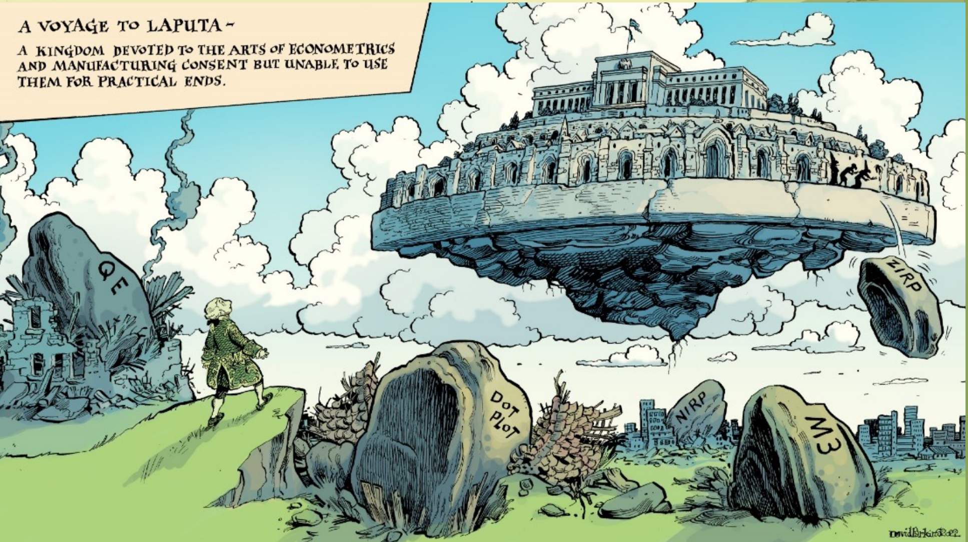

Why The DOLLAR Remains King

(and that's the problem)

eurodollar. UNIVERSITY

Dollar Mysticism

Dollar Misunderstanding

MONETARY POLICY > FEDERAL RESERVE

Part of UNDERSTANDING THE ROLE OF THE FED

How Moves in the Fed Funds Rate Affect the US Dollar

By EVAN TARVER Updated May 05, 2022

Reviewed by ROBERT C. KELLY

Fact checked by SUZANNE KVILHAUG

Changes in the federal funds rate can impact the U.S. dollar. When the Federal Reserve increases the federal funds rate, it typically increases interest rates throughout the economy. The higher yields attract investment capital from investors abroad seeking higher returns on bonds and interest-rate products.

Global investors sell their investments denominated in their local currencies in exchange for U.S. dollar-denominated investments. The result is a stronger exchange rate in favor of the U.S. dollar.

Dollar Misunderstanding

NO. NO. NO.

Investopedia EDUCATION MARKETS SIMULATOR YOUR MONEY

MONETARY POLICY > FEDERAL RESERVE

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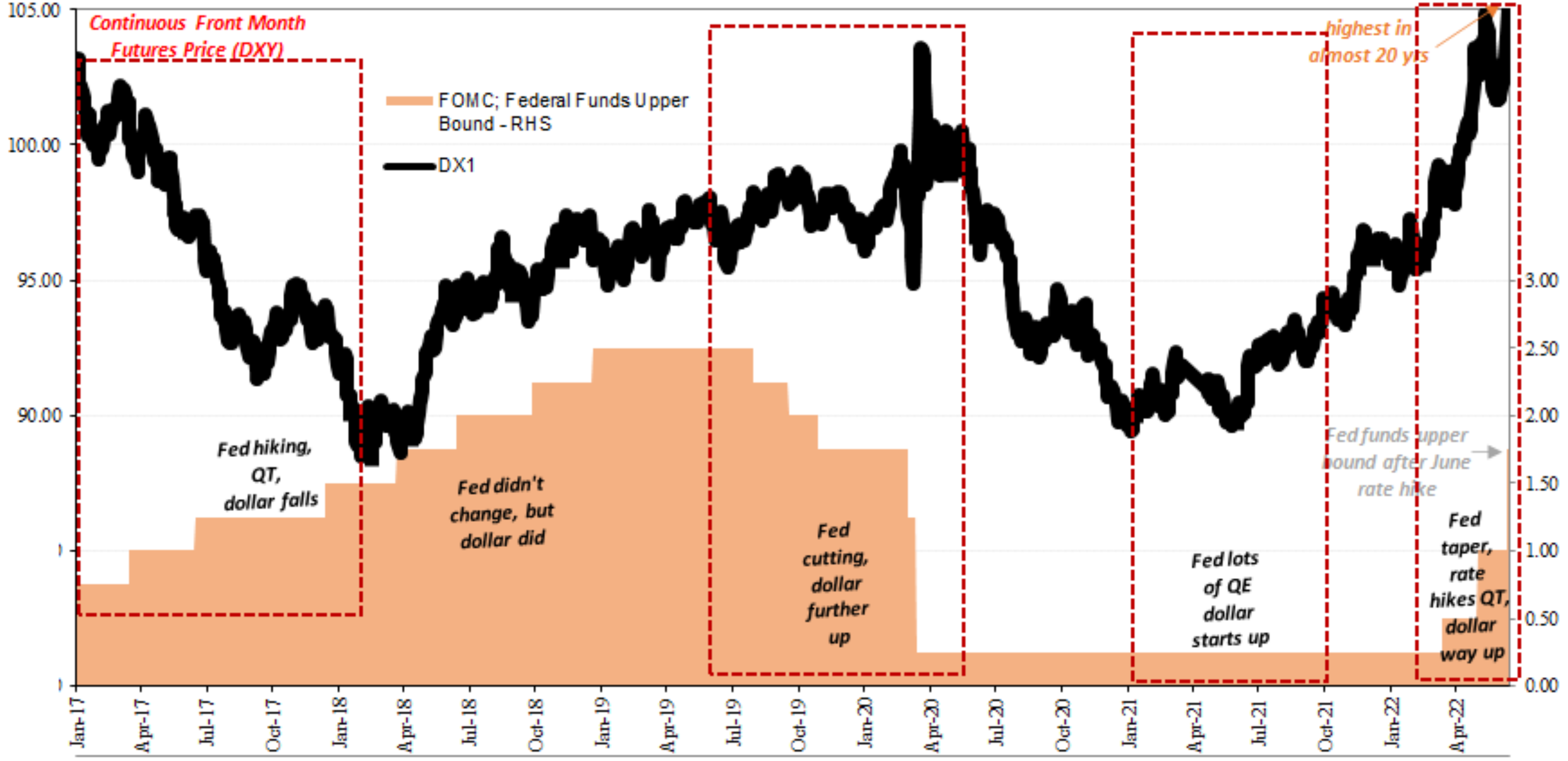
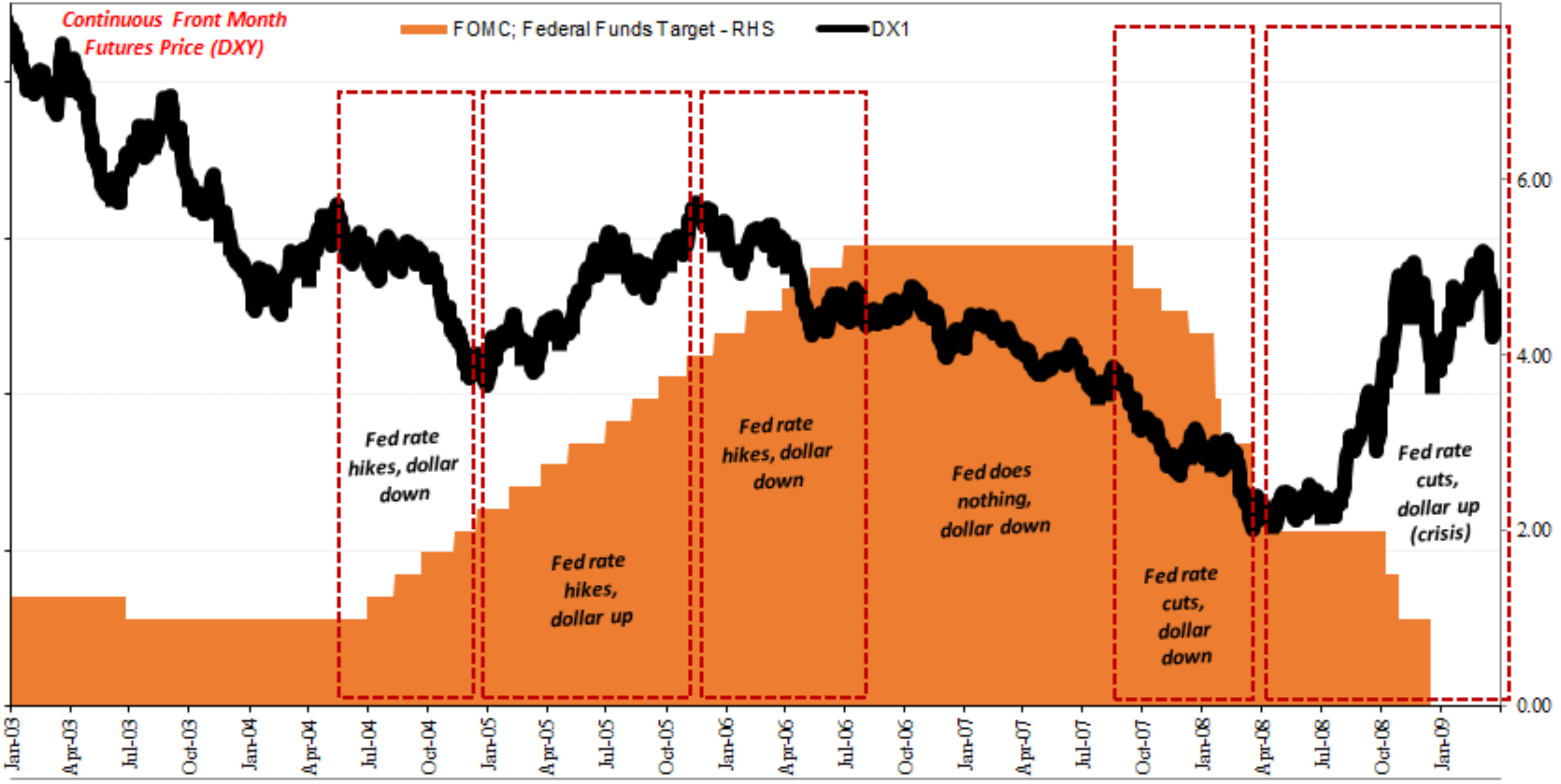
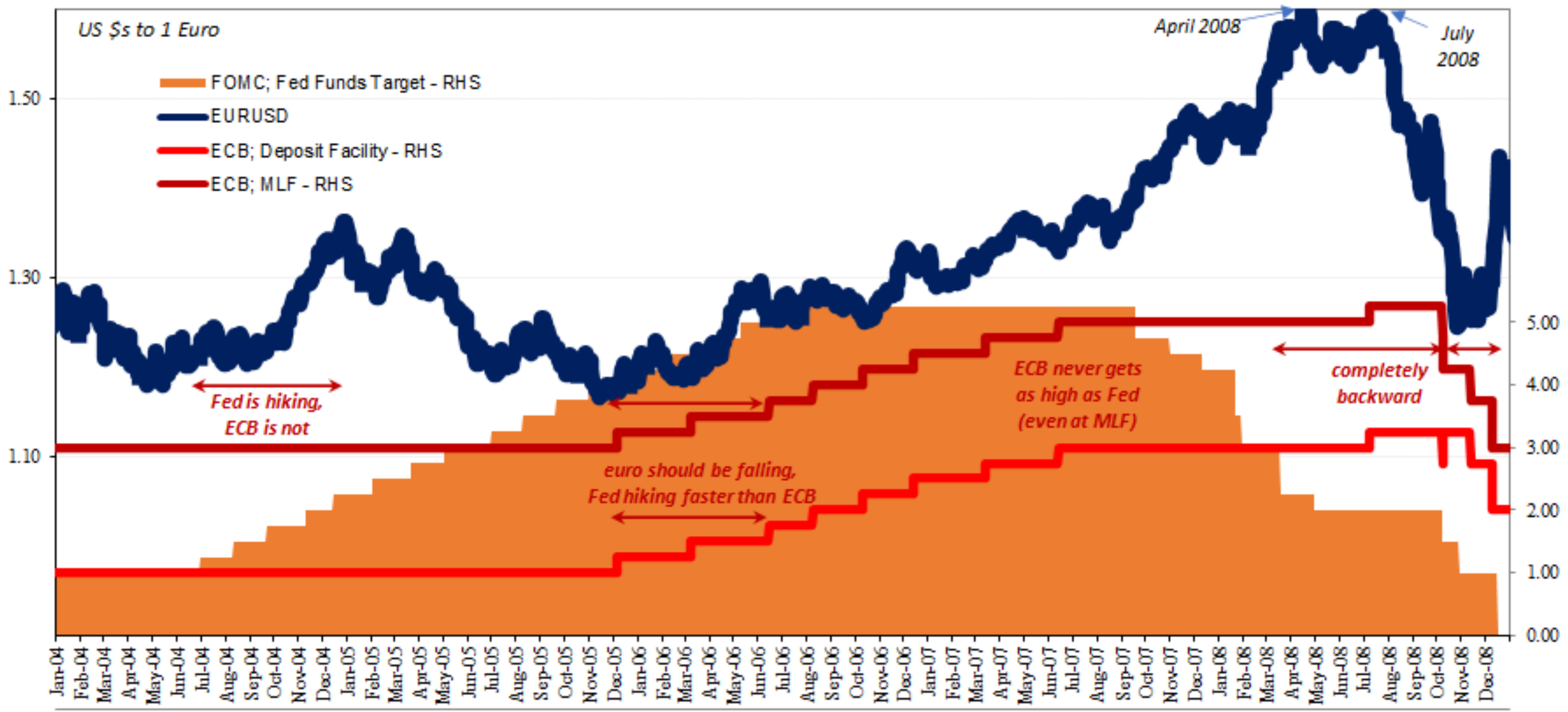
ICE: US$ Futures Index



