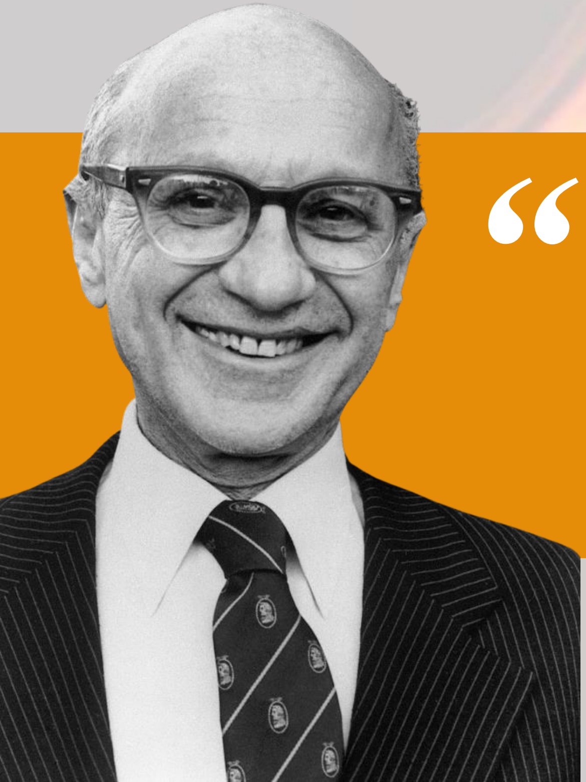
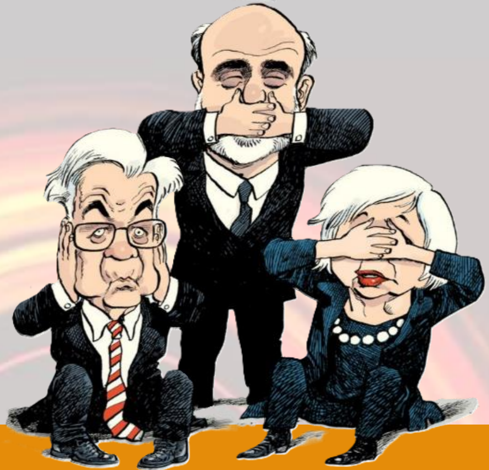
The EURODOLLAR WON'T BE ACCORD-ED

eurodollar.
UNIVERSITY





“The difficulty of having people understand monetary theory is very simple – the central banks are good at press relations. The central banks hire people and the central banks employ a large fraction of all economists so there is a bias to tell the case – the story – in a way that is favorable to the central banks.

Milton Friedman

Russ Roberts EconTalk
September 4, 2006

Weak [theory] $

The New York Times

Market Place; Agility Counts in Currency Chaos

By Allen R. Myerson

Sept. 17, 1992

The world's currency markets, it seems, are no longer governed by central bankers in Washington and Bonn, but by traders and investors in Tokyo, London and New York, as the chaos in the currency markets this past week has shown.

Weak [theory] $

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MARKET INSIDER

Wall Street firms see increased chance that Trump takes action to weaken the dollar

PUBLISHED MON, JUL 15 2019 1:55 PM EDT · UPDATED WED, JUL 17 2019 3:35 PM EDT

Patti Domm

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Trump Wants a Weaker Dollar. Getting One Isn't So Easy.

President Trump has made no secret of his frustration that the United States dollar has strengthened against other currencies.

By Matt Phi

Aug. 6, 2019

Weak [theory] $

Emil Kalinowski
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Why Zoltan Pozsar's Bretton Woods 3 is SO WRONG [Eurodollar University, Ep. 217]

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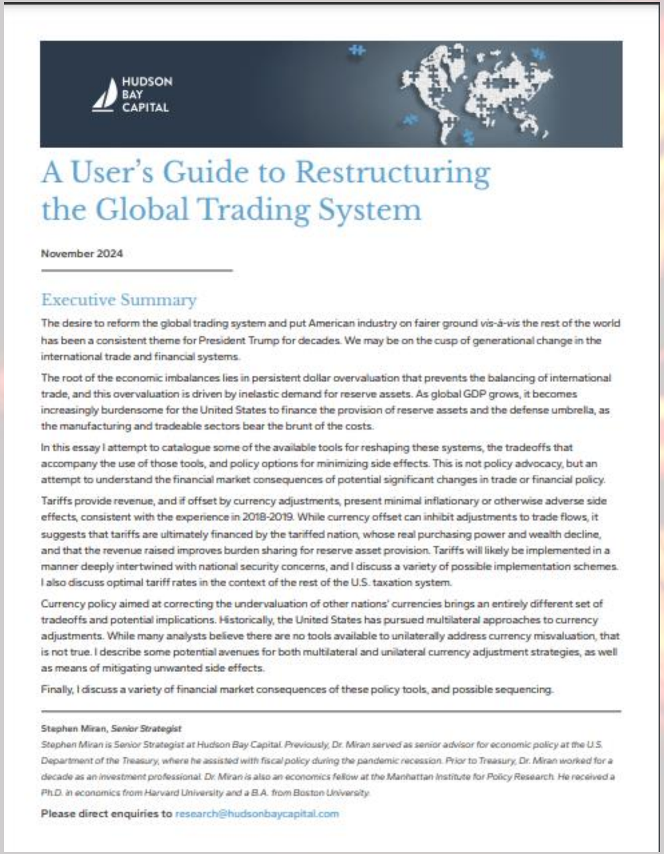
Zoltan Pozsar says a commodity-based, China-led monetary order—Bretton Woods III—is upon us, resulting in the decline of the US dollar and escalating repudiation of US Treasuries. This...



HUDSON BAY CAPITAL

A User's Guide to Restructuring the Global Trading System

November 2024

Executive Summary

The desire to reform the global trading system and put American industry on fairer ground vis-à-vis the rest of the world has been a consistent theme for President Trump for decades. We may be on the cusp of generational change in the international trade and financial systems.

The root of the economic imbalances lies in persistent dollar overvaluation that prevents the balancing of international trade, and this overvaluation is driven by inelastic demand for reserve assets. As global GDP grows, it becomes increasingly burdensome for the United States to finance the provision of reserve assets and the defense umbrella, as the manufacturing and tradeable sectors bear the brunt of the costs.

In this essay I attempt to catalogue some of the available tools for reshaping these systems, the tradeoffs that accompany the use of those tools, and policy options for minimizing side effects. This is not policy advocacy, but an attempt to understand the financial market consequences of potential significant changes in trade or financial policy.

Tariffs provide revenue, and if offset by currency adjustments, present minimal inflationary or otherwise adverse side effects, consistent with the experience in 2018-2019. While currency offset can inhibit adjustments to trade flows, it suggests that tariffs are ultimately financed by the tariffed nation, whose real purchasing power and wealth decline, and that the revenue raised improves burden sharing for reserve asset provision. Tariffs will likely be implemented in a manner deeply intertwined with national security concerns, and I discuss a variety of possible implementation schemes. I also discuss optimal tariff rates in the context of the rest of the U.S. taxation system.

