Weaker Dollar could soon be seen!
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It is often difficult to make sense of economic policymakers' frequently convoluted and occasionally obfuscating language. There are times, however, when they say what they mean rather clearly. In my opinion the Fed did exactly this in its September policy meeting statement. While these statements normally contain quite standard language that does not change materially meeting to meeting, last month was an important exception. The Fed chose to add some text which, when placed in context, implies that the Fed now has a bias to apply more unconventional stimulus to the economy. Here is the relevant excerpt:

Measures of underlying inflation are currently at levels somewhat below those the Committee judges most consistent, over the longer run, with its mandate to promote maximum employment and price stability. With substantial resource slack continuing to restrain cost pressures and longer-term inflation expectations stable, inflation is likely to remain subdued for some time before rising to levels the Committee considers consistent with its mandate.

Now if inflation is too low and is likely to remain too low for "some time", then the Fed clearly has a bias to do what it can to try and expedite a rise in inflation. But with policy rates already near zero and the Fed already preventing a natural shrinkage of its balance sheet as securities holdings mature, all that is left is for the Fed to reach further into its toolkit of unconventional policies.

I have commented on my examination of the Fed's various unconventional policy tools in previous reports and concluded that, absent a decline in the dollar and/or rise in commodity prices, the Fed is not going to succeed in increasing the rate of price inflation.

To me this is very clear it is because the money and credit transmission mechanism is the US is broken due to a weak financial sector, excessive household debt and associated high unemployment. I believe that Mr. Bernanke is no fool and as such he knows this. Indeed, in a speech from 2002, he cites currency devaluation as an effective means of policy in the event that the domestic money and credit transmission mechanism breaks down:

…there have been times when exchange rate policy has been an effective weapon against deflation. A striking example from U.S. history is Franklin Roosevelt's 40 percent devaluation of the dollar against gold in 1933-34, enforced by a program of gold purchases and domestic money creation. The devaluation and the rapid increase in money supply it permitted ended the U.S. deflation remarkably quickly. Indeed, consumer price inflation in the United States, year on year, went from -10.3 percent in 1932 to -5.1 percent in 1933 to 3.4 percent in 1934. The economy grew strongly, and by the way, 1934 was one of the best years of the century for the stock market. If nothing else, the episode illustrates that monetary actions can have powerful effects on the economy, even when the nominal interest rate is at or near zero, as was the case at the time of Roosevelt's devaluation.

I would ask members should note that Mr. Bernanke is on the record advocating currency devaluation as an effective means of ending deflation, supporting the stock market and promoting economic growth when interest rates are near zero.

Clearly with interest rates near zero and the Fed already buying Treasuries systematically to prevent any shrinkage in the monetary base, would members agree that a possible conclusion one can draw from the Fed's recent, explicit statement that inflation is too low amidst weak economic activity, is that the Fed is moving closer toward advocating a policy of dollar devaluation as the means to bring an end to deflationary pressures, support the stock market, promote economic growth and contribute to a decline in unemployment?

I would say "advocating" for a reason, in that it is the US Treasury, not the Fed, which has the mandate for US currency policy. Any decision to deliberately devalue the dollar must therefore be made by the Treasury! I would draw member's attention to the fact that this would be expedited presumably on the executive order of the president?

Although I am aware it is possible that an act of Congress would be used to provide additional legitimacy for such action. The Fed, however, would act as the agent, selling dollars in exchange for foreign currency government bonds, most probably those of the euro-area and Japan which are the largest foreign markets but they could use others.

In the event that the euro-area is certainly willing to allow their currencies to appreciate, then the cost of goods imported from those countries into the US is going to rise. The same is true for imports from any country which is willing to allow its currency to rise versus the dollar in this fashion. In time, the US will find that import price inflation is pushing up the prices of consumer goods generally. I believe that US wages are likely to remain stagnant amidst high unemployment, however, it is only when the dollar has fallen far enough to make US workers' wages somewhat cheaper relative to the rest of the world at which point businesses will begin to hire US workers again and unemployment will begin to decline.

If I am correct it is a strong reason to invest in RIO Professional, which could be viewed as wealth protection coupled with the additional benefit of liquidity, in a world in which currencies are no longer reliable bastions of value. Even more compelling perhaps when you consider this funds performance over the past twelve months +31.24%. Finally, the out performance is likely to continue this quarter as fund benefits from multiple trades now in position.

William Gray
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