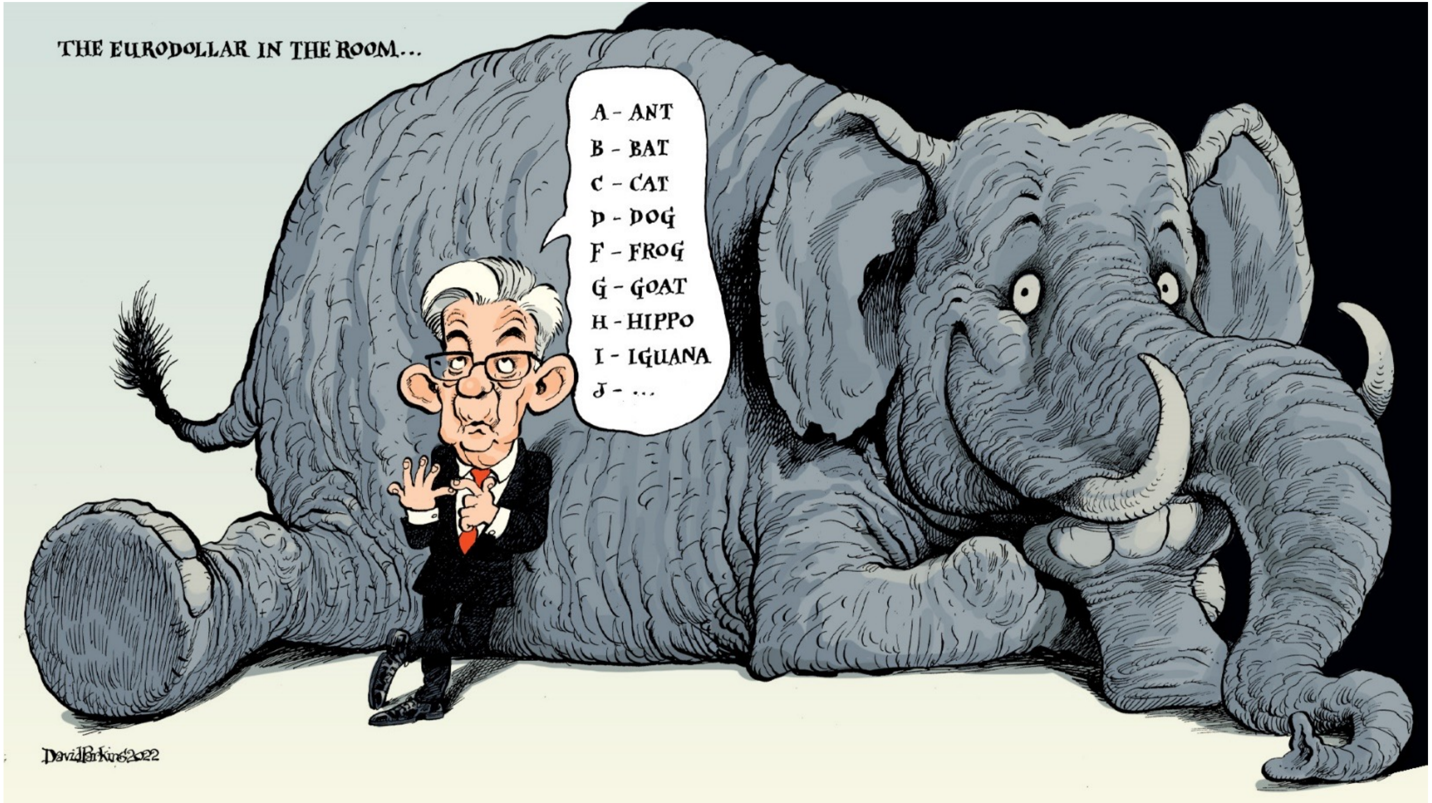
ICE: US$ Futures Index



Euro € / US$


US $s to 1 Euro
FOMC; Fed Funds Target - RHS
EURUSD
ECB; Deposit Facility - RHS
ECB; MLF - RHS
April 2008
July 2008
Fed is hiking, ECB is not
euro should be falling, Fed hiking faster than ECB
ECB never gets as high as Fed (even at MLF)
completely backward
1.50
1.30
1.10
5.00
4.00
3.00
2.00
1.00
0.00
Jan-04 Feb-04 Mar-04 Apr-04 May-04 Jun-04 Jul-04 Aug-04 Sep-04 Oct-04 Nov-04 Dec-04 Jan-05 Feb-05 Mar-05 Apr-05 May-05 Jun-05 Jul-05 Aug-05 Sep-05 Oct-05 Nov-05 Dec-05 Jan-06 Feb-06 Mar-06 Apr-06 May-06 Jun-06 Jul-06 Aug-06 Sep-06 Oct-06 Nov-06 Dec-06 Jan-07 Feb-07 Mar-07 Apr-07 May-07 Jun-07 Jul-07 Aug-07 Sep-07 Oct-07 Nov-07 Dec-07 Jan-08 Feb-08 Mar-08 Apr-08 May-08 Jun-08 Jul-08 Aug-08 Sep-08 Oct-08 Nov-08 Dec-08

(EURO)DOLLAR FUNDAMENTALS



Asian Fin'l Crisis: Regional $ Shortage

Meeting of the Federal Open Market Committee
May 19, 1998

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, May 19, 1998, at 9:00 a.m.

