President Obama’s handling of the economy may be reviled by his political opponents, but he is receiving support from a surprising quarter: foreign exchange traders.

The United States dollar, after one of its most prolonged weak spells ever, has now emerged as the preferred currency for global investors. Across trading desks in New York, London and elsewhere, analysts are rushing to raise their dollar forecasts based on the resurgence in the American economy.

In part, this bullish mood is tied to signals from the Federal Reserve that it will soon stop its bond-buying program — a change that would lift interest rates and buoy the dollar.

Yet the recent rally in the dollar — it has gained about 3.2 percent and about 8 percent against the yen since July 1 — underscores expectations that the United States economy will continue to grow at a faster clip than Europe, Japan and even large emerging markets, all of which are seeing their economies stagnate.

On Thursday, the dollar extended its rise, reaching a two-year high of 1.27 against the euro following the release of data in Germany that showed a decline in business confidence there. Against a broad basket of currencies, the dollar is now trading at a four-year peak.

After more than a decade of low interest rates and easy money, the notion of a strong dollar harks back to some seemingly distant periods in economic history,
like the years of balanced budgets under President Clinton in the 1990s or the height of Ronald Reagan’s popularity in the early to mid-1980s.

During those periods, the United States economy was flush with health, and a muscular currency — which made it attractive for Americans to travel and enabled investors to snap up overseas assets on the cheap — amplified this sense of global might.

It may be early days for the rally, however. In today’s global, highly interwoven economy, currency moves can be deceptive and fleeting. Still, the increasing push by investors into the dollar can be seen as a favorable report card on the United States economy, highlighting good performance in crucial benchmarks such as growth and fiscal responsibility, and an increasingly competitive position abroad because of a boom in energy exports.

“As long as the U.S. continues to grow and the rest of the world remains stagnant, the dollar will rally,” said Stephen L. Jen, a former economist for the International Monetary Fund who runs a hedge fund based in London.

A strong dollar is not always a plus. Over time, it can stall economic growth by hurting exports, although economists point out that even with its recent spurt the currency remains undervalued in historical terms.

Fed Signals No Hurry to Raise Interest Rates

By BINYAMIN APPELBAUM

Downgrading its economic forecasts, the Federal Reserve continued to say it would hold rates near zero for a “considerable time.”

Another consequence of a stronger dollar is currency instability in emerging markets.

As currencies like the Turkish lira, the Brazilian real and the Chinese renminbi weaken, investors will be less willing to hold on to their assets in these countries — choosing instead to park their money in higher-yielding dollar assets in the United States.
“The currency markets will become much more volatile,” said Mohamed A. El-Erian, a former top executive at Pimco, the bond giant, who also worked at the International Monetary Fund.

Bolstering the dollar’s fortunes is a realization among traders and economists that the growth gap between the United States and much of the rest of the world has not been this wide for quite some time.

According to estimates from Nomura, the investment bank, the United States’ estimated growth of 3.1 percent next year outpaces Latin America, emerging and developed Europe, and Japan, with only the Asian bloc of nations, at 6.2 percent, performing better.

“I can’t remember the last time there was such a gap,” Mr. Jen said.

Past periods of dollar strength came when the dollar’s status as a reserve currency was more firmly entrenched. More than a decade of easy credit in the United States, the start of the euro and China’s emergence as an economic colossus made the dollar less popular for global central banks, which diversified into euros, the renminbi and other alternatives.

Now, with the Federal Reserve cementing its role as a lender of last resort to central banks all over the world, the dollar is poised to recapture lost ground as the preferred currency for central banks.

“The dollar was never going to disappear and from a comparative point of view it is more attractive now,” said Barry Eichengreen an economist at the University of California, Berkeley, and the author of a recent book on the dollar.

In particular, Mr. Eichengreen cites the recent steps by the Fed to formalize the dollar-lending program that it established during the financial crisis when global central banks needed an influx of dollars to lend to their stricken banks.

The United States’ economic problems have not disappeared. Unemployment still remains stubbornly high, debt levels are elevated and there has been little effort to curb the growth of government spending on social security and other entitlements.
Nevertheless, in the coldblooded world of currency trading, the focus is always on relative, not absolute, performance and in that regard the United States economy is on a roll.

Some of the dollar’s recent strength has come against the euro, following a series of statements made by the European Central Bank’s president, Mario Draghi, that were interpreted by currency traders to be supportive of a weak euro. Many European economists say that, in light of the E.C.B.’s institutional restraints, a weak euro that would jump-start exports is the easiest way to spur growth in the eurozone.

Since Mr. Draghi touched upon some of these issues during his Jackson Hole speech in late August, the euro has lost significant ground against the dollar, a move that has taken many traders and analysts by surprise.

Traders have subsequently added to their bets that the euro will continue to fall, pointing to such long-term problems as anemic growth and persistent unease over Europe’s banks. Data from the United States Commodity Futures Trading Commission show that the short positions on the euro are now the most popular currency trades.

But it is against the Japanese yen that the dollar’s move has been most pronounced: up about 7.4 percent since mid-July. Traders are betting that a weak yen will support the aggressive policies put in place by Japan’s prime minister, Shinzo Abe, who has promised to revive the country’s slumbering economy.

With Japan carrying the largest debt load in the world — 227 percent of its economic output — and with the country’s growth rate at barely a percent, the yen would seem to be ripe for the type of precipitous fall experienced by many emerging markets in recent years.

Many traders point to the structural problems in Japan to bolster their prediction that the dollar will strengthen against the yen. More than ever though, underpinning their bullishness is the fact that the United States’ economy — younger, more flexible and with a better handle on its finances — is doing so much better than Japan’s.
J. Kyle Bass, a hedge fund investor based in Dallas, says an epic collapse of Japan Inc. may be approaching. He believes that the yen is going to weaken to at least 125 yen against the dollar by the end of the year, from about 109 yen now.

Mr. Bass has been a frequent and open critic of Japan’s economic policies dating back to 2010.

Now he notes that for the first time in recent history, Japan’s trade gap is widening, while the United States’ — thanks to buoyant energy exports — is shrinking.

In effect, his bearish call on Japan has become a bullish bet on the United States.

“There is no more export growth in Japan,” Mr. Bass said. “And we are the Saudi Arabia of natural gas.”