

Safe Haven Status of U.S. Delays Recovery

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May 6, 2009

A strong U.S. Dollar will soon become the biggest concern for the U.S. and the rest of the global economy. The dollar's strength against the Euro, Yen and most other currencies will confound the analysts, pundits, and experts who have forecasted a weaker dollar because of the gargantuan budget deficits that have been racked up by the U.S. Government. The surging Dollar will create additional U.S. job losses and delay any meaningful and sustainable recovery for the U.S. economy. It will also wreak havoc for the major U.S. stock market indices because a stronger dollar will have an immediate negative impact on the earnings of a majority of the companies, which reside in the S&P 500 and the Dow 30 Industrial composite indices.

The financial crisis that began in 2007 is the most severe that the world has seen since the Great Depression of 1929. It threatens the very sanctity of capitalism and the major countries of the world have all but declared war on it. Due to the depth and severity of the crisis, the countries that have the strongest democracies must bear the brunt of economic chaos because they are deemed to be "safe havens" by international investors.

When a "global" financial crisis occurs, money flows from those countries, which have geopolitical risk to those countries, which are safe havens, because money or capital will gravitate to the highest ground. That highest ground would be the currencies and securities of those countries that have the most politically secure democracies and currencies. *Currently the two longest standing democracies and currencies in the world are the United States (200+years) and Switzerland (700+years).* The incoming money, which flows into the interest paying debt securities of a safe haven country, is seeking a return of capital instead of a return on capital. As the money flows into a safe haven country the value of its currency increases relative to all other non-safe haven countries. *That is why the Dollar continues to gain ground on all currencies even though there are significant U.S. budget and trade deficits.* A safe haven country's strengthening currency creates an economic decline because it causes the prices of its exports to increase. Rising export prices reduces demand, and reductions in demand generate an increase in unemployment for a safe haven country.

A safe haven country should expect to have a weakened economy because the strengthening of its currency is inevitable during a global financial crisis. The one advantage that a safe haven country is able to enjoy is a low interest rate for borrowing money during a global financial crisis. *That is why Dollar denominated interest rates on U.S. Treasury bonds have remained low.* In a global financial crisis the economic fate of a safe haven country is sealed. As money flows in, the value of its currency appreciates and the cost of its borrowing goes down. Its economy weakens and its unemployment rate rises. There is only one issue or question that a safe haven country must address

during a global financial crisis. Is it willing to borrow funds during the economic decline so that it can subsidize its citizens' with healthcare and unemployment benefits, etc.?

In the present global economy there is only one "major" safe haven country, which is capable of surviving the most severe financial crisis of our lifetime. It is the United States and its currency has been strengthening against all other currencies. Switzerland has the longest standing democracy. However, its population of seven million and its economy are both dwarfed by the U.S. and its currency is not considered to be liquid enough for it to be considered as a reserve currency.

Other than the United States there are no other countries or Unions within the world's top ten largest economies according to Gross Domestic Product (GDP) which are in the position to be safe havens. Japan used to be one of them. However, its economy, now the world's fourth largest, has been stagnant for many years. Its population is aging and its economy is totally dependent on exports. It needs the Yen to decline in order to slow its rate of economic decline and avoid a complete collapse of its economy. It's certainly not in the position to pick up the slack. During past post World War II economic crises, Germany and its currency was considered to be a safe haven. Germany is no longer in the position to be a safe haven because as a member of the EU it no longer has any control over its monetary and fiscal policies. It's also dependent on the Euro, which is a currency that it shares with 16 other countries. France also is limited in its capacity as a safe haven because its issues are the same as Germany's. China, which currently ranks at number three in GDP, is dependent on exports, is still a communist country, and is the main current growth driver for the world economy. Neither China nor the world can afford for its currency, the Yuan, to strengthen against the world's currencies. For it to remain competitive, China may have no choice but to devalue its currency because it currently floats with the Dollar. Russia, India and Brazil are also countries who rank in the top 10 for global GDP. However, they and their respective currencies are much too immature to be considered as safe havens. The United Kingdom is a formidable country and in past economic crises it and its currency, the Pound have been a rock solid safe haven. However, its economy represents only a fraction of the total world GDP and the Pound or Sterling has been under severe pressure against the Dollar because of the significant problems that the U.K. has had with its real estate, banking system, and economy.

