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THE DOLLAR NOSEDIVE

Why America's Currency Is the World's Problem

The ailing US economy seems to be driving the exchange rate of the dollar inexorably downward, with serious consequences for the global economy. Politicians and central bankers are looking on helplessly as the economic outlook worsens by the day and European companies rack up huge losses.



DDP

Currencies out of balance

It costs about four cents to produce a one-dollar bill -- a pittance, compared to the greenback's influence on the world's economy.

The exchange rate of the dollar can boost the fortunes of companies and entire economies -- or plunge them into crisis. Its rate against the euro fluctuates by a few hundredths of a cent each day. But in the past five years that fluctuation has more often than not taken the US currency on a downward trajectory, causing consternation -- and now despair -- among people around the world.

Last Thursday, Thomas Enders, the CEO of Airbus, gave a speech to employees in building 261 at the consortium's production complex in Hamburg. He was there to tell them that a pain threshold had been reached. The graph he had projected on the wall revealed the horrifying progression of the dollar over time. The US currency has lost 13 percent of its value against the euro since the beginning of the year. Conversely, the euro has risen in value, and for a short time last Friday it even approached

the symbolic \$1.50 threshold.

According to Enders, the rate at which the US currency is falling makes "reasonable processes of adjustment" a virtual impossibility. Every cent the dollar drops against the euro costs Airbus €100 million. This has even the normally optimistic Enders alarmed. "It's life-threatening," he told his audience.

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But he declined to say how Airbus would react, that is, whether layoffs would exceed the 10,000 currently planned or whether the company will be forced to close some of its plants. Apparently even he doesn't know what will happen yet.

Like so many in politics and business, Enders hasn't a clue what to do about the decline of the dollar, still the world's reserve currency. The speed of that decline is especially worrisome. In the last 10 weeks alone, the dollar has lost 12 cents against the euro. Jean-Claude Trichet, the president of the European Central Bank, says that he already recognizes "brutal movements" in the international monetary structure.

Meanwhile, the price of oil is reaching record highs. A few years ago, anyone who would have predicted a euro exchange rate of \$1.50 and an oil price of close to \$100 a barrel would have been ridiculed as a notorious pessimist and prophet of doom. Either of these two numbers alone would have seemed sufficient to force the global economy to its knees.



But now these two pieces of horrific news are appearing in tandem, and yet the world economy continues to grow. Even stock prices on the world's



AP

The European Central Bank in Frankfurt: "Brutal movements" in the international monetary structure

markets have remained surprisingly high.

And yet every dollar increase in the price of oil and, especially, every cent the dollar loses in value heightens fears of the seemingly inevitable consequences, and fears that global growth could slow and, in an extreme scenario, even come to a grinding halt.

The world depends on the dollar. It is the most important currency in global trade. Aircraft, oil, steel and most natural resources are priced in the US currency. Central banks around the world invest a substantial share of their currency reserves in dollars. The competitiveness of entire continents depends on changes in the value of the world's reserve currency. For these reasons, the dollar's decline has the potential to send the world economy into a crisis.

Americans have been living beyond their means for years. That includes both consumers, who often buy their houses, cars and other consumer items on credit, and the government, which is adding billions to the national debt to pay for its programs, especially to fight terrorism and wage the war in Iraq.

For a long time, this constant borrowing wasn't a problem, because the United States enjoyed a virtually limitless credit line abroad.

But that confidence is now gone. Once the US real estate bubble burst, it became clear just how shaky the foundation of the country's economic growth really is. Banks around the world could very well end up writing off hundreds of billions of dollars in bad debts. A number of major international banks have already fired their top executives for making overly risky investments.

The world's lenders have become cautious, making it increasingly difficult for American consumers and businesses to borrow money. Consumer spending and investment, the two main pillars of the US economy, are faltering.



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Graphic: War Costs

This development has US critics and enemies alike practically dancing in the streets. "The realm of the dollar is collapsing," said Venezuelan President Hugo Chavez last week, implying that the United States itself would be next. Iranian President Mahmoud Ahmadinejad was quick to ridicule the US currency as nothing but "a worthless piece of paper."

But what the US's detractors apparently fail to realize is that the aftershocks of a US economic quake will also reach their countries. The Europeans, on the other hand, are already concerned about the fallout.

