BY THE WAY, ARE YOU HOLDING U.S. DOLLAR-DENOMINATED INVESTMENTS ?

For many a decade, the US dollar has been considered a safe haven, especially in times of economic and/or political turmoil, perceived or real.

And, now, it appears, the US dollar is under threat.

The bottom line is that it is highly likely that it will continue to be under threat for a number of very good and valid reasons.

So far, this year has seen rather robust investment climate in US, and US dollar-denominated, assets.

Though the US has had its fair share of economic problems, domestically, Europe's economic woes have been much worse, relative to the US.

The European problems have resulted in the voracious buying of US stocks, bonds and real assets by foreigners, looking to protect their *'hard'* currencies.

The end result of foreign purchases of US dollar assets has manifested itself in the, until recent, strength in the US dollar vis-à-vis the currencies of the US's main trading partners.

However, in view of the ever-widening, US Current Account Deficit, the US dollar has become somewhat overvalued.

The present correction in the market value of the US dollar poses a threat to the nascent economic recovery of the US.

Fundamentals determine that the strength of a country's currency is rooted in that country's productivity: Productivity growth, or the prospects of growth, has predicated the strength of a country's currency in exchange for other currencies.

The fact that the US dollar is, currently, overvalued is fully appreciated by most economists when viewing the US Current Account Deficit.

At this time, the Current Account Deficit is standing at about 4 percent of the **G**ross **D**omestic **P**roduct (GDP).

It is expected that, some time in 2003, the Current Account Deficit could hit as much as 5 percent of GDP in the US.

With the US economy strengthening, imports will pick up, thus widening, even further, the Current Account Deficit.

This will, inevitably, lead to the risk of inflation in the world's largest single economy.

While an orderly depreciation of the US dollar, vis-à-vis the euro and the Japanese yen, especially, might be beneficial in the short term to the US economy, it has its flip side, too.

US multinationals may well benefit from a relatively weak US dollar because profits, earned outside the Continental US, would be swollen due in large part to the theoretical translation of foreign currencies into US dollars in Profit and Loss Accounts.

With the US economic recovery still rather fragile, however, there are a number of negatives to a large-scale retreat from the US dollar by non-US companies/individual investors.

The first consideration, for the US Federal Reserve Board, no doubt, is that US consumers, purchasing manufactured goods, not produced in the US, will have to pay more for those goods since the purchasing power of the US dollar will have been eroded, relative to the exchange rate of the currency of the origin of the imports.

This is inflationary; the Fed will be watching for the first signs of inflation, without question.

When the US dollar was strong, US consumers had a gay time, purchasing a great number of foreign-made items from departmental stores and so-called, wholesale discount houses, as well as foreign motor-cars and other luxury vehicles since they were able to use the international currency of choice: The almighty greenback.

When the US dollar was strong, the prices of imported goods into the US were, relatively, cheap: And this had been a boon to US consumers.

It followed that if US consumers did not have to pay too much for consumables, hi-fi sets and what-have-you, then, they would have more money in surplus for the purchases of other, non-essential goods and services.

Now that the US dollar is depreciating against the euro and the Japanese yen, one is seeing a different international *'animal'* – which will start to devour part of the purchasing power of the US consumer.

US corporations are loath to raise prices because that would be akin to shooting oneself in one's foot.

Looking at US equity markets in isolation – if that is possible – one sees that the amount of US stocks and shares, held by non-US citizens/corporations, has doubled since about 1995, from 6 percent to about 12 percent.

Non-US citizens/corporations' purchases of US Government bonds and those bonds, issued by private enterprise, has doubled to nearly 25 percent, during that same time period.

Because of the relatively high yields in taking on mortgage-related *'paper'* into investment portfolios, non-US interests voraciously scooped up as much as they thought they could handle with ease.

Vital to such investments was a stable exchange rate for the US dollar against select *'hard'* currencies.

Now that the US dollar is under pressure, one may expect a partial exodus of non-US citizens/corporations from US dollar-denominated investments.

The knock-on effect, here, is lower prices for stocks and shares in the US and higher interest rates as the Fed determines that it must control inflation.

TARGET has disregarded, completely, any consideration of another terrorist attack or any international incident, similar to the attacks on US soil by Arab madmen on September 11, 2001.

However, having said that, the US dollar is, still, and is likely to be in the foreseeable future, the most important reserve currency in the world.

For global investors, the US dollar is still a haven from the vagaries of political/economic unrest outside of Continental US.

Due to the depletion of the build-up in inventories in the US, production has picked up, thus causing one to believe that economic recovery in the US is moving apace.

The Bank of Japan, the central bank of the second largest economy of the world, has been buying US dollars to the detriment of the yen.

This has had the immediate effect of causing prices of stocks and shares in Japan to rise, but only slightly, mind you.

But The Bank of Japan is fighting a losing battle; and, its unilateral action is doomed to failure.

The long-term prospects of the US dollar would appear to be that it will continue to buckle under the weight of its problems and, thus, it will continue to depreciate against the euro and the yen.

And this will see the Japanese yen, effectively, appreciate against its most important single trading partner's currency, making Japanese-produced goods less competitive in North America.

And so the cycle of recession will start to take hold, yet again, in Japan as its goods are considered too expensive in its major markets; and, US consumers have to tighten belts in order to make ends meet.

The importance of this cannot be denied because Sony Corporation, for instance, ships about 25 percent of its total production to the US.

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