Rank	Country	GDP
1	European Union	14,820,000
2	United States	14,290,000
3	People's Republic of China	7,800,000
4	Japan	4,348,000
5	India	3,267,000
6	Germany*	2,863,000

7	United Kingdom	2,231,000
8	Russia	2,225,000
9	France*	2,097,000
10	Brazil	1,990,000

*GDP also included in European Union GDP

Additionally, the European Union and many of its members are not in the position to increase debt. Even though the European politicians and finance ministers have been highly critical of the U.S.' recent borrowing binge and lack of fiscal discipline, 13 of 16 countries with the highest Debt to GDP (Gross Domestic Product) ratios are in Europe. Traditional safe havens such as the U.K. had the second highest amount of Debt to GDP (336%), while Japan came in at number 10 with a Debt to GDP ratio of 150%. Germany with Debt that equaled 137.5% of GDP, tied for 11th place with Spain. The U.S. came in at 16th with a debt to equity ratio of 95% and was the only country out of the top 16 which had total debt, which is less than total GDP. The debt to GDP ratio for a country is important because it gives an accurate snapshot of a particular country's ability to pay off its debts. For example, it would take Ireland over eight years to pay off its debts and that is under the assumption that it could use 100% of its GDP for eight years to pay off its debt. Under the same assumption it would take the U.S. less than a year. The high debt to GDP ratios of the European countries is the reason why Europe and the Euro will not likely be safe havens for the current global financial crisis. It would be difficult for them to borrow the capital needed by a safe haven country to support their social services such as healthcare and unemployment benefits during a recession.

Rankings by Debt/GDP		
Rank	Country	%Debt
1	Ireland	811.0%
2	UK	336.0%
3	Belgium	327.0%
4	Hong Kong	295.0%
5	Netherlands	268.0%
6	Switzerland	264.0%
7	Austria	191.0%
8	France	168.0%
9	Denmark	159.0%
10	Japan	150.0%
11T	Germany	137.5%
11T	Spain	137.5%
13	Sweden	129.0%
14	Finland	116.0%
15	Norway	114.0%
16	U.S.	95.0%

Even though it looks as though the United States and the Dollar is the primary safe haven, many economists and politicians have argued that the European Union (EU) has replaced the United States as the world's leading democracy and that the Euro has replaced the Dollar as the world's foremost reserve currency. I disagree for several reasons:

- The Euro as a currency only has a ten-year track record. It has not withstood the test of time since it has only been in existence since 1999. The Euro also has not experienced a recession much less a major global financial crisis. The late noted economist, Milton Friedman predicted that the Euro would not survive even one recession.
- The European Union (EU) does not have a unified government. The EU has sixteen sovereign countries or states, which utilize the currency. Since these countries do not have one ruling or governing body they are subject to un-resolvable disputes on how to allocate capital for economic stimulus, for the benefit of the group as a whole, and subsidies for those member countries that warrant them. The United States enjoys an advantage because it's governing system of having one Centralized or Federal government which makes decisions for the whole and on the subsidies to be provided to the States which need them. Until the European Union can do the same, the Euro would never be accepted as a replacement for the Dollar.

Note: A safe haven status cannot be anointed or given to a particular country. Throughout the history of the world those countries and their respective currencies, which have been deemed to have safe haven status earned it over time by building trust and confidence with generations of investors worldwide.

The European Union and the eight of the nine countries in the World's top ten GDP rankings are not currently in the position to be safe havens for various reasons. This leaves the United States as the only safe haven country among the top ten of the world's largest economies. Any attempts or any intervention to devalue the dollar would be futile because it would be the equivalent of paddling out to sea against an incoming tidal wave. Also, any argument for a strengthening of the Euro and the Yen against the Dollar would not be a viable solution to the global financial crisis. Both the European Union and Japan have aging populations. The populations of both would be more inclined to save instead of spend. Citizens of both would not likely be motivated to purchase imports from the U.S. regardless of how much the Dollar would weaken.

Based on the many countries in Europe that have democracies which have been in place for 20 years or less, who can blame European industrialists and businessmen for investing capital in a currency and the securities of a country (United States), which has little if any political risk? If you do not understand this or believe this you must ask yourself the question. Which country, the United States or Russia, has a higher probability of

reverting to communism should unemployment continue to rise in Europe and its economy remain in stagnation? The answer is simple. Russia has the higher probability because it was a Communist country only 20 years ago.

In the history of the world, Capitalism has not been around that long. Its only modern and main competitor, Communism or Socialism, established its roots in 1827 and got its ideology from the workers' movement of 19th century Europe. As the 19th century [Industrial Revolution](#) advanced, socialist critics and political economists blamed capitalism for creating a class of poor, urban factory workers who toiled under harsh conditions, and for widening the gulf between rich and poor. It's also important to remember that it was only 20 years ago when hundreds of millions of Europeans got their first taste of capitalism after the Communist regimes in Europe's Eastern Bloc toppled. Those who found their new freedom participated in the benefits of an unprecedented global economic expansion and bull market. The jury will soon be out on how they will react to the lost jobs and lower standard of livings that stem from the economic cycles of capitalism.

