

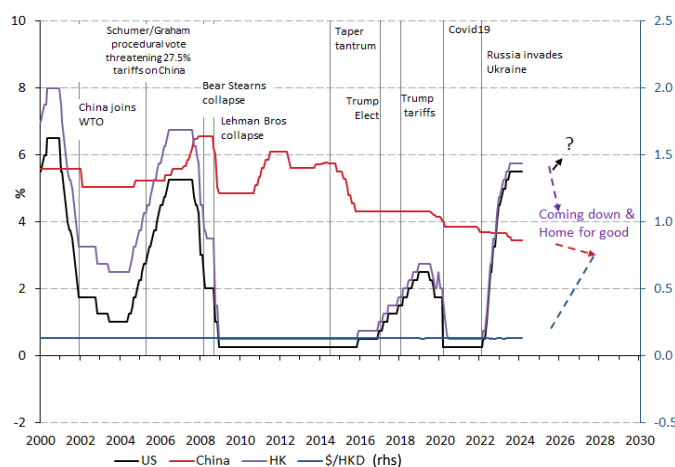
The threats lurking in the US dollar's shadows, as its stalkers and groupies cut their interest

Across all continents, & for a host of reasons we see FX' in fictions. Fiction after fiction where nations with 'sovereign' currencies, manage these, to if not exactly shadow the \$, then closely track it. This collection can be split into two quite distinct categories.

1. One sub-group of 'shadowy' dollarites is made-up (*sic*) of currencies "parasitically" attached to it (henceforth referred to as "stalkers"). These cling on in an effort to gain investor credibility, so as to issue 'dollarised debt' at a yield much lower than were they to raise it in their otherwise 'looked down upon' currency. This process of desperate 'clingons' invariably ends with a sudden (albeit much awaited) shock lower, & very possibly default on \$ debt. In the wake of such devaluation monetarily expensive efforts (read even more sharply higher interest rates) follow to again shadow the \$; until, that is, the next downwards episode hits. Then repeat, *ad nauseam*; or until you become **Zimbabwe** or **El Salvador** etc. & give up entirely on your own currency. In the camp of persistent \$ (re)peggers are the likes of **Turkey** (chart 2), **Egypt** (chart 3), **Argentina**, **Vietnam** (chart 4), & **Lebanon**.
2. In the other shadowy sub-group of currencies tied to the \$, the knot seems Gordian-like (henceforth referred to as the "groupies"). So secure in fact, the fiats of these nations have for long appeared perfect facsimiles of the USD. Consider in this regard, currencies in the likes of **HK** (chart 1), **Saudi Arabia** (chart 5), the **UAE** (chart 6) & **Qatar**. In many of these cases, the monetary-managerial effort to remain pegged is motivated by the 'fear' that without a strict alignment to the \$, the currencies aligned to it would strengthen against it, & lead to a form of Dutch-Disease. That many in this latter group come under the heading of petro-dollar states, is no coincidence. That **Hong Kong** is a member is quite frankly an anachronism, to which we shall return.

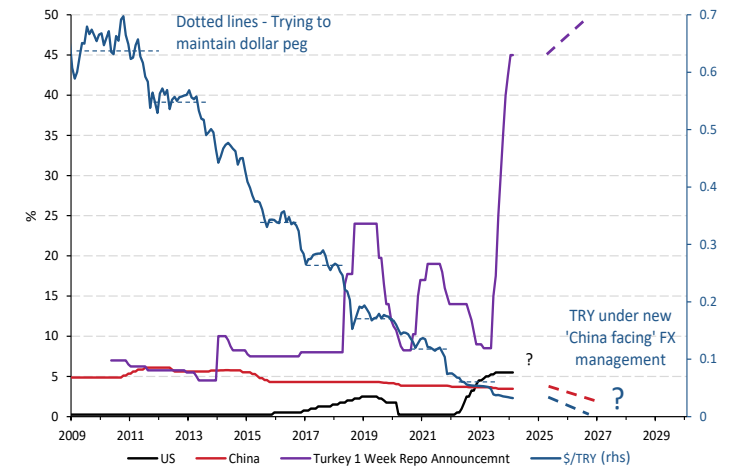
So, though sharing the fact their currencies are pegged to the USD, nations that are "stalkers" or "groupies", are quite distinct. The point which cannot be over emphasised is the following. Whilst we are conditioned to seeing the resolve of 'poor' central banks trying to keep their national currency pegged to the USD ("stalkers", charts 2-4) inevitably broken (read marked devaluation), there is practically no precedent for a well-capitalised dollar "groupie" voluntarily decoupling from it (charts 1 & 5-6). Yet please be in no doubt, whilst "stalker" decouplings are all too common, with some certain to come soon (*viz.* **Turkey** – chart 2), breaks from long-standing dollar pegs in the "groupies" must surely/shockingly come before too long.

