

The U.S. Dollar Dam is Breaking

U.S. TREASURY SECRETARY HENRY M. (HANK) PAULSON AND NEW FED CHAIRMAN BEN S. BERNANKE ARE TRYING TO PERSUADE THE RED CHINESE TO PREVENT THE U.S. DOLLAR DAM FROM BREAKING.

by Richard Benson
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Treasury Secretary, Henry M. Paulson, is rushing off to China next month and will lead a delegation to Beijing for the inaugural meeting of the U.S. - China Strategic Economic Dialogue. He'll be taking high-ranking Administration officials with him, including Federal Reserve Chairman, Ben S. Bernanke. Because Hank and Ben are responsible for stabilizing the financial markets and need to work together to try and stabilize the dollar, their activities in China will undoubtedly be closely watched worldwide.

Hank and Ben are also part of the Working Group in a team which includes the heads of the SEC and the Commodity Futures Trading Association, commonly referred to on Wall Street as the "Plunge Protection Team" (PPI). This Team has the entire United States Treasury at their disposal and this trip to China could undermine faith in the Administration's ability to fix the massive Trade Deficit problem in an orderly manner. Preventing another 1987 "Black Monday" is on the Agenda, but the investing public will never be told that it is.

The China trip means that the ticking time bomb at the bottom of the dollar dam needs to be defused before it blows up, and the value of the dollar is swept away. Both the Republican Administration and the Democratic Congress want China, and the rest of Asia, to end their policies of manipulating their currencies down, by building up massive foreign exchange holdings. The new Congress is tuned into the fact that China has tariffs of 25 percent on imports such as autos, and is very tired of seeing American labor slaughtered. (In 2007 GM, Ford and Chrysler - as well as auto parts suppliers such as Delphi - are buying 100,000 workers out of their jobs or just "letting them go".) To make trade fair again, Congress is willing to take the action of imposing tariffs if China and Asia do not revalue. In turn, China may threaten to dump their dollars, unless the Fed keeps interest rates high. If China starts selling dollars, the dam will break.

Not only does the U.S. owe a net \$3 trillion to foreigners, we now pay more in interest overseas than we collect from abroad. Foreigners hold \$13 trillion in dollar assets that are at immediate and painful risk to any dollar weakness. Indeed, that volume of liquid assets is just about equal to the total GDP. A 30 percent drop in the dollar, could cost foreign investors an easy \$3 trillion in lost purchasing power, not to mention the loss to U.S. citizens who own over \$46 trillion in dollar net worth assets. Our leaders must find a way to lower the U.S. Trade Deficit, or risk the dollar losing its unique position as the World's Reserve Currency. This fact alone warrants the trip to China.

America's currency problem is a very sad day for the Republic. It used to be that the Federal Reserve policy was set simply with domestic economic policy in mind. In years past, we could virtually ignore the dollar in setting monetary policy because it was totally secure in its role as the World Reserve Currency. But today, because of our country's profligate fiscal and over-easy monetary policies, the dollar has been undermined so much so that, sadly, it may be no more secure as a store of value than the citizens of Baghdad are, walking the streets.

The Federal Reserve must now be aware that the dollar has held its value on the world exchanges for two reasons: First, compared to the Euro, Yen, or Yuan, America has the highest interest rates by far. We pay carry traders to borrow in Yen at less than one percent and invest in U.S. assets, creating an artificial financial demand; Second, we have winked and have done nothing but talk as the Chinese, Japanese - and the rest of Asia - have manipulated their currencies down to rob America of its factories and keep consumers dumb and happy with artificially low interest rates, and excess consumption. All the while, the Asians have ended up with America's money.

Since Ben Bernanke is a student of history, it's likely he remembers when Alan Greenspan was put to the test during the stock market crash of 1987. You may recall this crash was triggered by the dollar taking a nosedive. Think now of those foreign investors, I mentioned earlier, who are holding \$13 Trillion in U.S. cash, stocks and bonds. What if they lost 20 percent on the price of their stocks as the stock market sold off, and another 30 percent as the dollar value plunged? Their losses in purchasing power could reach 40 percent! The financial market sell-off would be accelerated by the carry traders who borrow cheap foreign currencies, and could quickly be forced to sell at a really big loss, as the foreign currency moves up against them. The smart investors will dump when they realize the dollar is spiraling downward.

Hank and Ben may not talk openly with Chinese officials about this crash possibility, but you can be sure it's on their minds. The possibility of a panic and crash from foreigners fleeing the dollar will be with us for quite some time. Therefore, it is highly unlikely in my view that interest rates will be cut until the recession is self-evident. Managing the dollar decline won't permit the Fed to ease too soon.

So, with the U.S. stock markets up smartly the second half of this year, now is a wonderful time to cash in your chips at the stock market casino and head for the exit door before the mad rush. Remember, if you own dollar assets, a falling

dollar can cause havoc to most American and foreign investors. Only those who invest in foreign financial assets or real assets (such as commodities or gold and silver) are likely to be safe and not swept away when the dollar dam breaks.