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Will A Weaker Dollar Counter Subprime?

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With the US dollar hitting a record low against the Euro on concerns about the sub-prime sector, there are many people wondering whether more weakness is in store for the US dollar. The fear is that default after default will eventually lead to weaker spending and lower growth across the country, but many people have also forgotten the benefits that the weaker dollar can bring to the economy. With the outlook so dire, a weak currency could actually be what ends up saving the country. In Economics 101, we learned that the biggest beneficiary of a weak dollar is the export sector. As the currency declines, the cheaper US exports appear to foreign trade partners. We have already seen recent reports confirm the theory as fact with US exports skyrocketing to a record high in the month of May. According to the US Commerce Department's most recent trade balance survey, global partners bought $132 billion in goods from the US. It is not a mere coincidence that the dollar weakened significantly in the month of May,

Dollar Implications
With a lower dollar, things may not be as bad as they seem. There remains plenty of evidence in the economy that should keep Chairman Ben Bernanke and fellow Fed policy makers from turning significantly bearish and in turn keep the dollar relatively stabilized in the short term. Incidentally, it is also a lower valued dollar that is keeping the subprime mess from spreading any further than it already has. ISM has continued to climb while the labor market remains strong.

ISM Manufacturing	Jun - 56.0	**US Non-Farm Payrolls**	June - 132,000
	May - 55.0		May - 190,000
	Apr - 54.7		April - 122,000
	Mar - 50.9		March - 175,000
	Feb - 52.3		
	Jan - 49.3	**Average**	155,000

Here, a lower dollar has stemmed losses in the US economy as manufacturing and production have both picked up since the beginning of the year. Once again, not a coincidence, looking at raw data from the start of the year, manufacturing has shown considerable growth since dipping into contractionary levels in the month of January. After dipping to 49.3, the survey has roared back every single month with the exception of March when the survey pulled back slightly. This can only mean one thing, sector growth. The notion has been confirmed by regional surveys including the most recent New York Empire State manufacturing survey. Expected to show rather tepid growth, the regional Fed report instead showed considerable expansion in the area as the findings rose 47 percent from the previous month. Key driver: new orders. The lifeline of the manufacturing sector, it seems that a depreciated currency has lifted the sector and increased output and expansion, giving support for the overall economy. It is for this reason that Bernanke is still looking for a modest recovery over the next year.

The positive effects don't stop there. Employment as a result has additionally picked up. Just taking a look back on the past quarter, employment has increased on an average of 155,000. The results compare with a slightly weaker number in the first quarter when non-farm payroll figures were in the average area of 142,000. The increase in job opportunities bent on increased production are likely to keep confidence among consumers high, ultimately trickling into domestic spending gains. With employment higher, the Fed less likely to implement a rate cut anytime soon.

Fed Rate Decision
The evidence is plain and clear, and it seems that Chairman Bernanke is in line with the sentiment. Although Fed policy makers have been concerned with inflationary pressures in the past, focus is also being placed on growth. Noting that "core inflation should edge a bit lower, on net, over the remainder of this year and next year", Bernanke did see that the world's largest economy is "likely to expand at a moderate pace over the second half of 2007", followed by an additional expansion the year after. Currently, the Federal Reserve forecasts economic growth coming in at a stable 2.5 percent to 2.75 percent for the year.

Ultimately, given the state of employment and production in the economy, it remains highly unlikely that the Federal Reserve will be pushed to lower interest rates to boost output since the weaker dollar will accomplish that to some degree. As long as we do not have a big lender like Washington Mutual blowup, subprime woes will be contained, with even negative effects minimized as long as expanding exports keep labor conditions healthy. The path to a stronger dollar should be through a weaker one.