

Greenspan warns trade gap cannot grow 'forever'

Fed chief's remarks send dollar, stocks tumbling

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Federal Reserve Chairman Alan Greenspan sent global financial markets reeling Friday with an unusually direct reminder that the massive U.S. trade deficit "cannot continue to increase forever."

Greenspan's remarks to a conference of bankers in Frankfurt, Germany, pushed the dollar sharply lower against other major currencies. For many traders, the comments confirmed the widely held view that U.S. policy-makers favor a weaker dollar, which should help prevent the trade deficit from growing even more rapidly.

Stock and bond prices fell on the view that Greenspan's warning implies that higher interest rates will be required to continue attracting the overseas investment needed to finance the twin U.S. trade and budget deficits.

"We see only limited indications that the large U.S. current account deficit is meeting financing resistance," Greenspan said.

"Yet net claims against residents of the United States cannot continue to increase forever in international portfolios at their recent pace," he said. "It seems persuasive that, given the size of the U.S. current account deficit, a diminished appetite for adding to dollar balances must occur at some point."

Greenspan's comments triggered another round of dollar selling by currency traders. The U.S. currency fell to its lowest level in four and a half years against the Japanese yen and nearly nine years against the Swiss franc. It also fell to a near record low against the euro, which was up 0.8 percent to \$1.3055.

Treasuries sold off further after Greenspan essentially confirmed the Fed's intention to continue raising short-term interest rates, as it has been doing steadily since June.

"Rising interest rates have been advertised for so long and in so many places that anyone who has not appropriately hedged his position by now, obviously, is desirous of losing money," Greenspan said in response to a question after his speech.

Greenspan's speech came on the eve of the annual meeting of finance ministers and central bank governors from the G20 group of rich and emerging market nations in

Berlin, which will focus on issues of financial stability. While the falling dollar helps the prospects of U.S. producers, it makes life more difficult for export-reliant European businesses.

The dollar's 30 percent tumble over the past few years has stirred concern about a potential dollar rout that could destabilize the global economy. That dollar has fallen sharply since the Nov. 2 election on concern about the U.S. current account deficit, now running at an annual rate of \$664 billion, or 5 percent of gross domestic product.

Financial stability is on the agenda of the G20 meetings and would provide a forum for the major economies — United States, the euro zone, Japan and China — to hammer out any deal.

Currency issues are not on the formal agenda, though officials said they could be discussed on the sidelines.

While the dollar's drop is heightening risks for the euro zone's economic recovery, European Central Bank President Jean-Claude Trichet, speaking at the same session as Greenspan, steered clear of addressing the euro's climb. He merely repeated his usual line that "brutal" foreign exchange rate moves are unwelcome.

Greenspan's speech was all the more remarkable because officials of the Fed, which is independent, generally refrain from commenting on currency policy, which is the province of the U.S. Treasury.

"It's remarkable," said Jason Bonanca, director of foreign exchange research at Credit Suisse First Boston in New York. "In the short term, I think what he's calling for here is a weaker dollar, even though he's tightening (monetary policy). I think this is a watershed."

Treasury Secretary John Snow and other officials have said repeatedly that the U.S. favors a "strong dollar" whose exchange rate should be set by flexible, free markets. Currency market participants generally ignore the "strong dollar" mantra, noting that the administration has done nothing to prevent the dollar's fall.

"I think it's clear, given the language Snow is using while the dollar's falling, that the (Bush) administration tacitly approves of a weaker dollar," said Todd Elmer, currency strategist at Barclays Capital in New York.

Greenspan's address "makes it clear that U.S. policy-makers do not want to stand in the way of market adjustment that leads to a lower dollar," said Greg Anderson, senior foreign exchange strategist with ABN AMRO bank in Chicago. "This really lays it out. It makes it clear that all of the policy-makers in the U.S. are on the same page about it."

Reuters contributed to this report.

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