Currency policy aimed at correcting the undervaluation of other nations' currencies brings an entirely different set of tradeoffs and potential implications. Historically, the United States has pursued multilateral approaches to currency adjustments. While many analysts believe there are no tools available to unilaterally address currency misvaluation, that is not true. I describe some potential avenues for both multilateral and unilateral currency adjustment strategies, as well as means of mitigating unwanted side effects.

Finally, I discuss a variety of financial market consequences of these policy tools, and possible sequencing.

Stephen Miran, *Senior Strategist*

Stephen Miran is Senior Strategist at Hudson Bay Capital. Previously, Dr. Miran served as senior advisor for economic policy at the U.S. Department of the Treasury, where he assisted with fiscal policy during the pandemic recession. Prior to Treasury, Dr. Miran worked for a decade as an investment professional. Dr. Miran is also an economics fellow at the Manhattan Institute for Policy Research. He received a Ph.D. in economics from Harvard University and a B.A. from Boston University.

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Number of times 'eurodollar' is mentioned:

ZERO

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IEEPA

For instance, the International Emergency Economic Powers Act, signed into law by President Jimmy Carter in 1977, gives the President sweeping powers over international transactions in response to foreign-origin threats "to the national security, foreign policy, or economy of the United States."[18] Such powers include the ability to limit or prohibit transfers of credit, payments or securities internationally.[19] The Act is an important foundation of Treasury's sanctions powers and financial extraterritoriality.

IEEPA can also be used to disincentivize the accumulation of foreign exchange reserves, if the Administration wills it. If the root cause of dollar overvaluation is demand for reserve assets, Treasury can use IEEPA to make reserve accumulation less attractive. One way of doing this is to impose a user fee on foreign official holders of Treasury securities, for instance withholding a portion of interest payments on those holdings. Reserve holders impose a burden on the American export sector, and withholding a portion of interest payments can help recoup some of that cost. Some bondholders may accuse the United States of defaulting on its debt, but the reality is that most governments tax interest income, and the U.S. already taxes domestic holders of UST securities on their interest payments. While this policy works through currencies as a means of affecting economic conditions, it is actually a policy targeting reserve accumulation and not a formal currency policy.

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To help mitigate potential unwanted financial consequences (like higher interest rates), reserve selling can be accompanied by term-out of remaining reserve holdings. Increased demand for long-term debt by reserve managers will help keep interest rates down, even if there is overall selling of USD fixed income as a result of the currency adjustment. Reserve owners hold fewer USD reserves, pushing their currencies higher, but the reserves they do hold are longer duration, helping contain yields.

If the term-out is into special century bonds as suggested by Poszar, then the funding pressure on the U.S. taxpayer for financing global security is significantly alleviated. The U.S. Treasury can effectively buy duration back from the market and replace that borrowing with century bonds sold to the foreign official sector.

Such a Mar-a-Lago Accord gives form to a 21st Century version of a multilateral currency agreement. President Trump will want foreigners to help pay for the security zone provided by the United States. A reduction in the value of the dollar helps create manufacturing jobs in America and reallocates aggregate demand from the rest of the world to the U.S. The term-out of reserve debt helps prevent financial market volatility and the economic damage that would ensue. Multiple goals are accomplished with one agreement.

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Trump's ability to secure improved trade terms from Mexico and Canada, Korea, and China, and yet he succeeded.

Recall that the purpose of official sector currency reserves is to defend the value of the currency in the face of market volatility and finance imports in a potential crisis. The reason reserve managers tend to keep duration risk low is because they need to be able to liquidate reserves to defend their own currencies when volatility spikes. If they experience losses on their holdings because interest rates increase, they have reduced firepower for defending their currencies. Longer-term debt is less liquid than short-term debt, and crossing bid-offer spreads can be costly in ultra-long-term debt.

This mark-to-market risk of holding longer-term debt can be mitigated via swap lines with the Federal Reserve, or alternatively, with the Treasury's Exchange Stabilization Fund. Either institution can lend dollars to reserve holders at par against their long-term Treasury debt holdings, as a perk of being inside the Mar-a-Lago Accord. Such liquidity obviates the risk of mark-to-market loss on long-term debt, since reserve managers will always have access to liquidity at the face value of the debt. As Poszar (2024) points out, the Bank Term Funding Program which the Fed used to respond to the regional bank stresses of spring 2023 provides a model. Holding century bonds is less risky for reserve managers if they have access to swap lines granting them substantial short term dollar liquidity. The desire to maintain access to such swap lines will be a powerful long-term incentive for remaining inside the U.S. security and economic umbrella.

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Chapter 6: Conclusion

The next Trump term presents potential for sweeping change in the international economic system and possible accompanying volatility. It is important for investors to understand the tools that might be employed for such purposes, as well as the means by which government may attempt to avoid unwelcome consequences. This essay attempts to provide a user's guide: a survey of some tools, their economic and market consequences, and steps that can be taken to mitigate unwanted side effects.

Wall Street consensus that an Administration has no means by which to affect the foreign exchange value of the dollar, should it desire to do so, is wrong. Government has many means of doing so, both multilaterally and unilaterally. No matter what approach it takes, however, attention must be paid to … volatility. Assistance from trading partners or the Federal Reserve can be help…

FACT CHECK: FALSE

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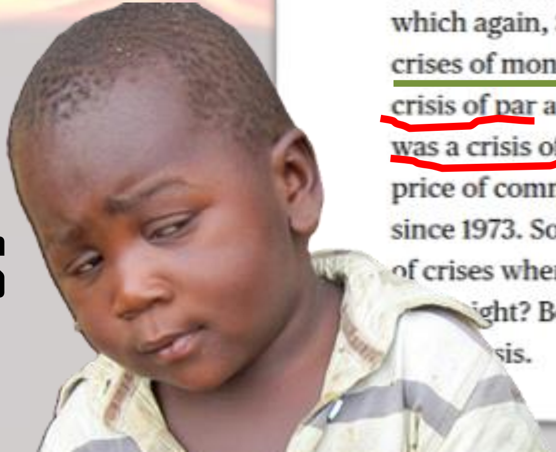
Markets
Odd Lots

Transcript: This Is Zoltan Pozsar's Vision For Bretton Woods III

And so once again, the par, interest, foreign exchange, and price level prices of money, as Perry has taught us, is the four prices. And basically this little historical review that I gave you tells you that crises that happen, the big crises that have happened since 1997, which again, Southeast Asia, 2008 and March, 2020, these were all crises of money. Okay. 1997 was about a broken FX peg, 2008 was a crisis of par and March, 2020 when the bond basis blew up, that was a crisis of interest. Okay. Price level type stuff, you know, the price of commodities in terms of money hasn't really been a big deal since 1973. So we were lucky. And we basically had only those types of crises where the central bank has to step into police a nominal ...ight? Because it's a nominal exchange rate and it's a nominal ...sis.



