Dollar intervention expected to edge into G-8 talks
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The dollar could grab the headlines at a weekend meeting in Japan of the Group of 8 nations that is meant to focus on oil and commodity prices, especially if there are signs that the shift in U.S. currency policy could lead to coordinated intervention.

Currencies are not at the top of the agenda for Group of 8 financial leaders, from Britain, Canada, France, Germany, Italy, Japan, Russia and the United States. With central bankers absent, currencies will not be mentioned in the communiqué, and officials have said the talks would focus on commodities and inflation.

But the strong correlation between dollar weakness and the rise in oil prices must surely feature in any such discussion.

And investors have detected a shift in Washington's view on the dollar after a flurry of comments from senior U.S. officials about the weak dollar stoking inflation and even raising the prospect of dollar-buying intervention.

So when the Group of 8 finance ministers convene in Osaka on Saturday, their comments will be scrutinized for clues on whether the United States will back its words with action and whether other governments will support intervention.

"Commodities will be a key topic of discussion, which means that the dollar, by default, will also be discussed," said Sharada Selvanathan, a currency strategist at BNP Paribas in Hong Kong.

The dollar plays an important role in the commodities rally and thus in global inflation.

Selvanathan noted a study by the International Monetary Fund showing gold and oil prices rise by more than 1 percent for every 1 percent decline in the dollar.

A paper by the Federal Reserve Bank of Dallas last month said the weaker dollar had contributed about a third of the $60 increase in oil prices between 2003 and 2007.

Stephen Jen, chief global currency strategist at Morgan Stanley, said in a note to clients this week that "the dollar-oil nexus is corrosive and damaging for the global economy."

The dollar's influence on oil was believed to have been a reason the Group of 7 - the Group of 8 minus Russia - said in April that it was concerned about the effect of sharp currency swings on the global economy and was watching exchange rates closely, an allusion to potential intervention.

Almost eight years have passed since the last coordinated intervention in September 2000 when the U.S. Federal Reserve Board, the European Central Bank and the Bank of Japan acted to stem the euro's decline.

The United States has long been seen as holding a policy of "benign neglect," speaking of the virtues of a stronger currency even while reaping the benefits of a weaker one through steady export growth.

Then last week the Federal Reserve chairman, Ben Bernanke, flagged the change from Washington by linking the weaker dollar to inflation and saying that he was watching the dollar closely with the Treasury, words that are rarely used by a top Fed official.

That was followed by the U.S. Treasury secretary, Henry Paulson Jr., saying he would not rule out dollar intervention and that all options were open.

The new sense of alertness, especially from Fed officials, has helped the dollar recover some ground against the euro and other major currencies.

Over the past six years, the dollar has lost nearly half its value against the euro. It hit record lows near $1.602 against the euro in April, but in the past two months it has clawed back nearly 4 percent to near $1.544 to the euro.

Jen of Morgan Stanley said investors should heed the change of U.S. tone because "the next step, whenever it takes place, is actual intervention."

Analysts say the United States, as well as possibly countries that peg their currencies to the dollar, is more worried that the dollar is driving the rise in oil prices to record peaks near $140.

One issue that will shape the environment for potential U.S., European and even Japanese intervention to support the dollar is the respective monetary policy stances of those countries.

It would be difficult for the Fed to prop up the dollar via intervention if it is cutting interest rates or keeping them on hold at the same time the European Central Bank is conducting euro-positive rate hikes.

The European Central Bank is expected to raise rates by a quarter-point to 4.25 percent as soon as next month, while comments from the Fed about discomfort with inflation and the need to act have stoked expectations the Fed could start lifting rates in the next few months.

That would bring the monetary policy of the world's top economic regions closer together, but not entirely.

"The Fed and ECB have a common interest on inflation, but monetary policy is still divided," said Koji Fukaya, senior currency strategist at Deutsche Bank in Tokyo.

Currency strategists at Citigroup said in a note to clients that European officials were more tolerant of a stronger currency as they try to contain price pressures, changing the intervention landscape since the April gathering.

"It would be a misstep for investors to completely discount potential for further verbal or actual intervention, but the bar on market skepticism should be set higher," they said.

Selvanathan at BNP Paribas said the intervention option will remain on the table.

"We cannot rule out intervention in the future if the dollar does not rise as is desired by the Fed, the U.S. Treasury and other central banks who have pegged their currencies to the dollar," she said.

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