As you can see, the value of the dollar was falling prior to the start of the current crisis. When the crisis hit, the dollar strengthened relative to European currencies, but it is now declining slowly. Also notable is the Chinese Yuan, which was pegged until July 2005, after which it slowly rose relative to the dollar until the financial crisis hit. Last July, however, China again fixed its exchange rate in order to maintain export levels during the recession.
The Current State of the World Economy

- The general economic environment has been strengthened somewhat by the positive effects of stimulus packages in the OECD countries which are boosting consumer demand and production.
- Gross world product is forecasted to rise in 2010.
- A revival in world industrial production seems underway and is spreading from East Asia to the more economically advanced countries of Europe and North America. Presently, in the more advanced countries the pace of the recovery is in the low single digits. For the world as a whole, industrial production rose 9 per cent in the third quarter of 2009.
- World trade flows stabilized in the second quarter of 2009 in the G-7 countries, with exports rising 0.8 per cent and imports declining 2½ per cent.
- International commodity prices are up on falling stocks and a weaker dollar. Oil demand remains weak but oil prices topped $80 a barrel recently.
- The residential housing market may be stabilizing in many countries. But the commercial real estate market is very weak and, indeed, dangerously close to collapse in some areas.
- While the financial sector is returning to normal, and many financial market segments such as equity markets show positive developments, in fact the sector remains in deep distress with many of positive indicators for this sector reflecting false and temporary improvements.
- The dollar is falling on foreign exchange markets and is near its (trade-weighted) pre-crisis value. Further substantial depreciation cannot be ruled out and a longer-term downward trend in the dollar is seen as an essential part of efforts to “rebalance” the global economy.
- Net foreign purchases of U.S. Treasury securities are down 44 per cent over 2009 when compared to the corresponding period of 2008. Many countries, notably China, have expressed their concern over their large holdings and are likely to reduce substantially their purchases of Treasuries over the course of the next year.
- A marked upswing in U.S. saving has contributed to the improvement in the U.S. trade deficit, with the personal saving rate climbing to a decadal peak of 5.9 per cent in May.
- International capital flows have picked up markedly during the third quarter of this year, led by a surge in both bond issuances and equity IPOs. On the other hand, bank lending remains depressed in the world’s major economies, down some 75 per cent during the first three quarters of this year compared to 2008. A strong and sustained recovery requires a financial sector in much better shape than it is today.
Recent News and Analysis on the World Economy

The Times Online reports that the UK’s “cash for bangers” system, which has been going on since May, has greatly reduced declines in automobile production. Similar to the American “cash for clunkers” program, the $650 million program encourages British drivers to sell their old cars for scrap.

In Canada, The Globe and Mail reports, many farmers have gone on a buyer’s strike against potash, a key fertilizer whose prices quintupled last year (though they’ve since decreased by half). The prices of the two other main fertilizer components, phosphate and nitrogen, also increased last year, but have since returned to normal. Despite these increases in price, potash manufacturers’ profits have fallen greatly this past year, with one of the two major potash companies losing 90-95% of its profits since last year. The Globe and Mail further reports that Brazil and China are also suffering from high fertilizer prices.

Meanwhile, the Wall Street Journal reports that China is starting to cut back on its stimulus due to fears of inflation. China’s economy has been making good progress towards recovery, and the nation seems to be focusing less on growth, and more on inflation. For example, China is expected to raise its interest rates sometime early next year.

Featured Article: G7 says to stabilize exchange rates (except Yuan)

Bloomberg reports that the G7 has advised central banks to stabilize their exchange rates, warning that “excess volatility and disorderly movements in exchange rates” can lead to economic trouble. The G7 recommends that these banks pursue policy to strengthen the dollar, which has fallen about 10% relative to the Euro and Yen since April. The G7 further recommends that China drop its restrictions on the Yuan, allowing it to appreciate.

Questions to consider:

1. The G7’s advice that exchange rates must be stabilized was directed to central banks, not legislatures. How might central banks accomplish such a goal?

2. The G7 worries that a declining dollar might hurt the global economy. What, specifically, are the effects of a declining dollar? Why might the dollar be declining (hint: think about the greatly increasing deficit)? The chart above indicates that the dollar strengthened at the start of the crisis. Why might this be?

3. The G7 advises that China should let the Yuan appreciate. Why might China want a weaker Yuan? China let its currency fluctuate somewhat from July 2005 until July 2008, shortly before the recession began, at which time it reimposed controls. Why might the threat of a recession have spurred China to keep its currency weak?

Send a quick e-mail to the editor (fredpoo@regent.edu) for answers to these questions.