Currency devaluations on the way

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Rapid deterioration in trade-dependent nations—Japan, China, and Germany —suggest that these countries will have to resort to competitive devaluations to boost economic growth. The yen and Yuan have sidestepped the Euro's rough beating in recent months, but all three look no match for the severe export thrashing currently underway.

The US Treasury Secretary wants China to revalue its currency in recognition of US manufacturing weakness. Current economic forces actually call for currency depreciation. China's exports are down by 20% since August 2008. Imports, a key part component to the export supply chain, have contracted even more than exports in a case of industry destocking. If that changes and China's trade balance turns negative, the US Treasury Secretary will be faced with a stark choice. Either the Yuan depreciates or the People's Bank of China must sell US Treasury holdings to support the currency.

Exports in Japan fell 45% in January and domestic demand is contracting. The yen rose from 110 to the dollar to 87 in the second half of 2008 as the yen carry trade, yen loans invested abroad, unwound. Now sitting at 98 to the dollar, the yen still looks very pricy. The increase in Japan's exports over the decade ending 1997, "accounts for a massive 48% of the increase in total supply (GDP plus imports) over the same period," according to Lombard Street Research. Sell the yen.

Germany's situation is perhaps worse than Japan's. If it wasn't for exports, Germany's GDP over the past decade might have been falling, according to Lombard Street Research. Now that exports haven fallen heavily over the past three months, it is, in recession that is. Throw in a banking crisis in Switzerland and Austria where billions in loans to emerging Europe are under threat and a weaker Euro looks like the only remedy for the sick man of Europe.

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