Center for American Progress

Bush's Weak Dollar

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Bush's Weak Dollar

America's working families have been squeezed for most of this decade by stagnant wages and diminishing health and retirement benefits. Now they face new economic pressures from rising gasoline, food, heating, and electricity prices. A portion of those higher costs are directly attributable to the weakening of the dollar and the economic policies that have produced a weak dollar.

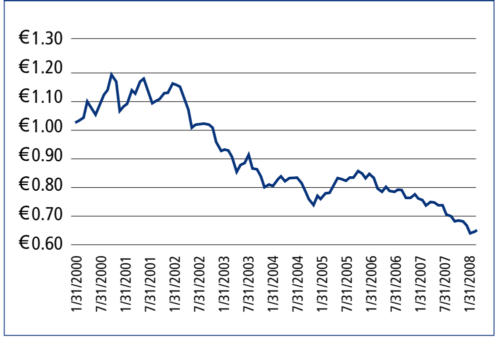
Since January 2000, the dollar has fallen by 37 percent against the euro, with nearly two-thirds of that decline occurring since January 2006. The dollar has fallen 31 percent against the Canadian dollar, and 17 percent against the British pound.

The fall of the dollar has affected oil prices in two specific ways. First, as the dollar falls against the euro and other major currencies, oil-exporting states have been demanding more dollars per barrel of oil to protect their ability to meet expenses paid in euros and other currencies.

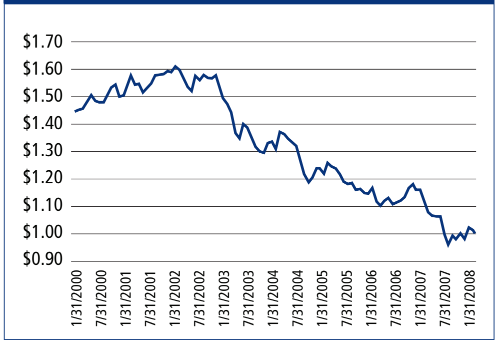
This can be most clearly seen in the price of oil (the spot price for Saudi light crude) as measured in U.S. dollars and euros during the first four years of the current Bush administration. As the dollar weakened, the dollar price of oil increased proportionately.

Measured in dollars, oil cost about 28 percent more on average in 2004 than it had cost in 2000, but the price remained

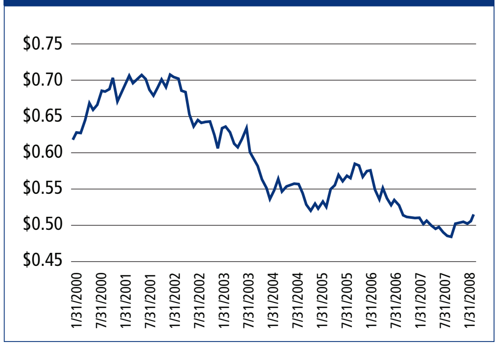
EUROS TO THE DOLLAR
2000 to Present



CANADIAN DOLLAR TO THE U.S. DOLLAR
2000 to Present



BRITISH POUNDS TO THE U.S. DOLLAR
2000 to Present



relatively constant if measured in euros. In fact, Europeans were actually paying about 8 percent less for oil in 2004 than they had paid in 2000.

More recently, the declining dollar has pushed the price of oil and other commodities higher for a second reason. Retirement funds, hedge funds, speculators, and other institutional investors around the world have tried to protect themselves against further declines in the dollar by moving money into commodity futures that are denominated in dollars—financial instruments that will remain stable or even rise against other currencies even as the dollar falls.

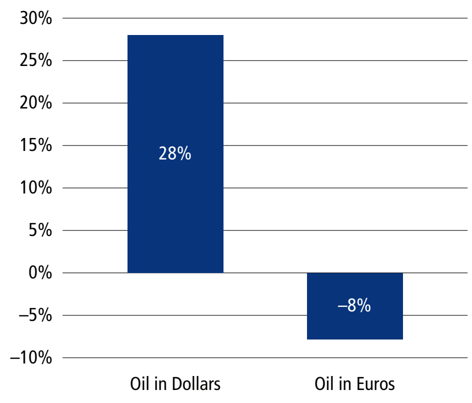
Stewart Bailey reported for Bloomberg last month that "global investments in commodities rose by more than a fifth in the first quarter to $400 billion, helping boost prices as investors sought a buffer against inflation and a weaker dollar."

Because so many money managers are attempting to use commodities to hedge against the declining value of the greenback, their investment strategies create at least temporarily additional demand for those commodities, driving the price upward.

This effect is demonstrated by the fact that although the increase in the price of oil has been substantial, it is not out of line with what has happened with other commodities, and in particular agricultural commodities.

Over the past 25 months, the dollar price of oil has increased by 79 percent. That is more than the increase in precious metals such as gold and silver. But it is significantly less than the increase in commodities such as soybeans, which have gone up 137 percent, or corn, which has gone up 167 percent.

CHANGE IN THE PRICE OF SAUDI LIGHT CRUDE IN U.S. DOLLARS AND EUROS
2000 to 2004



There are of course additional factors that influence the price of oil and other commodities. These include growing global demand, particularly from China and other emerging economies, and the so-called "security premium" or "tension premium" that results from the market estimation of the potential for hostilities that could interrupt the production or distribution of a commodity.

With respect to oil, recent U.S. saber-rattling toward Iran and the possibility of hostilities in or near the narrow Straits of Hormuz has clearly played a significant role in a number of recent spikes in oil prices, and perhaps in the ongoing higher price of oil.

Yet the fact that oil prices have risen nearly fivefold when measured in dollars, but slightly less than threefold when measured in euros, would indicate that nearly 40 percent of the increased price American consumers are paying for oil is attributable to the weak dollar.