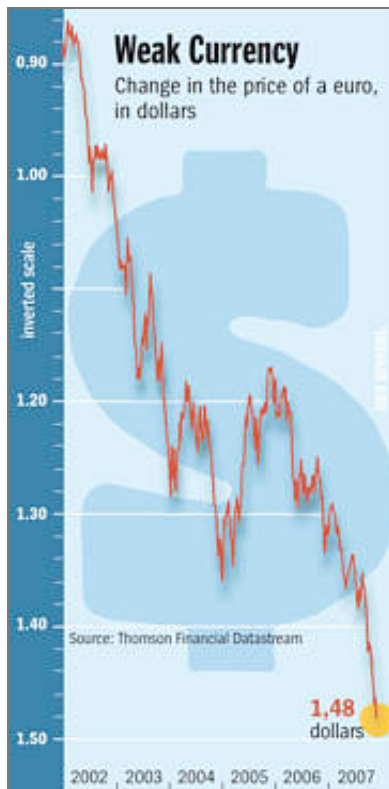
The German government has remained diplomatically low-key, although Chancellor Angela Merkel has said that the low price of the dollar is problematic for German exports. Merkel's comments reveal a shift within the coalition government of Social Democrats (SPD) and Christian Democrats (CDU) in Berlin. Only a few weeks ago, Finance Minister Peer Steinbrück (SPD) could hardly contain himself as he praised the advantages

of a strong euro. The high exchange rate reduces Germany's oil bill, Steinbrück argued enthusiastically, adding: "I love a strong euro."

That love affair has apparently faded. Steinbrück and Economics Minister Michael Glos, a member of the CDU's Bavarian sister party, the Christian Social Union (CSU), have recently become noticeably reticent on monetary issues. Glos has taken to offering mumbled excuses, for example, that he has already taken current exchange rate developments into account in his outlook for the German economy. But this isn't quite true. The government's economic experts based their forecast on a euro exchange rate of \$1.40, a

level that has long since been exceeded -- and that even staffers within Glos's ministry don't expect to return anytime soon.

Steinbrück's experts are also taking a much more cautious approach these days. In an internal memorandum, they recently warned that a further rise in the euro would be "noticeably detrimental to competitiveness, growth and employment in Germany."



Graphic: Weak Currency

French President Nicolas Sarkozy has made himself even clearer. He suspects that American politicians are deliberately using the weak dollar to improve the export prospects of American industry and weaken European competitiveness. It wouldn't be the first time. In the early 1970s, the then-Treasury Secretary John Connally openly confessed: "The dollar is our currency, but your problem."

To meet the challenge head-on, Sarkozy told the US Congress that Washington should do something to strengthen the dollar -- or else risk an "economic war."

US President George W. Bush is hardly likely to be impressed by this sort of talk coming from Old Europe. He has proven himself, once again, a master of ignoring the obvious, behaving as if the dollar problem were nonexistent. "The policy of this government is a strong dollar," he says, adding, "we believe that the marketplace is the best place to set the exchange rates."

It's a risky strategy, both for the United States and the world economy. That's because the market is no longer confident in the strength of the US economy. Ben Bernanke, the chairman of the US Federal Reserve Bank (Fed), knows this and is considerably more skeptical than his president. He warns that a continuing dollar crisis will result in higher inflation, declining consumer spending and lower growth rates.

Not too long ago, the Fed predicted 4 percent growth for the US economy in 2008. On Tuesday of last week, it scaled back its US economic growth forecast for the coming year to between 1.8 and 2.5 percent.

The current state of the US economy, says Klaus Kaldemorgen, the head of Germany's largest mutual fund company, DWS, reminds him of Japan in the early 1990s, when it slid into a recession lasting more than a decade. "In truth, America will have to sink even lower than that," says American economist Michael Burda of the Humboldt University in Berlin. "The country is in a serious dilemma. I expect a deep recession."

During Bush's term in office, the national debt has climbed to more than \$9 trillion. The US president has turned the \$236 billion budget surplus he inherited in 2000 into a deficit now approaching \$250 billion. And at close to \$760 billion, the balance of trade deficit makes up more than 6.5 percent of the US gross domestic product (GDP). "If the crisis continues well into the coming year," says Burda, "it may very well assume proportions like the worldwide depression in the 1930s."

For many economists, the fall of the dollar also symbolizes America's decline as a global economic power. China could take on this role at some point in the future. The problem is the transitional period, in which one power is weakening and the other is not yet capable of slipping into its shoes.



The potential dangers are so great because there have rarely been so many uncertainties in the world's monetary structure. No economist can confidently predict whether the dominance of the dollar, which provided relative stability in international trade after the end of World War II, is now coming to an end. And no one knows what happens next. Could the strengthened euro take on the dollar's role as the international reserve



AFP

The US Federal Reserve in Washington: The world depends on the dollar.

currency? Or will the euro and the dollar share the task until, one day in the future, an Asian currency outpaces both Western currencies?

