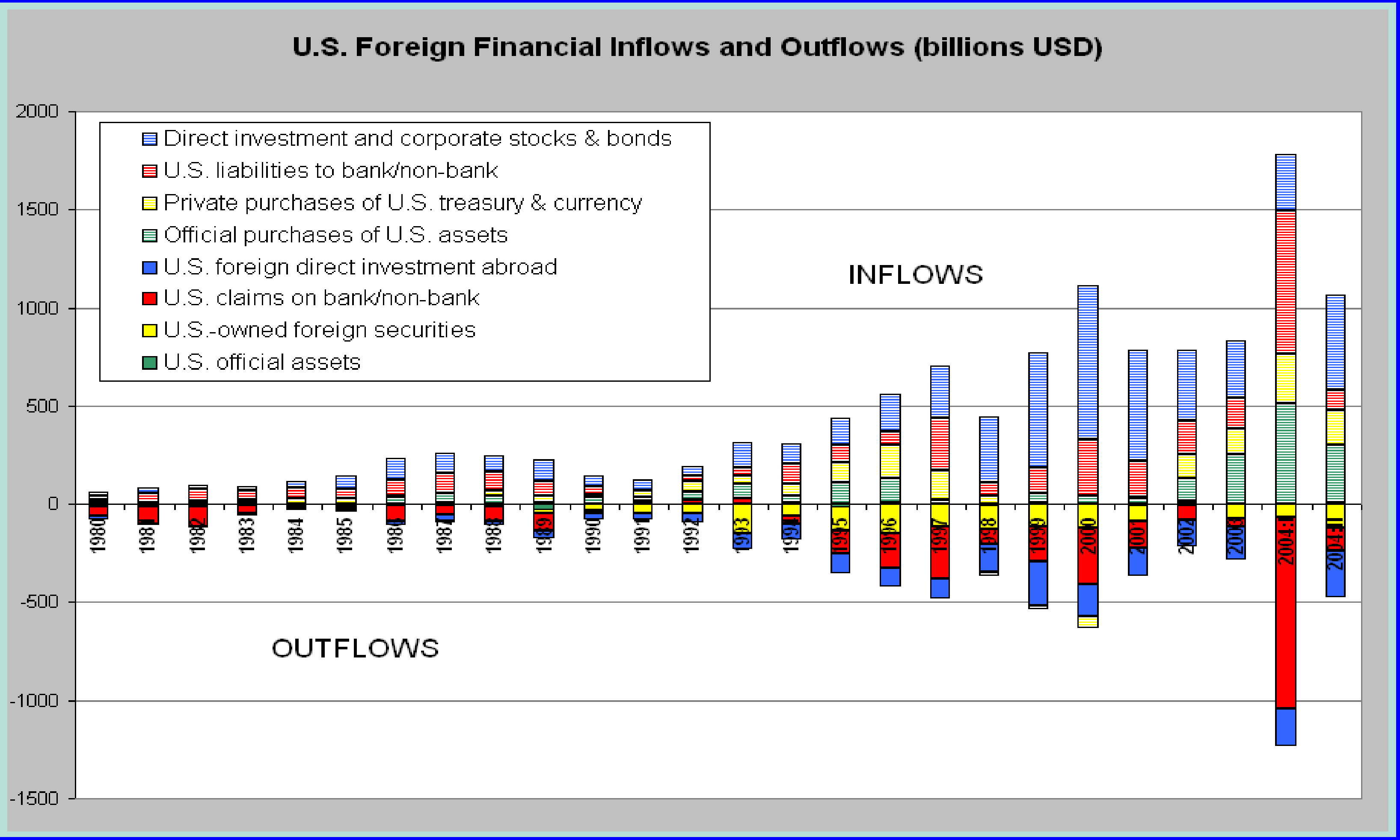
they all depend on net exports to US for growth



