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The serious contradiction in Trump's views on the dollar

By Ana Swanson January 18

For more than 20 years, the U.S. government has adhered to an official "strong dollar" policy -- defending the value of a robust currency and always rushing to dispel any rumors that the U.S. planned to devalue the greenback in order to make U.S. exports cheaper.

Then President-elect Donald Trump told the Wall Street Journal in a story published this week that the dollar was "too strong." He added, "Our companies can't compete with them now because our currency is too strong. And it's killing us."

Though Trump has a reputation for breaking with tradition, the unorthodox statement still came as a surprise. Few recent presidents have publicly commented on the value of the dollar, for fear of sparking instability in global currency markets. The dollar plunged in the immediate wake of Trump's remarks, before recovering somewhat Wednesday.

The comments point to a major economic conundrum facing the new administration. A number of policies being pursued by Trump and the Republican Congress are likely to strengthen the dollar, even as perhaps his most prominent economic goal -- revitalizing U.S. manufacturing -- could suffer as a result.

"The problem is that his jaw boning and his policies are trying to move the dollar in different directions. None of the policies he's talked about are going to weaken the dollar, they're only going to strengthen it," said Eswar Prasad, a professor of trade policy at Cornell University. "He's trying to talk the dollar down while his policies are going in another direction."

Until Trump's comments this week, the dollar was on a tear. A rally in U.S. stock markets and suddenly higher forecasts for U.S. economic growth -- thanks to expectations of tax cuts, regulatory reform and infrastructure spending -- helped drive the upswing. The dollar had already been appreciating for years, as the U.S. economy showed resilience in the face of problems in Europe and a slowdown in China.

A strong dollar makes U.S. goods more expensive relative to products from other countries. That makes it harder for U.S. companies to sell abroad -- and tends to hit manufacturing particularly hard.

Trump has blamed the strong dollar in particular on China, which he says has been devaluing its currency to give its companies a leg up. Though experts say China once did do that, they say it has abandoned the practice, and more recently began doing the opposite -- propping up the value of the yuan so that it doesn't depreciate against the dollar.

Trump had publicly inveighed against a strong currency before. "It sounds good to say 'we have a strong dollar.' But that's about where it stops," he told an interviewer in 2015.

Regardless of what China does, experts say that Trump's other policies could lead to a stronger dollar.

Among Trump's biggest proposals are plans to cut taxes and spend more on infrastructure, plans that economists say would boost growth. But since the economy is already relatively strong, these measures would also translate into inflation. To head off inflation, the Federal Reserve would likely raise interest rates. These higher rates of return attract more international investors to buy the dollar to invest in the U.S., which in turn bids up the dollar's price.

Trade measures that Trump has proposed, like tariffs or a border adjustment tax, could also strengthen the dollar, economists said. In the short term, the prospect of a trade war may unsettle markets and lead to flight to the safest asset in the world -- dollar-denominated Treasury bonds, bidding them up.

In the long run, if the U.S. consumes fewer imported goods, the U.S. demand for foreign currency falls. As a result, foreign currency gets cheaper relative to the dollar.

“Ironically, the policies being advocated by Trump are likely to make the problem worse. The tax cuts (and possible spending increases), enacted at a time of full employment, will result in higher interest rates and this will boost the dollar,” Martin Baily, the chair in economic policy development at Brookings, said in an email.

The strong dollar has weighed on American exports in recent years, but for American consumers it has largely been beneficial, said economists. The U.S. has long enjoyed cheap imported goods that boost standards of living.

In addition, seeking to help exporters with a weaker dollar may have other unforeseen consequences. Jed Kolko, chief economist at job site Indeed, points out that many of America's largest exporters are also large importers that buy the inputs that go into their products from abroad. A stronger dollar would hurt as well as help the U.S. manufacturing sector.

Furthermore, economists emphasized that the value of the dollar is not in itself a policy goal – but rather, the inevitable outcome of other factors, including the strength of the U.S. economy and global investment patterns.

“We don’t set the value of the dollar... it’s just a reflection of the goal of having a stronger economy, a better economy, a more dynamic economy, one that attracts global capital,” said Mark Zandi, chief economist at Moody's Analytics. “[Trump] has very little control over the value of the dollar other than his policies that affect growth, and at the end of the day you want a strong economy and a strong dollar.”

Trump can influence the dollar's value somewhat by making statements that shape investor expectations -- as he did in the last week -- though those effects are unlikely to be lasting, economists said. He could also direct the Treasury to intervene in foreign currency markets, selling U.S. dollars and buying foreign currency in an effort to bid the price of the dollar down.

Yet that effort is unlikely to be very effective, said Joe Gagnon, a senior fellow at the Peterson Institute for International Economics. The world's other major economies would be reluctant to help the U.S. in this goal, since that would mean their currencies would appreciate against the dollar, harming their exports.

Acting unilaterally, the U.S. is less likely to effectively lower the value of its currency. The stock of dollars the Treasury has to buy foreign currency is fairly limited, especially compared to the trillions of dollars that change hands each day in the global currency market.

Of course, if Trump did succeed in engineering a drop in the value of the dollar, he would be accomplishing something for which he has frequently criticized other economies. "The irony here is that we’re accusing other nations of manipulating their currencies, but if we want to solve that problem we’re going to have to end up doing the same thing," says Zandi.