Changes in the Price of the Dollar in 2004 and Some Predictions

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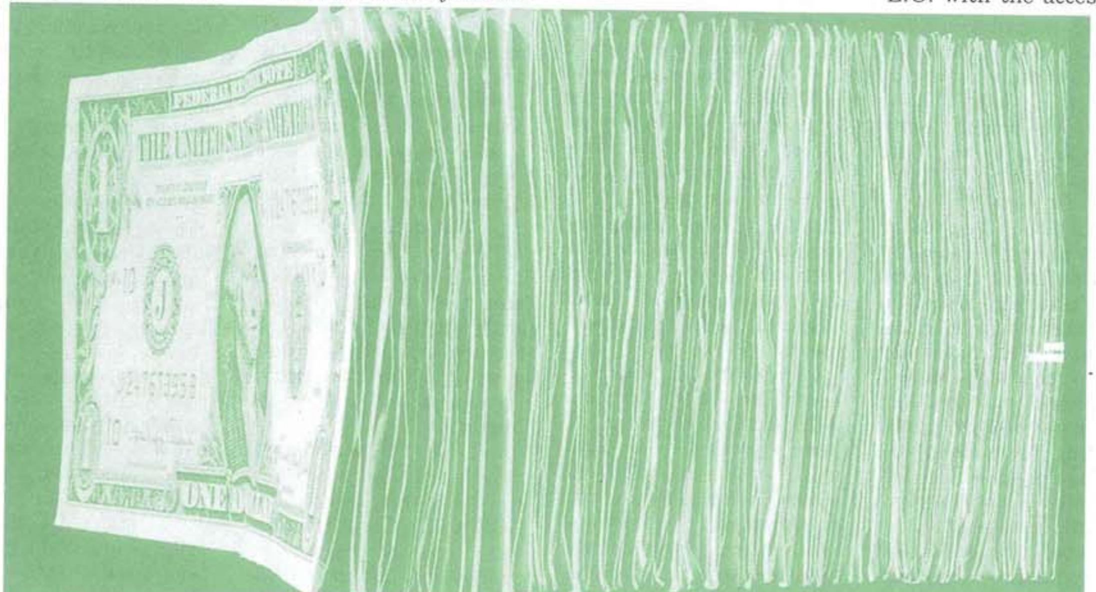
Looking back on changes in the dollar price in the past decade, we saw that its rises and falls were determined by cyclical fluctuations in the economy. But we should remember possibilities of direct and indirect interventions of the US Government to change the flow as experienced in the past. To guess based on the majoritarianism that the dollar will



keep falling is not wise and it is only suitable to speculators. As for businesspersons, they must exclude any affirmation when working out their future business plan.

1. An overview

To look for an answer to the question about perspective changes in the dollar price, we should look back on the exchange rate in the past 12 months.

We present here only main facts reflected in official indexes about the American economy. These are the most important factors that affected the falls of the dollar in 2004. We then conclude systematic factors that made the dollar fall and draw some predictions needed for local companies.

- January: In the first month of the year, the American economy showed good signs. Its growth rate in the third quarter of the previous year rose to 8.2%, the highest level ever seen in the last 19 years. The leaders of the European Central Bank (ECB) allowed the euro to rise without restraint and decided they would only consider the problem when the exchange rate surpasses the 1.3500 level. This decision made the exchange rate to the dollar rise by 19.9% within one year and more increases possible.

- February: The dollar kept falling against other hard currencies. The mains cause was the fall in personal expenditure (from 6.9% to 2.6%) and public expenditure (from 1.8% to 0.8%). The US Government planned to issue some US$58 billion worth of T-bills to cover the budget deficit.

- March: The dollar fell further because main indexes looked gloomy. The confidence index fell from 103.8 to 94.4 – the biggest decrease since September 2001. The main cause was the lack of signs of improvement in the job creation. Kenneth Rogoff from the IMF said, "The euro will rise strongly against the dollar and may reach 1.35 – 1.40 at the end of 2005."

April: The fall didn't stop when statistics showed that output of various industries was not on targets. Falls in order placed with companies was 0.9% in January and 0.3% in February. The confidence index fell to 57.6. This showed that the number of new jobs didn't come up to expectations.

May: May 1, 2004 was an important mark for the E.U. with the accession of 10 new members from the East, allowing this bloc to include 25 countries and a population of 450 million. It would become a counterbalance to the U.S., which made the euro rise against the dollar right away.

June, July and August: In this period, the dollar was under the pressure of increasing price of oil. That was why the public showed no surprise at the FED decision to increase the interest rate after four years of continuous cuts. The dollar interest rate rose from 1.00% to 1.25%.