XR management to avoid loss of exports is not surprising



And is reflected in official purchases of US assets

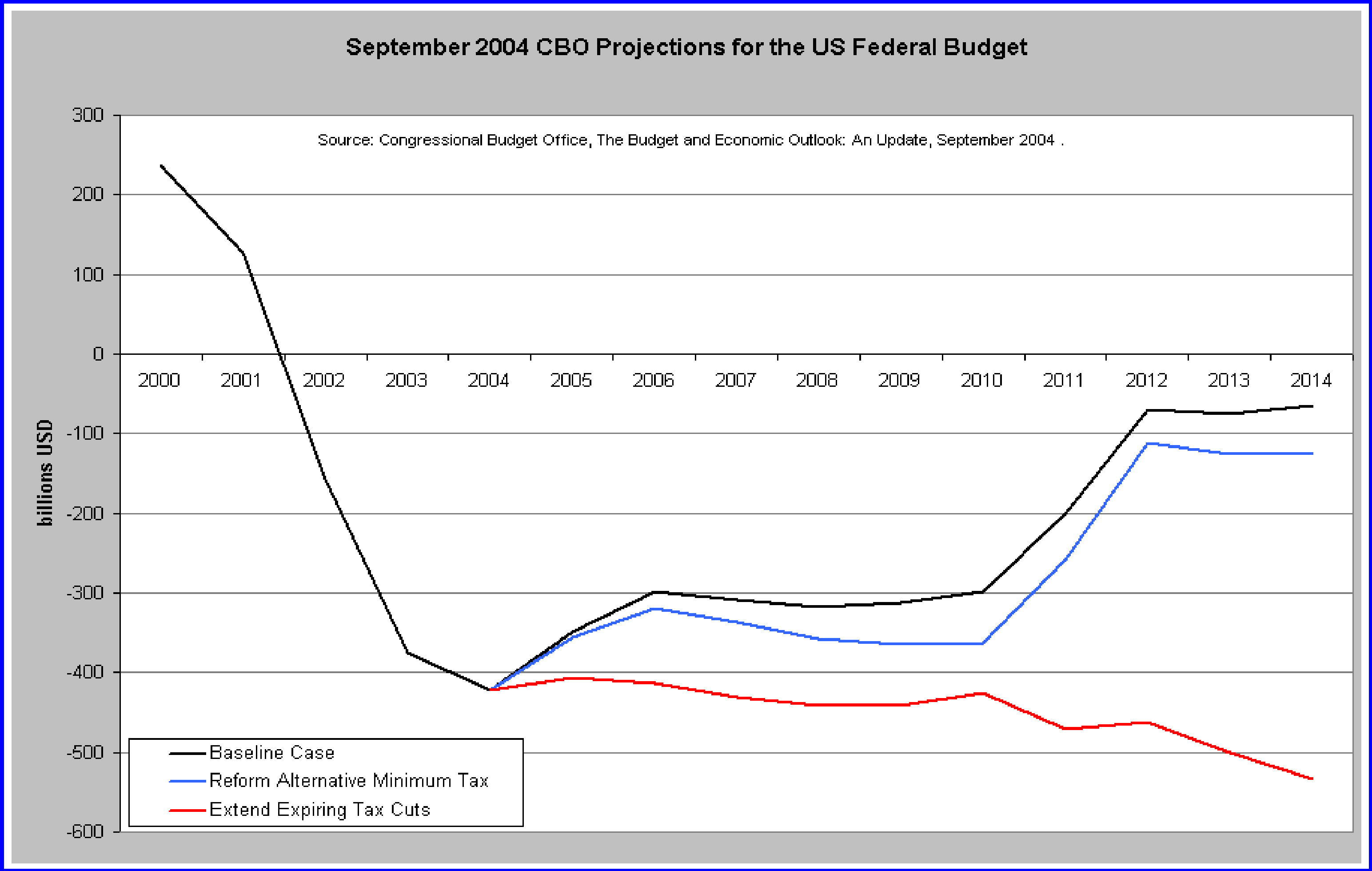


Composition & magnitude: More than sufficient inflow, but rising share interest-bearing
Official Purchases: Systematic purchase against $ depreciation, supports their X as structural policy…
but this is not a new behavioral pattern—just larger!

Who Breaks Up with Whom?

