<u>IS DR ALAN GREENSPAN CORRECT OR INCORRECT ?</u>

<u>You Be The Judge</u>

One can be very logical and still be very wrong.

Dr Alan Greenspan's remarks to The European Banking Congress 2004 of last Friday appear to fall into the realm of being very logical, but, in **TARGET**'s opinion, not completely correct.

But his remarks, nevertheless, caused a flurry of selling activity on Wall Street, bringing down key indices on both The New York Stock Exchange and The NASDAQ.

Dr Alan Greenspan, the world's most-celebrated economist, being the Chairman of the US Federal Reserve Board, said, inter alia:

> *'Current account imbalances, per se, need not be a problem, but cumulative deficits, which result in a marked decline of a country's net international investment position – as is occurring in the United States – raise more complex issues. The US current account deficit has risen to more than 5 percent of GDP* (GDP = The total value of goods and services produced in a country over a period of time). *Because the deficit is essentially the change in net claims against US residents, the US net international investment position excluding valuation adjustments must also be declining in dollar terms at an annual pace equivalent to roughly 5 percent of US GDP.*
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> *'The question now confronting us is how large a current account deficit in the United States can be financed before resistance to acquiring net claims against US residents leads to adjustment. Even considering heavy purchases by central banks of US Treasury and agency issues, we see only limited indications that the large US current account deficit is meeting financial resistance. Yet, net claims against residents of the United States cannot continue to increase forever in international portfolios at their recent pace. Net debt service cost, though currently still modest, would eventually become burdensome. At some point, diversification considerations will slow and possibly limit the desire of investors to add dollar claims to their portfolios.*
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> *'Resistance to financing, however, is likely to emerge well before debt servicing becomes and issue, or before economic return on assets invested in the United States or in dollars more generally starts to erode. Even if returns hold steady, a continued buildup of dollar assets increases concentration risk …*
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> *'This situation suggests that international investors will eventually adjust their accumulation of dollar assets or, alternatively, seek higher dollar returns to offset concentration risk, elevating the cost of financing of the US current account deficit and rendering it increasingly less tenable. If a net importing country finds financing for its net deficit too expensive, that country will, of necessity, import less.*
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> *'It seems persuasive that, given the size of the US current account deficit, a diminished appetite for adding to dollar balances must occur at some point. But when, through what channels, and*

from what level of the dollar? Regrettably, no answer to those questions is convincing. This is the reason that forecasting the exchange rate for the dollar and other major currencies is problematic …'

What upset Wall Street, last Friday, on learning that which Dr Alan Greenspan was expounding in Frankfurt, Germany, were the prospects of international financial institutions, cutting back on US dollar-denominated investments.

His remarks suggested, also, by innuendo, at least, that the US dollar might fade as the world's preferred international reserve currency.

International investors have to weigh, of course, the return on US dollar-denominated investments, made, primarily, in the US, against the foreign-currency, exchange-translation risk.

Foreign investors, placing their surplus funds in US markets, be they equity markets, the money markets, real-estate markets, or direct investments in industry, do not make such investments in the US out of loyalty, but in order to make a profit.

If they cannot see a profit in the future, they will shy away from US-dollar denominated investments.

The alternative to the US dollar as the preferred international reserve currency is, naturally, the euro.

In **TARGET**'s view, it is highly unlikely that the euro can replace the US dollar as the world's preferred currency of choice, at least, not in this decade.

The **E**uropean **C**entral **B**ank (ECB), in its September report on euro area securities issues statistics said, inter alia:

> *'The annual growth rate of outstanding debt securities issued by euro area residents decreased from 7.5% in August 2004 to 7.3% in September. For quoted shares issued by euro area residents, the annual growth rate was 0.9% in September 2004, the same as in August.*
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> *'Issuance of debt securities by euro area residents totalled EUR 660.6 billion in September 2004. As redemptions came to EUR 616.7 billion, net issues amounted to EUR 43.9 billion. The annual growth rate of debt securities issued by euro area residents (excluding valuation charges) decreased from 7.5% in August 2004 to 7.3% in September …*
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> *'Concerning the currency breakdown, the annual growth rate of euro-denominated debt securities decreased from 7.1% in August 2004 to 6.9% in September. For debt securities in other currencies, this growth rate decreased from 12.6% in August 2004 to 11.3% in September …'.*

In respect of the ECB's statistics, concerning the US dollar-euro exchange rate, it has declined from about 1.18 euros in December 2003 to about 1.3026, as at November 17, 2004.

This means that the US dollar's translation value to the euro has fallen in the past year by about 10.39 percent.

No great shakes!

Whereas the prospective eurozone investor has a quite a number of considerations with which to contend when viewing this region of the world as an area in which to park his money, for the short term or the long term, the only real problem in the US, for many people/institutions, at least, is the Bush Administration and its propensity for spending more than the country earns.

Which, of course, is a recipe for inflation.

But, there is a very stable Government in the US and there is, also, the US Federal Reserve, which monitors the economy, very closely, so that the political risks are non-existent for the international investor.

Not so in eurozone, sadly.

Even so, with all of the drawbacks, the US is, still, the best place in which to invest because foreign-exchange translation losses aside, the growth of US industry remains the bulwark against the potential for very material foreign-exchange losses.

In the event that things should go terribly wrong in the US and industrial production recedes, appreciably, then, that effect would hit every country in the world, especially eurozone.

And, if that should materialise, no currency in the world would be immune from the vagaries that would, undoubtedly, follow.

The US remains the world's largest and most dynamic consumer market; it is unlikely to relinquish this position in the foreseeable future.

Offshore outsourcing, the establishment of free-trade pacts with foreign governments, and the creative destruction of certain US industries, over the past decade, have helped to restrain inflationary pressures in the world's only superpower.

But, at the same time, the high price of energy, over the period November 13, 2003, and October 15, 2004, has hurt the US balance of payments, to be sure.

According to the statistics of **TOLFIN** (The Computerised Online Financial Intelligence Service and Web-Based, Credit-Checking Provider), the price of light sweet crude oil has risen by about 123.89 percent, from $US24.91 per barrel on November 13, 2003, to about $US55.67 per barrel, as at October 15, 2004.

Since the US is dependent on imports of crude oil to keep the wheels of industry oiled, this has hit the economy in its soft underbelly.

In October, alone, import prices in the US jumped about 1.50 percent, caused in the main by an 11.70-percent rise in the price of imported petroleum products.

But all of the above statistics does not alter the fact that US-produced products and services are still in strong demand, internationally.

And this situation is unlikely to be altered in this decade, too.

The US economy remains the economic leviathan of the world and, as such, it will continue to attract foreign investments to its shores.

There is no other alternative but the US as far as international funds are concerned, at least, not in today's world.

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