SYMPTOMS NOT CAUSES

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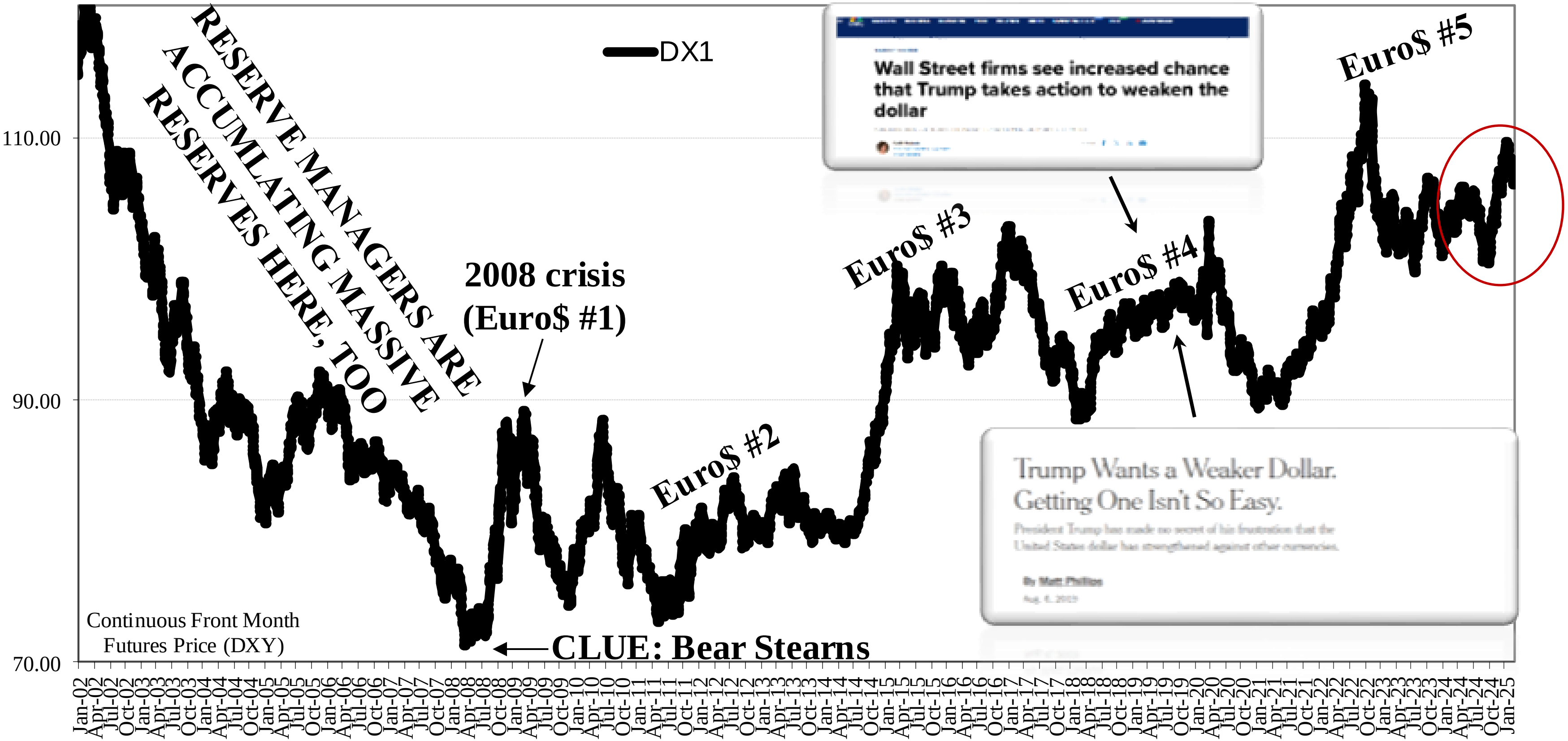
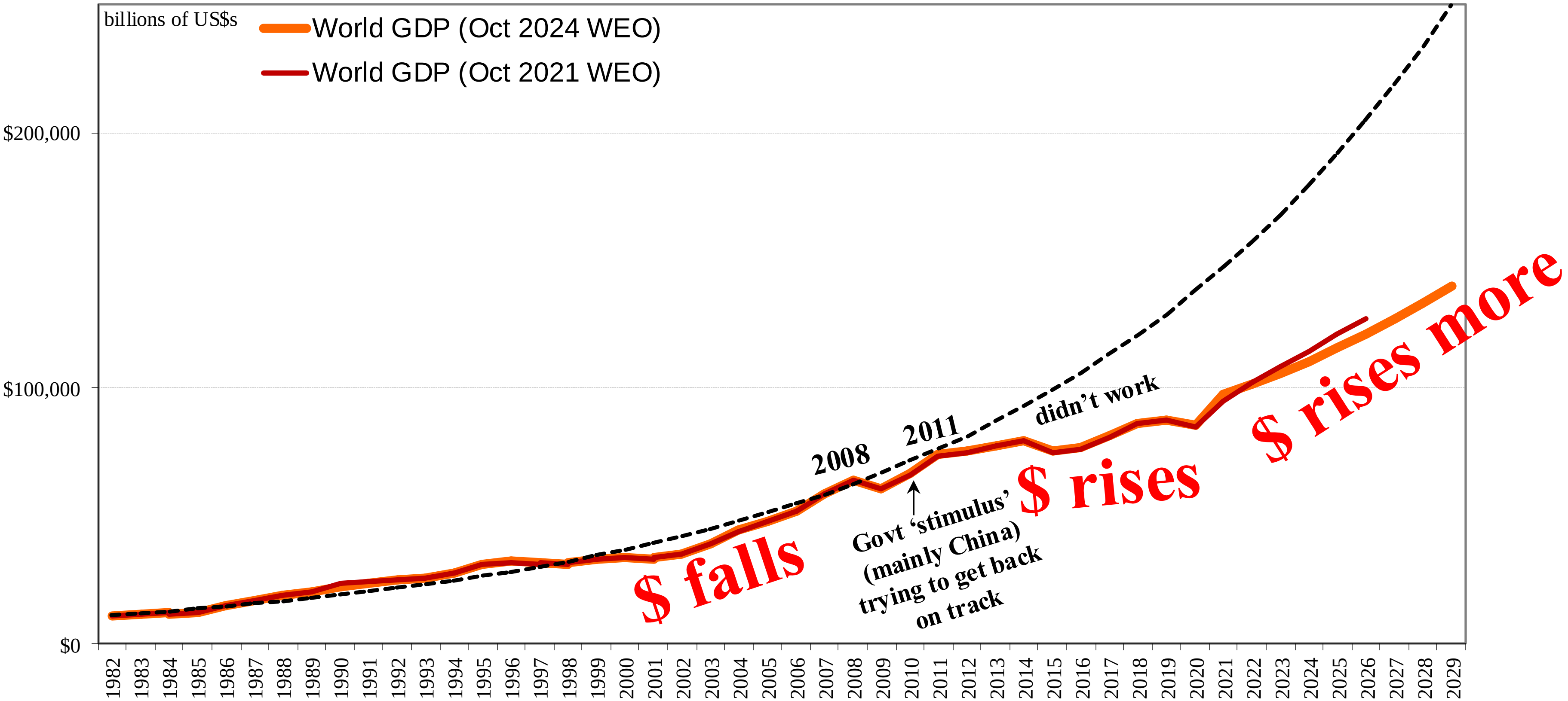