Big fiscal impulse via tax cuts for consumption … and lots of UST for sale

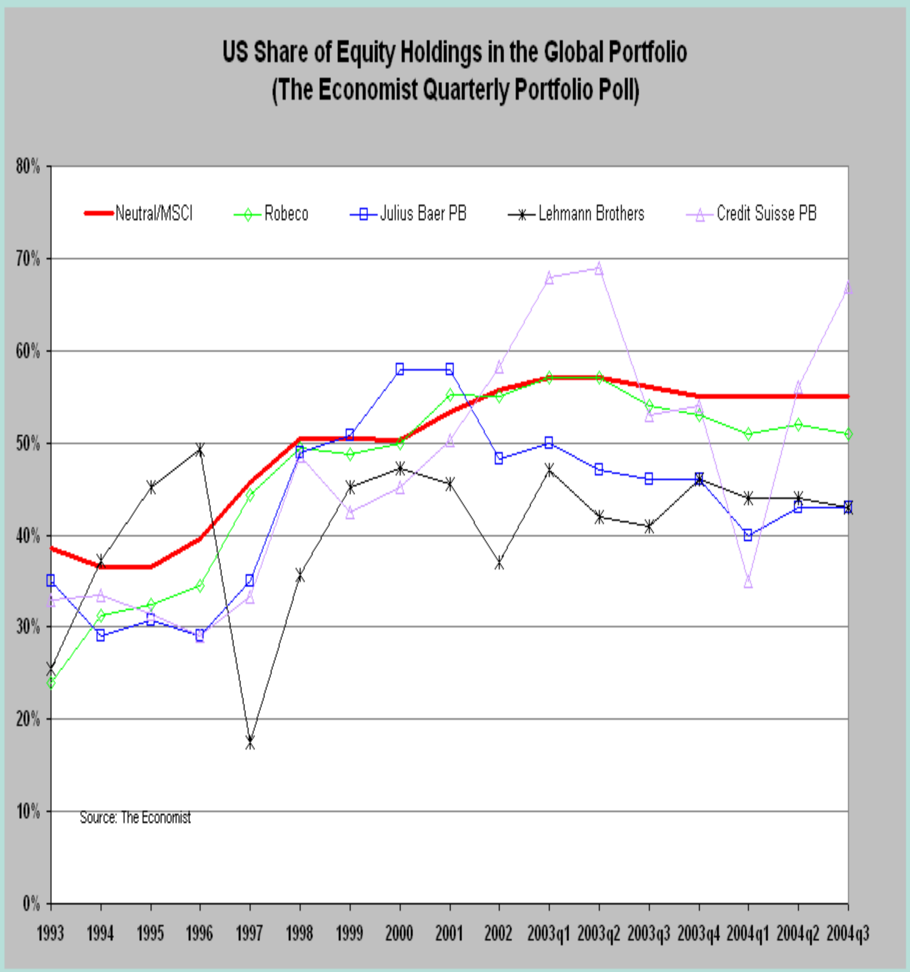
Catherine L. Mann, Institute for International Economics

