Financial Repression And The Water's Edge

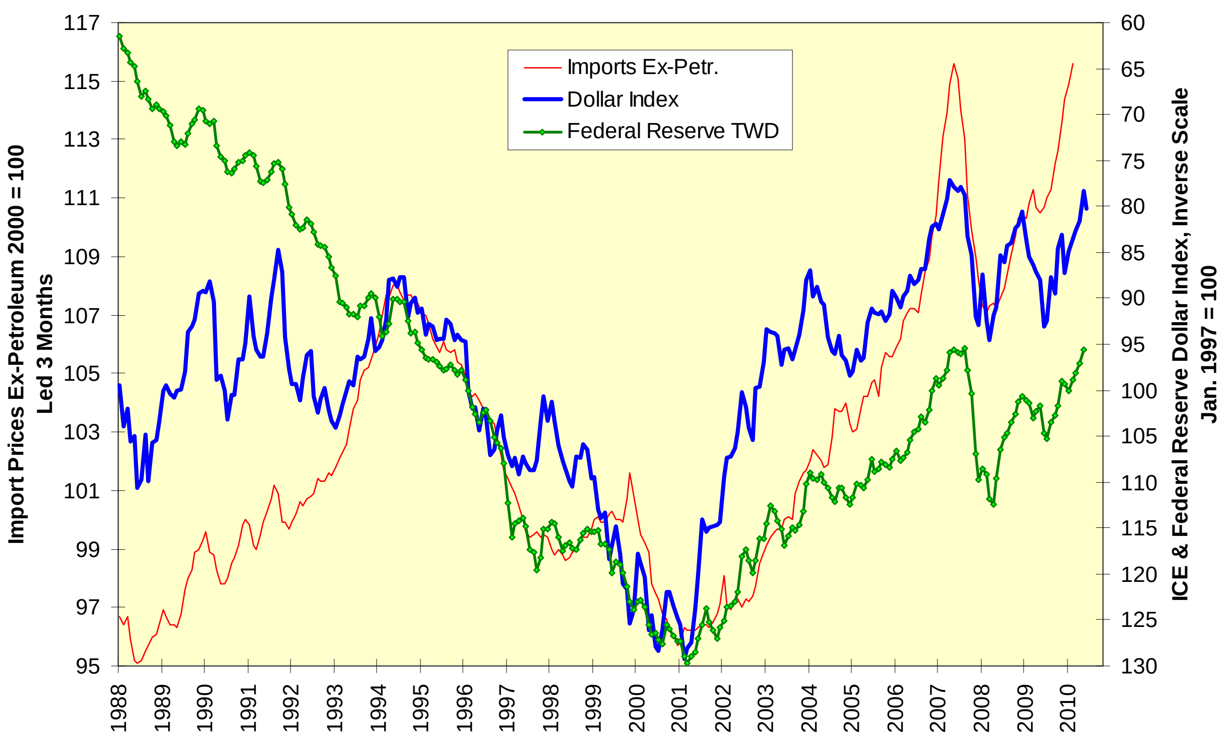
Back in the days when I was young, impressionable and learning a little about the early days of the Cold War, a professor described bipartisanship in a way that has yet to escape from the inner recesses of my skull into my middle ears, much less to the outside world: President Truman found himself a "chump" in Republican Senator Arthur Vandenberg of Michigan.

I later came to understand "bipartisan" meant "laugh about it / shout about it / when you've got to choose / any way you look at it, you lose." Also, "watch your wallet" can be thrown in for good measure.

Non-Petroleum Import Prices

Now that "financial repression" is well on its way to becoming today's phrase that pays, let's see whether exporters to the U.S. can be included on the list of those who have been fleeced by the money-printing machine. First, let's take a look at the index of non-petroleum import prices against two very different dollar indices, the fixed-weight ICE dollar index quoted so commonly and which underlies a large number of financial products, both long and short and leveraged up to three times for those who wish to pay their money and take their chances, and the Federal Reserve's trade-weighted dollar index (TWD here, even though that is the code for the Taiwan dollar). This index' weights change annually, its representation is broad and it is indexed to physical trade flows even though financial flows are far more important.

