

Chapter One



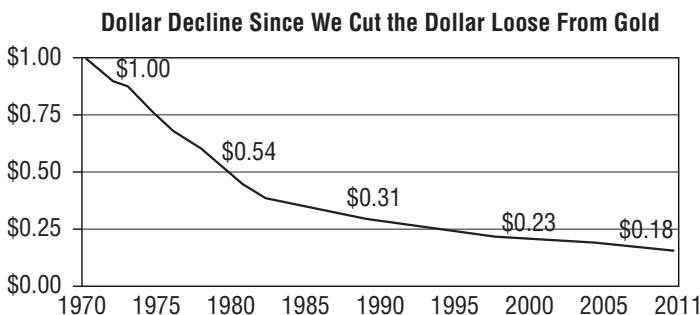
Dollar Decline

How Did We Get Here?

THINK THE DOLLAR HASN'T declined?

It has lost 80 percent of its purchasing power since 1970—the year before the great experiment of cutting the dollar loose from a fixed value in gold.

Back in 1970, if you just stashed a dollar coin under the mattress, today you'd find it buys you less than two dimes worth of goods. That doesn't even cover the price of a postage stamp or a can of Coke. It's practically worthless. (See Figure 1.1.)

Figure 1.1 The Dollar Deflated by the CPI

Source: See Testimony, Lewis E. Lehrman, March 17, 2011, before Congress.

Our currency is in a turbulent flux that's gotten worse and worse as the decades march on.

Today's dollar purchases five cents of what it purchased in the 1930s. Think that's too far back? Consider the 1980s. Today's dollar purchases only 50 cents of what it did back then.

But there will be critics who tell you that purchasing power isn't the only measure of currency strength.

Dollar's Popularity Doesn't Protect It

The U.S. Continental Congress created the U.S. dollar by an act of its own power in 1785. They hoped it would compete with the Spanish currency, which was the popular legal tender at the time.

Sure enough, here we are in 2012, and the U.S. dollar is now a victim of its own success. It's America's most successful export ever—more successful than Levi's, chewing gum, or Coca-Cola. No export is more popular. Let's look at the hard numbers.

Approximately two-thirds of U.S. dollars are held *outside* of the United States: 85 percent of global trade is made with the U.S. dollar. But all that stands to change.



I think the role of the U.S. dollar as the world's primary reserve currency will be gone in a decade. The foundation of our financial franchise, the US\$ brand is trust. That's trust in our determination not to debase the world's primary exchange mechanism—the world's primary store of liquid wealth. We no longer deserve the trust, and are rapidly debasing the brand.

—Rick Rule, Sprott Asset Management

The euro is the second most popular currency in the world's beauty pageant, although it's taking a pretty ugly beating as we enter 2012. Still, about 26 percent of the world's monetary reserves holdings are denominated in this 17-nation currency.

We'll cover the details in later chapters, but for now, let's look at a few tremors we've tracked that predict an earthquake ahead for the U.S. dollar.

The Old Lady of Threadneedle Street to USA: You're Toast

Let me introduce you to my friend Ralph Benko, of the American Principles Project. We first met at the watershed October 2011 Heritage Foundation Conference on "The Stable Dollar: Why We Need It and How to Achieve It."

At the end of 2011, Ralph told *Forbes* readers, "The world dollar standard's death certificate arrives in the mail this week."

He's referring to a paper issued officially on December 20, 2011, by the Old Lady of Threadneedle Street—aka the Bank of England.

The Bank of England, as you can guess from the nickname is *the* staid, prosaic, conservative bunch on the block of central bankers.

So it's no surprise this working paper hides its revelation under the dull title, "Reform of the International Monetary and Financial System." But here's the dollar bomb: The world was better off when the world's currencies were tied to the dollar and the dollar was tied to gold—however tenuously.

To understand the dollar's future, it's important to understand the dollar's past.

By now, we have a vast cornucopia of dollar-denominated debt securities. The scale of these markets is unprecedented. The bigger the market the lower spreads it can offer, making deals here the most attractive.

There are also plenty of ways to hedge dollar exchange rate risk (which will be part of the solution set you'll learn about in this book). It's the reason why everyone from corporations to governments and central banks consider it a great currency for doing business. Finally, it's a safe haven that benefits from there being a lack of superliquid, high-volume alternatives. Australia, for instance, has recently made a reputation for stability, but it simply accounts for too small a slice of global financial transactions.

So, basically, the U.S. dollar just so happens to be winning the beauty contest among the ugliest world currencies.

Another friend, resource expert Rick Rule, agrees. "The only reason," he says, "we still enjoy the status that we enjoy globally—and the benefits of seigneurage—is that other societies have proven even better at debasement than we have. Basing your brand on the attribute of being the least bad has been a consistently faulty strategy."

How do you know when your branding campaign isn't working? When consumers start buying from your competitors in increasing numbers. The same principle is at work with currencies.

Increasingly, we'll have to compete for our dollars to be used, bought, and saved.

Here's an early sign.

Russia and Iran Are Ditching the Dollar

The two countries will carry out their trade with each other using rubles and rials. Add that to the list. China and Russia abandoned the greenback in their bilateral trade more than a year ago.

The big rumble is that the Middle East will follow suit. Imagine if they no longer trade oil in U.S. dollars. It won't just be Iran as some "alternative" bourse. Plans are at work for a Gulf States cooperation, including Saudi Arabia and Abu Dhabi.

This shouldn't be too surprising, given that the United Nations itself has called for a "new global reserve currency." Why? They say it's dangerous to allow us the "privilege" of building up our massive trade deficit.

"Pretty soon," says EverBank's currency guru Chuck Butler, "having the reserve currency of the world isn't going to be such a big thing, if all the commodity trade isn't settled in dollars!"

Chuck is definitely in the camp that questions the safe haven currency status the dollar holds.

He doesn't blame any country for wanting to remove dollars from their reserves. After all, the dollars have lost so much value over the years.

Sure, he points out, it is the most liquid currency in the world, but if countries keep taking dollars out of the terms of their trade, how much longer can it remain the most liquid currency?

It's a real conundrum that any dollar earner (and investor) needs to be aware of. It doesn't mean we'll lose the world's preferred currency status today, tomorrow, or even next year.

Eventually, though, there will come a time when the world's nations will stop adding U.S. dollars to their already swollen coffers. They'll demand something else instead.

We would argue, like the Old Lady of Threadneedle Street, for something that looks a lot more like Bretton Woods.

We're betting other nations (especially the gold-hoarding ones we'll explore in later chapters) would totally agree.

Let us put a period on this by ending with the comment from England's central bank researchers. The Bretton Woods era "stands out as coinciding with remarkable financial stability and sustained high growth at a global level."

Sounds pretty nice, doesn't it?

They go on: "the solid growth outcomes were not simply the result of post-war reconstruction efforts." They say that in fact, GDP growth was actually stronger in the 1960s than it was in the 1950s.

Makes you wonder: What went wrong?