IMF – World Economic Outlook



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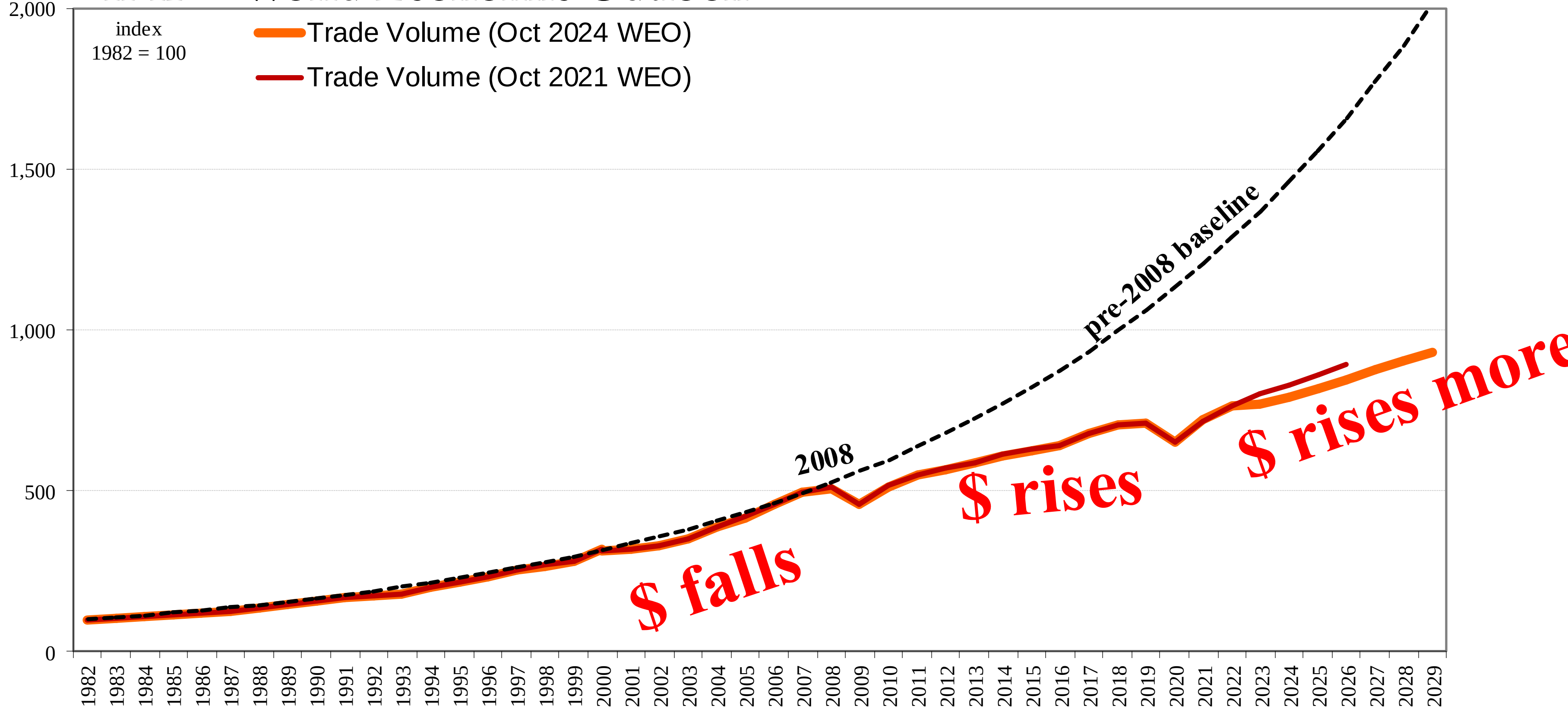
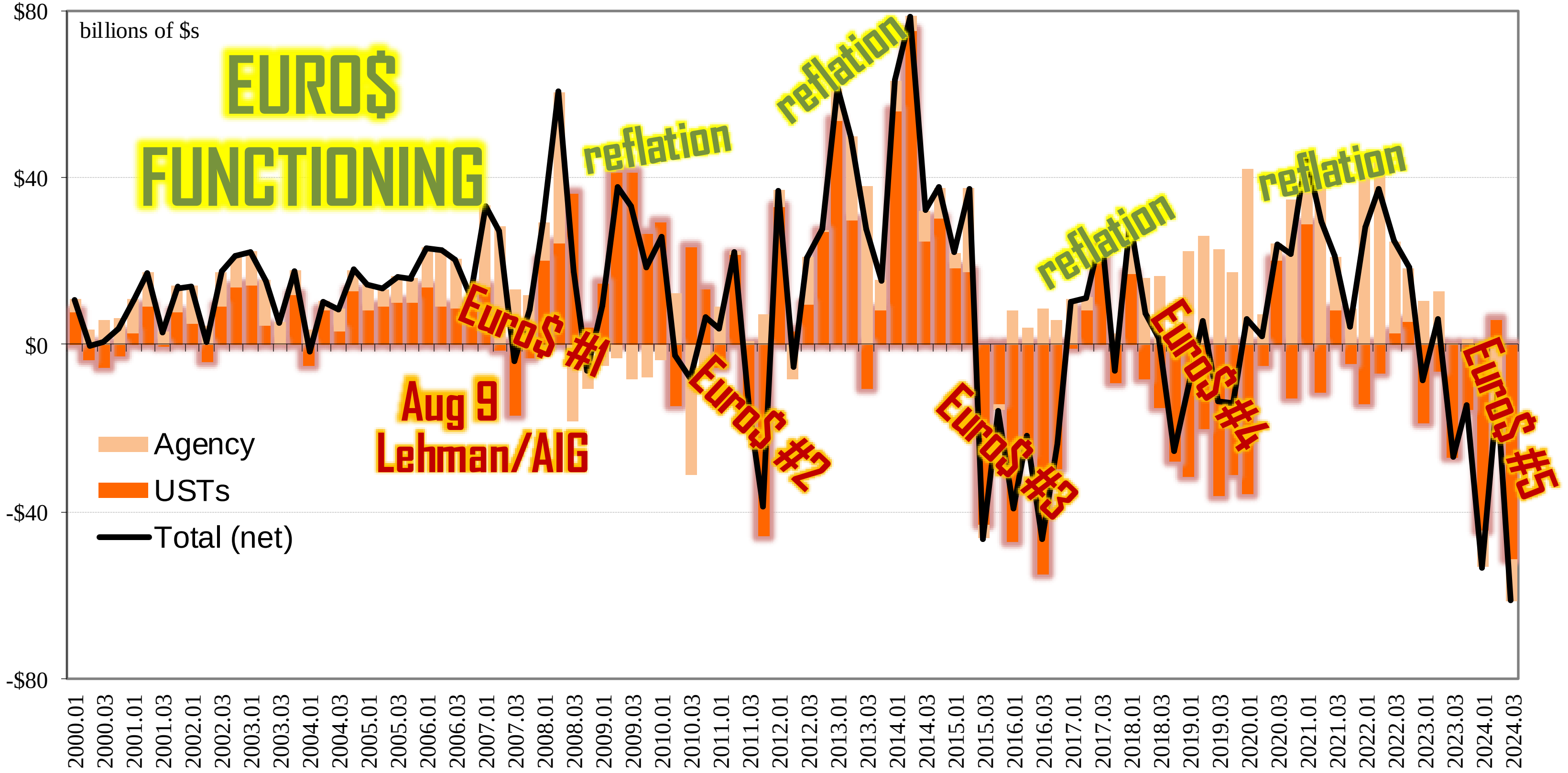
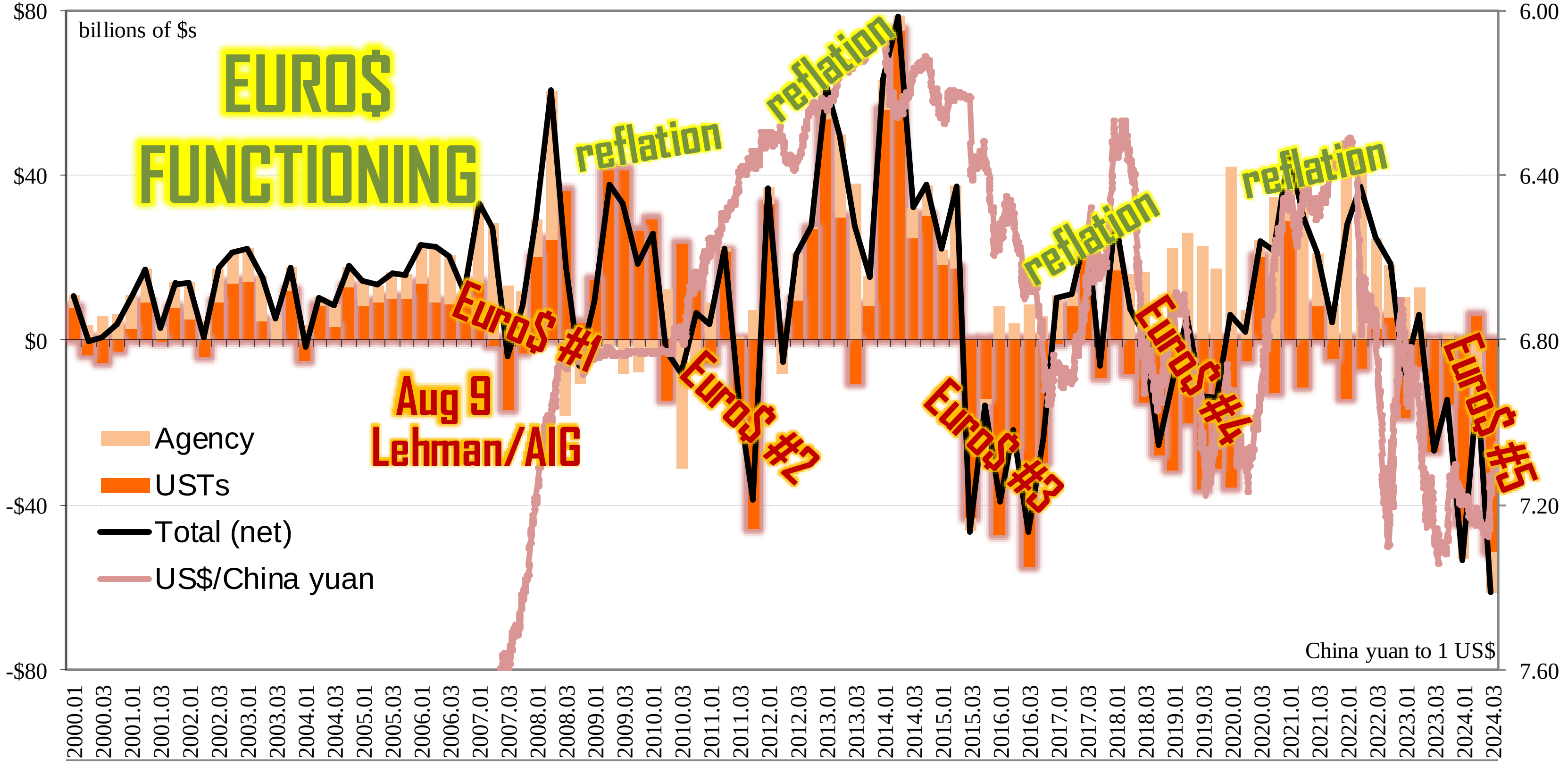