Chart 1: Interest Rates & FX: US, China, HK, & fcsts – "GROUPIE"



Source: Bloomberg

Chart 2: Interest Rates & FX: US, China, Turkey, & fcsts – "STALKER"



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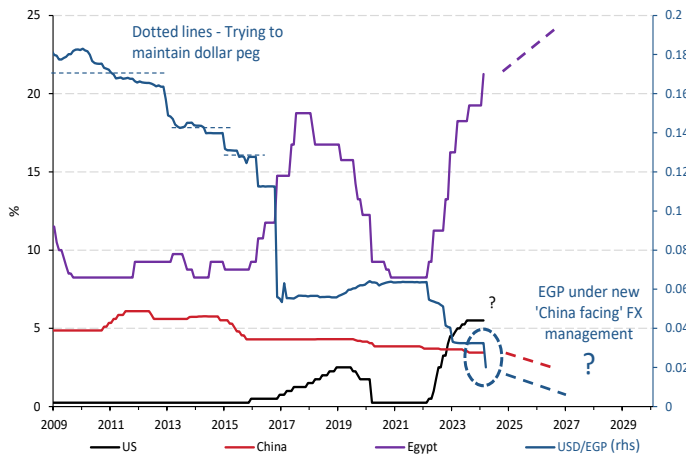
As for Egypt's pound (Chart 3), on March 6th, it was once again shockingly exposed as a "stalker"; its central bank claiming it would allow the exchange rate "to be determined by market forces", but in reality, returning to stalking the US\$ at a 40% lower level (circled, Chart 3).

To be clear, there was never any doubt the Egyptian pound's 'stalking' of the US\$ would be severely punished; nor that this new lower level will in time, be exposed and again punished; just as Nigeria's stalking has recently been.

We can be just as certain that the most recent bout of **dollar 'stalking' by Turkey's lira will cost it dear in the form of a marked devaluation and debt crisis.**

Surely, it can only be a matter of time before stalker currencies chose a new target. Why not China's yuan?

Chart 3: Interest Rates & FX: US, China, Egypt, & fcsts – "STALKER"

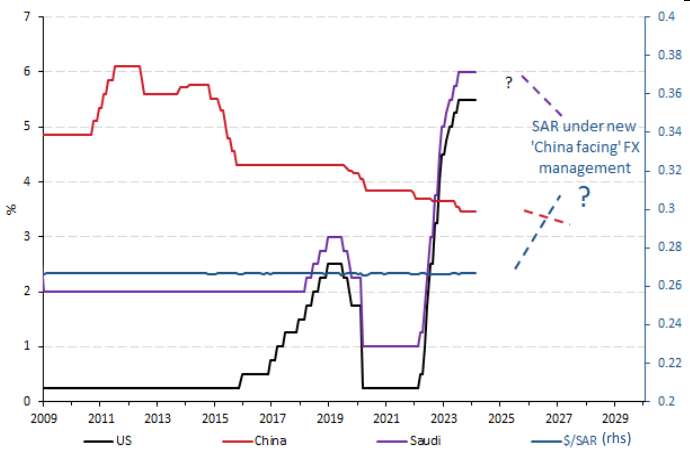


Source: Bloomberg

Chart 4: Interest Rates & FX: US, China, Vietnam, & fcsts – "STALKER"

