# *Dollar Talk*

*Devil Talk*

As I was watching the beautiful sunset over the mountains, as Kahlil Jibran did over the desert, the Dollar came to talk to me.

The Dollar: Most people in your economic and financial profession think my fate is doomed and all argue for a lower me. You seem to be among the very few[1], if not the only one, who believe that I am about to gain weight. Why do you think I shall be up and rising?

PhC: Why do you care so much about your value?

The Dollar: I want to fool all those who think I am doomed. Give me good reasons to do so.

*Prevailing Macro-dynamics*

PhC: You are no fool and know very well that forecasting your future prices amounts to appraising which macroeconomic dynamics currently prevail over your fate. Is it the current-account (CA) deficit? In the eighties, when you rose to $1.80 against the Swiss franc, the U.S. current-account deficits were widening, yet you became ever stronger. What prevailed instead at that time and saved you from crashing was not the CA deficit but the widening of the so-called ROEs between the U.S. and the rest-of-world. Indeed, U.S. equity markets rose on average 10.6% p.a. between 1980 and 2000,

[1] Rothschild still expects "the USD to be supported by a solid growth outlook and a large and widening interest rate differential". – Mosaique Views – February 2019 – p9



Rue du Rhône 65, CH-1204 Geneva | Tel. +41 22 989 55 55 | Fax. +41 22 989 55 56
| bourse@opfi.com | parfinance.ch |www.parfinance.ch

well above the 5.1% average of the past 118 years. During that period, investors got crushed expecting you to decline because of the widening current-account deficits!

*Volker-Reagan*

Today what carries you are two on-going macro-dynamics, which are likely to power you towards much higher levels.

- First, Powell at the Fed and Trump in the White House are reminiscent of the Volker-Reagan years, a period during which, at least at the beginning, you jumped ahead. In fact, Powell's tight monetary policy combined with Trump's fiscal loosening have enabled you to stand the widely heralded decline thus far. Isn't it stunning today that you still trade at CHF1.00 or JPY110 against the recently announced bad news, namely, that "patience" in rates and "flexibility" in QE will henceforth prevail over the course of monetary policy. In my book, you should have been creamed by these two pieces of news but were saved by the powerful dynamics "à la Volker-Reagan" that you enjoyed so much in the early eighties and also by what I coin, for lack of a better phrase: "Fake QE".

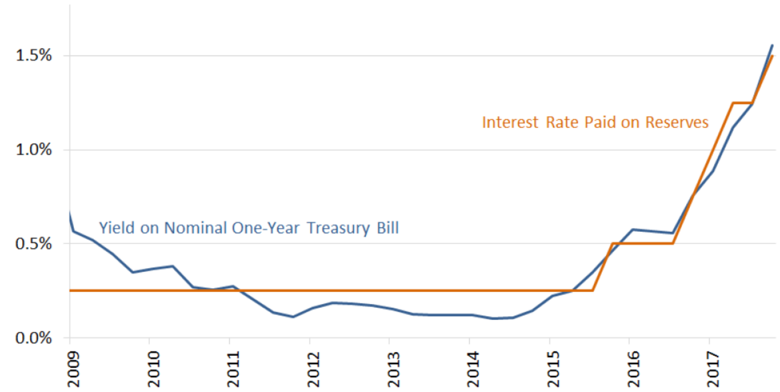
*Fake QE*

- In fact, along with the tight-money/loose fiscal policies in the foreground, another dynamics has been simultaneously playing in the background. "Fake QE" has had a tremendous impact on your current standing against most currencies and on your unbelievable arrogance today. Unlike you – the Dollar – I learn from others, and this time I did it from a fellow named Niels C. Jensen from Absolute Return Partners in London. In his last Letter, Niels argued very convincingly that the $5 trillion from QE has hardly been magnified by the commercial banks' fractional reserve credit activity. Why? Simply because banks had no interest in providing credits to the economy since the rate of return on their reserves had marginally been superior to that which they would have received from lending money. QE has certainly helped the banks to restore the health of their balance sheets, but in no way has it compelled them to issue credits to the economy. This can be seen in the following graph retracing the spread between the one-year Treasury yield and interest