US TIC - China Buying (Selling) of UST/Agency



US TIC - China Buying (Selling) of UST/Agency



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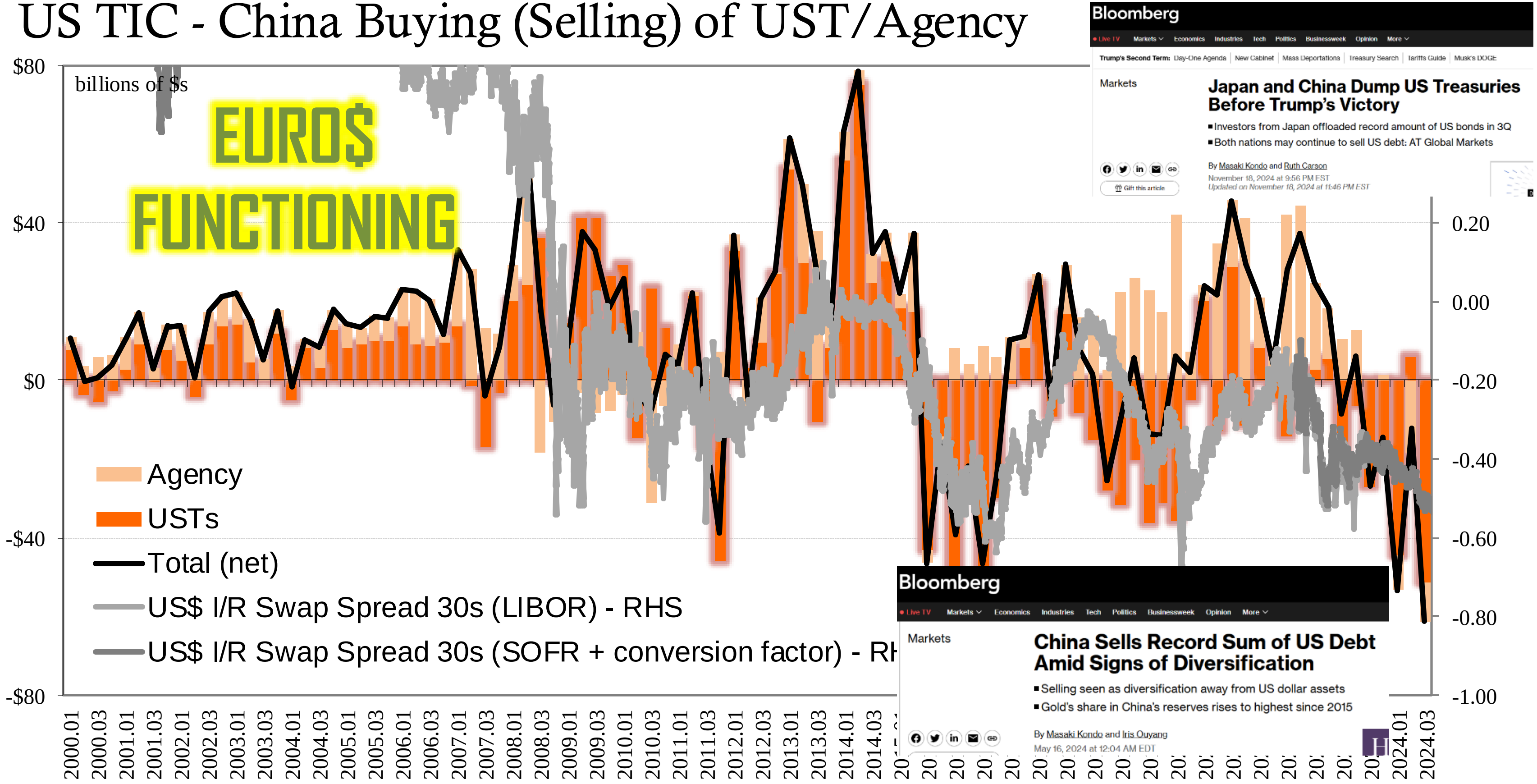
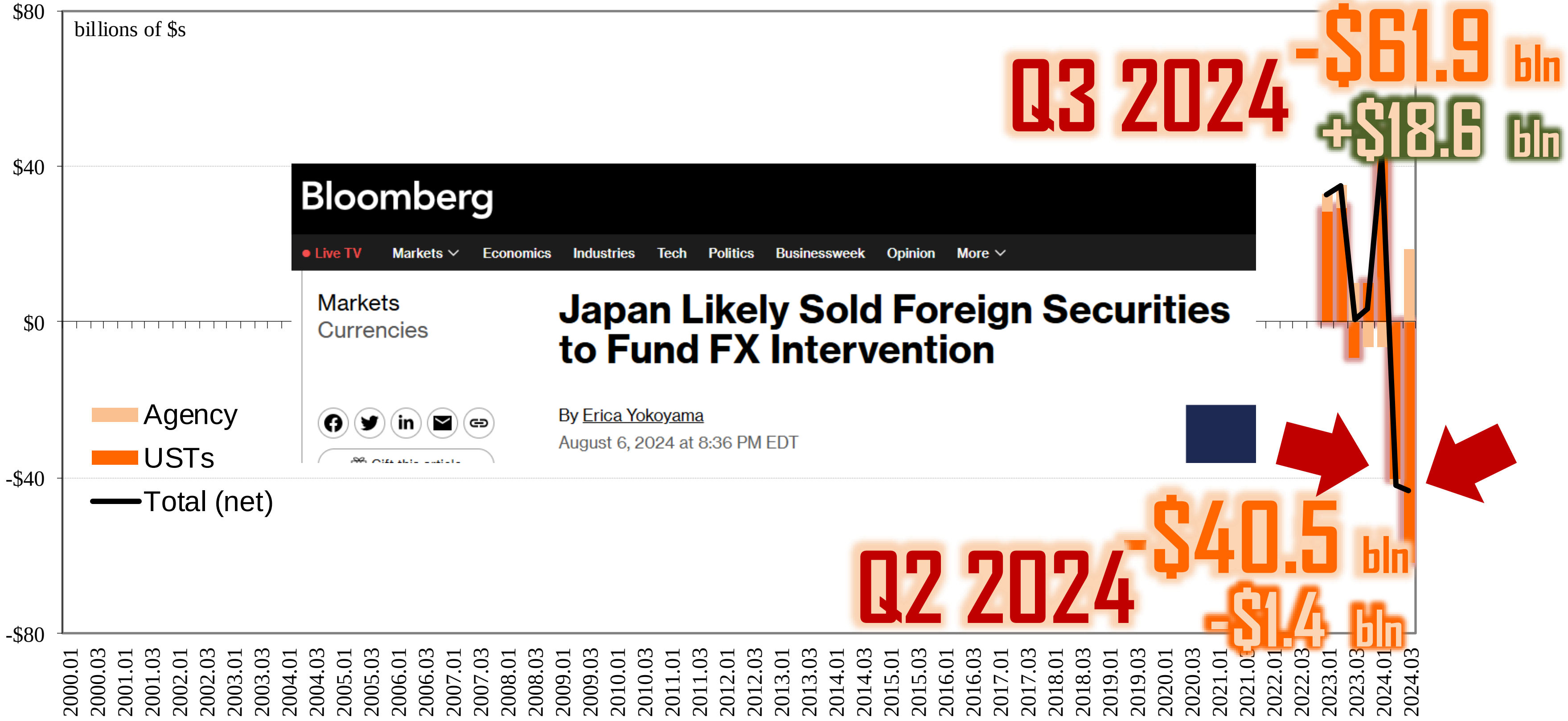


US TIC - Japan Buying (Selling) of UST/Agency



"But this combination of improvisations could not cope with, and indeed may have contributed to, the enormous expansion in markets for U.S. dollars offshore, and the new networks of interbank relations that made possible the creation of additional supplies of dollars outside the United States and beyond the control of the Federal Reserve.