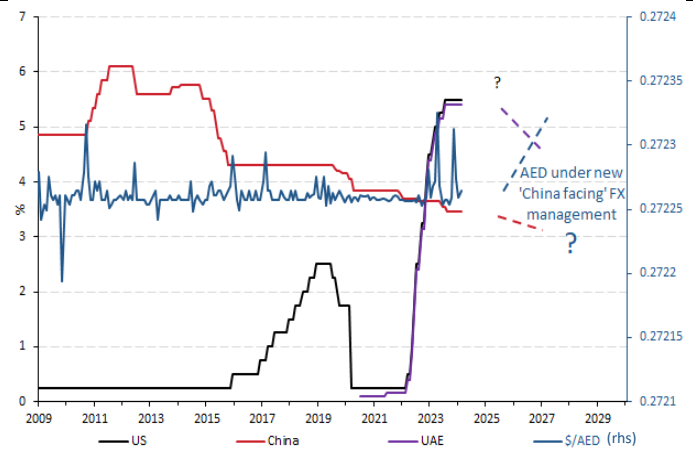


Chart 5: Interest Rates & FX: US, China, Saudi, & fcsts – "GROUPIE"



Source: Bloomberg

Chart 6: Interest Rates & FX: US, China, UAE, & fcsts – "GROUPIE"



Why its groupies and stalkers losing interest (literally) in the US\$ will come dear to T-Bonds

In the not-too-distant future, we are sure to see breaks from the dollar, just as through history we have witnessed currencies break from what seemed imperious leaders – from the British pound, the Florentine forint, and way back to Rome's once seemingly almighty and *eternal aureus*, itself minted in gold.

To be clear, once the first break comes with long-standing dollar FX'ing tradition, it will encourage others to follow; hitherto loyalist dollarites, far and wide, cutting-free, not least the long standing & seemingly staunch, petro-dollarists. **As for the opening "groupie" move, the Hong Kong dollar has for long been my candidate to be the first to break ranks** with seemingly "dyed in the wool", US dollar-tied tradition. Break its lock-step with the US dollar and, as such, the strict policy of following the Fed in how it sets interest rates. Break such ranks in place of a new monetary approach; one far more closely alignment to the People's Bank of China. After all, why should **Hong Kong**, a self-administered region of **China**, not of the **US**, align its interest rates with the latter? And break ranks all the more as the positive gap between the cost of dollar capital and that for the yuan widens.

Why the Emerging World will soon monetarily align with China

Having tried and repeatedly failed to hold pegs to the US dollar, why should currencies from **Vietnam** and **Turkey et al.**, not try to anchor to the Chinese yuan, or a basket in which it plays a large part? Well, there is no reason why not, and every reason why they should. Ever reason because it would provide them with the opportunity to lower interest rates. And when, not if, such seismic changes hit, the nature of global saving & spending will most certainly change. For with the \$ losing its exorbitant privilege (as coined over 60 years ago), so the **US debt market will suffer a sharp (read expensive) decline in outside appetite.**

AIIB versus the IMF/World Bank? A powerful and permanent shift in financial power from Washington to Beijing

The script is so common and tired, it can be recited from memory. A nation masquerades its currency as if it were a facsimile for the US dollar, and in so doing raises considerable dollar debt. This continues until the currency of the nation in question (be it **Nigeria, Egypt, Turkey, Lebanon, Argentina etc.**) suffers its inevitable marked devaluation. In the wake of this very nasty – but really not surprising – real shock, the **IMF** enters the fray with a 'financial rescue' package which come with austere conditions. Enter a period of economic discomfort for the population at large. This then becomes a new normal, and ushers in a new masquerade at imitating the US dollar, and so repeat. And to repeat, whilst the actors performing this pantomime change – one time a nation in Africa, then one in Central or South America, followed by another somewhere else – the script is the same. Well, if this paper is to be believed this script is set to be torn up and replaced by a new fresher one, that suits a 21st Century so very different from the one before.

Having been formed in 2015, the **Asian Infrastructure Investment Bank (AIIB)** centred in Beijing, came 70 years after the formations of the IMF and World Bank, based in Washington. To say one is a construct of an old century and the other the present one, is clear in these formative dates.

