



INDIAN RIVER STATE COLLEGE

“The International U.S. Dollar “

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First, let's get started with the nature of the US dollar. It's Fiat money no, not the car. That means that the dollar isn't backed by gold or silver but by "The full faith and credit of the US Government." (How does that make you feel)? And our currency is issued by the Federal Reserve System, a public-private partnership.



Virtually all major world currencies are “fiat” that is not backed by gold or silver. The next most important world currency is the Euro and it isn’t even issued by a country – rather by a currency union consisting of 19 European member countries and administered by the European Central Bank.



There are many “versions” of the “US Dollar” (some are 1 to 1 others not).



The US Dollar The World Currency For International Trade & Reserves

- The US Dollar accounts for 90% of the \$5.3 trillion a day in foreign exchange transactions.
- 80% of world trade finance is conducted in US Dollars.
- Accounts for 62% of the reserves of World Central Banks.
- 52% of overseas government and corporate finance is in USD.
- More than 63% of world commodity markets conducted is USD.
- The Eurodollar market averages \$140 billion each day in transactions.



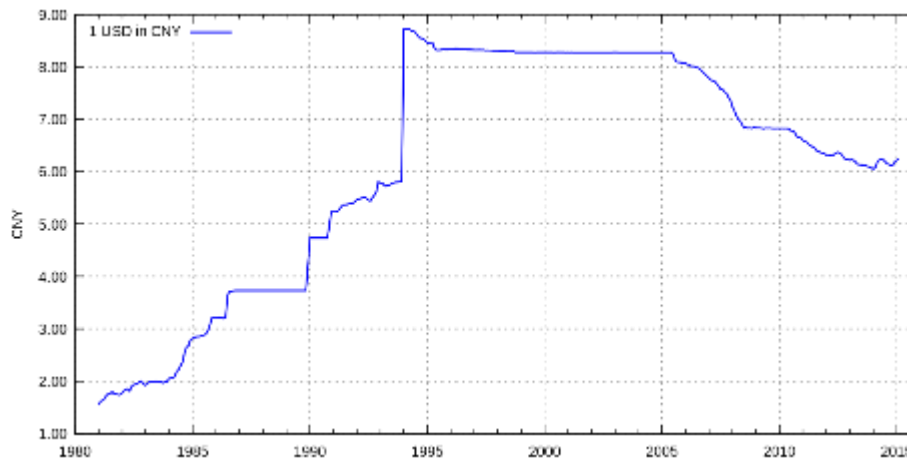
The US Dollar is Dominant in Spite of Unprecedented US National Debt Levels

- World public and private investors have increased ownership of US financial assets from from \$1 trillion in 2000 to \$5.6 trillion today!
- Even as US public debt balloons to \$18.4 trillion, that's \$57,222 per citizen or \$154,512 per taxpayer,(compared with US GDP of \$ 17.4 trillion), world investors continue to favor US Government securities. Why??



The World Linkage to the US Dollar is Remarkable

- First some fun – 75% of US \$100 bills are held overseas and 50% of \$50 bills are held outside the US. Why?
- The USD is used as the official currency in Ecuador and Zimbabwe as well as the BVI, Anguilla and T&C Islands.
- Other countries directly link their currencies to the USD including: the EC Dollar, Bermuda, Bahamas, & Hong Kong
- Other countries including China link their currency to the USD though the linkage is flexible around a defined band.



So, Why is the USD Dominant? What's the Prognosis?

- The USD is the currency of the largest economy in the world.
- The Federal Reserve, the issuer of US currency, is mostly independent from political intervention and seen as a professional, predictable custodian of the USD.
- US Financial markets are widely respected as open, competitive and liquid. NYSE trades more than \$40 billion each day.
- The US is widely seen as the ultimate safe haven for financial assets – the flight to “quality” and “liquidity.”

- *NYSE Floor*



So What's the Competition to the US Dollar?

- The Euro is the most likely candidate. It's the currency of 19 of 28 members states of the European Union but many more countries peg their currencies to the Euro. It is administered by the European Central Bank (ECB).
- The Euro has the highest combined value of banknotes and coins in circulation. (It's worth \$1.10 most recently)
- The Eurozone is the second largest economy in the world.
- But the Euro is a currency managed by a “committee of nations.”
- Recent problems with Greece have called into question the stability of the currency.



Well how about the Chinese Currency? That's a Very Large Economy With Major World Trade

- The Yuan is the currency of Mainland China. Its name means “people’s currency.” Trade is more that \$4tn annually.
- The Yuan has been pegged to the USD over a narrow trading band. It was recently slightly devalued leading to worldwide financial concern. (\$1.00 is worth 6.36 Yuan)
- It is the 5th most traded world currency.
- But the Yuan isn’t fully convertible and there are significant capital controls in place.
- The currency is seen as the creature of the Chinese Government.



How about other currencies?

- There isn't much to choose from:
- The British Pound Sterling was the world currency in the 1800's, but the British economy is only the fifth largest national economy today.
- The Japanese economy has been in the doldrums for decades, so the Yen isn't a prospect.
- The Swiss Franc is a stable currency but the Swiss economy is too small to support a major world currency.
- Canada, Australia and NZ are smaller commodity dependent economies.



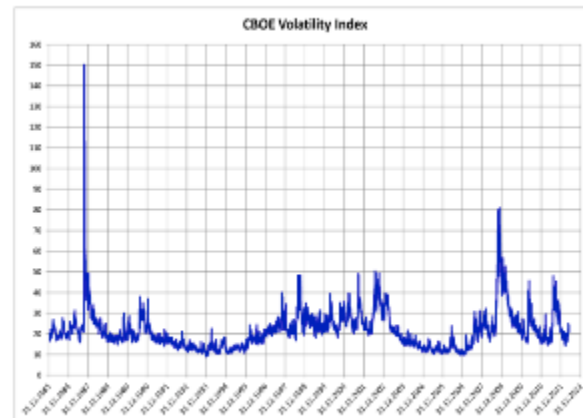
So the World is Stuck with the International US Dollar (and We are Too).

- US Monetary Policy (such as interest rates) has worldwide influence. The Fed is the Reserve Bank of the world economy.
- The USD is probably “overvalued” due to the demand for safe US financial assets (government securities and bonds).
- So US trade suffers because our goods are relatively more expensive on the world market as our currency appreciates.
- If exports suffer then employment suffers.
- Imports are cheaper but it’s harder to convince many in the public, labor unions and politicians that trade is good (and that is bad).



The World Economy is Dynamic and Volatile

- Recent events, following the slowdown in the Chinese economy, have produced an outflow of funds from developing economies and a “flight to safety” and “liquidity” to US government securities and US stocks and bonds.
- Commodity prices have plunged. The price of oil has dropped more than 50% measured in US dollar terms.
- The Fed can’t make up its mind about raising short term interest rates, with one year T-bills earning only .23% per annum.
- The world financial markets are very volatile.
- The role of the USD is center stage



Finally (At Last).....

- Whether we realize it or not, we are all affected by economic forces that we need to understand to take advantage of opportunities, make prudent investments and avoid career pitfalls.
- Economics is more than a requirement for your degree -- it's an opportunity to acquire the tools to more effectively manage you and your family's future.
- **The opinions expressed herein are mine alone.** Except I suspect that most all faculty members (especially economists) will agree with my first two points!
- *Coast Guard HH65 hoisting.*
- *Safe Boaters won't need this!!*

