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Dollar Market Update

The Dollar Stares into the Abyss

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As the dollar leaves behind the support in the 84 - 85 area on the index, the rate of decline is accelerating. The big questions now, of course, are "How far will it drop?" and "Are we in for a full-blown dollar crisis?" The simple answer to these questions is "a very long way" and "yes," respectively. Various factors are coming together to propel the dollar into a decline of seismic proportions that is expected to destroy its status as the world reserve currency and create conditions of economic crisis in the United States.

The United States is a country that has been living way beyond its means for a long, long time, and has been able to get away with it until now because of the dollar's reserve currency status, and also because of the curious appetite of foreigners for US assets and securities. The massive inflows of capital from the rest of the world, currently running at about \$1.5 - \$2 billion a day, have enabled US consumers to go on consuming in a low interest rate environment as the deficits have snowballed to massive levels. This is clearly a game that can only continue as long as confidence is maintained, confidence in the dollar, and confidence in the US. Vast quantities of US debt and dollar financial assets have been created and ingeniously packaged and marketed to foreigners who are right now waking up to the harsh reality that they have been played for suckers and are about to get stuck with this atrophying junk. They have delivered goods and services in the expectation of eventual fair payment, and are right now being defrauded out of a sizeable percentage of their earnings by the falling dollar. In this sense, the US government is laughing up its sleeve as the gullible foreigners learn about the sophistications of high finance the hard way. While these foreigners may be a bit slow, they are not completely stupid - the writing is on the wall and the race is on to offload dollars and dollar assets to whatever clowns will buy them, while there's still a chance. Due to the staggering quantity of these assets worldwide, there is clearly an acute risk of a vicious circle of forced liquidation creating a downward spiral, possibly of biblical proportions.

There is another dimension to the dollar crisis now almost upon us that should not be overlooked or underestimated, and that is the effect of the tremendous loss of esteem and respect from the rest of the world that the United States once enjoyed, until just four years ago. It seems like an age ago that Bill Clinton was President in the relatively

trouble-free times of the 90's. Bill Clinton was a very likeable personality and was very popular around the world. His reputation was besmirched by the affair with the intern, but many people largely forgave him for it, especially as the economy was apparently doing well. Unfortunately, the global reputation of the US has plummeted since that time, for reasons that are well-documented elsewhere, with the result that attitudes towards the US are hardening, so that consideration of the impact on the US of heavy selling of dollars and dollar assets will be much less of a factor in the decision to liquidate than would otherwise have been the case, and there are some countries, of course, that would be pleased to see the damage wrought on the US by a dollar crisis.

The rest of the world are the US' creditors and therefore have a lot of power. The rest of the world hold a lot of US dollars and US dollar denominated assets, and might just decide to sell them, fast. This is, I believe, a potent factor that will greatly exacerbate the dollar's decline and lead to a much more serious dollar crisis.

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