PRESENT: Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Ferguson
Mr. Gramlich
Mr. Hoenig
Mr. Jordan
Mr. Kelley
Mr. Meyer
Ms. Minehan
Ms. Phillips
Mr. Poole
Ms. Rivlin

Messrs. Boehne, McTeer, Moskow, and Stern, Alternate Members of the Federal Open Market Committee

Messrs. Broaddus, Guynn, and Parry, Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco respectively

Mr. Kohn, Secretary and Economist
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Ms. Browne, Messrs. Cecchetti, Dewald, Hakkio, Lindsey, Simpson, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Winn, Assistant to the Board, Office of Board Members, Board of Governors
Ms. Fox, Deputy Congressional Liaison, Office of Board Members, Board of Governors

"MR. FISHER. What interests me is that when I talk to bankers, many of them will tell me very frankly that **their credit lines to their Japanese counterparties are completely full**. That is, their traders are taking maximum advantage of trying to capture this premium and arbitrage it. But the bank credit departments are now in charge on an individual trade-by-trade basis, and they are up against their limits.

Peter Fisher, Federal Reserve Open Market System Manager
FOMC Transcript
May 1998

Asian Fin'l Crisis: Regional $ Shortage

Meeting of the Federal Open Market Committee
February 3-4, 1998

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, February 3, 1998, at 2:30 p.m. and continued on Wednesday, February 4, 1998, at 9:00 a.m.

PRESENT: Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Ferguson
Mr. Gramlich
Mr. Hoenig
Mr. Jordan
Mr. Kelley
Mr. Meyer
Ms. Minehan
Ms. Phillips
Ms. Rivlin

Messrs. Boehne, McTeer, Moskow, and Stern, Alternate Members of the Federal Open Market Committee

Messrs. Broaddus, Guynn, and Parry, Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco, respectively

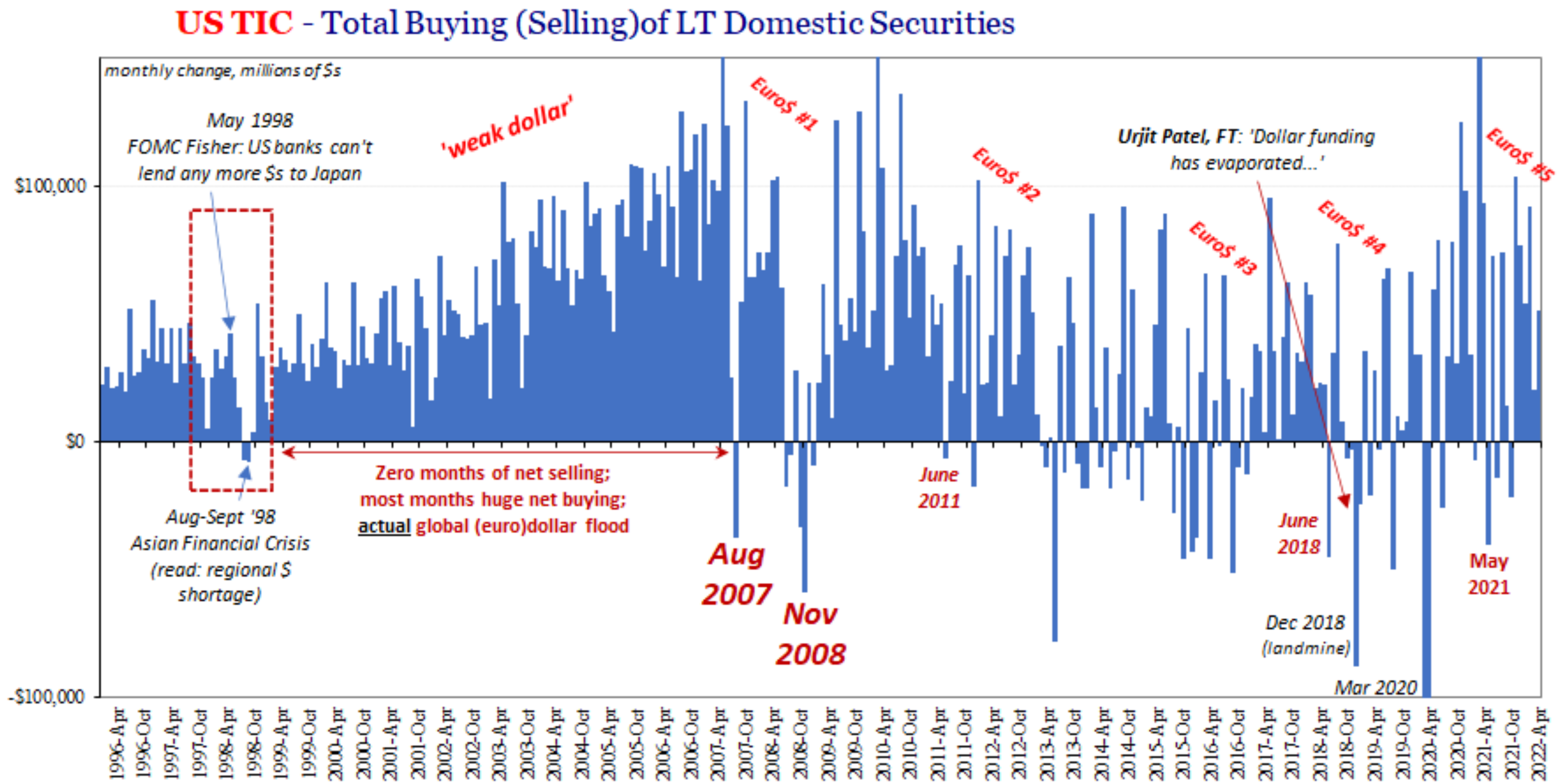
Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Baxter, Deputy General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Ms. Browne, Messrs. Cecchetti, Dewald, Hakkio, Lindsey, Promisel, Simpson, Sniderman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

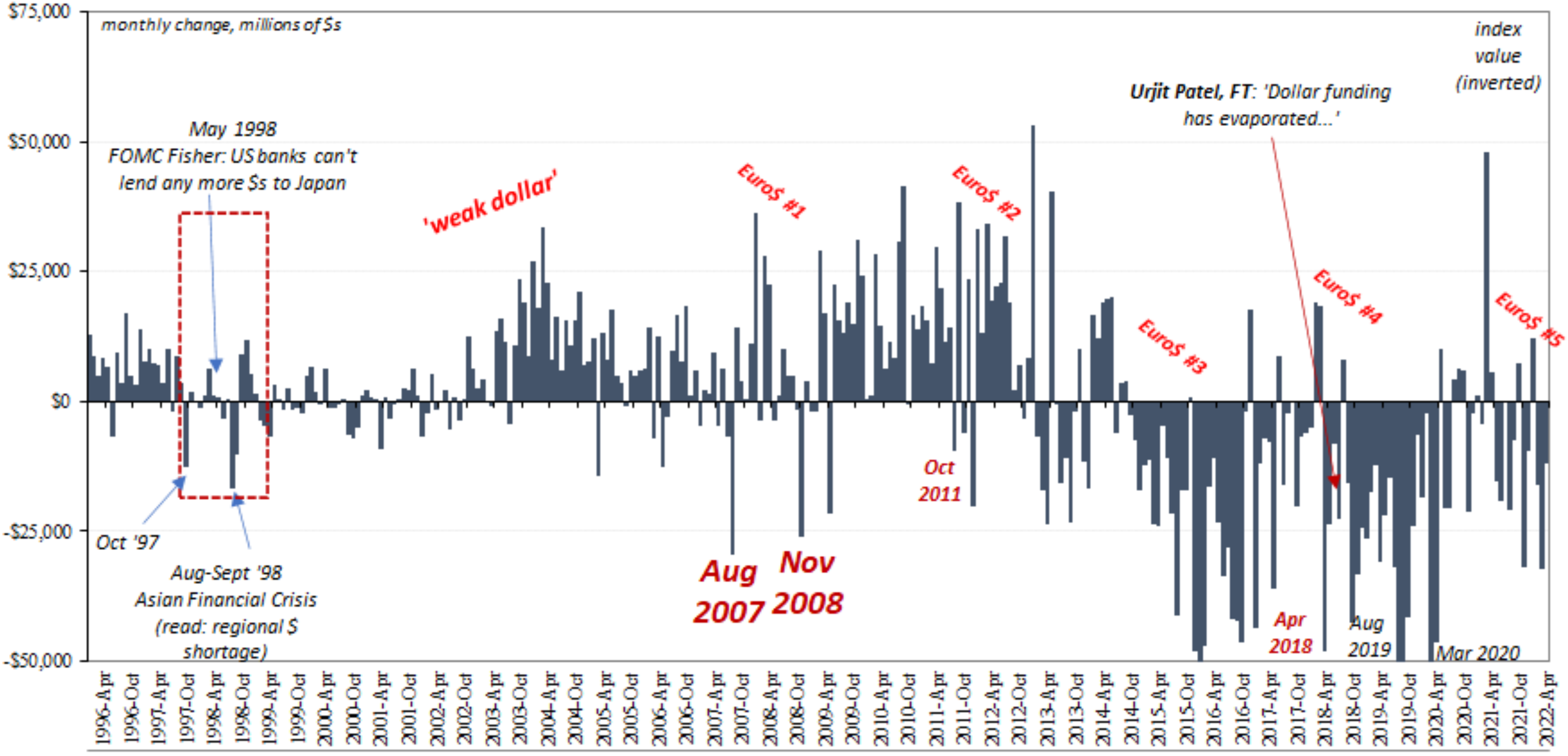
"MR. FISHER. Just before Christmas, we confronted **an order from the Japanese authorities to sell in Treasury bills**. In the absence of **[blank]**
We took **[blank]** of bills into the SOMA account, selecting bills that we would be able to run off in the course of January so as not to make our need to drain reserves any worse at the end of the month. We sold **[blank]** for them in the market and took another **[blank]** out of the repo pool, where we have had an elevated cash balance for them, to help them in effect to meet their cash needs.