This changing of the guard would not be unusual. Every era has had its reserve currency. When the Roman Empire dominated the world, the silver dinar took on the role. In the early modern age, it was the Dutch guilder, followed by the pound sterling, which dominated the globe until the decline of the British Empire following the two world wars. The dollar has been the world's reserve currency ever since.

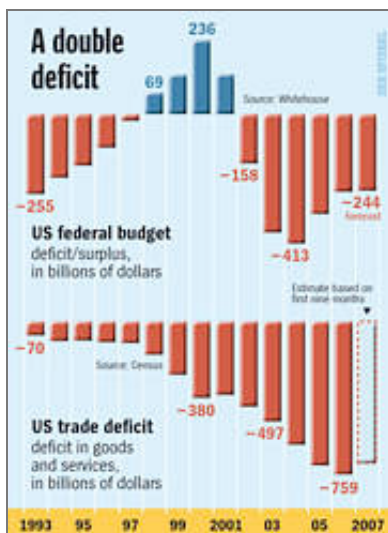
The dollar era began on a specific date. On July 22, 1944, 730 delegates from 44 countries met at a conference in Bretton Woods, a resort in the US state of New Hampshire. At the Mount Washington Hotel, the group decided what the world's monetary system would look like after the war. John Maynard Keynes, the great British economist, who led the British delegation at Bretton Woods, proposed the establishment of a sort of artificial currency that would be valid worldwide. It was a brilliant idea -- in theory. But the Americans, under the leadership of then-President Franklin D. Roosevelt, won out in the end.

Under the Bretton Woods agreement the dollar, tied to a fixed quantity of gold -- \$35 per troy ounce -- would be at the center of the postwar global economic order, while other currencies would derive their value from the dollar. If an individual country's currency became too strong or too weak in relation to the US currency, its central bank would intervene by buying or selling US dollars.

That was how the system worked, until 1971, when President Richard Nixon cancelled the US guarantee to redeem dollars with gold. The problem was that by then the dollar had become too popular, so that the volume of US currency outside the United States exceeded the country's gold reserves. In March 1973, the world's central banks decided that they would no longer intervene, and the Bretton Woods system came to an end.

Many feared at the time that countries would simply continue to devalue their currencies, thereby improving their companies' export prospects. This had already happened once before, between the two world wars, when it drove the world economy into a fatal crisis.

But the new freedom between currencies was more effective than expected. The elimination of the central banks' controlling roles allowed the strength of an individual economy to determine which nation would assume monetary leadership in the world. And that country, thanks to its enormous economy, was clearly the United States.



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However, currencies did continue to fluctuate considerably, while politicians attempted to reduce the magnitude of these currency swings with words. Meeting in New York in 1985, the finance ministers of leading economies talked down the dollar in the Plaza Agreement. Only two years later they signed the Louvre Agreement to prevent the dollar from crashing. But from then on the US dollar, despite its highs and lows, was the measure of all things -- as it has remained to this day.

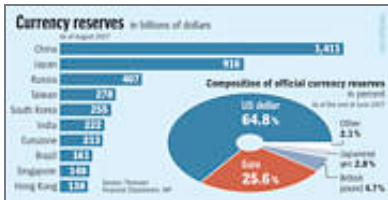
The dollar's dominance holds great appeal for Americans. They can continuously print green bills and sell them abroad without driving up inflation in their own country. They can go into debt to pay for things like the Iraq war or enjoy the benefits of tax cuts. This attitude has led to a record US national debt of \$5 trillion.

At the same time, Americans have enjoyed the luxury of consuming more than they produce. The balance of trade deficit has been growing for years -- from roughly \$80 billion in 1990 to a projected level of more than \$700

Graphic: A double deficit billion in 2007. This is more than 5 percent of the country's GDP.

America paid for its economic boom in recent years by borrowing money. Its current double deficit is the monetary evidence that the world's biggest economy has been living beyond its means for years.

The whole thing only works because a special system of giving and taking has developed, a mechanism that flies in the face of every economic theory. For years, huge amounts of capital have been flowing from poorer emerging economies into the United States, the richest nation on earth. This influx of foreign capital, most of it coming from the Far East, amounts to roughly \$2 billion a day.



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The central bank in Beijing, for example, has accumulated enormous hard currency reserves from the country's export business. China holds the astonishing sum of more than \$1.4 trillion in its reserves. The Chinese have invested most of their money in US Treasury Bills, a low-risk but also relatively low-return investment. In doing so, they have kept the dollar high and their own currency low, ensuring that their exports remain competitive.