Besides the decision, the investing community also felt unsatisfied with the FED Report that revealed worries about increasing inflation and interest rate.

The growth rate of the second quarter publicized in this period was 3%, that was lower than the planned target of 3.7% and the rate of 4.5% of the first quarter.

In July, the public kept a close watch on the salary scale of non-farming businesses publicized on August 6 in order to assess the possibility of raising the interest rate by the FED in August. This salary scale was considered as the most important data used for determining the credibility of the speech of Alan Greenspan. It was predicted that some 220,000 jobs would be created in July, higher than the unsatisfactory 112,000 level in June.

September: The dollar kept on falling because information about the confidence index and industrial output made investors disappointed. The confidence index in August fell to 98.2 as compared with a 103.5 level suggested by experts. According to some bankers, the dollar would fall drastically if the employment only rose slightly.

October: The dollar fell strongly against hard currencies when reports showed that personal expenditure in America decreased while the personal income rose by 0.4%. This showed that there was some decrease in the market demand, one of the most important dynamics of the economy. The unemployed rose from 18,000 to 369,000, the highest mark in the last seven months. These facts made many people think the September salary scale of non-farming businesses wouldn't be desirable.

November: The dollar fell further because publicized economic indexes didn't come up to expectations and many investors worried about security problems during elections. These indexes also gave no support to the dollar. The growth rate in the third quarter was only 3.7% compared with the expected 4.3% level. The main cause of this low growth rate was an increasing trade gap and low gross investment.

December: The dollar kept falling against other hard currencies in spite of the good news of the increase in the ISM from 56.8 to 57.8 compared with the expected 57.0 mark. This improvement came from an increase from 58.3 to 61.5 of the order index and an increase from 54.8 to 57.6 of the employment index. In the consumption area, the personal expenditure showed signs of recovery increasing by 0.2% in September and 0.7% in October. Meanwhile, the manufacturing and service sectors gained higher growth rate and the labor market seen improvements.

In Europe, an unofficial source revealed that the ECB estimated the European growth rate in 2005 at 1.9% instead of 2.3%. In spite of signs of recovery in the American economy and falls in the euro area, the euro rose to a record level. The exchange rate to the dollar was 1.3370. In this December, the EU Finance Ministers Conference agreed that the current exchange rate is "unacceptable." In reply to this opinion, the US Finance Secretary John Snow suggested letting the dollar determined by the free market.

2. Analyses and predictions

These facts allow us to draw the following remarks:

- The fact that the growth rate didn't come up to expectations of investors makes the dollar fall drastically. This means that investment in the dollar is risky. If the risk is unpredictable, the dollar will fall further.
- The falls in the confidence index means that the American public believed that there were problems with the American economy.
- In early 2004, the U.S. Government planned to issue 58 billion worth of T-bills to cover the budget deficit, which causes investors to think of more falls in the dollar.
- In December when the American economy showed signs of recovery and the euro area didn't gain the expected growth rate, the dollar kept falling. This worrying fact shows that the American economy is in recession, which makes investors think of future falls in the dollar price.
- The dollar could keep falling in the future because of the budget deficit and trade gap. To deal with this problem, the U.S. Government will maintain a weak dollar to promote its export and reduce the import.
- The EU and Japan take no measure to keep the dollar from falling. The ECB also refused to intervene into the foreign exchange market to buy the dollar.

These analyses mean that the dollar will keep falling in spite of the fact that President Bush has declared that the U.S. will support the policy to keep the dollar strong.

3. May the trend change its direction?

We should be cautious about the possibility of further falls of the dollar because:

- The U.S. Government didn't take suitable measures to keep the dollar from falling. What will happens if the dollar falls so drastically that it makes the world lose confidence? The American Government will certainly intervene. This means that:
- The FED will raise the interest rate although it is improbable.
- The FED will buy more dollars or reach an agreement with the G7 as it did many times in the past.
- The fiscal policy will be adjusted by stopping tax cuts.
- Changes in the world arena are in favor of the U.S.

4. Everything could happen

Rises and falls of hard currencies couldn't be predicted exactly, so exporters and importers should take precautionary measures when making or getting payments in the dollar. Companies and investors must be cautious when borrowing in the dollar without using derivatives. If the dollar rises, the debt burden and danger of bankruptcy will be more serious.

Because the VND is tied with the dollar, which makes it lose some external value. This will be an opportunity to promote the export.

In short, the rises and falls of the dollar are determined by cyclical changes in the American economy. The U.S. Government could take measures to intervene when necessary and at any time. So we shouldn't believe too much in future falls in the dollar price because such belief is only suitable to speculators. Companies must refrain from any affirmation when working out the future business plans.■