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US dollar seen rising in 2011 after rough 2010

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WASHINGTON (AP) — Never mind the lackluster economy, the huge trade deficit or the government's piles of debt: The U.S. dollar is still expected to outperform most of the world's major currencies next year.

"By all rights, the dollar should be declining in value, but it's not," says Eswar Prasad, economics professor at Cornell University. "For the dollar to decline in value, you must have currencies on the other side that will" rise.

FILE - In this April 15, 2010 file photo, a man walks past a collage of copies of Chinese RMB, U.S. dollar and other foreign bills at a money exchange store in Hong Kong. Never mind the lackluster economy, the huge trade deficit or the government's piles of debt: The dollar is still expected to outperform the rest of the world's major currencies next year. (AP Photo/Kin Cheung, file)

Bad as things are in the United States, they look worse in Europe and Japan, making the yen, the euro and the British pound riskier bets in 2011. A notable exception is the Chinese yuan, which is likely to rise next year as Beijing fights inflation.

"The dollar remains the ultimate safe haven," Prasad said.

A stronger dollar would make vacations to Europe a better bargain for U.S.

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tourists and reduce the cost of imports. But it would also make U.S. products more expensive in foreign markets, dulling businesses' competitive edge.

The U.S. dollar fell against the euro, pound and yen on Friday during thin year-end trading. The euro rose to $1.3367 late Friday in New York, from $1.3286 Thursday. The British pound rose to $1.5590 from $1.5415 while the dollar fell to 81.21 Japanese yen from 81.52 yen.

For the year, the euro fell 8.3 percent against the dollar and the pound fell 2.5 percent against the dollar. But the dollar was down 12.2 percent against the yen.

Currency analysts at Wells Fargo Bank predict that over the next 12 months, the dollar will rise 7 percent against the yen, more than 4 percent against the euro and 1 percent against the pound.

The thinking: The U.S. economy will gain strength throughout 2011, outpacing Europe and Japan and encouraging U.S. businesses and consumers to borrow more. The demand for loans will push up U.S. interest rates, luring investors to the dollar in search of higher returns.

Europe looks perilous by contrast. In 2010, Greece and Ireland required emergency bailouts from other European countries and the International Monetary Fund. The terms of the bailouts forced them to slash government spending, triggering street protests. Now analysts fear that debt-ridden Spain and Portugal will be next.

"The major issues in Europe haven't gone away," says Mark McCormick, currency strategist at Brown Brothers Harriman. "Certain countries are insolvent. Others have fiscal issues they have to deal with." Spain's troubles, in particular, could strain Europe's bailout fund and might even threaten the future of the euro as the continent's common currency if European countries refused to put up more cash.

The Japanese yen rose sharply in 2010, partly because investors saw it as a safe haven from the troubles in Europe. But analysts suspect the yen's strength against the dollar will be sapped in 2011 by a weak Japanese economy and huge government debts. Japanese policymakers may also seek to push down the yen to give their exporters a price advantage.

China is facing different pressures. The Chinese economy has roared back from the Great

Recession with such speed that it's set off inflation. Now, China is raising interest rates to cool growth. Chinese officials will have an incentive to let the country's currency, the yuan, rise against the dollar and other currencies to help tame inflation by pushing down the price of imports.

That could improve relations between Beijing and Washington, where politicians accuse China of keeping its currency artificially low. That has made Chinese exports cheaper in the U.S, and U.S. exports more expensive in China.

U.S. politicians were under pressure to ramp up the rhetoric against China in the election year 2010, especially with U.S. unemployment near 10 percent. In September, the House passed legislation that would allow the United States to impose tariffs on China if it didn't allow its currency to appreciate. The Senate never acted on the legislation.

Mark Zandi, chief economist at Moody's Analytics, says the tension should ease in 2011 as the U.S. economy improves, the yuan rises and politicians are no longer stumping for votes.

"Allowing a stronger currency would be consistent with the objective of cooling off inflationary pressure," says Wells Fargo currency strategist Vassili Serebriakov. "China will not want to be seen as responding to political pressure."

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