Authers' Note **Markets**

Authers Note: The dollar: tragedy or farce?

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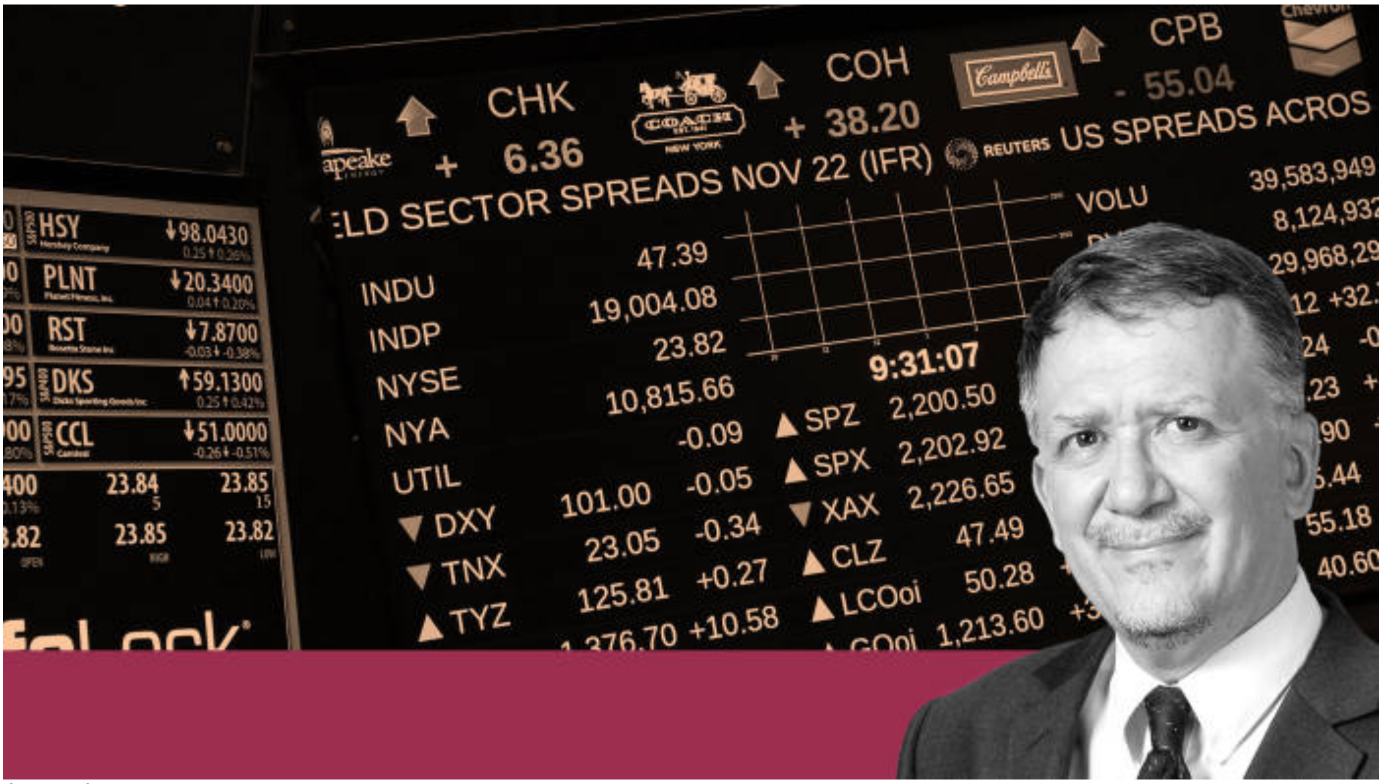

John Authers
A DAY AGO

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The year-old US administration has many critics, on both left and right, but they often seem to find it hard to agree on a criticism. For some, the Trump regime is a tragedy in the making. For Ross Douthat, a Conservative columnist for the New York Times, Trump is more farce than tragedy. After the past two days of garbled communications on the dollar, I suspect that many foreign exchange traders will tend to agree — with the rider that it could easily turn out to be both.

On Wednesday, the Treasury secretary Steven Mnuchin arrived in Davos and made some comments about the dollar that could be called anodyne, or revolutionary, according to taste. "Obviously, a weaker dollar is good for us as it relates to trade and opportunities," he said. "Longer term, the strength of the dollar is a reflection of the strength of the US economy and that it is, and will continue to be, the primary reserve currency."

