CURRENCY WARS, DOLLAR AND YEN SLIDES

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OVERVIEW AND CONCLUSION

Currency war fears and realities often reflect widespread economic crisis worries. From time to time during the ongoing international economic crisis that emerged in 2007, marketplace wizards and political sages have warned of currency wars. Many such observers label and bemoan currency battles as “bad”, especially if such competitive devaluations involve several key trading nations around the globe. Nevertheless, many countries view devaluation of their home currency (whether “in general”, or in a cross rate against another nation) as “good”, at least so long as such tumbles are “not excessive”. Might depreciation boost exports and thus help to generate the blessings of growth? Or, might depreciation (at least up to some point) reduce the burden of outstanding debt obligations denominated in the home currency? Thus, in some realms (or at least for powerful economic camps within such territories), depreciation (and sustained currency weakness) ironically often is akin to a military victory.

Substantial currency appreciation or depreciation often significantly reflects the deliberate policy of a nation’s economic and political leadership. However, numerous other variables intertwine with such goals and actions.

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In recent months, the US dollar and Japanese Yen have fallen, the Yen especially dramatically. However, the greenback already was feeble from a longer run historical vantage point, and its erosion has been rather steady since around June 2012. In America, the Federal Reserve and many politicians clearly endorse a relatively weak dollar. Look at the Fed’s massive and sustained money printing and rock-bottom Federal Funds rate. Have American economic generals in recent months been shouting about the merit of a “strong dollar”? The recent Japanese election and political pressures has accelerated the Yen’s weakness that emerged during 2012.

A weak US dollar in recent years often has been associated with bullish moves for US equities (S+P 500). Recent Yen weakness helped to rocket Japanese equities (Nikkei 225) sharply higher from their 6/4/12 (8240) and 10/15/12 (8490) valleys. The Yen’s weakness began from a so-called very strong level, so perhaps its decline will enhance Japan’s economic growth. Will this Japanese expansion, if it occurs, do so at the expense of others? Perhaps.

For the US, the broad real trade-weighted dollar probably will challenge its July 2011 record low depth in the relatively near future. A decisive breach of that bottom would not be surprising. A challenge of the July 2011 low, and therefore a break beneath it, probably would not be bullish for the S+P 500.

Recall the dollar trend weakness that continued into spring 2008. The April 2008 key low in the broad real trade-weighted dollar (“TWD”) around 84.0 not only followed a sustained decline, but also tested its prior major lows around that level. That April 2008 trough nearly coincided with the final top in the S+P 500 in May 2008 (S+P 500 major pinnacle October 2007). Remember also the greenback’s 1985-87 history alongside an eventual stock marketplace decline. The TWD peaked in March 1985 at 128.4, descended under 110.0 in March 2986, and decisively retreated beneath 100.0 after July 1987. The decline from the 1985 summit to July 1987 was about 22.1 percent (and the dollar kept eroding).

Will foreigners nowadays continue to be big net buyers, or continue to hold, US Treasury securities when the US dollar is weakening more and more and with the Fed printing money and keeping (and promising to maintain) interest rates near the floor? Keep in mind that the US has made little significant progress in resolving its current near term (and especially its long run) deficit troubles.

US DOLLAR: THE CURRENT TRADE WEIGHTED VISTA

The broad real trade-weighted US dollar (TWD) embarked in June 2012 on a renewed and so far gradual depreciation voyage.

Recall the TWD's major summit at 112.8 over 10 years ago in February 2002 (Federal Reserve Board data, H.10, monthly average). Though the dollar stumbled to 84.2 in April 2008, it climbed to 96.9 in March 2009. However, the TWD crashed to its record low around 80.5 in July 2011. The TWD managed to trudge up to a minor high (monthly average) at 86.2 in June 2012, but faded since then, falling in January 2013 to 83.1 (well below the key March 2009 ceiling and beneath the pre-July 2011 support levels around 84.0).

US DOLLAR: CROSS RATES IN TRADE-WEIGHTED DOLLAR PERSPECTIVE

TWD percentage weights (Federal Reserve, H.10; as of 10/10/12; percentages rounded; cross rates from Bloomberg also rounded). Levels in crosses are currency versus the US dollar, except for US dollars per Australian Dollar, Euro FX, and the British Pound. The 2/1/13 level in the table below was that around 1030 am EST.

Even though the US dollar has not declined against every cross rate since "around" June/July 2012 (or "recent months"), it generally has done so. The dollar/Yen cross rate's Yen weakness is an exception.

The table below focuses on the span from the beginning of 2012 to the present.

