

Meltdown of U.S. Dollar Underway as China Dumps the Currency

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The 'penny finally dropped' in insular China

Comments by China that it intends to move away from its reliance on the dollar triggered a sharp drop in the Dow Jones Industrial Average and heightened worldwide fears about the U.S. currency's stability. Chinese Central Bank Vice Director Xiu Jian said that his country is planning to shift much of its \$1.4 trillion national currency reserve from dollars to more stable currencies, such as the euro or Canadian dollar. After these comments, the dollar fell to record lows relative to other currencies -- the lowest ever against the euro, the lowest in a generation against the British pound, and the lowest in 57 years against the Canadian dollar.

"The big issue on any currency is if its rate of depreciation is so fast that it scares away all capital, and the announcement that we heard from China sort of feeds those fears," said Larry Smith, chief investment officer at Third Wave Global Investors.

China is the world's largest investor in U.S. Treasury bonds and securities, holding more U.S. debt than any country but Japan. Because China's currency is linked to the dollar, the country also maintains a massive reserve of the currency.

But this policy had already begun to shift at the time of Xiu's comments. China has divested approximately 5 percent of its \$400 billion holdings in the U.S. Treasury and established a \$200 billion fund to help diversify its investments in equities and stocks around the world.

"We will favor stronger currencies over weaker ones, and will readjust accordingly," said Cheng Siwei, vice chairman of China's National People's Congress.

It is not just U.S. investors who are concerned. Because the dollar's fluctuations have driven up the euro, exports in Europe have fallen and sparked fears for the stability of that continent's economy. In a recent speech, French president Nicolas Sarkozy added his voice to those calling for the Bush administration to act to stabilize the currency.

"The dollar cannot remain 'someone else's problem,'" Sarkozy said. "If we are not careful, monetary disarray could morph into economic war. We would all be its victims."

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