The Depreciating Dollar:
Causes and Consequences

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Structural Factors Impacting the Dollar

- U.S. private consumption binge is at an all time high
- Correspondingly, U.S. personal savings is at a low
- U.S. budget deficit outlook is alarming caused by a combination of ill-conceived tax cuts on the revenue side and the “wages of war” on the spending side
- High commodity prices, driven by demand from BRIC, are having an inflationary impact on the dollar
- The above factors have contributed to unsustainable levels of current account deficits in the country’s balance of international payments
- The need to finance the twin deficits has led to a weak dollar
American Consumer at Risk

US Consumption Binge

US Personal Consumption Expenditure as a % of GDP

Average: 1975-2000

Source:
National sources, Morgan Stanley Research

Morgan Stanley
The Global Consumer

Scale Matters

Source: National sources, Morgan Stanley Research

Morgan Stanley

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Wages of War

Tax cuts and military spending for operations in Iraq and Afghanistan have increased the federal deficit.

The dollar has fallen most against the euro...

Dollar exchange rate and indices (rebased)

...with no sign yet of reductions in global trade imbalances

Current account balances ($bn)
Consequences of a weak dollar

- Over dependence on foreign savings to maintain U.S. economic growth
- Gradual move away from dollars to euros as a choice of reserve currency
- Increased capital flows to emerging market economies
- Imported inflation and the potential for rising interest rates could slow U.S. economic growth
- Income inequality is likely to continue to rise
- Emergence of strategic competitors as U.S. investment in education and health deteriorates.
Capital is flooding into emerging markets...

Emerging market equities (rebased in local currencies, 2001=100)

...forcing countries with dollar pegs to increase reserves

International reserves rebased (2000=100)
<table>
<thead>
<tr>
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<tbody>
<tr>
<td>United States</td>
<td>13,233</td>
<td>2.5%</td>
<td>18,698</td>
<td>299</td>
<td>0.8%</td>
<td>334.3</td>
<td>44,258</td>
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<td>China</td>
<td>10,153</td>
<td>7%</td>
<td>26,180</td>
<td>1,312</td>
<td>0.6%</td>
<td>1426.6</td>
<td>7,739</td>
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<td>Japan</td>
<td>4,229</td>
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<td>5,209</td>
<td>128</td>
<td>-0.2%</td>
<td>124.5</td>
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<tr>
<td>India</td>
<td>4,217</td>
<td>7%</td>
<td>10,874</td>
<td>1,110</td>
<td>1.2%</td>
<td>1311.7</td>
<td>3,799</td>
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<tr>
<td>Germany</td>
<td>2,623</td>
<td>2%</td>
<td>3,461</td>
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<td>79.7</td>
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<td>U.K.</td>
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<td>2,834</td>
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<td>0.3%</td>
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<td>France</td>
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<td>2,717</td>
<td>61</td>
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<td>61.0</td>
<td>33,754</td>
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<tr>
<td>Italy</td>
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<td>-0.3%</td>
<td>56.6</td>
<td>30,322</td>
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<tr>
<td>Brazil</td>
<td>1,661</td>
<td>5%</td>
<td>3,289</td>
<td>189</td>
<td>1.1%</td>
<td>220.3</td>
<td>8,788</td>
<td>14,929</td>
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<tr>
<td>Russia</td>
<td>1,656</td>
<td>5%</td>
<td>3,279</td>
<td>142</td>
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<td>132.4</td>
<td>11,662</td>
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<tr>
<td>European Union (25)</td>
<td>13,965</td>
<td>2%</td>
<td>18,427</td>
<td>488</td>
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<td>508.9</td>
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<tr>
<td>World TOTAL</td>
<td>66,596</td>
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<td>96,702</td>
<td>6,518</td>
<td>-0.04%</td>
<td>6481.6</td>
<td>10,217</td>
<td>14,919</td>
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Thank You!

Questions?