If only 10 percent of the price increase is attributable to the flow of dollars and other currencies into commodities to hedge against further weakening, then at least half of the explanation for high gas prices is the weak dollar.

Is a Weak Dollar Necessary?

Just as the increases in oil prices are not attributable to a single cause, the same is true of the devaluation of the U.S. dollar. Chronic trade imbalances play an important role. But the recent policies of the U.S. Federal Reserve have had an extraordinary effect on the value of the dollar.

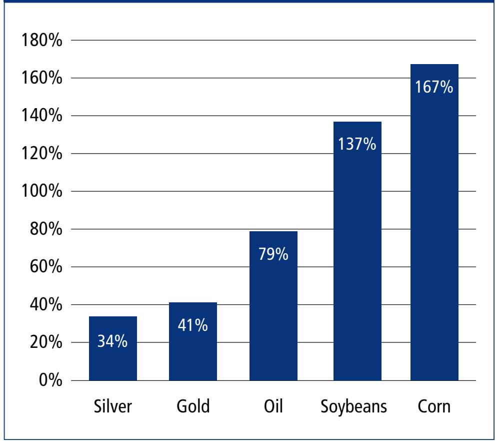
When the Federal Reserve began cutting rates last September the dollar traded against the euro at 0.73 euros to the dollar. The 14 percent decline in the dollar over the succeeding eight months can be clearly tracked against each of the seven cuts in the Federal Funds Rate over that period (see chart below).

The explanation is relatively simple—the lower the interest paid on a currency, the less likely foreign investors will want to invest in bonds, money market funds, and other instruments denominated in that currency, and the more likely U.S. investors will want to search for better returns overseas.

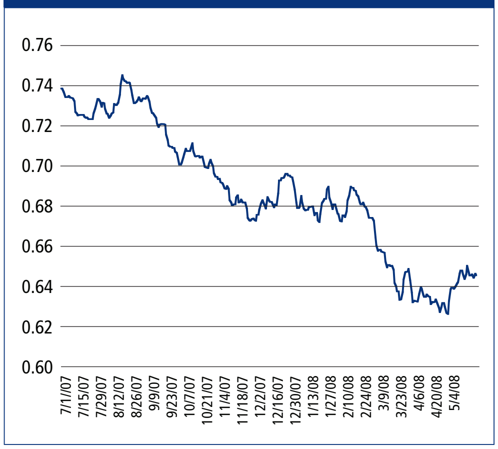
Certain industries do very well with low interest rates and a weak dollar. The banks and Wall Street investment firms are greatly benefited by low interest rates, which is why the Federal Reserve has made the dramatic cuts that have occurred since last September.

Energy companies are directly benefited by a weak dollar since the value of their domestic reserves increase in proportion

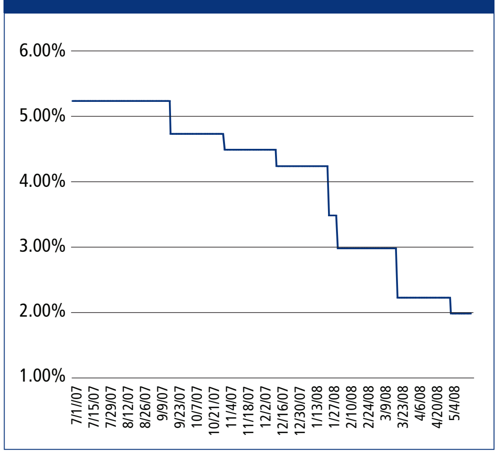
INCREASE IN COMMODITY PRICES
April 2006 to May 2008



EXCHANGE RATE, EUROS TO THE DOLLAR
July 1, 2007 to May 16, 2008



FEDERAL FUNDS RATE
July 1, 2007 to May 16, 2008



to the dollars decline. While the value of most businesses rise and fall in rough proportion to the value of their local currency, oil companies can gain significant value in comparison to other businesses as a result of a devalued currency.

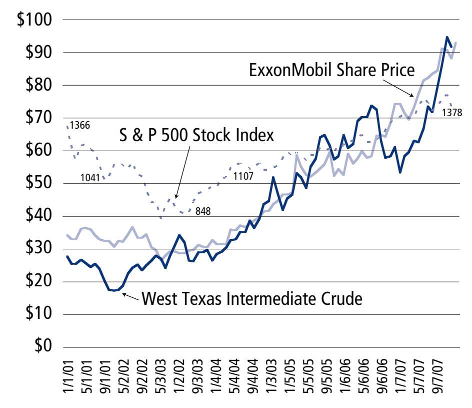
The nation's largest oil company, ExxonMobil, is only one of many examples of how powerful appreciating commodity prices are in determining stock valuations of companies owning substantial reserves of those commodities.

At the beginning of 2001, ExxonMobil shares traded at less than $36 apiece. By early 2008, the share price had jumped to nearly $85. For most of that period (as the chart below demonstrates), the increase in ExxonMobil's share price matched almost precisely the appreciation in the price of a barrel of crude oil.

The 138 percent appreciation in valuation of ExxonMobil during these seven years was reasonably typical of energy companies in general, but at stark variance with the increase in share prices of other large companies. Case in point: Between January 2001 and January 2008 the Standard & Poor's

EXXON STOCK CLOSELY PARALLELED CRUDE OIL PRICES, JAN 01–JAN 08

Average Share Price of Non-Energy Corporations Remained Unchanged



500 Index moved from 1,366 points to 1,378 points—an increase of less than 1 percent—but had energy companies been removed from the S&P index the remainder would have doubtlessly shown a significant decline.

The government's monetary policy and the weak dollar not only create winners and losers in terms of consumers and businesses, but also benefit some businesses far more than others.