

Dollar Devaluation Continues

by John V. Kamin

Do you solve riddles? The U.S. dollar is beginning to devalue faster against other major world currencies: euro, British £1, Japanese ¥, Chinese Yuan, Australian \$1, and the Canadian \$1. Surprisingly, leaders in Washington D.C. applaud the dollar's decline. Leaders seem to feel that a lower, weaker U.S. dollar will give American factories and American exporters the opportunity to price their goods cheaper abroad, make more sales and decrease the red ink in the International Trade Agreements, the U.S. Balance of Payments. Example: trade with China and Japan.

Sciences Merge

The laws of the Science of Economics can resemble the laws of the physical sciences. For example – the basic laws of physics and chemistry are well accepted, such as, “For each action, there is an equal and opposite reaction”.

In economics, the reaction can be very different in strength and consequences from the original action. In a speech on November 28th, Ben Bernanke, Head of the FOMC, at the Federal Reserve, suggested something new. Bernanke suggested that inflation is still at “uncomfortable” levels. He mentioned that housing could rebound and add to inflation if interest rates stay low.

In Economic Science, the FOMC's responsibility is to keep things stable, otherwise known as “price stability”. But, that's not always easy to do in a giant economy such as the USA.

And the consequences of a bad decision in economics can have massive unexpected (by the public) ballooning consequences up or down because many of the people's reactions are psychological. For example – to invest, to speculate, to spend, to borrow or to leverage (such as with a mortgage or overly many credit cards or massive borrowing). A bad decision can be as bad as a dead battery making the engine and the vehicle useless unless you can get it started. In economics, you can't just call the Auto Club or insert a new battery.

Tax and Spend Policies

More examples. During WWII, USA corporations were taxed as high as 90% on any profits at the Federal level, plus State taxes. It was literally possible to make \$1 profit and pay \$1 or more in tax on what you made. So, big corporations limited by high taxes spent prolifically, often on worthless advertising and other schemes, just to “use up” all incoming super-taxed WWII dollars.

John F. Kennedy proved that lowering taxes would boost the economy in his short leadership. Lyndon Johnson then reversed course during the Vietnam War, added a 10% income tax surcharge while corporate taxes and personal taxes remained high. Federal corporate taxes were as high as 70% plus State income taxes plus the busted-budget surcharge.

It wasn't until Ronald Reagan took over that he reproduced JFK's approach to lowering taxes. By 1986, Congress had refused to cut spending and overspending again overwhelmed budgetary restraint leading to busted budgets again (the dead battery). Many poorly-managed S & Ls went under during 1987 to 1990. FSLIC had to be taken

over by FDIC. Resolution Trust Corporation was born to sell off repo properties and bad loans.

The Riddle

It's clear that lowered taxes can stimulate an economy heading for recession or stuck in a recession. But newly-elected leaders have their own new spending plans and they don't want to cut spending; spending cuts being a cure for inflation, not increased taxes.

Kamin's 20th Law: *Raising taxes raises the inflation rate. Therefore, tax increases are not a cure for large government deficits. Spending cuts are.*

Paraphrasing Dr. Bernanke, if lower interest rates cause more people to be attracted to mortgage borrowing to buy houses, prospects who were hesitant to buy as interest rates rose could start housing price ball rolling again.

Certain newly-elected politicians have said things in November of 2006 such as "Americans would not mind paying higher taxes to balance budgets" and such. That's nonsense. Most American workers are already close to the budget-breaking point with present taxes. Higher taxes would sink them.

Kamin's 21st Law: *As soon as taxes are raised to "cure deficits", bloated overspending will resume to create newer and greater deficits.*

Boost Inflation for John Doe?

Prediction: While officials may like a lower \$1, as do American manufacturers, lowering the currency unit such as the \$1 is not good for consumers. E.G. WalMart reportedly gets 41% of its merchandise from China and much more from other foreign countries.

Therefore, a lower \$1 means American customers would have to pay more not only at WalMart, but at Macy's, J.C. Penney, Target, Kmart, Toys R Us, Sears, other big retailers and carmakers. The same clothing, appliances, etc. would inflate the cost of living; add to inflation and clear consequences of a cheapened U.S. dollar. Of course, maybe the elected and appointed officials would benefit from the time gap between the prices paid with the weakened dollars and the (later) time that competing retailers raise their prices to American customers.

Forecast: Think how poor Americans felt when gas prices were going up, pushing past \$3.00 per gallon. Then think how you and your neighbors would feel if you suddenly had to pay more for shirts, pants, dresses, underwear, kids' clothes and everything still sold in the major retailers and department stores! I don't think you would like it and I don't think your neighbors would like it. And the inflation watchers and the number crunchers in D.C. would be watching inflation numbers go higher, through the roof, heading much higher than today.

Kamin's 12th Law: *The inflation rate is not directly affected by the phase of the business cycle, but only indirectly affected by recession or boom. The inflation rate is more closely tied to levels of government credit creation, deficit spending policies and directly tied to the rate of money creation under a fiat money economic system.*

Forecast: Frankly, in this economist's opinion, a weaker-dollar policy (dollar devaluation against other major currencies) appears to this Contrarian as a shortsighted policy with dire consequences. A strong economy needs a strong currency to facilitate trade, jobs, higher standards of living, more productivity and lower costs to consumers.

But based on what the media is conveying about a weaker dollar, (talking heads analysis), I don't think they've got the economic message.

What Can You Do?

One successful strategy has been to own hard assets such as your home, rental real estate, commercial cash-flow properties, gold, silver, proprietary businesses and specialized skills, (DDS, MD, LLB, CPA, etc.). If the U.S. dollar is going to get weaker, that strategy will continue to be useful. Other successful items in a weakened \$1 fight strategy can be rare coins, resalable artworks and profit-making machinery, (machines that don't go obsolete).

Kamin's 18th Law: *The ordinary paths to wealth are well traveled, and hence returns are low in relation to risk. For high gains, the individual must seek out little known situations that are unfamiliar to the general public.*

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