

ECONOMIC NEWS UPDATE

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It's not easy to separate the good news from the bad

The most important economic news of recent weeks is the recovery of the long-comatose dollar. On a single day earlier this month it recorded its biggest jump against the euro in eight years, before retreating a bit. Sounds like unambiguous good news, since a stronger dollar might lower import prices, which have risen 21.6% in the past year. But economics is never that simple. Here's why.

The good news is that the dollar is showing signs of strength. American consumers, who needed \$200 to buy a pair of Italian shoes, can now step into that footwear for around \$180. And that £200 British cashmere sweater that set American customers back \$400 only a few weeks ago, can be had for only about \$370, assuming

competition forces hard-hit retailers to pass on the savings they rack up when buying abroad. The lower prices resulting from the dollar's strength make it easier for Federal Reserve Board chairman Ben Bernanke and his monetary policy colleagues to resist pressures to raise interest rates during the current credit crunch and economic slowdown, although Fed watchers are wondering whether that resistance will melt in the face of July's rise in consumer inflation: prices soared at the fastest rate in almost twenty years.

The bad news is that the dollar is showing signs of strength. Booming exports, fueled by a weak dollar that makes US goods cheaper overseas, have prevented the economic slowdown from

turning into an actual decline. But a \$10,000 piece of equipment that cost a French farmer only €6,250 when the euro was at its peak and the dollar sagging just one month ago, now costs him close to €6,700, and a Brit wandering into New York's fabulous Mac store beneath the General Motors building will find he needs £540 to buy that \$1,000 MacBook that he could have had for only £500 pounds a few weeks ago. All economics is about what happens on the margin, and these price increases will tip a few French farmers to make do with older equipment, and some Brits -- and Aussies, who also find our stuff about 10% more costly -- to do without a MacBook.

And investment bankers, who have been flogging US companies to foreigners with their high-flying currencies, are finding life a bit tougher. For example, the rise in the dollar has driven the cost of InBev's bid for Anheuser-Busch from about \$52 billion to almost \$57 billion, as InBev's euros buy fewer dollars.

The good news for Americans is that the euro and the pound are weakening. That is making it less expensive for us to visit some of our favorite European vacation destinations. And for businessmen to cross the Atlantic to close such deals as are still being consummated. A £300

London hotel room that cost \$600 now can be had for closer to \$550 -- not a snip, but somewhat less off-putting.

The bad news for Americans is that the euro and pound are weakening. The weaker currencies make it more expensive for Europeans to buy our goods, exacerbating the effect the shrinkage of the EU economies will have on the demand for US exports. France's trade deficit is at a record and its economy is moribund; Germany's economy, the eurozone's largest, shrank in the last quarter; the housing market in Spain makes America's look robust by comparison; Italy's economy is shrinking; the Irish are wondering where the boom that attracted so many foreigners, now fleeing, went; and Britain is headed for mounting unemployment and stagflation, according to the latest Bank of England report.

Not good news for America's exporters, as the economic weakness in Europe more than offsets the attraction to investors of European interest rates that are about twice as high as those set by Bernanke. Jean-Claude Trichet, president of the European Central Bank, is hoping that the "very, very weak" EU economy will cool inflationary pressures and perhaps allow a bit of a rate cut -- which would earn a round of

applause from Nikolas Sarkozy, who has no more patience with central bank independence than he does with free trade.

The good news is that the price of oil is finally coming down, from close to \$150 per barrel, to \$110 or even lower. That has brought the price of gasoline to an average of \$3.86 per gallon, with another 50-cent drop forecast, giving the Fed hope that the lower prices will start to feed through and bring down inflation.

The bad news is that the price of oil is finally coming down. Investors in alternative sources of energy fear that the technologies that America must have if it is to end its addiction to foreign oil will be unable to compete with cheaper oil. And if Americans again begin eyeing those big, comfortable, safe SUVs that are clogging dealers' lots, as they did the last time gasoline prices fell from crisis levels, the recent drops in gasoline consumption will be reversed.

The good news is that construction of new homes has dropped below the pace consistent with population growth, lending support to the view that the inventory glut might be ending, and to Alan Greenspan's prediction that "Home prices in the US are likely to start to stabilize or touch bottom sometime in the first half of 2009." The bad news is that

less construction means more layoffs in the construction industry.

The really good news for the longer-term is that productivity continues to rise at an annualized rate of 2.2%, keeping unit labor costs and therefore prices down. But the bad news is that in the near-term firms can maintain output with fewer workers, leaving those who are in work in a weak position to bargain for higher wages despite rapid inflation.

But don't leap to the conclusion that there are no win-win situations. There are. Banks are unloading tainted assets at knock-down prices to vulture investors who are hoping for substantial profits on the upswing. The banks take big write-downs, but at least seem to be putting themselves in a position to assure potential investors that they now have only quality assets on their balance sheets. That they must do if they are to attract the new equity capital they must have to get their balance sheets in order. Meanwhile, investors who are optimistic and willing to take on the risk of assets that might, only might, increase in value when the credit crunch eases, have an opportunity for out-sized profits. Everyone is happy or, in the case of the banks, at least relieved.

Which is more than you can say for most Americans, 70% of

whom have a gloomy view of the economic outlook.

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