Looking ahead, and not that far, the world must see emerging nations shift the focus of their currency management away from an adherence to dollar dominance, to a regime closely following China's yuan. This displacement will have to come with a far greater role for the AIIB and as such, a much diminished one for the IMF/World Bank.

To be clear, whilst the AIIB will channel capital into all those emerging nations that apply to it for it, the process will not be driven by benevolence. Just as the **US** has long used the IMF/World Bank to wield soft-power, so Beijing will employ the AIIB, to the same purpose but also much more. The much more will be that its 'generous' financing far and wide across the emerging economic world, **China** will be serving its on-going very ambitious internal growth drive.

In short, from **Nigeria**, to **Egypt** and **Turkey**, and indeed all those nations which have obsessed with forcing their national currencies to stalk the US\$, and as such, risk regular severe devaluations and IMF imposed austerity conditions to be 'bailed-out', it is time for a huge change. Change that is from stalking the US\$ to the RMB.

A very Un-United States/Un-Civil Peace

There will no doubt be those dismissing all the above as long feared, and long turned stale; "wolf crying" of a dollar debacle, at its currency forecasting worst. Others who accept the above will indeed soon come to pass, will argue that once it does, we should fear for the global economy *writ large*; something I dismiss out of hand. There is still a third opinion, which is the one I hold.

Once the momentous dollar shocking events predicted above begin to show themselves, we should welcome them. Embrace them as being part of the shift to **China** in how the global economy, in essence its ever faster growing national 'Acorns', come under new and IMPROVED monetary management (table 1). **China** opening-up its capital account will facilitate this all the more, albeit all the more imperil debt markets in a **United States**, showing precious little unity. One could even argue the sadly not-so-United States, is more fractious or uncivil, than since it was embroiled in the war 'between the **Vietnams**'; or possibly even when torn asunder, by its own Civil War.

The UK economy and sterling, in global context: lose the tropes

As with any (non-consensual) macroeconomic outlook, one is minded to ask what matters might mean for the **UK** if the events this piece predicts, were to indeed shockingly-happen. And in the context of a piece on FX futures, the specific question must be what the US dollar (and Treasury market) losing many long-standing "groupies" and "stalkers", would most likely mean for the pound, Gilts and UK economy?

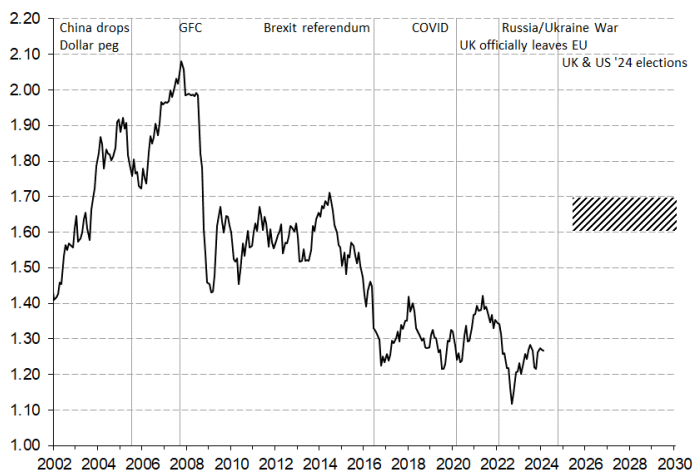
No doubt there will be those who see the US dollar being eclipsed by the yuan, as casting a dark shadow over the pound, and by association the UK debt market and macroeconomy. It will be further claimed that matters would be made all the worse for the **UK**, if, as is predicted in this piece, a loss of interest in the US dollar, results in persistently high US interest rates, indeed even higher. This argument conforms to the tropes that the pound is hostage to the dollar and "when the US sneezes, the UK economy catches...". Now, whilst there was a time such alarming maxims carried merit, that time was in the 20th, not 21st century.

Why it has never been least costly to become dis-INTEREST'd in the US\$

Far and wide for a long time, the low-level of **US** lending rates was envied; and as the saying goes, 'imitation is the sincerest form of flattery'. With this Wildean proverb in mind, many nations in the thrall of how cheaply it was to borrow in the dollar, tried to disguise their own currency, as if theirs, was it. Welcome then to the shadow dollar phenomenon. Well, that was then, and this is NOW.