Graphic: Currency reserves

While Asia finances America's excessive consumer spending, the Americans buy Asia's cheap T-shirts, cars and flat-screen TVs. "Getting this much into debt while at the same time enjoying returns on long-term government bonds of less than 5 percent -- I'd call it the biggest free lunch in modern

economic history," says Harvard historian Niall Ferguson, referring to the audacity with which the Americans take advantage of their privileges as holders of the world's reserve currency.

Rarely has the world economy been so out of whack or have global imbalances been greater. The Americans were the world's financiers for years. Today they are its biggest borrowers, while the Asians serve as America's bank.

It's obvious that this does not bode well for the long term. For years, economists and politicians have been warning against an impending crash. Now it seems that the time is ripe for this to happen.

The dollar's plunge in the last 10 weeks is a sign that America's pact with East Asia has become fragile. The Asians have become far less willing to buy dollars and Treasury bills. As the countries of the Far East become increasingly impatient with the United States, they have begun shifting their reserves to euros.



REUTERS

Lenders are unwilling to simply look on as the value of their US Treasury bills drops; they have already lost billions upon billions in recent weeks. The dollar's share of worldwide currency reserves has shrunk from 80 percent in the 1970s to about 65 percent today. China, Russia and Malaysia have already partially uncoupled their currencies from the dollar, and Kuwait plans to follow suit in May 2008. Many oil producers are now distancing themselves from the US currency, both for economic and ideological reasons.

Investment bank Morgan Stanley considers it unlikely that Saudi Arabia would abandon its peg to the dollar. But according to a recent study, smaller Gulf states could follow Kuwait's lead: "This could deal yet another psychological blow to the dollar" -- and to America, that once-proud economic power.

Hotel in Dubai: Oil producers are now distancing themselves from the US currency

The nation is deeply uneasy, as the collective head scratching begins over the causes of the crisis. Many Americans feel by now -- and justifiably so -- that their future could be far gloomier than the present.

In her book "A Year Without 'Made in China': One Family's True Life Adventure in the Global Economy,"

author Sara Bongiorni describes the average American's mixed feelings when he or she walks into the nearest supermarket. "When I see the label 'Made in China,' part of me says: good for China. But another part feels a rush of sentimentality, because I've lost something without exactly knowing what it is."

The experts know what it is. What America has lost is nothing less than a substantial share of its production base. The industrial economy left the country's shores and the service economy arrived, but it is incapable of filling the gap.

The impressive growth figures the US economy has been achieving for years offer nothing but the illusion of a prospering economy. This growth is based primarily on Americans' rising consumer spending, which in turn is paid for in large part with credit or the sale of assets. To put it simply, the Americans are eating their past for breakfast and devouring their future for dinner.



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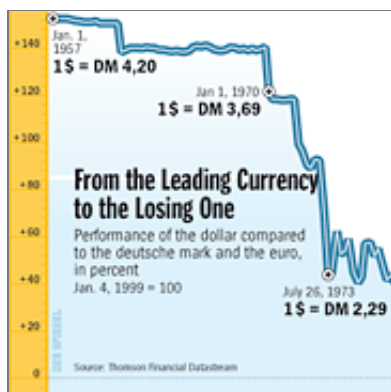
Graphic: US household debt

The savings rate is practically nonexistent. US foreign debt grew by about \$1 billion a day in 2006, and it now exceeds \$2.5 trillion. Private American households now owe about \$13 trillion to lenders at home and abroad. Thirty-six percent of this debt was created within the last five years. Americans can no longer afford much of the present.

The only thing that has doubled in the seven years of the Bush administration is the country's military budget. By comparison, the average US family income has stagnated in the last decade or so.

It has been a long time since the country has been able to report successes in foreign trade, which in Germany represents an important pillar of the economy. America's share of global exports has been cut in half since 1960. The value of the dollar is ultimately a number that represents the sum of all of these transactions. It is an indicator of the direction the economy is taking, and for years that indicator has been pointing downward.

The dollar has lost 24 percent of its value against the euro since the European currency was introduced. Brazilian supermodel Gisele Bündchen, beautiful, blonde and apparently far from unintelligent, announced, through her manager and twin sister Patricia, that she prefers to be paid in euros instead of dollars in the future.



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Graphic: From the Leading Currency to the Losing One

America today is a country largely deprived of its industrial core. Today's American factories are located across the border in Mexico or Asia. Their products may be "Conceived in America," "Sold in America" or "Designed in America," but the term "Made in America" seems to have gone the way of the dinosaurs.

