

Recently, Federal Reserve Chairman Ben Bernanke has hinted that the U.S. is going to try to strengthen or at least stabilize the weak dollar. So what might happen to the economy with a stronger dollar? And how has the economy been affected by a weak one?

**Effects of a weak dollar.** The dollar has fallen more than 40% versus the euro and 26% versus the yen in the last six years.<sup>1</sup> Its value has dropped 28% since 2001 compared to other benchmark currencies.<sup>2</sup> This devaluation has meant boom times for U.S. corporations and companies that do business overseas, reflected in their earnings reports (and in their stocks on Wall Street). A weak dollar also helps to shrink the U.S. trade deficit, which has slimmed notably in the last couple of years.

On the other hand, a weak dollar breeds inflation and drives up the prices of imported goods. It also helps drive investors to the commodities markets, as they turn to oil, gold and other hard assets for a hedge against inflation. Witness the amazing ascent of oil and gold prices.

**Effects of a strong dollar.** If the Fed raises interest rates, that could strengthen the dollar, tame inflationary pressures, and help to weaken oil prices. But it also risks crimping the economy further, given that the housing market has yet to pull out of its slump and that consumer spending is already pinched due to high energy and food prices. The U.S. could also strengthen the greenback by buying dollars in the foreign exchange markets, something that hasn't happened since 1995.

That was the year U.S. Treasury adopted a strong dollar policy. Between 1995 and 2001, the dollar gained 29% in value against a basket of other major currencies.<sup>2</sup> However, because of that increase in valuation, demand for U.S. exports lessened, and that was a contributing factor to the 2001 recession.

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**Citations.**

<sup>1</sup> [fool.com/investing/general/2008/06/05/bernanke-changes-strategy.aspx](http://fool.com/investing/general/2008/06/05/bernanke-changes-strategy.aspx) [6/5/08]

<sup>2</sup> [marketwatch.com/news/story/makes-economic-slump-different/story.aspx?guid=%7b8f4ab40b-962a-419c-a478-cab86547edfb%7d&print=true&dist=printMidSection](http://marketwatch.com/news/story/makes-economic-slump-different/story.aspx?guid=%7b8f4ab40b-962a-419c-a478-cab86547edfb%7d&print=true&dist=printMidSection) [5/19/08]