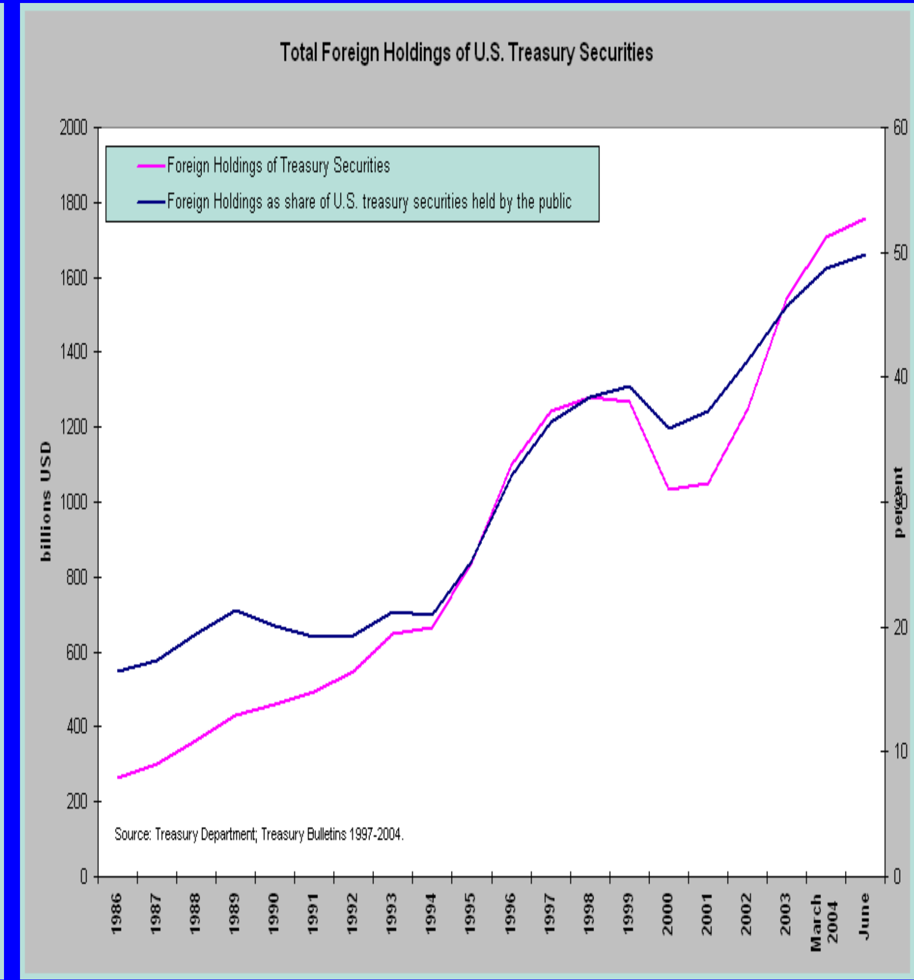


Will Private Portfolios Get Satiated?

Lots of choices: US equities, US bonds, UST

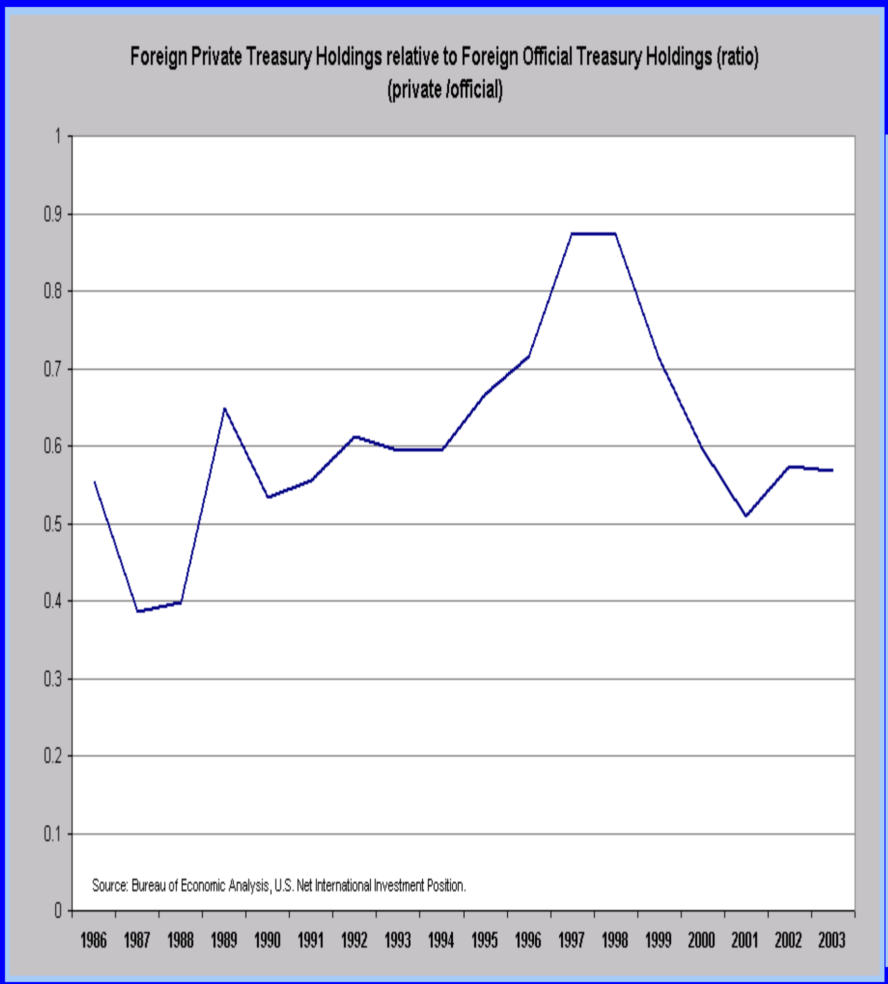
Catherine L. Mann, Institute for International Economics

