The springing buck

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Money makes the world go round. But what happens when the money stops flowing? Judging from currency markets, the US dollar goes up. Over the past month, the trade-weighted dollar has risen 7 per cent. Might this mark a longer-lasting trend?

One reason to think it could is that the world has come to the end of the almost uninterrupted bull market of the past seven years. This was driven by financial innovation and rising leverage in the west (especially in housing markets). This in turn spurred rising consumption, satisfied by the plasma screen and car manufacturers of Asia. It also triggered a global construction and infrastructure boom. Commodity producers could not match the demand. Prices soared as a result.

Now this cycle has gone into reverse, as research boutique **Gavekal** notes. The "financial revolution" hit the buffers last year. Then emerging markets started to struggle. Most recently commodity prices have dropped. Deleveraging, just about everywhere, is wreaking its effects. New trends are emerging instead.

Courtesy of the country's spent consumers, one of these is the falling US current account deficit. Simply put, this shrinkage in turn means fewer dollars to recycle elsewhere. Lower global liquidity spells trouble for other countries with large deficits to fund. That includes the UK - hence sterling's freefall; much of Latin America; and overindebted Mediterranean countries in the eurozone, such as Spain, whose problems explain euro weakness.

The exhaustion of the US economy also explains why the dollar might keep rising. After all, there is still one US balance sheet with room to expand: the government's.

Allowing for the nationalisation of Freddie Mac and Fannie Mae, the US debt to GDP ratio would be "only" 70 per cent, Andrew Hunt Economics reckons. Fiscal spending can boost currencies - it worked for Reagan in the early 1980s. A rising dollar also helps beat inflation. The "strong dollar policy" may yet make a comeback.