IBM moved its PC production to the Far East long ago. Apple's iPod is produced in iPod City, a Chinese factory town that is home to more than 120,000 low-wage workers. Even clothing manufacturer Land's End, which sells its customers a piece of down-home America along with its clothing, produces its wares in China's industrial Pearl River Delta.

A large share of the toys, food products, furniture and cars being produced today come from Japan, Taiwan, South Korea and China. Wal-Mart, Home Depot and Safeway, three of the country's major shopping chains, are practically satellites of the Asian export industry. According to Lou Dobbs, one of CNN's top journalists, America is in the process of outsourcing itself.

Presidential candidate John Edwards routinely condemns the "shipping out of American jobs."



US industry today isn't even capable of satisfying the demands of the country's consumers. The once proud industrial nation is little more than a



DPA

Chinese shoe factory workers: Americans buy cheap consumer products from the Far East and the Asians buy dollars.

skeleton of its former self. Nowadays the production chain, from suppliers to production facilities to service personnel, spans the globe. The world economy is booming and the profits of US corporations are exploding, but American workers have been left out in the cold.

What Germans call structural change is in fact structural fracture in America, where it has turned many citizens into victims. The former industrial centers in the country's northeast are now referred to as the Rust Belt. Gary, in the state of Indiana, is one of the most glaring symbols of America's industrial decline.

On the shores of Lake Michigan 20 minutes south of Chicago, Gary was once the heart of the American economic miracle. In the days when Gary was the home of the world's biggest steel company, the running joke was that US Steel was so hard up for workers that it would even hire dead people. The company attracted workers from around the world, and Gary's steelworkers pumped prosperity into America.

US Steel has moved its headquarters elsewhere and has severely cut back its Gary operations. The market for steel is booming, but the industry is now in Indian, not American, hands. Gary itself has become a ghost town. Once a city of 200,000, half of its population has since left for greener pastures. Many businesses along Broadway, the city's main drag, are boarded up today, as shadowy figures walk the streets, their grey hooded sweatshirts pulled up to conceal their faces. Gary is not America, and yet many Americans have the sense that America could soon look a lot more like Gary. Indeed, Detroit, the center of the US automotive industry, is already headed in Gary's direction.

Detroit is the home of the US's Big Three automakers: Ford, Chrysler and General Motors. They are still making cars, but what these companies are really producing are losses in the billions. Detroit's automakers have reported combined losses of more than \$23 billion since 2005 alone. Today Japanese competitor Toyota is the world's biggest and most valuable automotive company.

As car sales decline so do wages, harming the economy as a whole. After weeks of negotiations between automakers and the unions, the new hourly, entry-level wage for autoworkers was finally announced: \$14. Most cleaning women in Washington charge more for their services.

In the days of Henry Ford, the prospects for Detroit's workers were decidedly better. The founder of the Ford Motor Company doubled his workers' wages to \$5 a day. In 1914, Ford was quoted as saying that he wanted to turn his workers into car buyers. The *Wall Street Journal* wrote at the time that Ford's wage increase was "immoral," and that he was practicing Christian values "where they don't belong."

The *Wall Street Journal* is a lot happier with the new \$14 an hour entry-level wage today, but workers are not. Until now, the average cost of employing a Detroit autoworker amounted to \$70 an hour, because it also included both pension insurance and lifelong health insurance. But corporations are now trying to shed and outsource their wage costs. "We keep giving and giving," says union leader Jim Stoufer. When asked where he thinks his wage concessions will end, Stoufer shrugs his shoulders. "We need our jobs. We want a future."

In return for this vague outlook, the unions representing the autoworkers at Chrysler, Ford and General Motors were also willing to give up company-paid health insurance. In return for stock in the auto companies, the unions themselves will assume the risk of healthcare costs in the future. This will likely make the United Auto Workers (UAW), with its 16 percent share of Ford, the company's biggest shareholder in the future.

The situation in Detroit is mirrored throughout America, where many corporations are simply eliminating their company health insurance plans. Partly as a result of these changes, 16 percent of the US population -

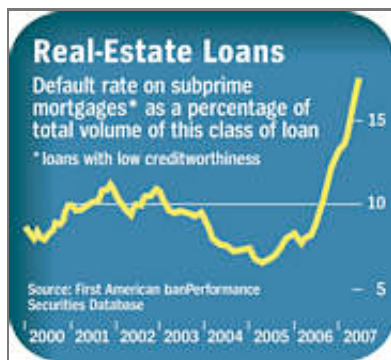
- 47 million people -- now lives without any health insurance whatsoever.