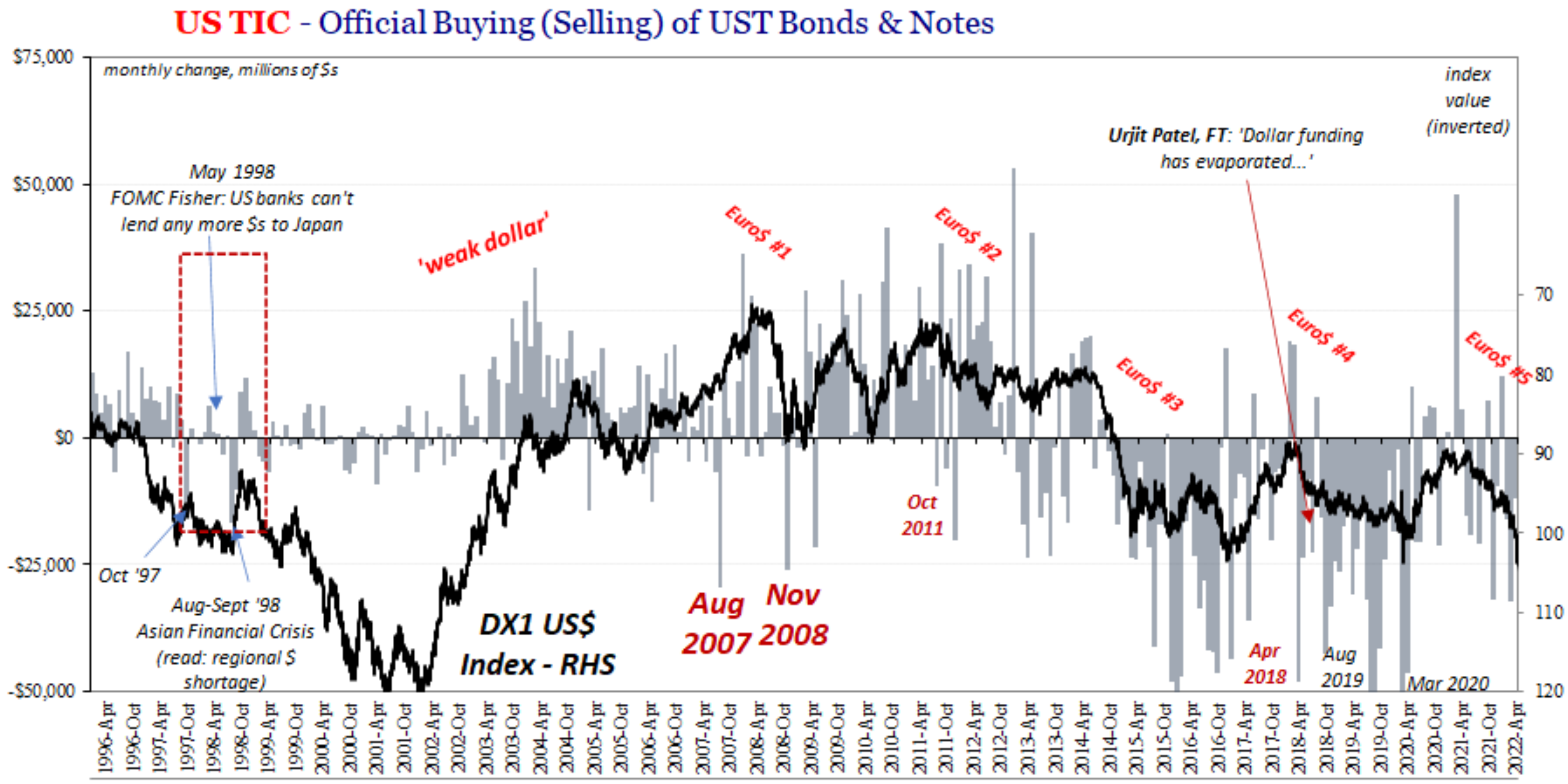
Peter Fisher, Federal Reserve Open Market System Manager
FOMC Transcript
February 1998


US TIC - Total Buying (Selling)of LT Domestic Securities
monthly change, millions of $s
$100,000
$0
-$100,000
May 1998
FOMC Fisher: US banks can't lend any more $s to Japan
Aug-Sept '98
Asian Financial Crisis
(read: regional $ shortage)
'weak dollar'
Zero months of net selling;
most months huge net buying;
actual global (euro)dollar flood
Aug 2007
Nov 2008
Euro$ #1
Euro$ #2
June 2011
Euro$ #3
Urjit Patel, FT: 'Dollar funding has evaporated...'
Euro$ #4
June 2018
Dec 2018 (landmine)
Mar 2020
Euro$ #5
May 2021

eurodollar.UNIVERSITY

US TIC - Official Buying (Selling) of UST Bonds & Notes




US TIC - Official Buying (Selling) of UST Bonds & Notes
monthly change, millions of $s
index value (inverted)
$75,000
$50,000
$25,000
$0
-$25,000
-$50,000
70
80
90
100
110
120
May 1998
FOMC Fisher: US banks can't lend any more $s to Japan
Oct '97
Aug-Sept '98
Asian Financial Crisis
(read: regional $ shortage)
'weak dollar'
DX1 US$
Index - RHS
Euro$ #1
Aug
2007
Nov
2008
Euro$ #2
Oct
2011
Euro$ #3
Urjit Patel, FT: 'Dollar funding has evaporated...'
Euro$ #4
Apr
2018
Aug
2019
Mar 2020
Euro$ #5
1996-Apr
1996-Oct
1997-Apr
1997-Oct
1998-Apr
1998-Oct
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2017-Apr
2017-Oct
2018-Apr
2018-Oct
2019-Apr
2019-Oct
2020-Apr
2020-Oct
2021-Apr
2021-Oct
2022-Apr

Local Euro$ Shortages

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Tuesday, December 17, 1963, at 9:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Bopp
Mr. Clay
Mr. Daane
Mr. Irons
Mr. Mills
Mr. Mitchell
Mr. Robertson
Mr. Scanlon
Mr. Shepardson

Messrs. Hickman, Wayne, Shuford, and Swan, Alternate Members of the Federal Open Market Committee

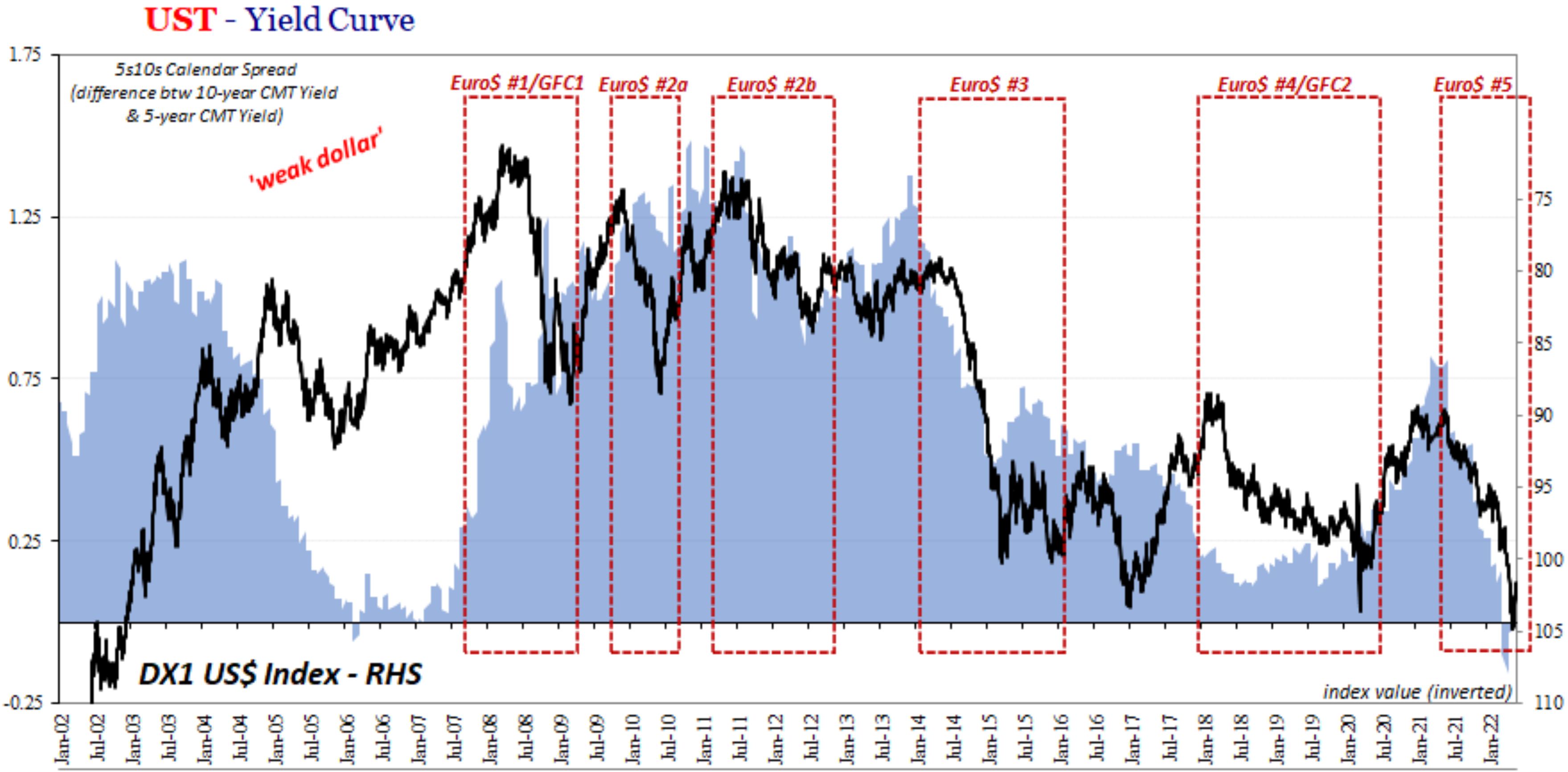
Messrs. Ellis, Bryan, and Deming, Presidents of the Federal Reserve Banks of Boston, Atlanta, and Minneapolis, respectively

Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Noyes, Economist
Messrs. Baughman, Brill, Eastburn, Furth, Garvy, Green, Holland, Koch, and Tow, Associate Economists
Mr. Stone, Manager, System Open Market Account

Mr. Molony, Assistant to the Board of Governors
Mr. Cardon, Legislative Counsel, Board of Governors
Mr. Broida, Assistant Secretary, Board of Governors
Mr. Williams, Adviser, Division of Research and Statistics, Board of Governors
Mr. Yager, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Miss Eaton, Secretary, Office of the Secretary, Board of Governors

"Mr. Daane mentioned that there had been confirmation in Europe during the past week, particularly from the Japanese, that the **flow of new funds into the Euro-dollar market was drying up**…It was reflected, however, in transactions in the New York money market; **the Japanese government**, for instance, **was selling U. S. Treasury bills to provide funds for Japanese commercial banks to repay Euro-dollar loans they were unable to renew.**

Federal Reserve FOMC Meeting
Historical Minutes
December 1963


UST - Yield Curve
5s10s Calendar Spread
(difference btw 10-year CMT Yield
& 5-year CMT Yield)
'weak dollar'
Euro$ #1/GFC1
Euro$ #2a
Euro$ #2b
Euro$ #3
Euro$ #4/GFC2
Euro$ #5
DX1 US$ Index - RHS
index value (inverted)
1.75
1.25
0.75
0.25
-0.25
75
80
85
90
95
100
105
110
Jan-02
Jul-02
Jan-03
Jul-03
Jan-04
Jul-04
Jan-05
Jul-05
Jan-06
Jul-06
Jan-07
Jul-07
Jan-08
Jul-08
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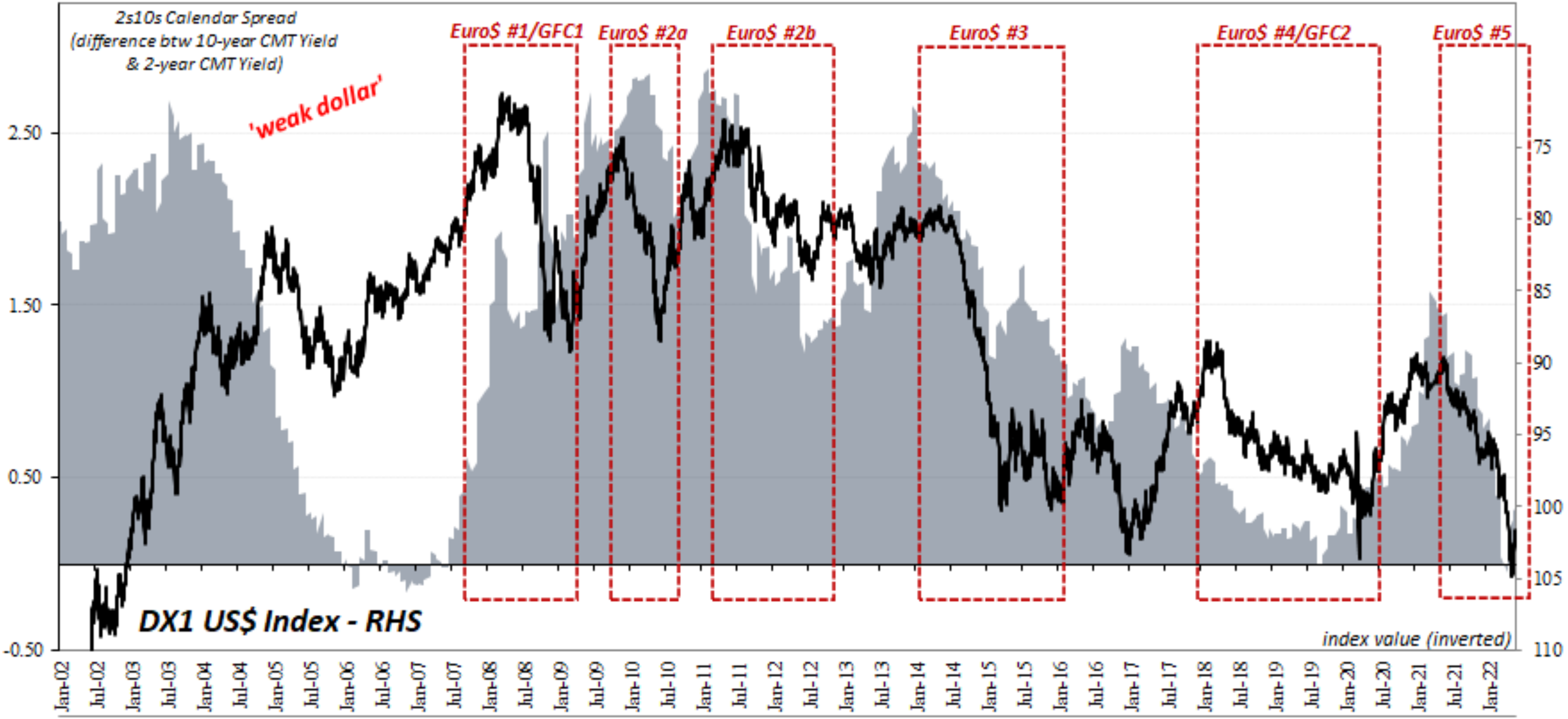
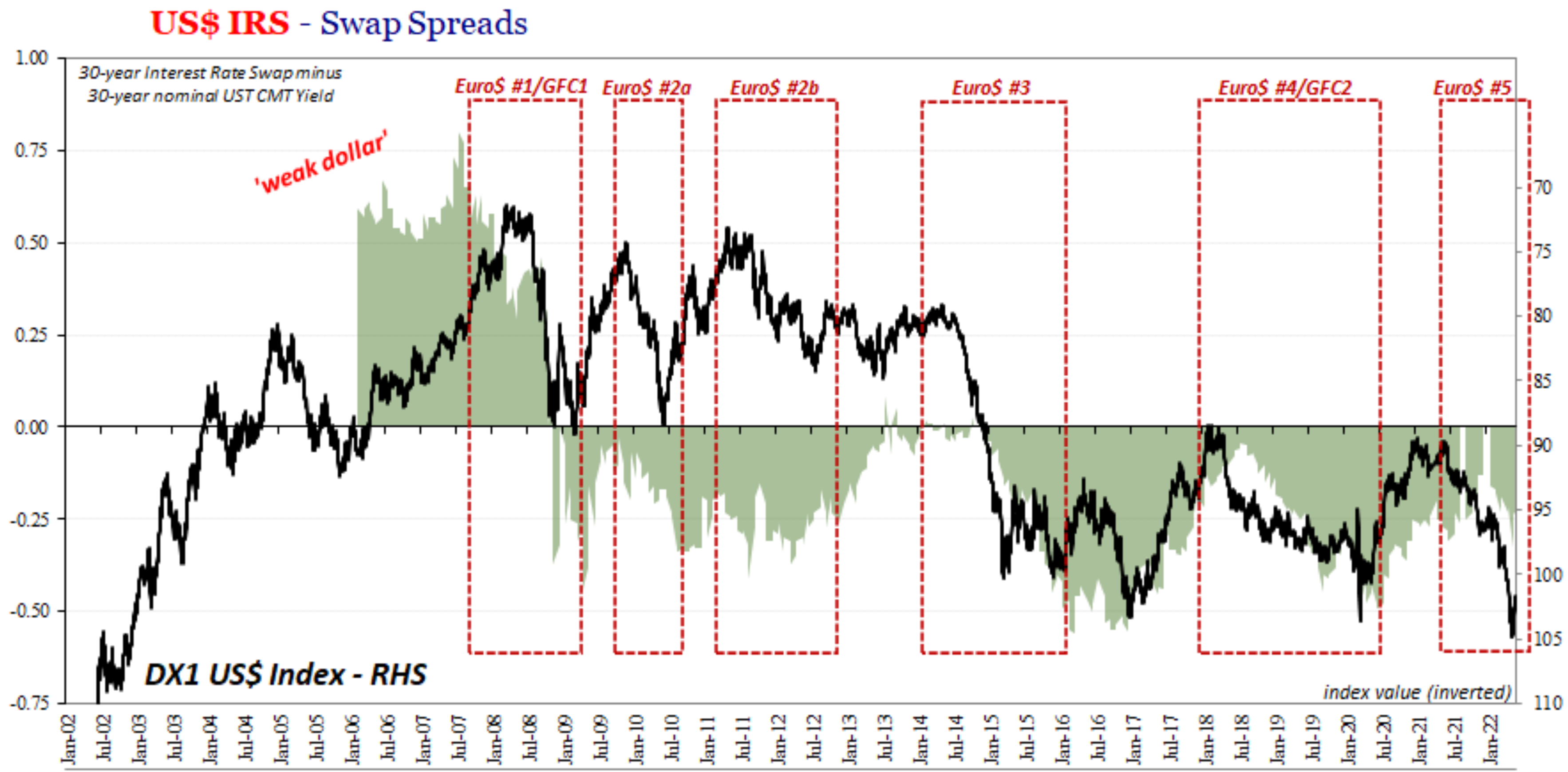
Jul-21
Jan-22