The possibility of inflation has been a reason why some investors have been bearish or negative on the U.S. Dollar. I disagree because I believe that deflation currently poses a bigger risk than inflation. For more on deflation and why it poses great risk for any economy I suggest a review of my article "[The Boogeyman is Deflation.](#)" In further support of my position, a strengthening Dollar decreases the prices of imported goods and commodities such as oil. Conversely, it's no coincidence that the Dollar bottomed against the Euro at the same time that oil traded to a new all time high in July of 2008.

Other critics say that because the U.S. Government is borrowing so much money it will soon be insolvent. Solvency is the one thing that has never been an issue for the U.S. Government because it has the power and authority to increase the taxes on its citizens. Its citizens also have a 200+ year track record of paying taxes. The U.S. Government's ability to levy taxes to pay its debts is just another reason why it and the Dollar are the currently the world's only safe haven. The government's ability to tax its people is why the U.S. government has the highest credit rating on the planet.

The Chinese government, which is one of the largest holders of U.S. Treasury debt securities, has been openly critical of the U.S. Government and its fiscal policies. They have even called for a new "world currency" to replace the Dollar. The new currency would be derived from a basket of the world's primary currencies. As I have already stated the anointing of or the formation of a new world currency would not work because in times of global economic crisis, investors will flee to the currency that has served them for generations. My belief is that the Chinese are purposely stoking fear about the U.S. Government and the U.S. Dollar because their currency, the Yuan is pegged to the Dollar. This poses a serious dilemma for the Chinese because a Dollar rising against most currencies increases the prices of the goods, which the Chinese are manufacturing and selling to Europe and Japan, etc. The Chinese are fully aware that should the Dollar keep rising against the Euro and other currencies they would have little choice but to devalue the Yuan versus the Dollar. Should the Chinese have to resort to a devaluation of the

Yuan, it would wreak havoc on their debt and equity markets and curtail foreign investment into China. This is why the Chinese have “openly” made innuendos that they might discontinue their purchases of U.S. Treasury securities and have expressed concerns about U.S. fiscal policy. The Chinese government is purposely attempting to talk the Dollar down.

My prediction is that it will be Europe and not be the U.S., or Japan, which will lead the global economy out of the recession. This will also be a stunner because a majority of analysts and economists have been predicting that the U.S. will be the first to recover. Here are my reasons why I believe that it will be Europe:

- The EU alone is a union of countries that has the critical mass required to initiate a global economic recovery. Its population of 500 million is four times greater than Japan’s and it has a middle class that is the world’s largest. The EU’s GDP is also the world’s largest and it is three times greater than Japan’s. A decline in the Euro would stimulate tourism and make its products more attractively priced for exports.
- The EU is facing the most geopolitical risk. It has ten former communist countries who are members. A good portion of Germany’s population now includes a couple of generations who were formally East German communists. Its currency, the Euro, will have no choice but to decline in an environment of rising unemployment and economic chaos. Spain, one of the larger members of the EU, is a good example of a country facing economic chaos and increasing geopolitical risk. Its unemployment rate in March of 2009 recently rose to 17.4%, which is above the peak of 17% that its government had been predicting for the end of 2009. Analysts are now predicting that Spain’s unemployment rate will now peak at 23%. If the Euro is not devalued against the Dollar, its unemployment rate will continue to soar. The consequences could be social and political unrest for Europe and a move politically to the left. Therefore, I believe that the Euro is the one currency, which is the most vulnerable of all major currencies to weakening global economic conditions.
- As I have already explained, the current borrowing capacity of the EU and the countries within it is low. Most of the EU member countries have debt to GDP ratios much higher than the U.S. The EU has an aging population and is totally dependent on exports for its economy because it has zero population growth.
- The confidence and the support for the Euro has been waning and the Euro, according to its technical charts, is on the verge of a major descent against the U.S. Dollar. Should it fall to below \$1.25, its next level of support would be at \$1.20. If it gets through \$1.20, it could quickly fall to under \$1.00. A decline of the Euro to new lows below \$1.00 would be devastating for U.S. exports and would extend the length of the current U.S. recession.

Despite the worsening global economic conditions and the ultimate devaluations that the Yen and Euro are facing, both of the currencies have not yet fully spiraled down against the U.S. Dollar. The main reason why is because both Japan and Germany, with Germany being the EU's biggest member country, will be holding new elections over the next 12 months. Japan's election will occur by the Fall of 2009. Germany will be holding elections in the Spring of 2010. The political parties who are currently in control of both countries have done everything that they can to prop up their currencies. They want to demonstrate to their respective electorates that they have inflation under control because it is the biggest concern of their aging populations.

