Impact of Weak U.S. Dollar

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Since the Federal Reserve cut the federal funds rate from 5.25% to 4.75%, the U.S. dollar decline has accelerated further. This follows a five-year period, since June 2002, of a gradual weakening aggravated by low interest rates, and twin deficits. Inflation pressures are now more likely, as commodities and imports rise further in price.

The weak dollar also means that imports, such as oil, clothing, electronics, and durable goods cost more. If Americans keep buying items that are costing more each month, the trade deficit could grow even larger, this in turn would put further downward pressure on the dollar. However, exports, tourism, hotels, and retail benefit from a cheap dollar. Travelers from Europe and the UK are increasing travel here. This in turn raises local prices for such products, as demand shifts upward.

Currently, the U.S. economy is experiencing rising energy and food prices, declining residential real estate values, and slowing consumer demand – these indicators suggest a recession.

A weak dollar attracts foreign direct investments. If the economy continues to experience outflows of capital, the result could force up yields on government bonds, because higher rates would be needed to attract bond investors. Bond yields have a direct impact on a wide variety of interest rates paid by consumers and businesses, including mortgage rates.

Weakening Dollar

Advantages

- Increase U.S. exports
- U.S. firms can raise local prices.
- More foreign tourists visit the U.S.
- More direct investment by foreign investors
- Foreign companies outsource facilities to the U.S.

Disadvantages

- Higher import prices contribute to higher cost of living.
- Price to travel abroad increase.
- U.S. firms and consumers must pay a premium for foreign assets.
- Foreign ownership (and influence) of U.S. assets rises.
- Confidence in U.S. economy strength falls.
- Trading partners threaten tariffs for pricing parity.