Non-Petroleum Import Prices And The Dollar

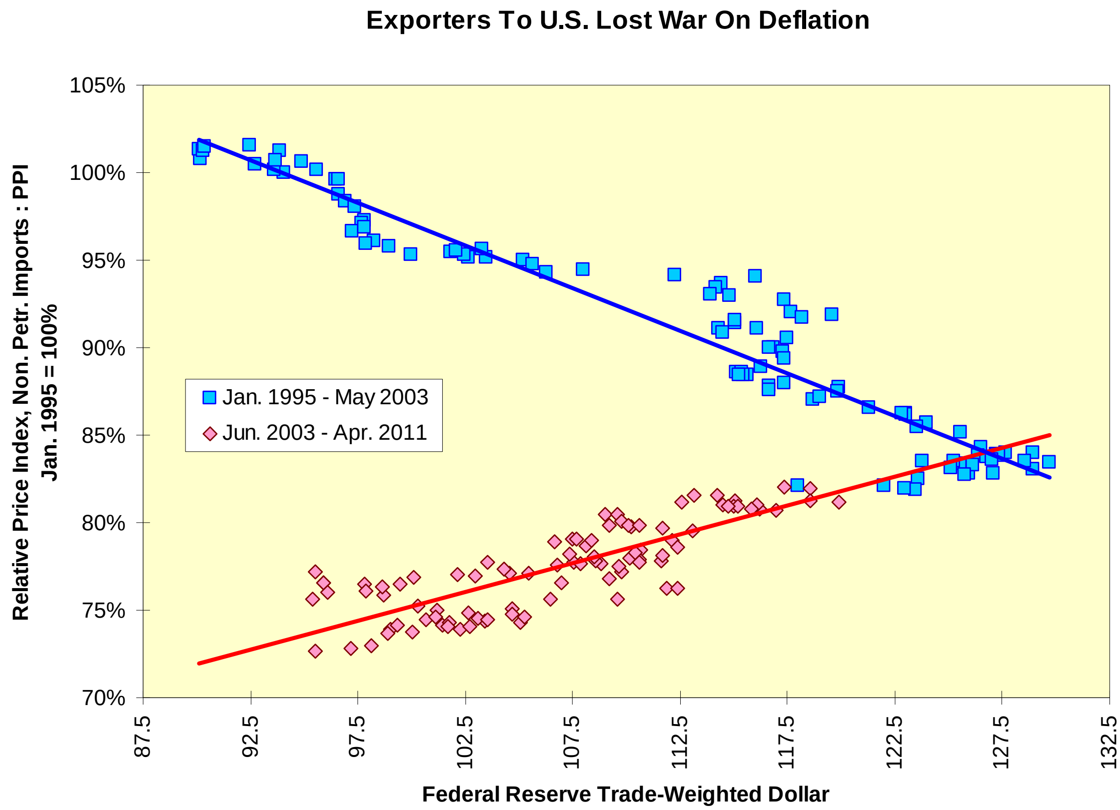


One of the more obvious aspects of this chart is how non-petroleum import prices come into convergence with the dollar indices at the start of 1995. This is no accident; it represents the period when NAFTA was starting to affect trade patterns, when China fixed the yuan and when the consequences of the peso's collapse led the Clinton Treasury Department to look after the interests of wayward bankers by – you guessed it – ending its campaign of rate hikes.

A second feature of the chart is how non-petroleum import prices kicked higher with the dollar's downturn beginning in early 2002. While you cannot tell by visual inspection, the TWD has been a better descriptor than the ICE dollar index of these import prices since that time.

Change In Pattern

If we switch from an absolute to a relative frame of reference and normalize non-petroleum import prices to the Producer Price index, a remarkable feature emerges. Prior to the Federal Reserve's first declaration of war on deflation in May 2003, import prices rose faster than the PPI as the dollar weakened. After May 2003, normalized non-petroleum import prices fell as the dollar weakened.



This is the exact opposite of what you might expect. The only explanation that works is loose money pulled the prices of producer goods higher worldwide; the goods manufactured therefrom and exported to the U.S. faced downward price pressures from competition and American economic struggles.

Restated, the U.S. has been printing money and buying ever-cheaper goods therewith. Oh, and others have been lending us the money at rock-bottom interest rates to do so. The working definition of "bipartisan" has been met, but maybe we should keep this between us.