The industrial meltdown and declining wages have caused serious damage to the US economy. The new service sector jobs are generally lower paying, and they produce no exports. The concept of the working poor has become a mass phenomenon in America.

The crisis for the real estate market is both a direct result of general weakness in the economy and a cause of further weakness. It is now becoming abundantly clear that the banks have generated the growth of recent years with loans that will likely turn into bad debt.

The so-called subprime loans -- to borrowers with poor or nonexistent credit -- may look like mortgage loans, but in reality they are nothing but a modern form of speculation. They are wagers on the future of the lower middle class and on rising real estate prices, and they represent a market already worth more than \$1 trillion in America today.

According to recent figures, 20 percent of US mortgages were issued to borrowers with extremely poor credit. In 2001, that number was only 5 percent. The industry's motto today might as well read: "My home is my house of cards."



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What has now happened was inevitable. As the economy declines, the first to go are its lower wage earners -- often the holders of subprime mortgages. As energy prices rise and disposable income shrinks, consumer spending is bound to head south.

Real estate prices have been falling for some time. As home values fall below the principal on many mortgages, borrowers default on their loans and mortgage lenders are forced to take huge write-offs. More than 20 mortgage lenders have already filed for bankruptcy. Citigroup, the world's largest bank, is slipping into a financial disaster that could run into the billions.

All of this depresses America's currency, but a weak dollar also has its advantages. Some US corporations that may have outsourced jobs in the past, to Canada, for example, are now planning to bring production back to the United States. And thanks to the weak dollar, many companies that would otherwise have a hard time remaining competitive are achieving unexpected successes on the world market. One of them, the Terex Corporation, a manufacturer of construction equipment, was able to double its workforce at one of its plants to 3,000 workers, because exports, to Europe in particular, are booming.

These advantages could tempt US politicians to continue to look on as the dollar falls. But because the dollar is the reserve currency and not just any currency, all they are doing is exporting their problems to the rest of the world. Europe's export industry has already been affected.

Two industries with central importance for the German economy are suffering from the weak dollar: the aviation and automotive industries.

Together Airbus, Daimler, BMW, Volkswagen, Porsche and their suppliers employ more than 700,000 people. These companies play a key role in making Germany one of the world's leading exporters. But it is precisely this success in global markets that also makes them so susceptible to currency fluctuations.

Airbus, with its Power 8 restructuring program, is in the process of reducing its costs by €2 billion a year by 2010. This will mean the sale of 7 of the conglomerate's 16 European plants and the elimination of 10,000 jobs. But these steps were intended to keep the company competitive at an exchange rate of \$1.35 per euro. But that was yesterday's exchange rate. Today one euro is worth almost \$1.50.

Of course, Airbus could be made far more efficient by abandoning the politically motivated division of labor

among Spaniards, British, the French and the Germans and assembling aircraft wherever it makes the most sense economically: the giant A380 in France and the A320 family in Germany.

But the executives seeking to streamline Airbus are currently running a race with the US currency that they cannot win. For instance, it is already a great step for Airbus' Germany headquarters in Hamburg that productivity in portions of final assembly in the plant there has improved by 40 percent since 2005. It may be a step in the right direction, but it is still far too small to offset exchange rate losses.



AP

Airbus supporters Sarkozy and Merkel at the company's French headquarters in Toulouse: a running race with the US currency

The dollar will have fallen even farther and forecasts been thrown off kilter long before Airbus's cost-cutting measures have taken effect. Every cent by which the euro exceeds \$1.35 costs the company €100 million in revenues. A rate of \$1.50 a euro translates into losses of €1.5 billion for Airbus.

Of course, the financial managers at Airbus and other companies have sought to offset the expected weak dollar with hedging transactions -- by buying options that guarantee a fixed exchange rate for their dollars in one or two years. This is nothing but a temporary stopgap measure. If the US currency continues to plunge as severely and rapidly as it is now, European companies will not have enough time to react with the usual adjustment mechanisms.

Airbus can hardly counteract the trend by laying off workers and closing factories. Its order books are full and its workers are working extra shifts to keep up with the demand. Wage cuts will also be insufficient to offset exchange rate losses.

It is now time for Airbus to take a step it should have taken years ago: The company needs to shift some of its production to the United States. It was worse than careless of executives at the European aerospace company not to have done this long ago. Airbus is more dependent on the US currency than almost any other European enterprise. And it is more vulnerable than most to turbulence in the foreign currency markets.

In addition to lacking aircraft assembly facilities in the United States, Airbus also purchases far too few parts in the dollar zone. Even if Airbus CEO Thomas Enders decides to change this situation, it will be a long time before new suppliers can be found and a possible US plant can begin operations. Until then the company is likely to face substantial losses, forcing it to postpone investments in new aircraft. Airbus's ability to compete with Boeing will suffer as a result.

