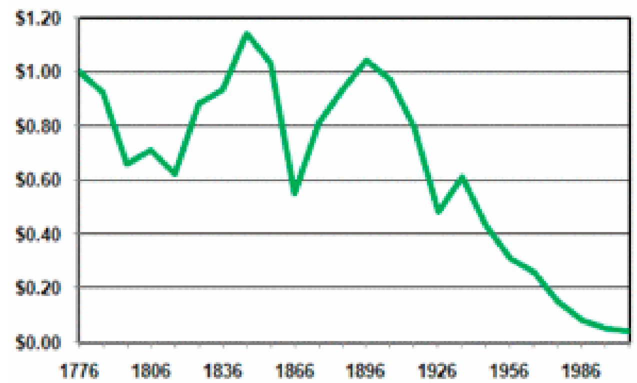
The effect of the Falling Value of the Dollar on the Price of Oil

Summary

This paper shows that the declining value of the dollar (from 2000 – 2008) accounts for nearly $1 of the increase in price of gas (assuming a gallon of gas costs $4.50. With a dollar as strong as it was in 2000, gas would be about $3.50/gallon! *And if the dollar had actually increased in strength the same amount it decrease, gas would be about $2.50/gallon, now.*

The Falling Dollar

The value of the U.S. Dollar has fallen dramatically since it was first put in place in the late 1700s:



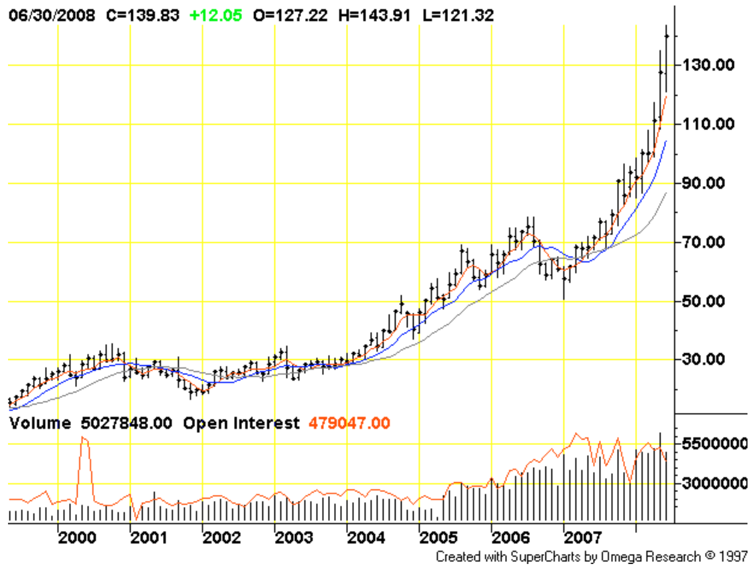
The dollar has lost about 95% of its value over this period.

Looking at how the dollar has fared against a new, stronger currency (the Euro)

(Not well: this graph is an inverse graphic, that shows the value of the Euro against the dollar.)

Oil Price Increases

Comparing the above dollar value with the price of oil over the same period,



one can see that, indeed, there is a correlation between the falling dollar and rising oil prices. In fact, from the middle of 2000 to the beginning of 2008, the Euro increased 64% (90 cents to $1.475 per Euro). To the middle of 2008, the Euro increased 75% (to $1.575 per Euro). Meanwhile, oil prices increased 300% (a factor of 3). Looking towards the middle of 2008, oil increase is 400% (a factor of 4).

The challenge in making such a claim is that there is also a strong correlation between rising oil prices (cause) and decreasing dollar value (effect). What this means is – if we do not work on the root cause of a falling dollar, rising oil prices will make our current downward spiral seem trivial. *However, the dollar increased during the year of 2005 and the price of oil decreased a year later… indicating a dollar-to-oil correlation more than an oil-to-dollar correlation – or "cause & effect" relationship.*

Assuming a direct correlation, one could argue that (from the end of 2000 to beginning of 2008), the decreasing dollar value accounted for 21% of the (increasing) price of oil. Due to the rapid increase in oil prices since the beginning of the year, I suspect that the downward spiral started in earnest the first half of this year, and – short of dramatic demand reduction – is the beginning of even more radical price increases.

If the declining value of the dollar accounts for about 20% of the price of oil, one can surmise that nearly one dollar of the price of gas increase is due to the falling dollar ($4.50 x 21.333% = 96 cents).

One might want to look upstream from oil prices to determine what caused the dollar to collapse. Consumers shopping at Wal-Mart, sending dollars to China? The Federal Reserve allowing interest rates to be too low for too long? A Bush (II) policy of no dollar support, to "export our way out" of the 2000 economic slowdown?

<u>Root cause</u>: The uptick in the dollar value in 2005 and dramatic decrease in prices one year later indicates there are decisions and actions (or lack of decisions and actions) that led to the falling dollar. Those need to be reversed. We need Action This Day!