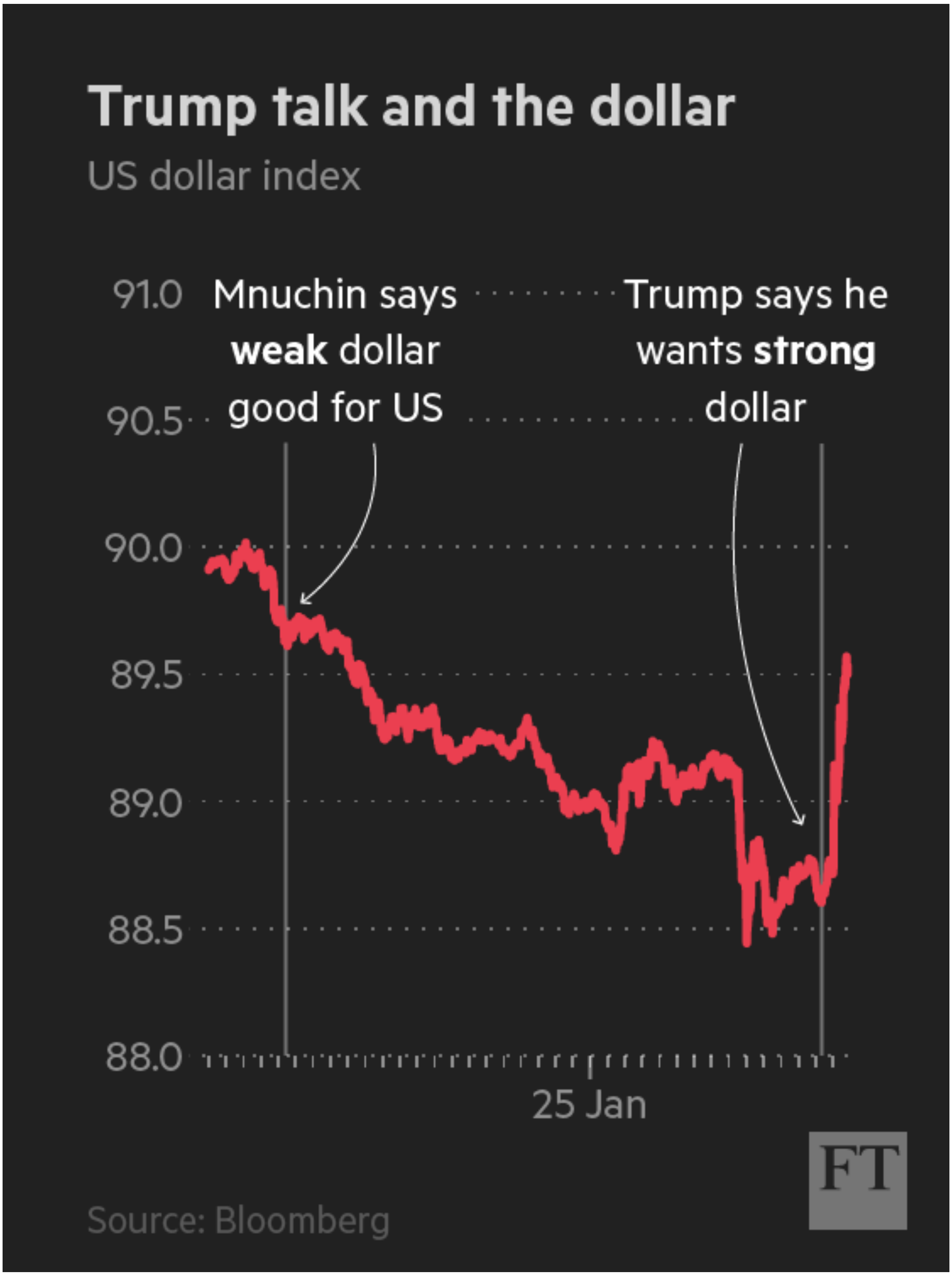
It is hard to disagree with any of this, but the first sentence was reported far, far more widely than the second. Many traders appear almost to have sold the dollar as soon as they reached the end of the first sentence before moving on to read the next one. Wednesday saw the dollar drop to a three-year low. As I tried to say in Thursday's Short View, there is obviously far more to the dollar's ongoing decline than Mr Mnuchin's comments, but they plainly moved the markets on Wednesday.

