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Weekly Financial Article for the Week of September 24, 2007

The Falling Dollar, Part 2

What effect does it have at the store, and around the world?

What is a dollar worth these days? In the world currency market, the answer lately is “less and less”. A euro is currently worth about \$1.40, and last Thursday, one Canadian dollar was worth one U.S. dollar, a parity that hasn’t happened since 1976. While the dollar is by no means facing a meltdown, its falling value has some notable effects.

The effect on the economy. A falling dollar contributes to inflation. When the value of the dollar goes down, the prices of imports go up. A depreciating dollar can also inflate the prices of domestic goods and services, because companies that buy raw materials outside the U.S. may have to raise prices on their products.

The effect on the financial markets. As the dollar gets weaker, it entices foreign investors and drives up commodities prices. Oil prices are now at record levels, as oil futures have become cheaper. Gold prices have gone up 16% this year, to a level we haven’t seen since 1980. Copper, silver, wheat and corn prices have all moved north. A weak dollar also makes American products cheaper in other countries, and more attractive to American consumers. That can mean higher profits and better earnings reports for big corporations, and that helps to rally the stock market.

The effect on borrowing. Foreign investors finance a portion of America’s debt. When the Federal Reserve cuts interest rates, that cuts returns on dollar-denominated investments such as U.S. Treasuries. When those returns diminish, foreign investment in U.S. bonds and notes diminishes. Eventually, this increases the cost of borrowing.

Historical perspective. Over the last year or so, the dollar has declined quite gradually. That may promote inflation, but consider that the dollar rose by about 30% between 1995 and 2002 relative to the currencies of America’s trading partners. With that rising value came the ballooning of America’s trade deficit.

Quote of the week. “The use of solar energy has not been opened up because the oil industry does not own the sun.” – Ralph Nader

Riddle of the week. A helium-filled balloon is tied to the floor of a car that makes a sharp right turn. Does the balloon tilt while the turn is made? If so, which way? The windows are closed, so outside air is not involved. (Read the answer here next week.)

Answer to last week’s riddle: ZERO. With a 2/3 chance of drawing a white pair, 5 of 6 socks in the drawer must be white. The chances of drawing two white socks would thus be: $5/6 \times 4/5 = 2/3$. With only 1 black sock, there is no chance of drawing a black pair.