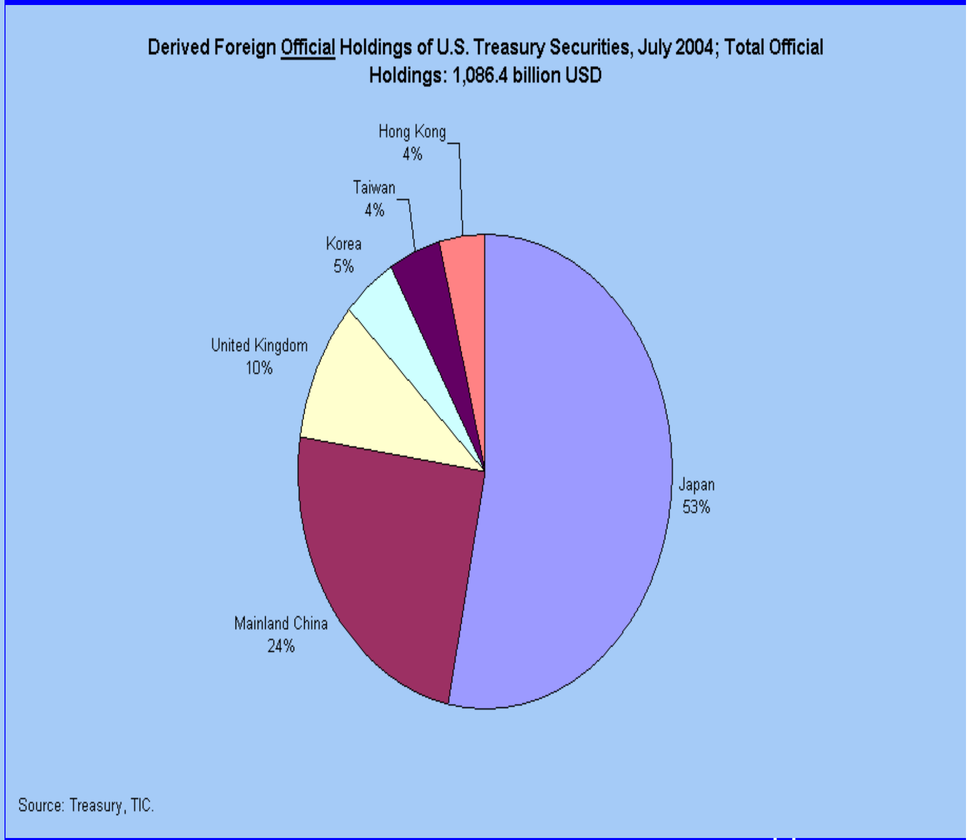




Will Central Banks Get Satiated?

They tend to buy when we issue—
why do they buy so much 'insurance'?