UST - Yield Curve




US$ IRS - Swap Spreads
30-year Interest Rate Swap minus
30-year nominal UST CMT Yield
'weak dollar'
Euro$ #1/GFC1
Euro$ #2a
Euro$ #2b
Euro$ #3
Euro$ #4/GFC2
Euro$ #5
DX1 US$ Index - RHS
index value (inverted)
1.00
0.75
0.50
0.25
0.00
-0.25
-0.50
-0.75
70
75
80
85
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95
100
105
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Jul-02
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Jan-05
Jul-05
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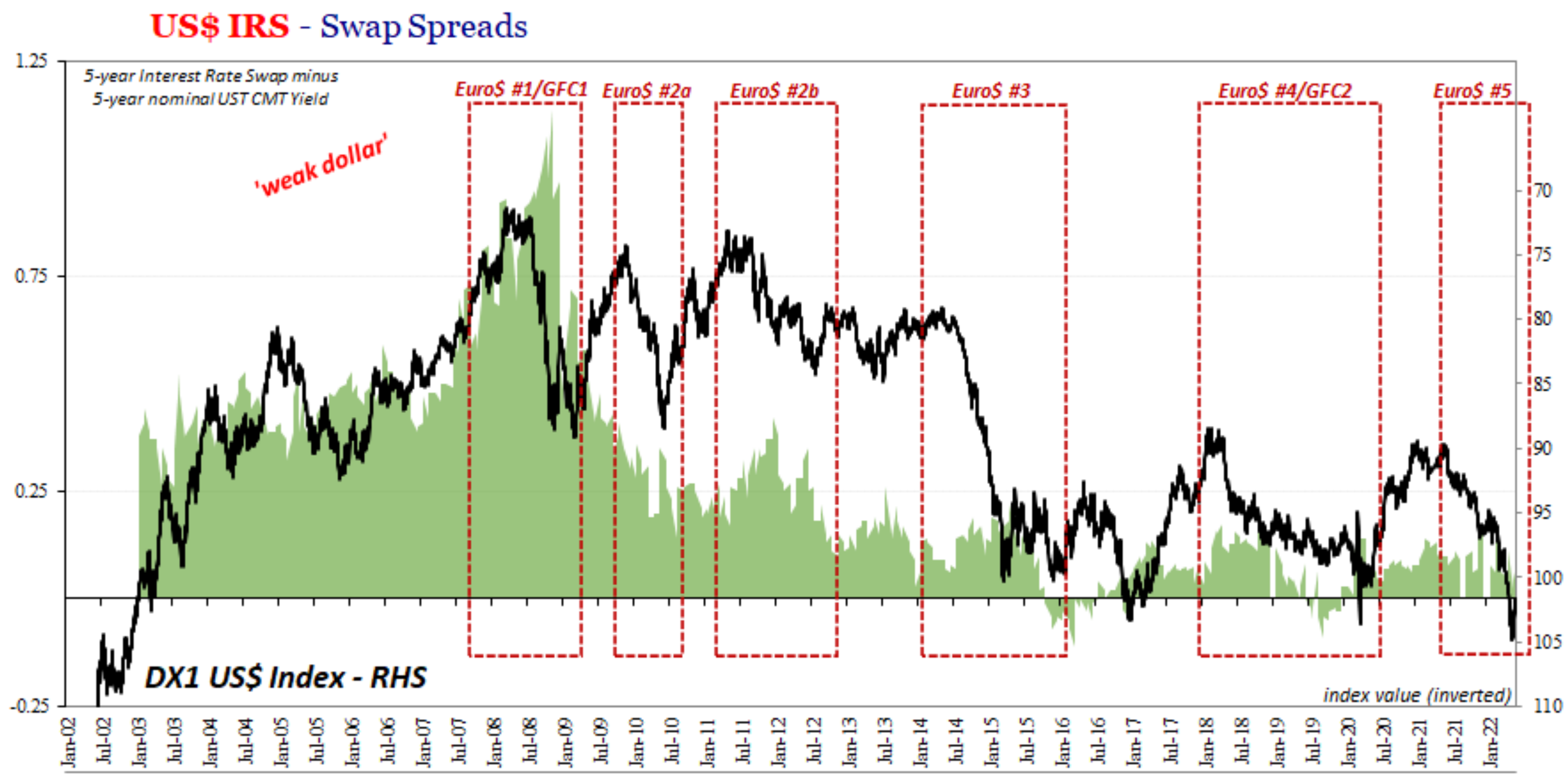
Jul-21
Jan-22


US$ IRS - Swap Spreads
5-year Interest Rate Swap minus
5-year nominal UST CMT Yield
'weak dollar'
Euro$ #1/GFC1
Euro$ #2a
Euro$ #2b
Euro$ #3
Euro$ #4/GFC2
Euro$ #5
DX1 US$ Index - RHS
index value (inverted)
1.25
0.75
0.25
-0.25
70
75
80
85
90
95
100
105
110
Jan-02 Jul-02 Jan-03 Jul-03 Jan-04 Jul-04 Jan-05 Jul-05 Jan-06 Jul-06 Jan-07 Jul-07 Jan-08 Jul-08 Jan-09 Jul-09 Jan-10 Jul-10 Jan-11 Jul-11 Jan-12 Jul-12 Jan-13 Jul-13 Jan-14 Jul-14 Jan-15 Jul-15 Jan-16 Jul-16 Jan-17 Jul-17 Jan-18 Jul-18 Jan-19 Jul-19 Jan-20 Jul-20 Jan-21 Jul-21 Jan-22

Broad Euro$ Shortages

Negative Swap Spreads

Nina Boyarchenko, Pooja Gupta, Nick Steele, and Jacqueline Yen

OVERVIEW

- Market participants have been surprised by the decline of U. S. interest rate swap rates relative to Treasury yields of equal maturity over the past two years, with interest rate swap spreads becoming negative for many maturities.
- Although many factors have narrowed interest rate swap spreads, the authors focus primarily on the impact of regulatory increases in required leverage ratios.
- The authors argue that when exogenous factors narrowed spreads, the leverage requirements reduced incentives for market participants to enter into trades that would have counteracted the effects of exogenous shocks.
- The analysis suggests that, given balance sheet costs, spreads must reach more negative levels to generate an adequate return on equity for dealers—suggesting there may be a "new normal" level at which dealers are incentivized to trade.

An interest rate swap enables two counterparties to swap interest rates for a specific period, typically with one rate fixed and the other an agreed-upon floating rate, such as the three-month Libor (London interbank offered rate). At $288 trillion outstanding in notional value,[1] the interest rate swap market is the largest over-the-counter derivatives market in the world, representing an important source of duration for both interest-rate risk management and investment.[2] Corporations use these swaps to transform their interest rate obligations between fixed and floating rates without having to change the mix of bonds they issue. The use of swaps enables issuers to hedge interest rate risk that could affect investment decisions.

Interest rate swap spreads are the difference between the fixed rate in a swap and the yield of a Treasury security of the same maturity. Historically, most swap spreads have been positive (Chart 1). A market participant may be able to narrow a positive spread by paying the floating rate Libor on an interest rate swap, receiving the fixed rate, and selling short a Treasury bond of the same maturity by lending cash against it in a reverse repurchase agreement (reverse repo).

Nina Boyarchenko is a senior economist, Pooja Gupta an analyst, and Jacqueline Yen an analyst at the Federal Reserve Bank of New York. At the time this article was written, Nick Steele was an analyst at the New York Fed. Currently he is a deputy director at the U.S. Department of the Treasury. Email: nina.boyarchenko@ny.frb.org; pooja.gupta@ny.frb.org; jacqueline.yen@ny.frb.org; nicholas.steele@treasury.gov.

The views expressed in this article are those of the authors and do not necessarily reflect the position of the Federal Reserve Bank of New York or of the Federal Reserve System. To view the authors' disclosure statements, visit https://www.newyorkfed.org/research/epr/2018/epr_2018_negative-swap-spreads_boyarchenko.html.

"Although we cannot precisely measure the costs SLR capital requirements impose, it appears that executing swap spread trades is now **more expensive for dealers than in the past** largely because of the amount of capital that dealers must hold against these trades…As a result, while current negative swap spread levels may have presented attractive trading opportunities in the past—which would have reduced deviations from parity—our analysis suggests that, **given the balance sheet costs**, these spreads must reach more negative levels to generate an adequate ROE for dealers.

Nina Boyarchenko, Pooja Gupta, Nick Steele, & Jacqueline Yen
Negative Swap Spreads
FRBNY Economic Policy Review 24, no. 2, October 2018

Broad Euro$ Shortages

RealClear Markets Newsletters Articles Video Off The Street


(AP Photo/Ahn Young-joon)

Repo gets all of what tiny little bit of attention the world might pay (pun intended) to collateral. It shouldn't be the sole star of this deeper shadow money world. There are other segments on the inside which gobble up collateral use, some of which might have even *surpassed* repo in terms of potential flashpoints if not overall importance to the smooth flow of the world's ridiculously fickle private bank money reserve system.