TWD Percentage Weight	Recent Cross Rate Low Versus Dollar (date)	Level, morning 2/1/13	Dollar Fall in Percent, High to Level on 2/1/13
China 20.3 percent	6.396 (7/25/12)	6.227	2.6 percent
South Korea 3.9pc	1185 (5/25/12)	1097 (1/15/13 high 1055)	7.4pc
Taiwan 2.6	30.2 (7/25/12)	29.6 (1/11/13 high 28.9)	2.0
Malaysia 1.6	3.207 (6/4/12)	3.117 (1/15/13 high 3.003)	2.8
Thailand 1.4	32.0 (7/23/12)	29.8 (1/21/13)	6.9
Japan 7.3pc		92.4	

(High in Yen versus the US dollar was 75.4 on 10/31/11. It rallied to 84.2 on 3/15/12. Although the Yen firmed to 77.1 on 9/13/12, it plummeted to its 2/1/13 low to date of 92.4, a bloody twenty percent cratering from the 9/13/12 high.)

Canada 12.9pc	1.045 (6/4/12)	.999	4.4pc

(The Canadian dollar had rallied to 9/14/12's .963. Compare that mid-September date with the Yen's 9/13/12 one. However, the Canadian's retreat since mid-September versus the dollar carried only to 1.010 on 1/25/13.)

Mexico 11.3 percent	14.60 (6/1/12)	12.65	13.4pc
Euro 16.5pc	1.204 (7/24/12)	1.365	13.3pc
United Kingdom 3.4	1.527 (6/1/12)	1.577	3.2

(The British Pound roughly has been in a sideways trend versus dollar. Recall its 1/13/12 low at 1.524, its relatively lofty 1.638 high on 1/2/13.)

Switzerland 1.7	.997 (7/24/12)	.905	9.2pc
Australia 1.4pc	.958 (6/1/12)	1.041	8.7pc

(9/14/12 Australian Dollar high 1.063)

Brazil 2.2pc		1.985	

(The US dollar cross rate low versus the Brazilian real in 2012 was 2/29/12 at 1.689. It rallied to about 2.111 on 5/23/12, but slipped to 1.971 on 5/28/12. The dollar rallied to 2.138 on 12/3/12. However, it now is little changed from its 5/28/12 and 7/3/12 (1.978) levels. Yet the dollar has fallen about 7.2pc versus the real since 12/3/12.)

India 1.9pc	57.33 (6/22/12)	53.20	7.2pc
Russia 1.2pc	34.15 (6/4/12)	29.90	12.4pc

CURRENCY BATTLEGROUNDS, CONTINUED

Though many accuse China of currency "manipulation", some might wonder about the American government's interest rate and foreign exchange policy maneuvers. What do the Fed's huge money printing campaigns and its long run quest of a depressed Federal Funds rate seek to accomplish? Given China's large share of the broad real TWD, sharp appreciation in the cross rate versus the US dollar may have significant consequences inside and outside the foreign exchange arena.

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For Japan (and other nations), players should view currency strength and weakness from the trade-weighted/effective exchange rate viewpoint. Crosses provide only a partial picture.

Compared to America, Japan recently had (and arguably still has more) "room to depreciate". The Japanese Yen effective exchange rate ("EER", monthly average; Bank of England data) reached a pinnacle at 185.6 in January 2012. In July 2012, at 183.7 it bordered that plateau. The Yen in EER terms in midyear 2012, in contrast to the TWD, was very strong from the long run historical vantage point. Anyway, note the Yen's precipitous decline since July 2012; its collapse is enormous compared with the broad real trade-weighted dollar's decline since midyear 2012. For December 2012, the Yen EER was 169.1 (no January monthly average released yet). On 9/13/12 (daily data) it was 183.5, evaporating to around 153.4 on 1/31/13.

Both Japan and America have been running large government budget deficits. Both have substantial government indebtedness. Though Japan's indebtedness dwarfs America's as a percentage of GDP, Japan has a greater domestic saving reserve (better ability to finance from domestic sources).

Note the mid-January 2013 highs in some Asian currencies other than the Yen relative to the US dollar. Is this a sign they have started to engage in a competitive devaluation fight with the Yen?

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Some currency crosses rate levels and trends reflect substantial and perhaps very severe domestic (internal) conflict. Given the dollar's international reserve status, many monitor cross rates involving the dollar. Neither Egypt nor Pakistan is very significant for the broad real TWD picture. Yet these nations of course possess major importance for the world geopolitical situation (and American geopolitical interests).

The rallies in the US dollar against the Egyptian pound and the Pakistani rupee are noteworthy. The Egyptian Pound's 11/23/12 level was just under 6.09 versus the US dollar. After only about two months, it has deteriorated 9.4 percent to about 6.72 now. Pakistan's rupee, though it fluctuates as a "managed float", has steadily withered 19.7pc in four years, from 78.2 on 2/9/09 and 83.5 on 4/19/11 to about 97.4 now

Other currency crosses can reflect international conflict and concerns. Note pressures on the Iranian currency relative to the dollar during the nuclear situation (watch black market currency rate trends).

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