

How to Lose Reserve Currency Status

History is full of economic and societal collapses. The Incan and Roman societies disappeared, the Ottoman Empire fell apart, the United Kingdom saw the pound lose its reserve currency status. So, anyone who says the US, and the dollar, couldn't face the same fate doesn't pay attention to history.

The question is: will it? Russia, China, Brazil, and others, including Saudi Arabia, all seem to think they can find a way to replace the dollar and undermine US dominance on the world economic stage.

They may try. And they may cause many to fret, but we highly doubt these countries will succeed. In order to understand why we think this, it is important to understand the ascendance of America. In the late 1700s, the US was a patchwork of colonies barely clinging to the Atlantic Seaboard.

But it wasn't victory in the revolutionary war that made America strong, it was the writing of the Constitution and the culture that created that Constitution. The rule of law, private property rights (especially to inventors through patents), democracy (and free elections) made America different and ushered in two centuries of supercharged human progress.

While the US ran up large debts to fight wars, it managed to grow its way out. At the same time, our monetary system kept the value of the dollar fairly strong and stable relative to other currencies. The combination of all of this led to deep and robust capital markets, and a dominant 60% representation by the dollar in foreign currency reserves and nearly 90% of global financial transactions.

If the US reverses course, printing too many dollars, undermining entrepreneurship with high taxes and regulations and growing government too much, then the dollar's standing will diminish. Clearly, we are on that path today. Federal

government spending has reached an all-time high of 25% of GDP in the past three years, state and local spending is near 20%...so, combined, government controls 45% of US output.

As Milton Friedman said, the more the government is involved, the higher the price of things and the lower the quality. More importantly, for the dollar, the Federal Reserve has embarked on an experimental "abundant reserve" monetary policy that has flooded the financial system with more liquidity relative to GDP than at any time in US history. In 2007, the Fed's balance sheet was 5% of GDP, today it is more than 30%.

Massive government involvement in the economy, combined with excessive money creation is a perfect recipe for the decline of a currency. But, before you become convinced that this will happen to the US anytime soon, think about what might replace the dollar. It would have to be a currency managed by a country that had better policies.

What made America strong is not its natural resources (which it definitely has), but its human resources and freedom. China, Saudi Arabia, and Russia may have resources, but they are not free. It will not be any of these countries that replaces the dollar and it is highly unlikely to happen in our lifetimes. However, that's not to say it won't happen in our children's lifetimes. Bad policies beget bad outcomes. King Dollar will only stay that way if the US keeps its fiscal and monetary house in order. Limiting government spending, keeping tax rates low, and returning to a "scarce reserve" monetary policy are our suggestions.

The problem we see is that politicians have used the last two "crisis" periods to expand the size and scope of government, not shrink it. With government so big, we are likely to face another crisis. It's past due time to head that off.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
4-12 / 7:30 am	CPI – Mar	+0.2%	+0.2%		+0.4%
7:30 am	“Core” CPI – Mar	+0.4%	+0.4%		+0.5%
4-13 / 7:30 am	Initial Claims – Apr 8	235K	233K		228K
7:30 am	PPI – Mar	0.0%	+0.1%		-0.1%
7:30 am	“Core” PPI – Mar	+0.2%	+0.3%		0.0%
4-14 / 7:30 am	Retail Sales – Mar	-0.4%	-0.4%		-0.4%
7:30 am	Retail Sales Ex-Auto – Mar	-0.4%	-0.3%		-0.1%
7:30 am	Import Prices – Mar	-0.1%	+0.1%		-0.1%
7:30 am	Export Prices – Mar	0.0%	+0.1%		+0.2%
8:15 am	Industrial Production – Mar	+0.2%	+0.4%		0.0%
8:15 am	Capacity Utilization – Mar	79.0%	79.4%		79.1%
9:00 am	Business Inventories – Feb	+0.3%	+0.3%		-0.1%
9:00 am	U. Mich Consumer Sentiment - Apr	62.2	62.0		62.0