What are those other segments? Derivatives. Some of these others act in every way, in every bit as if cash and credit. While I don't intend to get too heavy into them here, forex, mainly, there is much to be learned from derivatives as a group to understand just how collateral has become a centerpiece component for the global monetary arrangement.

"On the small-scale, this is also a key factor of the IRS arbitrage the FRBNY authors omitted. Focusing on the long UST side of it…to complete the arb requires participating in the IRS which therefore means being cleared via a CCP – which means putting up more initial collateral to get it started.

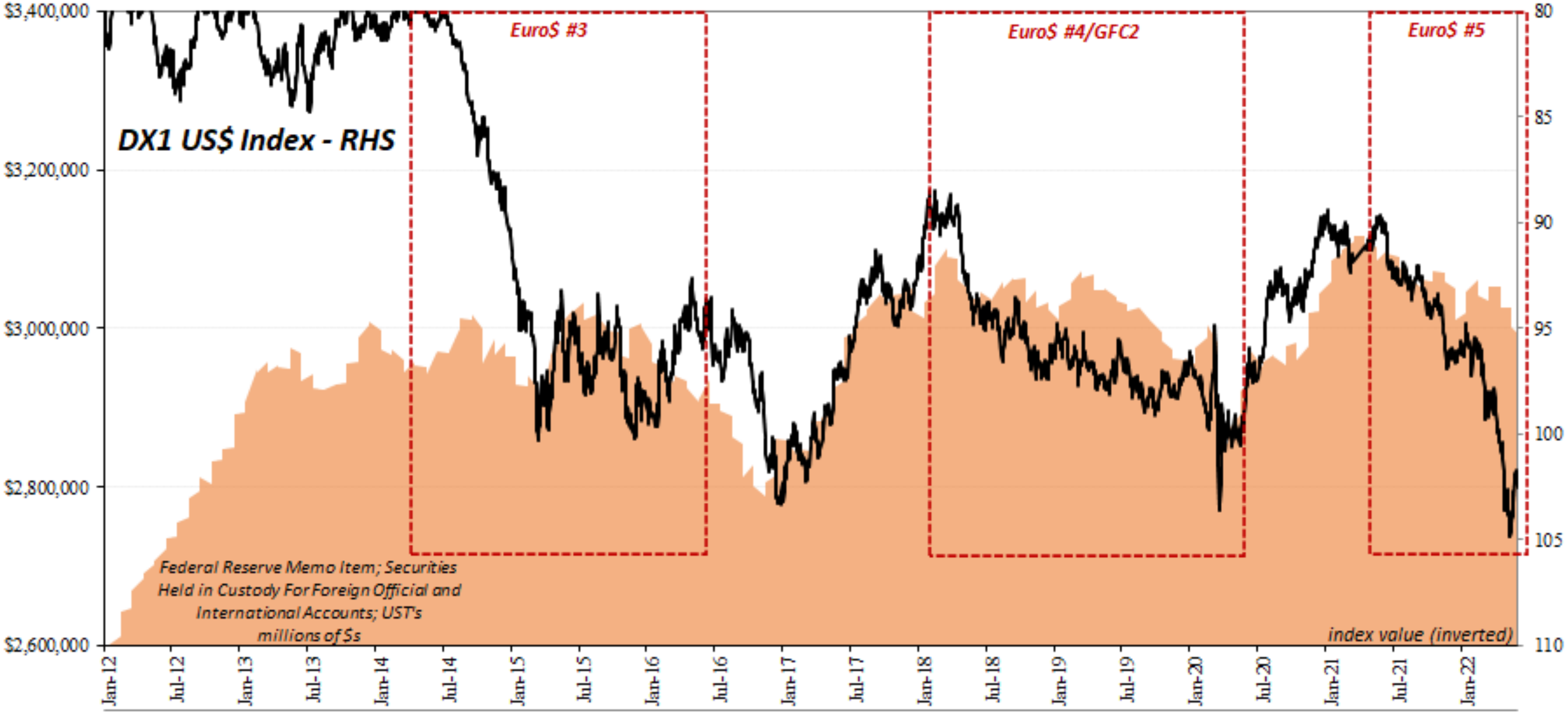
Meaning, **it takes both balance sheet capacity along with collateral** in order for the dealer to even think about arbitraging any **negative or low swap spread**.

Jeffrey Snider

It Isn't the Fed's Theater of Rate Hikes That Got Us Here

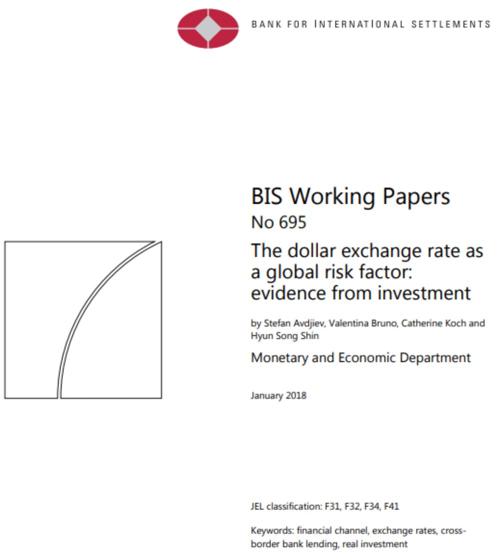
RealClearMarkets; May 6, 2022

Federal Reserve - Balance Sheet Memo Items




GLOBAL
DOLLAR
SHORTAG
WHEEL OF FORTUNE
IS THERE A Q?
THE WORD FINDER

Broad Euro$ Shortages


BANK FOR INTERNATIONAL SETTLEMENTS

BIS Working Papers
No 695

The dollar exchange rate as a global risk factor: evidence from investment

by Stefan Avdjiev, Valentina Bruno, Catherine Koch and Hyun Song Shin

Monetary and Economic Department

January 2018

JEL classification: F31, F32, F34, F41

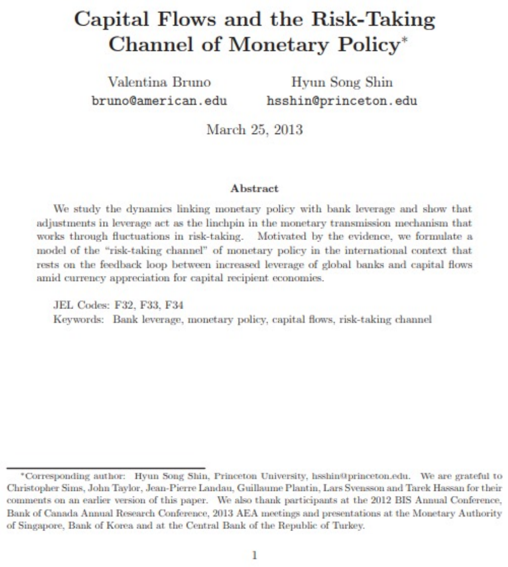
Keywords: financial channel, exchange rates, cross-border bank lending, real investment

“First, there is a **strong negative relationship between the US dollar and cross-border bank lending denominated in US dollars**. Second, an increase in US dollar denominated cross-border lending to a given EME is associated with greater real investment in that EME. Finally, a decline in the value of a country’s currency against the US dollar triggers a decline in real investment in that country.

Avdjiev, Stefan, V Bruno, C Koch, and H Shin (2018)
“The dollar exchange rate as a global risk factor: evidence from investment,” BIS Working Papers, no. 695.

Broad Euro$ Shortages

“ The focus on the US dollar as the currency underpinning global banking lends support to studies that have emphasized the US dollar **as a bellwether for global financial conditions**.



Capital Flows and the Risk-Taking Channel of Monetary Policy*

Valentina Bruno
bruno@american.edu

Hyun Song Shin
hsshin@princeton.edu

March 25, 2013

Abstract

We study the dynamics linking monetary policy with bank leverage and show that adjustments in leverage act as the linchpin in the monetary transmission mechanism that works through fluctuations in risk-taking. Motivated by the evidence, we formulate a model of the "risk-taking channel" of monetary policy in the international context that rests on the feedback loop between increased leverage of global banks and capital flows amid currency appreciation for capital recipient economies.

JEL Codes: F32, F33, F34
Keywords: Bank leverage, monetary policy, capital flows, risk-taking channel

*Corresponding author: Hyun Song Shin, Princeton University, hsshin@princeton.edu. We are grateful to Christopher Sims, John Taylor, Jean-Pierre Landau, Guillaume Plantin, Lars Svensson and Tarek Hassan for their comments on an earlier version of this paper. We also thank participants at the 2012 BIS Annual Conference, Bank of Canada Annual Research Conference, 2013 AEA meetings and presentations at the Monetary Authority of Singapore, Bank of Korea and at the Central Bank of the Republic of Turkey.

