RIO remains negative on the US Dollar and US debt

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The smart money, we are told by the media, is taking big positions on bank debt; their sense is that the banks have been oversold. “It’s not smart to short the United States,” said Buffett. A lot of people – probably most people – believe him. They think that now is a good time to go long on America...and bank debt fits this scenario.

They may be right. We have no opinion on bank debt, but we do have an opinion on the currency in which the bank debt is calibrated – the U.S. dollar. In short, we still feel negative on this currency. It may be going up against the euro, but neither is the euro attractive at present.

The problem with both paper currencies is obvious. When Buffett buys a business, he says he wants a ‘business with a moat around it.’ What he means is that he wants some protection from competition – either a trade secret, a patent, or a brand. Without a moat, outsiders can attack! They may then be able to run you out of business or simply force you to trim your profit margins. Either way, it’s not an ideal position for a business.

The problem with the dollar is that it has no protection at all, and the people in charge have no interest in protecting it. Each new dollar that comes into existence competes with every old dollar. Inevitably, they all fall in value. While this insight is of no particular concern to people who do not hold dollars, it comes as a recurring nightmare to those who have a lot.

Who has dollars?

The current world monetary system is relatively simple, if markets are generalized to their key assets or activities. Arab nations export oil. Europe exports luxuries. Asia exports automobiles and gadgets. America exports dollars as the main currency for trade the US dollar standard trading system! Thus the dollar circulates round the globe. RIO wrote a detailed report on this topic during 2004 forecasting that we could see the eroding of the US dollar trading system and the fact that it would come under additional pressure should our 2004 forecast on the Sub prime mortgage crises be accurate. “As we know it has”

The Treasury Department declares that most of the world’s dollars are now outside the United States; sixty percent of them pass through hands in non English-speaking countries. Much the same is true for U.S. government debt. There is three times as much of it in the hands of foreigners – $2.11 trillion – as there is in the hands of American citizens.

The trouble is as we have stated on many occasions and to quote Buffett, is that there is no moat around this money. It takes a whole chain of supply machinery capital and skilled labor to produce an automobile. An automaker has a moat – because the costs of entering the business are so high. But it takes almost nothing to make a Dollar. And as the greenback sinks in value – thanks to the competition from billions of new Dollars all bidding for the same oil, gold, wheat and automobiles – many of these foreign dollar holders are going to look for other places in which to deposit their wealth.

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