VOLUME VI No. 238 W E D N E S D A Y December 15, 2004

THE U.S. ECONOMY WILL CONTRACT IN 2005; AND, THE CANADIAN DOLLAR WILL STRENGTHEN IN 2005

In a recent, brief discussion with an accountant in Toronto, Canada, **TARGET**'s opinion, that the US dollar would continue to maintain its privileged position as the world's *'reserve'* currency and that the Canadian dollar would strengthen in 2005, was heaped with scorn, with this cantankerous accountant, stating disdainfully, words to the effect:

> *'Bullshit baffles brains! You brief the Chairman of the US Federal Reserve Board, Dr Alan Greenspan, and I will advise the President of the United States, Mr George W. Bush.'*

This accountant's nose was put a little out of joint by **TARGET**'s intransigent stand that the Canadian dollar would, despite the US dollar's recent falls against most of the *'hard'* currencies of the world, continue to rise to higher levels vis-à-vis the US dollar, all other factors, being equal.

According to this accountant, the US dollar will, in the fullness of time, find itself demoted in the eyes of the world, with, perhaps, the euro, replacing it as the world's most sought-after currency.

Balderdash!

The euro, which some people might think could be a logical alternative to the US dollar as the world's *'reserve'* currency, to be employed in satisfying international debts, is plagued by problems within the **E**uropean **U**nion (EU).

France, Germany and Italy, just to mention 3 leading, powerful EU members, are riddled with fundamental economic problems, with many of these countries' industries, retracting rather than expanding.

A flexible monetary policy among the motley group of EU members is, just, not on.

It may never be possible.

Cultural differences, leading to one communications' impasse after another, are the norm for many EU members rather than the exception.

With the US, being the leading importer of crude oil in the world, it is almost unthinkable that the price of a barrel of crude oil could be denominated in any currency, other than the US.

As for the Japanese yen, Japan is, still, trying to wrest itself out of 3 decades of stagflation, with the present Japanese Government debt, known to be about 170 percent of Gross Domestic Product.

This Canadian accountant, who took umbrage at **TARGET**'s recent prognostications about the direction of the US dollar on the world stage, vis-à-vis the Canadian dollar, especially, went so far as to state that the world was changing rapidly, that many formulae of the past might not be applicable, today, at least, not fully, and that the US Government and the US dollar would both lose their respective significance on the world stage in due course.

Well, **TARGET** continues to be intransigent with regard to our stance:

a. The US will continue to be the world's only superpower for years to come;

b. The US dollar will continue to fall to lower levels over the next year or so;

c. The US will continue to enjoy record-breaking Current Account Deficits; and,

d. The Canadian dollar will, most likely, rise to about $US1.10 by this time, next year.

(In fact, **TARGET** has wagered with this cantankerous accountant that if the Canadian dollar does not rise to about $US1.10 by December 2005, this medium would pay to this bald gentleman, 2 cups of coffee)

Please see **TARGET** Intelligence Report, Volume VI, Number 228, published on December 1, 2004, headlined,
'SELL U.S. DOLLARS AND BUY CANADIAN DOLLARS'.
This **TARGET** analysis should be read in conjunction with this report.

Adverse Conditions Lead To Rethinking.

It is fact that, in times of extreme adversity, the preferred medium of exchange ceases to be paper money: Commodities, such as gold, silver, platinum and/or jewels etc become the preferred medium of exchange.

Gold, silver, platinum, rubber and sugar, historically, have been among the commodities whose prices have risen sharply at the outbreak of any major conflict or the perceived prospects of an imminent war.

In Canada, it is rich in commodities, such as nickel, zinc, copper, lead, silver, molybdenum, potash, gold and, especially, crude oil (reserves are estimated to be not less than 5.50 billion barrels).

More than 80 percent of Canada's exports go to the US, making the US, Canada's most- important, single customer.

Whereas, one may severely criticise the socialistic politics of Canada and of the work ethic, in general, because of the country's proximity to the US, it is unlikely that The Land of The Free and The Home of The Brave will not continue to play an important role in the economics of this country, which is the largest in the Western hemisphere, in terms of land mass.

As the US dollar slips to lower levels against other *'hard'* currencies, such as the euro, the Japanese yen, the British pound, etc, so the Canadian dollar will strengthen and its commodity prices, automatically, will cost more in terms of the US dollar.

It is inevitable.

The Government of Canada is unlikely to raise interest rates because the last thing that the Government of Prime Minister Paul Martin wants is to see hot money flood into the country.

