**Dollar depreciation**

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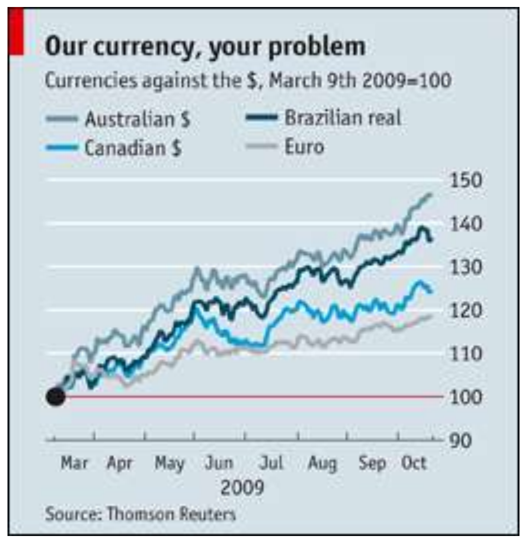
**The dollar's slide is complicating life for countries with floating exchange rates**

IN ONE sense, a weak dollar is good news for the world. Behind the global economy's current revival is a returning appetite for risky investments, such as equities and corporate bonds. At their most panicky investors shunned all but the safest and most liquid assets: American Treasuries were a favoured comfort blanket. That demand for safe assets prompted a rally in the dollar in the months after the collapse of Lehman Brothers last September.

Now that stockmarkets and economies have bounced back, dollar weakness has returned, causing a headache for countries with floating exchange rates (see chart). That has prompted three responses: direct measures to stop currencies rising; attempts to talk them down; or acceptance of a weak dollar as a fact of life.




Brazil has gone for the direct approach. Foreign capital has flooded in, attracted by the healthy prospects for economic growth and high short-term interest rates. That has pushed up local stock prices, as well as the real, Brazil's currency. To stem the tide, the government this week reintroduced a tax on foreign purchases of equities and bonds. Though many doubt the long-term efficacy of such measures, it had an immediate effect. The real, which had risen by more than one-third since March, fell by 2% (before regaining some ground). Brazil's main stockmarket dropped by almost 3%.

Others have resorted to talking their currencies down. In a statement released after its monetary-policy meeting on October 20th, Canada's central bank said the strength of the Canadian dollar would more than offset all the good news on the economy in the past three months. The currency's strength would weigh on exports, said the bank's rate-setters, and mean that inflation would return to its 2% target a bit later than previously forecast. Foreign-exchange markets took the hint: the Canadian dollar fell by 2% against the American one after the bank's statement.

Europe's efforts to contain the dollar's weakness have had rather less impact. This week the dollar slid to $1.50 to the euro, just as Henri Guaino, an adviser to Nicolas Sarkozy, the French president, described such a rate as a "disaster" for Europe's economy. Mr Sarkozy has often moaned about the harm done to exporters by a muscular euro.

Other euro-zone countries are less rattled. "A strong euro reflects the strength of the European economy," shrugged Walter Bos, the Dutch finance minister. Germany, Europe's export powerhouse, feels that its firms can just about live with a euro worth $1.50. Its exporters still flourished when the euro last surged to that level, because demand from Asia and the Middle East for its specialist capital goods proved insensitive to price. France, however, struggled. A report earlier this year by the European Commission showed that French exporters lost market share in the euro's first decade. Other euro-area countries such as Greece, Ireland, Italy and Spain have at least benefited from the recent revival of risk appetite through lower premiums on their debt.

Even so, there is palpable concern that the dollar's decline might get out of hand. Jean-Claude Trichet, head of the European Central Bank (ECB), has repeated his line that policymakers across the Atlantic say a strong dollar is in America's interests. That is meant to signal a shared interest in avoiding a dollar rout. In fact America needs a weak dollar to help revive its economy and reorient it towards exports and away from consumer spending. Since China and some other Asian countries track the dollar, the burden of exchange-rate adjustment falls on the euro. Mr Trichet, Joaquín Almunia, the European Union's economics commissioner, and Jean-Claude Juncker, who chairs the Eurogroup of finance ministers, will visit China later this year to press for a stronger yuan.

Some think part of the solution is in the gift of the ECB: if it lowered its interest rates it would weaken the euro against the dollar. Yet the monetary-policy setting in the euro area has scarcely been different from that in America. The ECB's main policy rate, at 1%, is higher than the Federal Reserve's, but it has been so liberal with its provision of long-term cash loans to banks that excess money has pushed market interest rates close to those of other rich economies. A strong euro may even help by allowing the ECB to maintain a loose monetary stance for longer, says Stephen Jen of BlueGold Capital, a hedge fund.

The ECB will eventually face a problem that some central banks are already encountering. As long as America keeps its interest rates low, attempts by others to tighten policy (even stealthy ones that leave benchmark rates unchanged) are likely to mean a stronger currency. That is a price that Australia's central bank seems prepared to pay. The minutes of its policy meeting on October 6th, at which it raised its main interest rate, revealed the exchange rate was not a consideration. The bank's rate-setters ascribed the Australian dollar's rise to the economy's resilience and strong commodity prices. In New Zealand, similarly, the central-bank governor, Alan Bollard, told politicians that the kiwi dollar's strength would not stand in the way of higher rates.

When the global economy was in free fall, all countries looked to stimulate their economies at the same time. "What looked like co-ordination was really coincidence," says David Woo of Barclays Capital. Recovery is more uneven. Countries with greater exposure to buoyant emerging Asia, such as Australia, are sanguine about a weak greenback. Even Japan seems relatively unfazed. But elsewhere, an ailing dollar feels much more threatening.