Robert Roosa

The International Monetary System: Forty Years After Bretton Woods; May 1984

Weak [theory] $

The New York Times

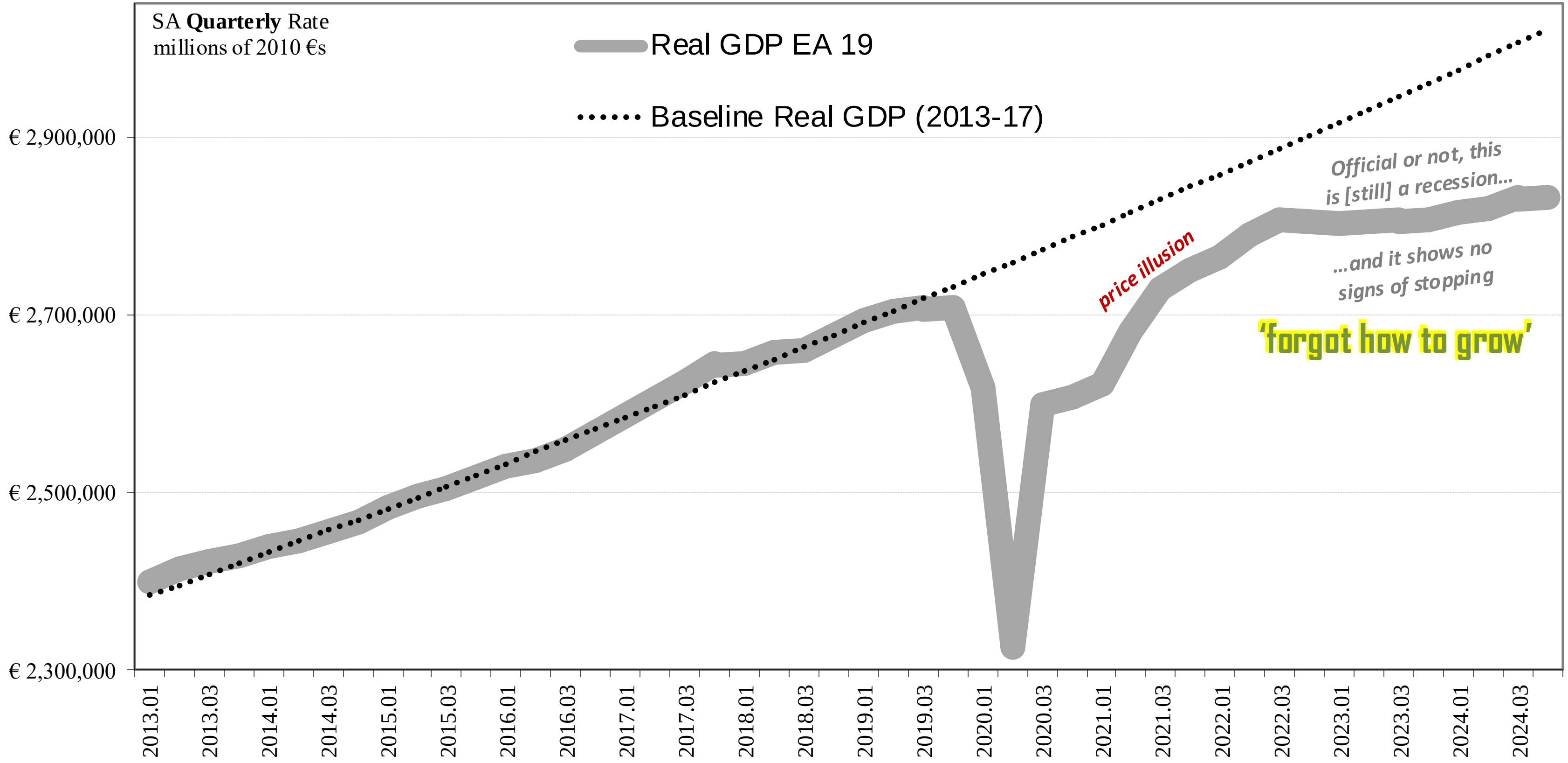
Market Place; Agility Counts in Currency Chaos

By Allen R. Myerson

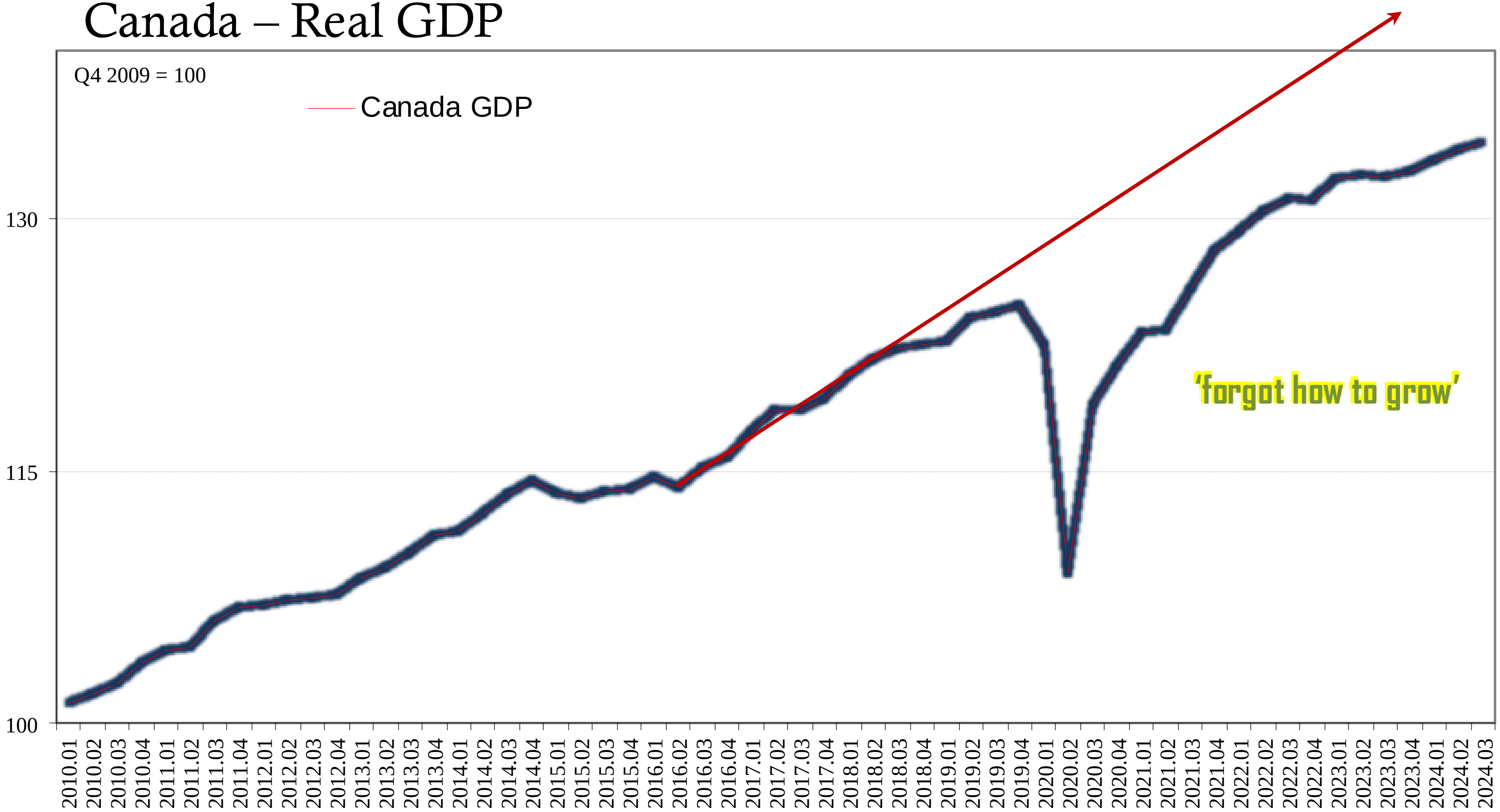
Sept. 17, 1992

The world's currency markets, it seems, are no longer governed by central bankers in Washington and Bonn, but by traders and investors in Tokyo, London and New York, as the chaos in the currency markets this past week has shown.

