

Daily Policy Digest

Economic Issues

April 20, 2011

Weak Dollar Policy and Inflation

The Chairman of the Federal Reserve Ben S. Bernanke has embraced a weak dollar policy. And he is not alone. The idea even has a certain appeal to the common man on the street. After all, a cheap dollar is advertised as an export stimulant and the fuel for an economic boom. But, the common man is often wrong, and so is Chairman Bernanke, says Steve H. Hanke, a senior fellow at the Cato Institute.

Commodity prices are booming, but Chairman Bernanke and his colleagues at the Fed focus on the consumer price index, absent food and energy. By doing so, they exclude those items that are experiencing price surges and continue to play down the inflation threat.

If the Fed is in denial about the inflation threat, it's blind to the possibility that the weak dollar is causing energy and food prices to surge. Oil and most other food and industrial commodities are invoiced in dollars. Accordingly, when the dollar goes "down" the price of primary commodities tend to automatically go "up," and vice versa.

The course of the U.S. dollar-euro exchange rate and the price of crude oil since January 2011 tells the story:

- Since January, the dollar has lost value against the euro and the price of oil has increased.
- For each 1 percent decline in the dollar against the euro, there was on average a 0.5 percent increase in the price of oil.
- The biggest single contributor to oil price increases in recent months is not located in Libya, but at the headquarters of the Federal Reserve in Washington, D.C.

Thanks to the Fed's weak dollar policy, the U.S. faces an inflation problem and so does the rest of the world. The weak dollar and the lack of "flexibility" -- broadly understood as code for advocating floating exchange rate regimes -- also threaten the free flow of capital and the stability of the international monetary system. It's time for the Fed to start focusing on the value and stability of the U.S. dollar, says Hanke.

Source: Steve H. Hanke, "The Weak Dollar Problem," Cato Institute, April 15, 2011.

For text:

http://www.cato.org/pub_display.php?pub_id=13024

For more on Economic Issues:

http://www.ncpa.org/sub/dpd/index.php?Article_Category=17