The time of ultra-low lending rates is now behind the dollar, and as such there is a cost of debt headwind in front of the **US** economic ship, and all those that sail in it. No surprise then that long-standing dollar "groupies" will opt for their best interest to jump. Jump down to the lower rates which being in **China's** realm provides.

Chart 7: Dollars per Sterling, & fcsts – £ strength ahead



Source: Bloomberg

Chart 8: Euro per Sterling, & fcsts – £ strength ahead



The UK engaging with a China in the 21st Century, unrecognisable from what it was in the last

The modern macro world, contains a fully-economically and ever more, engaging **China**. Moreover, exchange rates are the relative prices of the world's currencies, of which the pound is one of the few well-established fiats. Sterling after all holds a weighting in the IMF's Special Drawing Rights (SDR). It also has a role in how China's CFETS manages the ever more powerful yuan (Table 1). Additionally (*sic*), UK fixed assets and Gilts are globally very widely held.

So, were the events in this piece to unfold, the pound COULD ONLY strengthen against the dollar (Chart 7). Furthermore, demand for Gilts COULD ONLY rise in the event the appetite for Treasuries markedly lessened. One must also add that the pound would strengthen against the euro were the latter to be abandoned by some of its very own long-standing "groupies" and "stalkers". The latter would, after all, force the ECB to act on rates, downwards on them and downwards on the euro relative to the pound (Chart 8).

Summary

Let me close by considering the counter arguments to all that came before.

There will be those claiming that Washington would NEVER SANCTION defections from the dollar-pegged ranks made-up (*sic*) by the "groupies". Those dismissing the views expressed above will continue that members of sub-group two would not dare to alter matters. Never deem to change their currency ties, not because they fear how the **US** might respond with ire, but rather because of concerns that either their currency will fall if free of its dollar peg, or, much more likely, rise, and infect them with the Dutch Disease. This line of reasoning will go on to claim that with so much of their wealth tied-up in the US Treasury market, cutting their currency tie to the dollar, and in so doing risking an undermining in US yields (i.e. sending them higher), would cost them dear. As always, when weighing-up costs and benefits from an action, one has to make a decision. And as things stand, the balance is shifting ever more towards cutting free of the dollar, despite the costs that will almost certainly come with it; the benefits being so much greater.

The pegs in both "stalkers" and "groupies" are voluntary, and as such, NOT held under political duress from Washington. Indeed, regularly over the decades US Presidents have complained that the dollar has been kept unfairly high. We have seen efforts to devalue the dollar made by Nixon in 1971, Reagan in 1985, and George Bush Jnr. in 2005. That Trump failed to get the 'dollar down' during his (first) term was down (*sic*) to a poor approach in trying to achieve as much from **China**.

Returning to, say, the Saudis and other dollar-ites in the Gulf, one should not assume they will staunchly honour their dollar-pegs. These nations are reorientating their economies away from exporting oil and gas. And in so doing they are pivoting away from selling commodities priced in dollars. Pivoting away too from 'the west', for which read turning more towards a **China** which so many other nations are turning to as their new sun king. And turning away from a **US** sinking under social division.

Let me return to why the counter argument, which runs along the lines that was claimed at the beginning of the section, cannot possibly come to pass. It will not happen, because dollar "groupies" would fear contracting The Dutch Disease if they allowed their respective currencies to strengthen against the dollar, or suffer a different ill, were their fiats to fall. To be clear, this short piece predicts the former. Our forecasts that "groupie" currencies would strengthen were they not zealot-like followers of the dollar can clearly be seen in the relevant graphs; our FX forecasts pointing upwards. The point to make is that if a sufficiently large collection of dollar "groupie" currencies were to defect in short order, their values would be closely synchronised in moving higher, thereby ensuring their trade-weighted levels headed up on a comparatively shallow path; shallower, that is, than were they to unilaterally defect from being a dollar "groupie". And whilst not claiming "groupies" somehow collude or are a cartel, we can be sure that were/if one to move, so too, three, four...

