



Will the US Dollar Come to the Rescue?

The recent rally in the US Dollar against other major currencies shows it may have been knocked down, but certainly not knocked out. Below we discuss why the Dollar is due renaissance, and why this may actually come to the aid of faltering global economy.

It was the sub-prime crisis that so spectacularly hit the US economy and prompted the Federal Reserve to embark on one of their most aggressive rate cutting campaigns to date. In contrast the Bank of England and the European Central Bank chose a different route by focusing on the soaring level of inflation to keep their rates relatively unchanged (the later actually hiking last month). As the interest rate differential between the Dollar and Sterling (and the Euro) increased, the Dollar fell. However, it is now clear that the troubles that started in the US have spread across the Atlantic with the UK and Euro economies nearing recession also. We have recently seen;

- The IMF announced that Britain is in for an "extended period" of high inflation and lower growth, with their growth forecast drastically cut to 1.4% this year and 1.1% in 2009.
- UK House prices fell by 1.1% in the three month to June this year and mortgage lending was down 32% in the first half of the year.
- German industrial orders dropped sharply in June (down by 2.9%); the German economy represents a third of Eurozone output.

In the face of such weak data will either of the European central banks feel confident enough to raise rates, or even keep them unchanged regardless of the level of inflation (CPI 4.4% in the UK this month)? Or will they expect the global slow down to curtail this naturally, (oil has fallen 20% from the heady heights reached last month).

We know commodity and currency markets influence each other; A stronger Dollar certainly helps drive down commodity and energy costs, which in turn, helps moderate inflation, which gives the BoE and ECB room to cut interest rates, which leads to a stronger dollar.....

Expect the dollar to regain its strength for some time to come.

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