The United States sees strength in a weakening dollar

By David Parkinson

January 24, 2018 – *The Globe and Mail*

The United States may have just unpacked a new weapon in its protectionist trade war: its own currency.

The U.S. dollar slid to three-year lows against a basket of leading global currencies on Wednesday after U.S. Treasury Secretary Steve Mnuchin told a news conference at the annual gathering of global economic heavyweights in Davos, Switzerland, that "obviously, a weaker dollar is good for us as it relates to trade and opportunities."

While there is certainly some truth to his assertion, it's nevertheless a shock to hear it from the mouth of such a high-ranking official. It's been more than two decades since the U.S. government has expressly supported a weak dollar. Unless he was talking totally out of school – which itself would be an unnerving faux pas – this could represent a tectonic policy shift.

It should be noted that the statement came at a time when the U.S. dollar has been on a downward slide for months anyway, as the rest of the world's economy starts gaining momentum. And there's nothing particularly wrong with a government watching its currency undergo what is, essentially, an overdue correction and saying, "Hey, that's the market, we're okay with it."

But it's the current U.S. trade-policy context in which Mr. Mnuchin made his comment that should give us pause.

The U.S. trade deficit with the rest of the world is an obsession with President Donald Trump, and he campaigned hard on fixing it. The main focus of his ire has been the North American free-trade agreement, but he has found that rewriting it to his liking is a very hard sell indeed with his trading partners, who have dug in their heels. The President, a self-proclaimed great negotiator, is finding it difficult to negotiate his way to a new U.S.-friendly balance in global trade.

It's against this backdrop that the Trump administration has now voiced its support for a weaker U.S. dollar on one of the world's biggest stages. This suggests the possibility of a new tack in Mr. Trump's quest to reverse the trade deficit: Allowing the dollar to slide to the benefit of U.S. exporters – at the expense of trading partners and competitors. It also could signal that the U.S. may wield the threat of a competitive devaluation to put pressure on its trading partners to bend to its will, one way or the other.

The U.S. has done this before. In the 1980s, it threatened protectionist trade actions on multiple fronts, complaining (as it is doing today) that the global trading deck was stacked against it. The result was the Plaza Accord of 1985, in which the world's five biggest free-market economies agreed to a co-ordinated effort to devalue the U.S. dollar. Within a few years, the U.S. trade deficit was reduced by half.

It seems unlikely that the U.S. could pull that off again. The U.S. dollar isn't nearly as overvalued as it was at that time. And with many of the world's leading economies still in the relatively early stages of recovery, it's unlikely they would agree to inflate their own currencies, regardless of U.S. trade threats.

However, simply by voicing support for a weaker U.S. dollar, the Trump administration may help accelerate the downward trend that is already under way in the currency. Given that major currency corrections have a way of snowballing – and, commonly, of overshooting

what is considered fair value – nudging the dollar a little further down that slope could actually help the U.S. achieve a currency-fuelled reversal in its trade imbalance much more quickly than via the long, uncertain slog of a trade-pact renegotiation.

But the administration's voicing of its support for a weaker dollar will only get it so far. The greenback, as the world's dominant reserve currency, has a life of its own – well beyond the reach of the administration. If the United States is actually going to pivot to pursuing a weaker dollar as a core element of its "America First" trade policy, it would be a big help if it had the co-operation of its own central bank, the Federal Reserve; the Fed's interest rates exert a much stronger influence on the currency than anything the President or his cabinet might say or do.

The Fed is supposed to be independent from the elected government – and for good reason: Manipulation of monetary policy for political reasons is a proven route to economic folly. For sophisticated, advanced economies, it's considered a non-starter.

But the Trump administration is not your typical government of a sophisticated, advanced economy. The President has already declined to re-appoint Janet Yellen to a second term as Fed chair, the first time in almost 40 years that a Fed chair did not serve two terms. When her term runs out early next month, she will be succeeded by Jerome Powell – Mr. Trump's personal selection.

Would the administration put pressure on the new guy to toe the line on a low-dollar policy, by at least slowing the pace of rate hikes? Would the Fed bend to this pressure? Would Mr. Powell stand firm, putting his monetary policy at odds with the economic agenda of his own government?

The prospect is deeply disconcerting. And while we're a long way from any of that coming to pass, the arrival of a weak-dollar policy, from an unpredictable administration, has opened the door to such risks. In uneasy times, things just got a little uneasier.