**Rue du Rhône 65, CH-1204 Geneva | Tel. +41 22 989 55 55 | Fax. +41 22 989 55 56**
**| bourse@opfi.com | parfinance.ch |www.parfinance.ch**

paid on reserves. When the proxy spread was large "banks had a strong incentive to lend rather than just sit on their reserves". [2] However, when that spread was non-existent, as the graph below reveals since 2009, it was preferable for banks to refrain their credit activity, which they did. Hence, the QE largess was muted by the coincidental rise in the Discount Rate. There was no abundance of dollars but in fact a scarcity of them. No wonder it saved you from utter collapse.




*Source: Federal Reserve Bank of St. Louis*

*The Dollar Twilight*

The Dollar: I have one more question. What could go against my continuing to rise?

PhC: Go and visit the consensus. They have a myriad of reasons to justify your downfall. As far as I am concerned, Donald Trump has sown the seeds of an alternative currency medium in the financing of world trade. He has done so by over-extending the sovereignty of the U.S. to you, the Dollar. Therefore, a subtle change in the paradigm[3] is taking place in your own backyard.[4] Currently you finance 70% of world transactions while the Euro only finances 20% of them. China has now become the third most used currency.

[2] Niels C: Jensen, The Absolute Return Letter - 6 February 2019
[3] The European Commission will release a blueprint that describes its plan to challenge the dollar's dominance in global finance, in part by bolstering the use of the Euro in strategic sectors like energy, where the Dollar is king.
4 The possibility of the Dollar losing its reserve status has been hinted at again by the Fed in February of 2019.



Rue du Rhône 65, CH-1204 Geneva | Tel. +41 22 989 55 55 | Fax. +41 22 989 55 56
| bourse@opfi.com | parfinance.ch |www.parfinance.ch

These financing shares are now likely to change over time. Initially trading in dollars with Russia,[5] Iran, North Korea and Venezuela has become a risky proposition. Henceforth, I expect the commodity-producers throughout the world to slowly renounce carrying on their external trade in dollars.[6] The world accumulation of dollars will therefore slacken over time. In my book, it is the beginning of the end of your "exorbitant privilege" over world transactions. Corollary: The Euro and the Yuan will mechanically benefit from this in the long run.

*Conclusions*

The U.S. budget deficit, already 5% of GDP, is doomed to widen mainly because of a widening national debt ($22 trillion) and of substantially higher carrying costs ($1.5 billion a day). From a microeconomic standpoint, the economy is not heading towards a 2.5% rate in 2019 but rather towards substantially more, based on the strength of the job market.[7] Never will "patience" be so thin at the Fed, and rate increases will resume in the course of 2019. The Powell/Trump dynamics has not yet abated, nor has "Fake QE" dynamics faltered. Therefore, monitor the Dollar this year and next, but above all do not short it. It could initially rise to Euro 0.90 and to CHF 1.20 before overshooting thereafter to Euro 0.80 and to CHF 1.30, when it will suddenly have become apparent to all that QE has not soaked the world economy with bank credits.

*Thanks, but no thanks*

The Dollar: I shall work along those lines and make you famous.

PhC: I am not Doctor Faust. I don't want to have it all. Keep your fame for yourself and leave me alone.

[5] In 2018, the Russian National Bank reduced its reserve currency holding by $100 billion in favor of the Euro, the Yen and the Yuan.
[6] Most Russian oil/gas companies, such as Surgutneftgaz, have already annexed to their contracts the possibility of signing in Euro.
[7] 20 million new jobs since 2009.



**Rue du Rhône 65, CH-1204 Geneva | Tel. +41 22 989 55 55 | Fax. +41 22 989 55 56**
**| bourse@opfi.com | parfinance.ch |www.parfinance.ch**