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Table 1: The changing way the PBOC has managed the RMB since 1994

	Post '94	July '05	Jan '16	Jan '17	Jan '20	Jan '21	Jan '22	Jan '23	Jan '24	Jan '25?		Jan '16	Jan '17	Jan '20	Jan '21	Jan '22	Jan '23	Jan '24	Jan '25?
US \$	100	100	26.40	22.40	21.59	18.79	19.88	19.83	19.46	↓	South African rand		1.78	1.48	1.47	1.21	1.43	1.42	↑
Euro			21.39	16.34	17.40	18.15	18.45	18.21	18.08	↓	Swiss franc	1.51	1.71	1.44	1.10	0.76	1.16	1.40	↓
South Korean won				10.77	10.68	9.88	9.67	9.51	9.05	↓	Polish zloty		0.66	0.84	0.97	1.05	1.11	1.12	↑
Japanese ¥			14.68	11.53	11.16	10.93	10.76	9.76	8.96	↓	Turkish lira		0.83	0.73	0.72	0.82	0.90	1.00	↑
Australian \$			6.27	4.40	5.20	5.89	5.71	6.07	5.48	↑	New Zealand \$	0.65	0.44	0.57	0.63	0.61	0.65	0.62	↑
Malaysia ringgit			4.67	3.75	3.70	4.31	4.44	4.64	5.11	↑	Swedish krona		0.52	0.58	0.61	0.61	0.55	0.52	↓
Russian ruble			4.36	2.63	3.65	3.85	3.66	3.85	4.60	↑	Danish krone		0.40	0.40	0.41	0.46	0.47	0.40	↓
Thailand bhat			3.33	2.91	2.98	3.19	3.35	3.44	3.41	↑	Hungarian forint		0.31	0.37	0.35	0.40	0.41	0.40	↓
Hong Kong \$ *			6.55	4.28	3.57	3.59	3.46	3.60	2.98	?	Norwegian krone		0.27	0.21	0.26	0.37	0.40	0.33	↑
Singapore \$			3.82	3.21	2.82	3.12	3.02	2.47	2.96	↑	New Entries?					New Taiwan dollar			
Saudi Arabia riyal				1.99	2.16	2.71	2.28	2.29	2.79	↑	Brazilian real	Indian rupee			Czech Koruna				
£			3.86	3.16	2.75	3.00	3.13	2.96	2.66	↑	Egyptian pound	Romanian leu			Chilean Peso				
Mexican peso				1.69	1.98	2.11	2.06	2.27	2.45	↑	Nigerian naira	Philippine peso			Israeli Shekel				
Canadian \$			2.53	2.15	2.17	2.26	2.17	2.15	2.43	↑	Pakistani rupee	Vietnamese dong			Argentine Peso				
UAE dirham				1.87	1.57	1.69	1.67	1.90	2.39	↑	Indonesian rupiah	Colombian peso			Peruvian sol				

Source: CFETS

Postscript

Just to make clear, the nations identified in sub-groups one and two, as respectively the dollar's "stalkers" and "groupies", are far from exhaustive. Moreover, the dollar is not the only currency other fiats anchor to; the euro having its own "stalkers" (**Serbia, Macedonia, Armenia, Georgia, Moldova and Bosnia-Herzegovina**) and "groupies" (**Hungary, Czech Republic, Romania, Bulgaria, Denmark and Sweden**). Indeed, on occasion, even the Swiss franc has been a euro "groupie"; although one could claim this as the strange case of the star, for its own protection, following the "stalker". Controversially, whilst the euro has been moving up against the Norwegian krona, a nation with enormous natural resource capital, it had been weakening relative to the Albanian lek – which most recently has seen a peg policy applied - a nation whose national human capital has been deserting it. Anyway, just as pegs to the dollar 'will go', so too will some (many?) held against the euro (**Hungary** being the first-mover "groupie" in shocking lower against the euro, just as **Turkey** will be the next "stalker" to go, for the dollar).

The issue is that whereas the euro's "groupies" and "stalkers" are, as it were, "close to home", the dollar's followers exist far and wide, or rather, will do so for only a short time more. After all, when celebrity fades, so "stalkers" and "groupies" fade away from it. Shift from it and instead align themselves to a new Star and be happy basking in its constellation (see Table 1).

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