By Thursday, Mr Mnuchin's candour had earned a rebuke from the European Central Bank's Mario Draghi, who said that the eurozone's central bank "would not target our exchange rate for competitive purposes", and added that the ECB's concern was "broader than simply the exchange rate, it was about the overall status of international relations right now". Expressed less diplomatically, the worry was that an administration that was prepared to threaten a currency war almost by accident would do so.

How to get out of this mess? Our own columnist Larry Summers, a former US Treasury secretary himself, offered some useful advice. On his next public appearance, Larry said, Mr Mnuchin should say something like: "An economic truism about trade is not a policy pronouncement. I believe, like my predecessors, that a strong dollar is in the national interest. That is all I have to say on the subject."

But as it turned out, Mr Mnuchin's boss was prepared to help him out. Early on the Thursday afternoon, he told CNBC: "The dollar is going to get stronger and stronger and ultimately I want to see a strong dollar." A year ago he had complained that the dollar was "getting too strong", partly because people had so much confidence in him, but now he saw a strong dollar as part of his ambitions for the US: "Our country is becoming so economically strong again and strong in other ways, too." He added that he had read a transcript of his Treasury secretary's remarks and they had been taken "out of context".

The result was an instantaneous rebound for the dollar, which rallied by a full percentage point. A chart of these hectic hours of trading makes for good entertainment:



The strong dollar prompted an equally instant and drastic sell-off in the US stock market. At its worst the S&P 500 had shed more than $110bn in market cap since Mr Trump's intervention — equivalent to wiping out the value of an entire Netflix.

As my colleague Matt Klein points out, there is room for sympathy with the president here. He is often pilloried for wild, misjudged, offensive or simply untrue comments. The financial markets never seem to care. On this occasion, Mr Trump's intervention was sensible, truthful and accurate in every particular way. Mr Mnuchin had indeed been taken out of context. And yet once the president told the statesmanlike truth, the US stock market sold off on him. Let us hope that the lesson he derives from this is not that he should be less truthful and statesmanlike in future.

That said, the past two days have been farcical. There are precedents for presidents and their Treasury secretaries failing to keep in step on the dollar. Most famously, back in 1987, Ronald Reagan often repeated that: "A strong dollar means a strong America." When his Treasury secretary, James Baker, appeared on Sunday morning talk shows to threaten the German authorities by saying "either inflate your mark, or we'll devalue the dollar", the next step has gone down in history. The Black Monday crash came the next day.

But somehow this incident seems to suggest that the players are not ready for prime time. It should not be underplayed. Deutsche's Alan Ruskin thundered about the significance of what was occurring before the president's intervention:

> *Will January 24th go down in currency folklore as "The Davos Divorce" in much the same way as we remember the Plaza and Louvre Accords? Yes, in our view, unless Treasury Secretary Mnuchin beats a hasty retreat from comments he has made in the last two days. It could not be clearer from the Draghi post-ECB press conference, that the US and Europe are at greater loggerheads over how to communicate about currencies than any period since the late 1980s.*

After warning that it is much easier to talk a currency down than talk it back up again, Mr Ruskin made clear how great the stakes are:

> *[T]he US economy really does not need this extra FX boost to add to the fiscal stimulus. Mnuchin's actions add to risks of overheating, even though the Fed will almost certainly counteract the reflationary impulse. However, it is less about economics than it is politics why the US will over the longer-term lose any currency war. What is at risk is the US's authority in esteemed institutions and global forums, most obviously when encouraging more flexible currency regimes and arguing against currency manipulation.*
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> *Currently, the main difference Mnuchin can argue about his verbal intervention actions and those countries the US could accuse of currency manipulation, is the US is a long way from intervening and selling USD. Intervention is by far the most overt signal of FX manipulation. Many of the countries that intervene, are relatively small economies that are much more open than the US. One ready made retort to a US accusation of manipulation is to explain they are only intervening (buying USD) as their way of offsetting US verbal intervention! "America First" applied to currencies, can either be a rush to the bottom for all currencies in classic beggar thy neighbor world; or, in more benign fashion encourage intervention by large open economies to avoid their currencies appreciating.*
>
> *What is certainly at stake here is the G20 world order to avert currency manipulation across the developed and developing world. The G20 forum at least as it relates to currency manipulation, has been running with growing success since 1999. Ironically the Trump Administration's tactics on trade appear to have helped limit some Asian country intervention over the past year. The Mnuchin comments risk undermining these gains that the Trump Administration can rightfully claim as their own.*

This could yet turn into a tragedy. For now, however, I will go with farce. Trump and Mnuchin could yet turn into another great American double act, if we can work out who is on first:

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