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CONSEQUENCES OF AMERICA'S ADDICTION TO ASIAN CREDIT

"Now, how do they pay for that deficit? They have to go borrow money. Most of it they borrow from the Chinese and the Japanese government. Sure, these countries are competing with us for good jobs, but how can we enforce our trade laws against our bankers? I mean, come on." - Bill Clinton at the 2004 Democratic National Convention

This quote by former President Bill Clinton was perhaps his most important quote in several years, yet the media didn't give it much attention. While Clinton's intentions were no doubt entirely political, it is worth some time to give a little thought to the growing purchases of U.S. Dollars by Asian central banks.



Asian central banks have been financing America's \$500 billion current account deficit mostly via the purchasing of U.S. Treasuries. To get a better grip on this number, try to understand that America needs \$1 million of Asian capital every minute in order to maintain its current standard of living. Asia presently holds over \$2 trillion in foreign exchange reserves and shows no sign of reversing this trend.

While it is not news that Asia's reserves continue to increase, it is worth noting that Japan, China, South Korea and other countries have started to reassess their appetite for U.S. treasuries. Some Asian finance ministers have spoken out openly about diversifying out of dollars and plowing reserves into alternatives such as gold and euros. As the dollar has fallen to record lows against several currencies, more international scrutiny has been applied to how the United States would fund its fiscal and current account deficits without Asian credit. If America doesn't decrease its dependence on foreign capital, the



dollar could weaken further, forcing the Federal Reserve to choose between (1) protecting its currency by raising interest rates and choking off economic growth or (2) continuing to debase the dollar, which could potentially result in hyperinflation.

Unfortunately, American businesses, consumers and governmental organizations show no signs of reducing their addiction to foreign capital. Eventually however, the pace of dollars pouring into Asian coffers will slow or, even scarier, reverse. And with a global dollar glut becoming reality, it will take an increasing amount of currency to purchase the same goods and services. When this happens, we expect to see rising prices at Wal-Mart stores, gas stations and grocery stores as tanker loads of dollars end up back on our shores.

The fact is that Japan and China have America by the throat economically - although a dollar crisis here will have adverse effects everywhere. While America's military power is undisputed, there have been signs of China flexing its economic might in order to contain the United States militarily. Our government's stance on Taiwan, for example, has changed significantly in China's favor over the last decade. It was only eight years ago when the U.S. responded to Chinese missile threats by sending warships to the Taiwan Strait, in what would become the largest show of naval force since the Vietnam War. It will be interesting to see what America's reaction will be to Chinese aggression in the future as its leaders have clearly stated that Taiwan is next in line for reunification. During the past few years, reports have surfaced that China has deployed hundreds of short-range ballistic missiles opposite Taiwan. According to the *Asia Times*, Pentagon officials told Taiwan that by next year, China might be able to deter U.S. counterattacks as "China is adding not only 75 short-range missiles against Taiwan each year but also an inventory of amphibious carriers and light tanks, cruise missiles, unmanned aerial vehicles, and a network of surveillance satellites."

So while President Clinton points out America's inability to enforce its trade laws against its creditors, we suggest readers read the military and monetary tealeaves as well. If tensions arise with Japan or China, then we expect to see massive dollar selling as a result.

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