Sorry Mr. Trump, you can't make America great again and have a weak dollar

By Ian McGugan

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Donald Trump is discovering an awkward truth: When it comes to waging currency wars, it is awfully hard not to shoot yourself in the foot.

The U.S. President rocketed to power by thundering that China is a currency manipulator and declaring that Federal Reserve chair Janet Yellen should be "ashamed" of herself for keeping rates artificially low to boost the economy and the Obama administration.

This week, Mr. Trump executed U-turns on all those positions. China, it turns out, is not a currency manipulator after all. Low rates are just dandy. And Ms. Yellen? Gosh, she's actually a fine person who just might be reappointed to her job, he told the Wall Street Journal.

The President's brand-new opinions may be a welcome sign that reality is, at last, penetrating the White House. But the education of the leader of the free world remains a work in progress. For evidence of that, look to his assertion that the U.S. dollar is "getting too strong."

The pronouncement sent waves rippling through currency markets as traders tried to figure out what the comment portended. Could Mr. Trump be signalling a major shift in the strong-dollar policy that has ruled Washington since the mid-1990s? Could he be mulling a new international pact designed to weaken the greenback? Could he be signalling a new currency war?

Maybe. But he could just be displaying, once again, his lack of economic polish.

The fundamental issue he faces is that his vow to make America great again is also a pledge designed to drive the dollar higher.

Think about it: If the U.S. economy picks up speed, interest rates will climb in response. Higher rates would then make Mr. Trump's America an even more powerful magnet for foreign capital seeking good returns. And, everything else being equal, that inflow of global funds would drive up the value of the greenback.

"When it comes to the dollar, Donald Trump is his own worst enemy," Barry Eichengreen, an economist at the University of California, Berkeley, wrote in the Financial Times in January.

Prof. Eichengreen, a renowned economic historian and former senior adviser to the International Monetary Fund, pointed out that Mr. Trump's stated priorities – tax cuts plus greater spending on infrastructure and defence – are designed to raise demand for U.S. goods.

"With the economy near full employment, other spending will have to be diverted to foreign goods. Further appreciation of the dollar, which makes imports cheaper, is the market mechanism by which this shift in the direction of private spending is induced."

There is no obvious way out of this dynamic, Prof. Eichengreen wrote. If, for instance, Mr. Trump slapped tariffs on Mexico and China, the trade barriers would divert U.S. spending toward domestic supply. But in an economy nearing full employment, a stronger dollar would be necessary to shift spending toward foreign sources and prevent the added demand from stoking an outburst of inflation.

To be sure, while Prof. Eichengreen does not mention it, one scenario could conceivably rein in the greenback.

It's an outcome, however, that seems directly at odds with what Mr. Trump has promised: It would consist of a world in which other countries begin to grow faster, perhaps even faster than the United States itself. If that were to happen, other central banks would feel pressure to raise rates and that, in turn, would help to attract capital away from the United States, weakening the U.S. dollar.