1

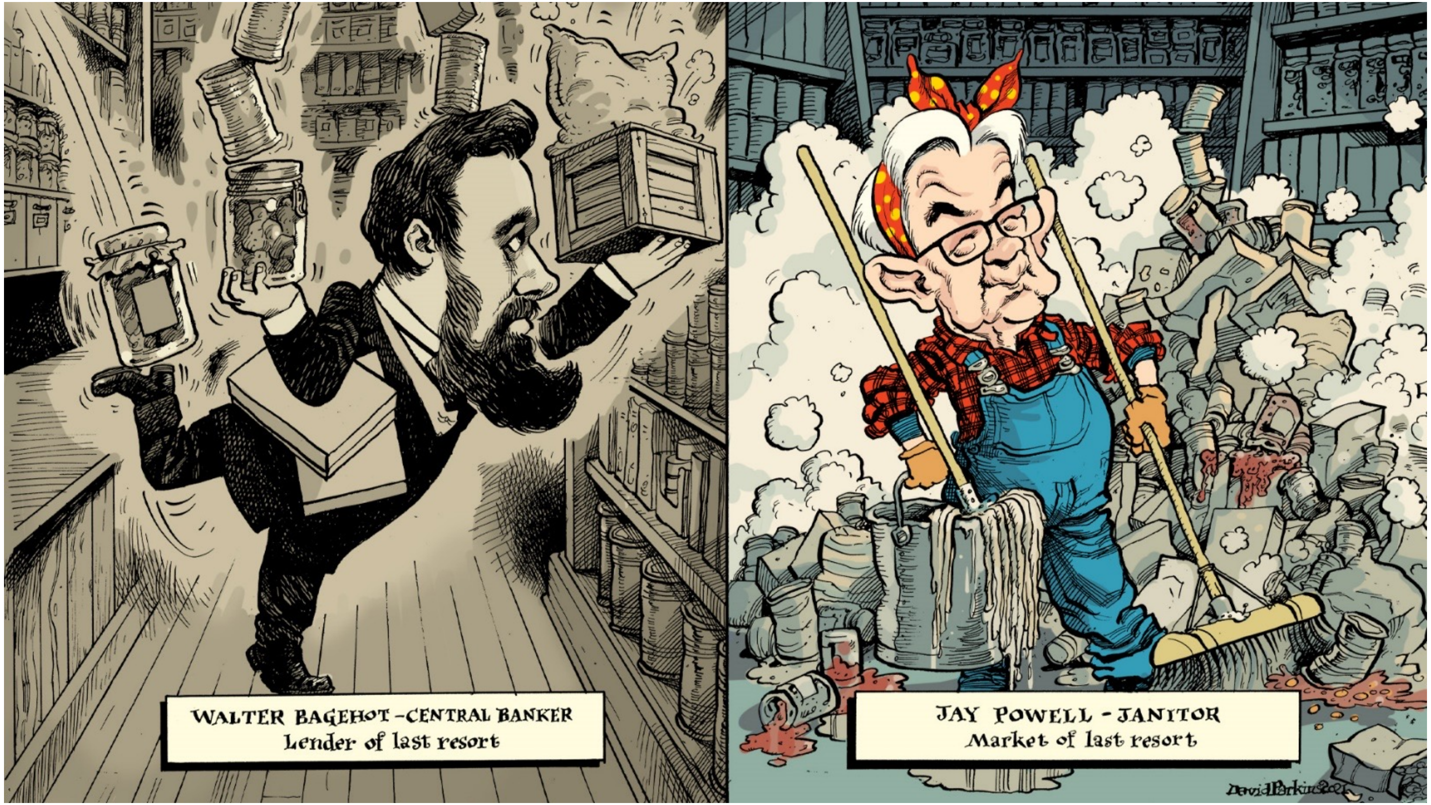
Bruno, Valentina and H Shin (2013)
“Capital Flows and the Risk-Taking Channel of Monetary Policy” Griswold Center for Economic Policy Studies Working Papers, No. 237b.

Broad Euro$ Shortages

"A rising dollar is the eurodollar system demanding a higher coverage charge to come in and drink at the only drinking establishment in town.

Emil Kalinowski
Eurodollar University

(EURO)DOLLAR MARCH 2020



1. FOREIGN BANKS & FOI'S SELL USTs (mostly OFR) to US DLRS

2. US DLRS FIND REPO MKT 'CLOGGED'

3. W/out REPO, US DLRS DISTRESSED SALE OFR USTs

4. FED BECOMES 'MARKET-OF-LAST-RESORT' BUYING USTs

5. QE SAVES THE DAY, LIMITED ECON/FINANCIAL FALLOUT

FEDERAL RESERVE AND MEDIA FOCUS EVERYONE'S ATTENTION ON ONLY THIS PART - A CONTROVERSIAL INTERPRETATION OF ONLY THE END OF THE PROCESS

SELF-REINFORCING/REPEAT FROM THE BEGINNING w/EVEN GREATER INTENSITY

GLOBAL $ SHORTAGE

1a. FOREIGN BANKS & FOI'S SELL USTs (mostly OFR) to US DLRS

1b. REPO MKT IMPAIRED

REPO

2a. W/out REPO, US DLRS DISTRESSED SALE OFR USTs

2b. FUNDING MKTs STAMPEDE INTO OTR USTs

3a. FED BECOMES NON-ECONOMIC BUYER of USTs

3b. QE/'REPO OPs' DO NOTHING FOR RAMPAGING COLLATERAL (OTR) SCARCITY

4. ~~QE SAVES THE DAY, LIMITED ECON/FINANCIAL FALLOUT~~

REALITY:

GLOBAL MELTDOWN (GFC2) & RELATED US$ SURGE*

WE SHOULD BE FOCUSED ENTIRELY ON WHAT STARTED THE MESS IN THE FIRST PLACE, NOT APPLAUDING WHAT THE JANITORS DID TO HELP CLEAN UP AFTER IT WAS ALL OVER

*full extent of long run fallout yet to be determined

THE FED IS NOT A CENTRAL BANK

82a The Federal Reserve is NOT a Central Bank Pt. 1

Emil Kalinowski • 5.8K views • 1 year ago

What should a central bank be? What does one do? Is what the Fed does 'central banking'? What did Ben Bernanke promise in 2002 that the Fed would never do again -- learning the lesson of the...

https://www.youtube.com/watch?v=0EHWqbuf-eM

82b The Federal Reserve is NOT a Central Bank Pt. 2

Emil Kalinowski • 4.5K views • 1 year ago

In March 2020 long-term US Treasury yields shot higher - why? Aren't these safe assets? Did the 'Treasury market break'? No. Yields shot higher due to illiquidity. And liquidity is JOB #1 of...

https://www.youtube.com/watch?v=LaQhyd2h974

82c The Federal Reserve is NOT a Central Bank Pt. 3

Emil Kalinowski • 3.9K views • 1 year ago

Central banks inject liquidity into money markets to PREVENT a crisis. Let us review the last 14 years: Global Financial Crisis I (2008), European Sovereign Debt Crisis (2011), Chinese Reserve...

https://www.youtube.com/watch?v=QuEKIEsks8I

Volcker Myth

" MR. SCHULTZ. But it seems to me that this is only half of the problem. Half of the problem is that **we don't know what the monetary aggregates are**; the other half of the problem is that we don't know what the relationship is between the aggregates and GNP.

Federal Reserve FOMC Meeting
Transcript
July 1981

Volcker Myth

"MR. MORRIS. Well, Mr. Chairman, all this conversation, or much of it, suggests to me that we ought to face up to the fact that **we do not know how to measure transactions balances** in our present society. We have overnight RPs, for example, that are used by a good many corporations as transactions balances, and RPs are not in M-1B at all. **I really don't think we will ever, from now on, be able to have a concept of a transactions balance** in which we can have the same confidence we used to have in the old M1.

Federal Reserve FOMC Meeting
Transcript
July 1981

VOLCKER MYTH SERIES

The Myth of Paul Volcker: Part 2 [Eurodollar University, Ep. 247]

Emil Kalinowski • 10K views • 6 days ago

We are told that Paul Volcker led the Federal Reserve into the breech and bravely and knowingly raised short-term interest rates so as to bring about a recession and extinguish the 1970s Great...

https://www.youtube.com/watch?v=4HbXUJXhqM4

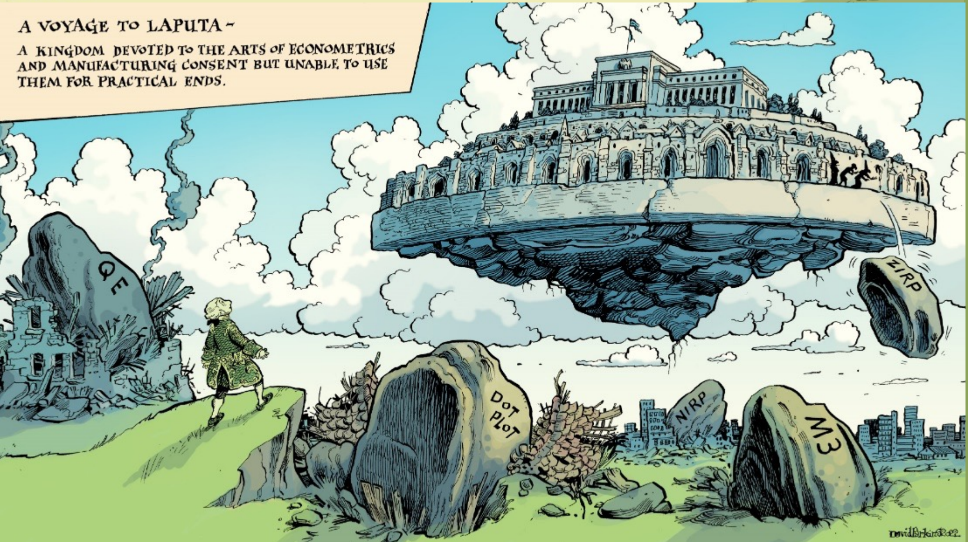
The Myth of Paul Volcker and the Powerful Fed [Eurodollar University, Ep. 221]

Emil Kalinowski • 15K views • 1 month ago

Paul Volcker is widely credited in ending the 1970s Great Inflation with stratospheric rate hikes, purposefully pushing the USA into recession. Balderdash! Volcker blinked when rates spiked....

https://www.youtube.com/watch?v=9XqHyZOLiEc

The Myth of Paul Volcker: Part 3: TBD



Why The DOLLAR Remains King

(and that's the problem)

CONCLUDED

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