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Market Scan

Fed Doing In The Dollar

Ruthie Ackerman, 03.06.08, 8:04 PM ET

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The Federal Reserve is caught in a dilemma: stimulating the slowing economy with low rates risks giving free rein to inflation. As it squirms, the U.S. dollar continues to weaken against the euro, highlighting the divergent monetary policies of the Fed and the European Central Bank.

So what will the Fed do?

On the one hand, the Fed has to address U.S. consumer weakness and the financial markets, which have been in virtual freefall in recent weeks, says Georges Yared, chief investment strategist at Yared Investment Research. Lowering interest rates between 50 and 75 points at the next meeting on March 18, if not beforehand, would calm the jittery credit and equity markets. On the other hand, Yared says, investors are buying up commodities including oil, gold, silver and platinum as a hedge against inflation and low interest rates. "It's a delicate balancing act," Yared said. "The Fed has to decide which is a bigger urgency."

Right now, it looks like stabilizing the consumer and credit markets is the Fed's biggest task, which means one thing: more rate cuts. Once the credit market and consumer confidence is stabilized, Yared said, supporting the dollar will become an easier thing to do.

The Fed has already slashed rates by 225 basis points in order to try to stop the economy from sliding into a recession. Word on the street is that it will cut rates again, possibly even before the next meeting.

Meanwhile, European Central Bank President Jean-Claude Trichet dampened speculation Thursday that an interest rate cut is in the cards--bad news for the dollar with the euro reaching new heights. The euro hit another record Thursday against the greenback following Trichet's comments, rising to \$1.5380 intraday.

Trichet said there is "strong upward pressure on inflation" at a press conference in Frankfurt, indicating the ECB is likely to leave its key rate at a six-year high of 4.0%.

While the ECB seems willing to accept a strong euro and dampened exports in order to keep commodity and food prices in check, the Fed is prepared for a weak dollar and possible inflation to spur growth.

The euro has appreciated 17.0% against the dollar in the past year, weakening European export growth.

The dollar also lost ground against other major currencies, dipping to a session low of 102.66 yen on Thursday, down from 103.96 the day before,

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and to 1.0007 Swiss francs, down from 1.0007.

Yared says the dollar is likely to weaken more.

Investors seem to be dumping greenbacks for commodities. The dollar's weakness has helped send oil prices skyrocketing well above \$100 in the past few weeks.

Light sweet crude rose 95 cents to a new record Thursday at \$105.47 per barrel after an unexpected decline in U.S. crude supplies and a widely anticipated decision by OPEC not to increase production.

Gold fell Thursday, but remains only about \$20 away from the important psychological mark of \$1,000 an ounce.

Reuters contributed to this article

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