The German automobile industry is better prepared for currency fluctuations. Years ago, BMW and Mercedes-Benz built plants in the United States, where they produce and assemble cars, especially SUVs: 100,000 at BMW and 170,000 at Mercedes-Benz. But this isn't enough to offset the consequences of the declining dollar. Both companies still sell many vehicles in the United States that are exported from Germany. And even the vehicles they assemble in their respective plants in Tuscaloosa, Alabama and Spartanburg, South Carolina require engines, transmissions and axles made in Germany.

Munich-based BMW lost €666 million (\$983.5 million) last year because of the weak dollar. The company has responded with plans to expand its US production volume to 200,000 vehicles.

Martin Winterkorn, the chief executive of Volkswagen, plans to decide soon whether his Wolfsburg-based company will build a plant in the United States. But his decision has practically been made for him. With almost all experts assuming that the dollar will continue to fall, VW can hardly afford additional billions in losses in the US market. Pulling out is not an option, either. VW's only likely option will be to build a plant in the southeastern US where it can produce roughly 200,000 cars a year.

So far German carmakers and machine builders have not had to cut jobs in Germany when they open new factories in the United States. But it is clear that even if these companies continue to grow, they will hardly

be creating any additional jobs in Germany. Instead, the new jobs will be going to Asia or the United States, which is fast becoming the land of cheap currency.

The fact that the dollar crisis has not affected Germany, one of the world's major exporters, more seriously than it has is because most German exports go to other European countries. Only 13 percent of German exports end up in the dollar zone.

So is the situation not as bad as it looks? It may not be. But no one knows whether the dollar will continue to fall -- or, if it does, how rapidly.

Individual companies are already hard hit, especially small to mid-sized companies that have not adequately offset their expected dollar revenues and that lack the big corporations' resources to build factories in the United States. But all other industries will also feel the effects of a worldwide economic slowdown in the wake of the dollar crisis.

Some experts hope that an opposing movement will begin in the foreign currency markets, as it did more than three years ago, when the euro kept rising, and it was only a matter of time before it would reach the \$1.40 mark and then the \$1.50 mark, or even, as experts feared, would climb to \$1.80.

But the exchange rate suddenly stopped climbing at \$1.40, when speculators cashed in and unloaded their call options. The dollar recovered and the specter of a crash seemed to have been averted.

Now it's back. Nothing has really changed since then. The Americans -- the citizens and government alike -- continue to live beyond their means. And economists agree that as long as this continues, the tendency will be for the dollar to lose value.

But opinions are divided over what happens next. There are three possible scenarios. Which of them becomes reality will depend on whether the participants behave more or less rationally -- or whether panic breaks out.

In the best-case scenario, the dollar's decline will slow down. Americans will tighten their belts, saving more and spending less. Imports will decline while exports grow, because American goods will be cheaper and more competitive. The foreign trade deficit will shrink and the dollar's fall will end.

Perhaps the Chinese will even agree to a revaluation of their currency.

The world economy will settle into a new equilibrium. But even in this case it will suffer, as all experts have scaled back their forecasts for the coming year. Nevertheless, they still expect positive growth rates. This is not what a recession looks like.



AFP

If the subprime crisis worsens, so too could the US and world economies.

This could change if -- in the second scenario -- the subprime crisis continues to grow, possibly expanding into consumer loans. In this case -- when the "infection spreads," as a leading German banker puts it -- banks would be forced to make far more drastic value adjustments. Not only would this poison the spending climate, but it would also undermine foreign investors' confidence in the US economy. This in turn would lead to a far more substantial slide in the dollar's value, and probably a crash on the markets, which are still at surprisingly high price levels today.

This would deal a double blow to the German economy. Not only would it adversely affect exports to the United States, but the damage to the world economy would be so substantial that it could no longer be offset by booming Asia. The Asians are still driving the global economy today and there are no signs of looming crisis in their own economies. If a US recession affects the economies of these nations, they too will reduce their orders for German goods, more than likely leading to a recession in

Germany.

The first two scenarios are based on the assumption that the affected countries remain levelheaded. But what happens if the dollar just keeps on falling? What if fear of a permanent decline in values spreads in all of those countries that have accumulated vast quantities of the US currency in the past few years, countries like China, Japan and the Asia Tiger states, as well as the oil-exporting countries and Russia? What if panic breaks out and the new mantra is to "get out while you can?"

