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A Word From A Dollar Bear

WARREN BUFFETT'S VOTE OF NO CONFIDENCE IN U.S. FISCAL POLICIES IS UP TO $20 BILLION.

BY ROBERT LENZNER AND DANIEL KRUGER

The dollar has fallen savagely against the euro for the past three years, and the trade deficit is running $55 billion a month. Is the currency rout over? Can the trade deficit be fixed with a rise in interest rates or an upward revaluation of the Chinese currency? Warren Buffett, the world's most visible dollar bear, says the answer to both these questions is no. His bet against the dollar, reported at $12 billion in his last annual report (for Dec. 31, 2003), has gotten all the bigger. Now his Berkshire Hathaway has a $20 billion bet in favor of the euro, the pound and six other foreign currencies.

Buffett has for a long time been lecturing fellow Americans about their bad habit of borrowing from abroad to live well today. He made a big stink about his currency trades in his March 2004 letter to shareholders. FORBES phoned him recently for an update, hoping for the news that the Scold of Omaha had softened his views on the decline of the dollar. What we got was more doom and gloom, more than we have ever heard from the man. In other words, he is not about to cover his short position on the dollar.

Buffett said that he began buying foreign currency forward contracts when the euro was worth 86 U.S. cents, and kept buying until the price reached $1.20. It's now worth $1.33. Buffett said he is not adding new positions now but has been rolling over contracts as they mature. Berkshire lost $205 million on currency speculations in the first half of 2004, but more than made that back with a $412 million gain in the third quarter. It's likely that the December quarter report will show another huge gain.

Since January 2002 the dollar has fallen 33% against the euro. Buffett blames that on bad policy, coming from both the White House and Congress. It does appear that forex speculators are no big fans of George Bush or his Treasury secretary, John Snow. Since Nov. 2 the dollar has fallen 4.4% against the euro.

Says Buffett: "The rest of the world owns $10 trillion of us, or $3 trillion net." That is, U.S. claims on foreign assets run to only $7 trillion. "If lots of people try to leave the market, we'll have chaos because they won't get through the door." In a nutshell, the trade deficit is forcing foreign central banks to ingest U.S. currency at a rate approaching $2 billion a day. Buffett continues: "If we have the same policies, the dollar will go down."

The $20 billion bet has to be put in context. Berkshire has a huge portfolio of investments that includes $40 billion of Treasury securities. Budget and trade deficits are likely to make dollars worth less and bonds worth less. So the currency play is a partial hedge of a large position that can be read as bullish on the U.S.

Still, that Buffett is making a currency bet at all is striking given that this investor has, in his 74 years, rarely made macroeconomic bets. He built Berkshire to a $130 billion market value by acquiring parts or all of lots of businesses, primarily in the insurance sector and primarily in the U.S. Now some of those assets are antidollar assets. Example: In 2002 he bought bonds of Level 3, a telecom company, that were denominated in euros. In 2000 Berkshire picked up MidAmerican Energy, a gas pipeline company. By doing so, Berkshire indirectly acquired the assets of Northern Electric, a utility in England, at a time when the pound was worth $1.58. Now it's worth $1.94, so Berkshire has a paper gain irrespective of any appreciation in the electric company's pound-denominated earning power.

A continuing fall in the dollar "could cause major disruptions in financial markets. There could be unpredictable side effects. It could be precipitated by some exogenous event like a Long-Term Capital Management," Buffett says, referring to the 1998 collapse of a steeply leveraged hedge fund.

How about a soft landing for our deficit-addicted economy? Don't count on it. We're running $100 billion a year in the hole against China, but Buffett doesn't expect that an upward revaluation of the renminbi (stoutly resisted, in any event, by the Chinese government) would greatly reduce this number.

How about a rise in short-term interest rates? They used to say on Wall Street, "Six percent interest will draw money from the moon." Buffett is skeptical, though, that the recent tightening by Fed Chairman Alan Greenspan will do much more than "put off the day of reckoning."

Nor does Buffett support the notion that intervention in the currency markets by one or another central bank can overcome the momentum of a currency that's losing value. "Sooner or later markets win over the intervenors. The intervenors always run out of gas," says Buffett.

What is absolutely necessary to bolster the dollar is "a public policy that brings imports and exports together." Buffett has proposed a grand scheme to force imports and exports into perfect balance by demanding that each dollar of imports be accompanied by a certificate bought from an exporter who moved a dollar the other way. He concedes, using the self-deprecating humor for which he is known, that this scheme has met with deafening silence from policymakers.

Moving beyond cloudland to economic history, Buffett reflects wistfully on the writings of David Ricardo, the 19th-century trade theorist: "In those days the trade imbalances got settled in gold—and when they ran out of gold, people stopped doing business with you." A gold standard? More wishful thinking. But Buffett is no goldbug. It's more that he's an antidollar bug. In dollar terms, gold, copper and oil have all climbed in the past several years; in euros, not so sharply.

So, Warren, what are you buying now? And what's your prediction for the dollar next year? His answers, respectively: No comment, and I'm not making one.

But here's a long-term perspective. He says he may hold foreign currencies "for years and years." And he says that the electorate of the U.S. may be strongly tempted to get out of hock by inflating away the country's dollar debts. **F**

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