A decline in the Yen and the Euro against the Dollar would increase the prices of commodities, including oil for Japan and the EC. Both countries are doing everything that they can to trying to avoid that from happening on the eve of their elections. As much as they try it will become increasingly difficult for the two countries to sustain the inflated value of their currencies because their economies are rapidly deteriorating. Should these currencies spiral down against the Dollar before the elections it could significantly increase the geopolitical risk.

The Euro has had a history of leading or predicting significant increases and decreases in the U.S.' major stock market indices, including the Dow Jones Industrial and S&P 500 composite indices. Its 15% advance in the first half of 2002 to a two year high against the Dollar during the summer of 2002 predicted the rally for the major U.S. indices off the bottom in October of 2002. The Euro's rapid descent, which began against the dollar in August of 2008, preceded the collapse of the major stock market indices in October of 2008. Its low point against the Dollar in 2008 occurred the day after both the Dow 30 Industrials and the S&P 500 hit their 2008 lows on November 20, 2008. The Euro's 2009 low against the Dollar on March 3, 2009, was followed by both the Dow and S&P 500 composite indices making new lows on March 9, 2009. Since few if any analysts or mutual fund managers truly understand the relationship between the Euro and the major U.S. stock market indices, I believe that the stock market has not yet discounted the recent and future devaluation of the Euro against the Dollar. As the Euro breaks to new multi-year lows against the Dollar I believe that the major indices including the Dow 30 industrials and the S&P 500 will also make new lows.

A strengthening Dollar will have a significant effect on investments and commodities worldwide. It will have a negative impact on gold, oil, and all other commodities which are priced in Dollars. For example, the Dollar's all time low against the Euro in July of 2008, occurred at the same time that the price of a barrel of oil hit its all time high. U.S. investors should avoid making investments in foreign countries or in their securities and also should avoid investing in emerging country mutual funds because profits on emerging country shares could be offset by lower currency exchange rates. U.S. Investor should have 80% of their money invested in short term U.S. Government securities and 20% of their monies invested in emerging U.S growth stocks. Foreign or non-U.S. investors should be investing in U.S. Government short-term securities because their monies will be secure and they will also profit significantly from the increasing exchange rates for the U.S. Dollar. Foreigners should also be investing in U.S. emerging growth

stocks because in doing so they would be positioned to generate profits on both share price increases and on foreign exchange rates from a strengthening Dollar.

I believe that the U.S. will have no choice but to remain in an extended economic recession until the global economy mounts a sustained recovery. It will only be after the economies of Europe and Japan enter into a recovery that the U.S. Dollar will substantially weaken against most of the world's currencies. It is only at that point that the U.S. Economy will begin to recover. The U.S.' politicians, citizens and its corporations need to accept the fact that the U.S. economy will not likely begin to recover until late 2010 or 2011 at the earliest. Global investors should be keeping a wary eye on the foreign exchange rates of the U.S. Dollar, the Yen and the Euro.

My conclusion or predictions are that (1) a stronger than expected Dollar against the Euro due to the deepening recession and increasing geopolitical risk in Europe will "eventually" cause another downturn or leg down in the U.S. economy. (2) Europe and the EU will be the first of the global economies to recover because the Euro's significant devaluation against the Dollar will stimulate U.S. consumer purchases of goods manufactured in Europe. (3) The Japanese Yen will also experience a significant devaluation against the Dollar after the Japanese elections are concluded in the Fall of 2009. (4) The Obama administration and U.S. politicians will become increasingly frustrated when they discover that U.S. government stimulus packages directly benefit European and Japanese instead of U.S. businesses because of a stronger than expected Dollar. (5) China will have no choice but to devalue the Yuan. Because, I believe that the probability is high that some or all of my predictions could prove to be accurate or could unfold, investors should avoid the shares of any large cap global multinational public companies. Based on some or all of these predictions occurring, investors in the U.S. should also avoid ownership in the shares of companies in emerging market countries including China. Investors worldwide should have a high concentration of their investment capital in short term U.S. Government Treasury notes and bonds.

Since it is highly likely that the U.S. Dollar will continue to strengthen against the Euro and most currencies until Europe clearly emerges from its recession it could be years before the U.S. economy averages sustainable GDP growth rates at or above 3%. The probability of a strengthening Dollar is another reason why I believe that the Super or Secular Bear Market for stocks, which began in 2007, will last until at least 2015.

For more information on the Super Bear Market go to: www.BearMarketNavigator.com The other reports and articles on the global financial crisis that I have written and recommend for reading include ["A Super Bear is Upon Us"](#) and ["The Boogeyman is Deflation"](#).