

THE OMNIVEST MARKET VIEW



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The Obama Folly

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Is it possible that Obama went open-handed to Beijing and came back empty-handed? The answer is clearly “yes” with respect to pushing China to allow its currency to appreciate versus the US dollar. China is not usually bullied into making currency decisions before they are ready and it is clear that they are not ready now to re-peg the yuan.

The administration has certainly lost a bit of face in the international community, but not necessarily because China did not budge on currency issues. Rather, it has been humbled because the US President, the Chairman of the Federal Reserve and the Secretary of Treasury have all articulated the need for a “strong US dollar policy” in the past two weeks with no success in moving the dollar higher.

While it is fair to say that the yuan is undervalued versus the US dollar, imagine how undervalued it must be against the euro, the pound, the yen or any currency against which the US dollar has fallen.

It is one thing to challenge China to allow its currency to appreciate, but it is quite another to recognize that the US is not in a position of strength. Our deficit is 9.9% of GDP and there are no visible measures to shrink it. It is true that the Debt/GDP ratio can shrink because of a rise in GDP, but that is not sufficient. The fact remains that our deficit is now at \$1.4 trillion and likely to continue to rise. With respect to debt as a percent of GDP, the US has now surpassed India, Pakistan and Sri Lanka. Given this information, why would anyone expect the US dollar to appreciate against any currency?

The burden of our vast and growing deficit is shouldered by the broad weakening of the US dollar. However, the concern is not just that the US dollar will weaken further; it is that the impact of the already weak US dollar may spread and ignite inflationary pressures globally. Yesterday, core CPI recorded a year-over-year increase of 1.7%, up from 1.5% in September. Given that commodity prices are at a 12-month high and that some commodities have more than doubled in price, inflation will most likely increase in the coming months.

The weak US dollar is also a contributor to the de-coupling of emerging country growth rates from developed country growth rates. This economic de-coupling may thrust the US deeper into a cost-push inflation cycle that will be difficult to break without a sustainable increase in the value of the dollar.

As a large debtor nation, it is difficult for President Obama to demand anything from China, our leading banker. We are approaching a critical point with respect to the US dollar in which it may 1) lose its role as the world’s reserve currency; 2) lose its mantle as the financial capital base of the world; and 3) lose all credibility outside the US. When senior officials make hollow declarations about a strong US dollar policy, one must ask “What policy?”