If that happens -- and this is the horror scenario -- the dollar will crash and, along with it, the international financial markets. Then the globalized world will be in a worldwide depression. This scenario is less likely, because promoting it cannot be in anyone's best interest. And yet it cannot be ruled out completely, as even the most sensible bankers privately concede.

A key role now falls to China. Ironically, this (officially) communist state now has the power to determine whether the bastion of capitalism will implode. If China were to unload even just a portion of the dollar reserves it has accumulated over the years onto the market, the dollar's exchange rate would crash.

But in doing so China would inflict great harm on itself. Its remaining reserves would be almost worthless, and who would be able to pay for the vast quantities of consumer goods its factories pump out every day? Both sides, the Americans and the Chinese, benefit from the current system, which provides the former with cheap consumer goods and the latter with dollars in abundance.

FROM THE MAGAZINE



Nevertheless, this mechanism appears to be reaching its limits. Recognizing this, Western politicians have been urging the Chinese leadership for years to abandon the artificial undervaluation of its currency, but with little success. Aside from a few minor revaluations, nothing has happened so far.

Jean-Claude Juncker, the chairman of the Euro group of euro zone finance ministers, traveled to Beijing this week to urge the Chinese to revalue the yuan once again. German Chancellor Angela Merkel said in an interview last week on the N24 television station: "We are working internationally on achieving a reasonable balance among currencies."

But the work she referred to consists of little more than visits and appeals, because what is lacking is a set of suitable instruments to ensure that actions can follow words. Most of all, however, there are serious doubts that the Americans are interested in a strong dollar in the first place.

Senior officials in the German Finance Ministry strongly suspect that the US policy -- as it was in the 1960s and 70s -- is systematically oriented toward reducing the value of the currency through higher inflation, thereby reducing the country's debt to the Chinese and other Asian nations. According to a high-ranking official in the Finance Ministry, exchange rates of \$2 per euro are possible in the medium term, even if, as some conjecture, there is a short-term correction next year.

"From the US's perspective, there is little pressure to do anything about the weak dollar," says Michael Heise, chief economist with German insurance giant Allianz. "Pressure on the government and the Federal Reserve will only grow if there is a true crisis of confidence in the currency and the flow of capital begins to ebb as a result." But this is a risk Heise doesn't see materializing, not yet, at least.

Because the Americans are apparently unwilling to take any steps against the weak dollar, there is growing support for the Europeans to take a more proactive approach and boost the US currency by buying dollars and selling euros on the currency markets. "The ECB (European Central Bank) must make it clear that it will not accept a continued rise of the euro and could even intervene," says Gustav Adolf Horn of the Düsseldorf-based Macroeconomic Policy Institute, a group with ties to trade unions.

However, interventions in the foreign currency market are usually effective only if all central banks cooperate, as happened seven years ago. Securities dealers are only impressed when they notice that all

major players have joined forces. Then they no longer have the confidence to bet on a declining dollar. Those who speculate against the combined power of the central banks have rarely walked away as winners.

But the central banks and their governments are a long way from the necessary unanimity. The Americans, most of all, would not play along.

Besides, there is disagreement over whether interventions would even be effective in the current situation. Joachim Poss, the deputy head of the Social Democrats parliamentary group in the German parliament, believes "an attempt to bolster the dollar could dissipate all too quickly."

The reason being that there are enough countries that are simply waiting for the right opportunity to shift at least some of their dollar reserves to euros. If the ECB intervened against the dollar, there would be great temptation in these countries to take advantage of higher dollar prices to buy euros.

"Additional dollars would enter the markets again, which would fully or partially eliminate the intended stabilization," says Poss.

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Rarely has the ECB been as powerless as it is today. It can do nothing against the weak dollar, nor can it perform its real task of protecting the intrinsic value of the euro. Inflation in Europe rose above the target level of 2 percent some time ago, which should have prompted the ECB to raise interest rates. But this would make the euro even more expensive against the dollar -- and do even more damage to the economy.

For this reason, many economists fear that the ECB can do nothing but follow the Fed's example and continue reducing interest rates. But this sort of monetary policy has its price: higher inflation.

This leaves politicians and central bankers with little choice but to take a helpless wait-and-see approach -- and hope that the end result will not be quite as bad as many fear.

Klaus-Peter Müller, the CEO of Germany's Commerzbank, also hopes that things will turn out better than anticipated. He expects the euro to fluctuate between \$1.50 and \$1.60 over the next 12 months, but adds that this is "not very optimistic."

But many observers take a completely opposite view of this outlook. They call it highly optimistic.

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Translated from the German by Christopher Sultan

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