That, too, would appear to be inevitable because, in terms of the country's other trading partners, other than the US, that is, a stronger Canadian dollar means that Canadian exports become less competitive on the world stage.

Turning to the **E**uropean **C**entral **B**ank (ECB) and the Central Bank of Japan – The Bank of Japan – it is unlikely that the governors of these financial powerhouses will sit still while the euro and the yen rise to higher plateaus vis-à-vis the US dollar.

Although Mr Jean-Claude Trichet, the President of the ECB, has gone on record to state that the ECB was unlikely to intervene on international currency markets in order to alleviate the pressure on the US dollar, Mr

Hiroshi Watanabe, Japan's Vice Minister for International Affairs, went on record to state that he, personally, was in close contact with Europe and that his government was ready, and well prepared, to take definitive action.

It has, always, been Japan's policy to stand in foreign-exchange markets in support of the US dollar because, by so doing, it keeps the pressure on the translation value of the US dollar-Japanese yen and, in this way, permits Japanese exports to remain competitive with the country's most important single customer, namely, the US.

During the period, January 1, 2004, and March 31, 2004, The Bank of Japan spent upwards of $US150 billion in trying to reverse the course of the US dollar, whose translation value against the yen was carving out a deep swath.

President George W. Bush has, personally, asked the Prime Minister of Japan, Mr Junichiro Koizumi, to apply pressure on the Governors of The Bank of Japan to stop intervening in foreign-exchange markets.

Prime Minister Junichiro Koizumi, who heads the second-largest economy of the world, went on record to state that he saw nothing wrong with the manner in which The Bank of Japan had been conducting its affairs in defence of the economy of the country.

The point of all this is that certain Central Banks of the world will have to consider, very carefully, whether or not they should intervene on the international foreign-exchange markets in order to try to protect their own economies … or suffer the consequences of their non-action.

There is strong opposition to the stance of Mr Jean-Claude Trichet, the President of the ECB, because industrialists of the European Union know only too well that a strong euro, relative to the US dollar, means that products and services, produced in this part of the world, become less and less competitive to their American counterparts with every penny that the US dollar depreciates against the euro.

Ditto for Japan where more than 30 percent of all of its domestic exports end up in the US.

Intervention on foreign-exchange markets, especially by The Bank of Japan, which has been buying up US Treasury Bills, has an added advantage for the US Government in that it tends, obliquely, to finance the US Current Account Deficit.

Foreign investors are less and less keen to finance the US Current Account Deficit, compared with the period when the US was enjoying Current Account Surpluses, by buying US stocks and shares and other negotiable instruments.

In the days of US budget surpluses, it was relatively simple for *'America Incorporated'* to raise money, internationally.

Things have changed, however.

With a prospective Budget Deficit of about $US600 billion for this Fiscal Year, foreign capital is unlikely to be easily disposed, as it was in the year 2000, to assist in funding US corporate operations by buying corporate paper.

The foreign-exchange translation risk in buying, heavily, into US-dollar denominated corporate *'paper'* is high, too high for the likes of many international institutions.

And, as the US dollar's value, in terms of other *'hard'* currencies, depreciates, so it will cut into the Current Account Deficit of the country.

This must come about because, as US exports become more and more attractive due to the cheaper US dollar in terms of the currencies of the country's trading partners, so, conversely, imports will become more and more expensive to the US consumer because the US dollar will have lost a large part of its buying power in terms of the yen, British pound, the euro, etc.

US households will, by necessity, have to rein in monthly spending habits because of the waning value of the US dollar at the supermarket, the departmental store, etc.

This is where offshore outsourcing will tend to prove to the Doubting Thomases of the US that creative destruction is positive, not negative, despite what some popular television presenters would have us, all, believe.

Domestic exports from the People's Republic of China, Vietnam, Thailand, Cambodia, etc, bound for the US, especially garments, textiles, shoes, towels, toys, furniture, batteries, computer accessories and other consumables, have tended to keep the lid on inflationary pressures in the US, at least to some extent.

US industry and US consumers have come to rely, heavily, on these Asian imports, resulting in the death of homegrown industries, which were once in competition with the producers of those imports, in some cases.

The reasons for this reliance include:

1. The Asian imported products are cheaper than those that can be manufactured in the US;
2. The quality of the Asian imports are often superior to their former US counterpart, in many cases; and,
3. Many of the Asian imports are no longer produced in the US.

The bottom line, of course, of all of the above is that the US economic growth will, most likely, shrink in the year 2005.

How much will the US economy shrink?

TARGET is not strong on crystal-ball gazing.

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