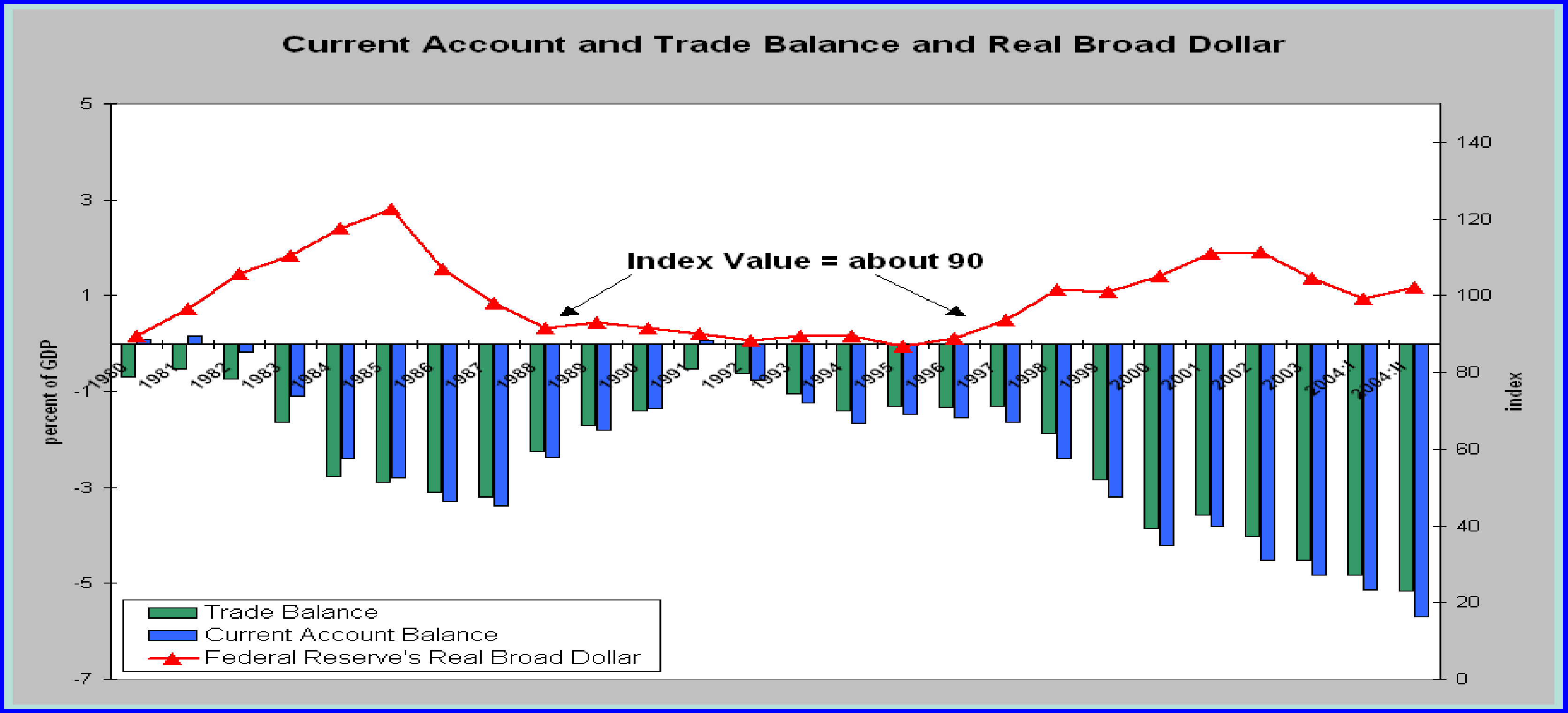




Catherine L. Mann, Institute for International Economics

So what if the dollar declines?

Can it change enough to close the deficits without major change in consumption/savings here & abroad?



Plenty of caveats: dollar depreciation reduces NIIP;
but higher interest rates will eventually mean net interest payments
How large is pass-through: small on consumer goods, larger on capital goods
But, price competitiveness needs to be complemented with demand abroad …

For More

- "Managing Exchange Rates: To Achieve Global Re-balancing or Evidence of Global Co-dependency?"
  - *Business Economics* (2004)
- "How Long the Strong Dollar?" (2003)
  - in Bergsten and Williamson eds. Dollar Overvaluation and the World Economy (IIE)
- "Perspectives on the US Current Account Deficit and Sustainability" (2002)
  - *Journal of Economic Perspectives*
- Is the US Trade Deficit Sustainable? (1999)
  - Institute for International Economics