Europe - Real GDP



Canada – Real GDP



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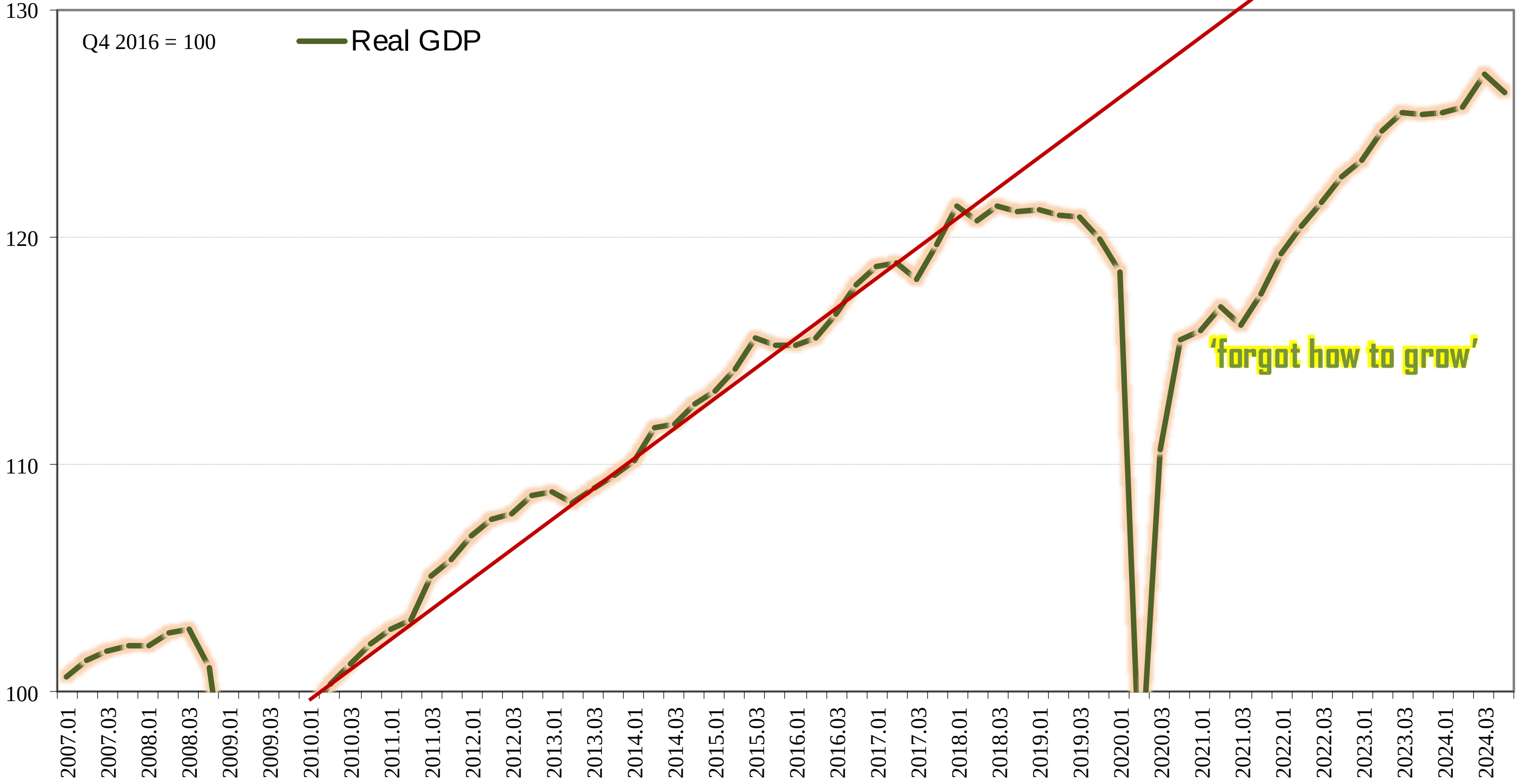
Mexico – GDP



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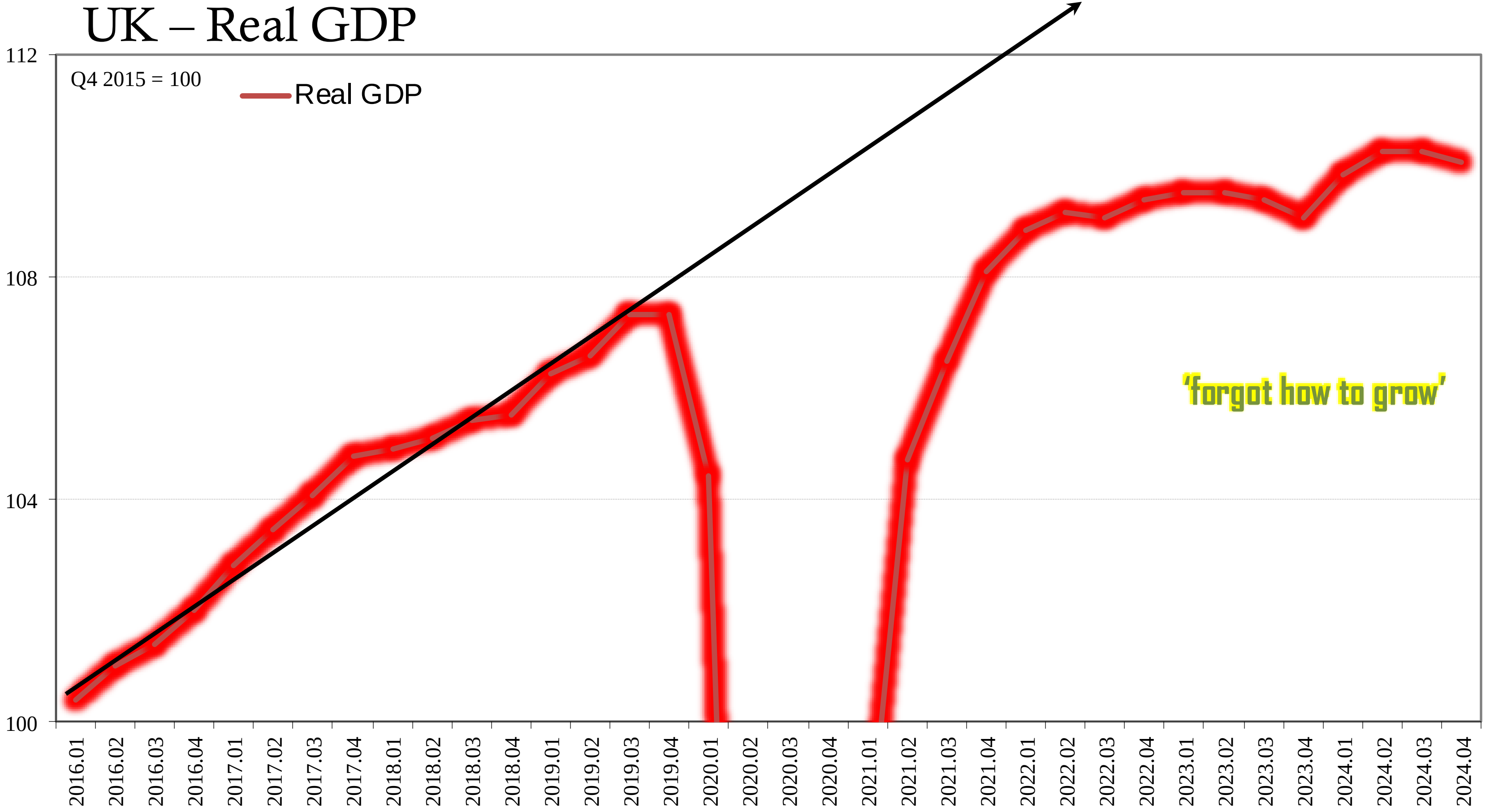
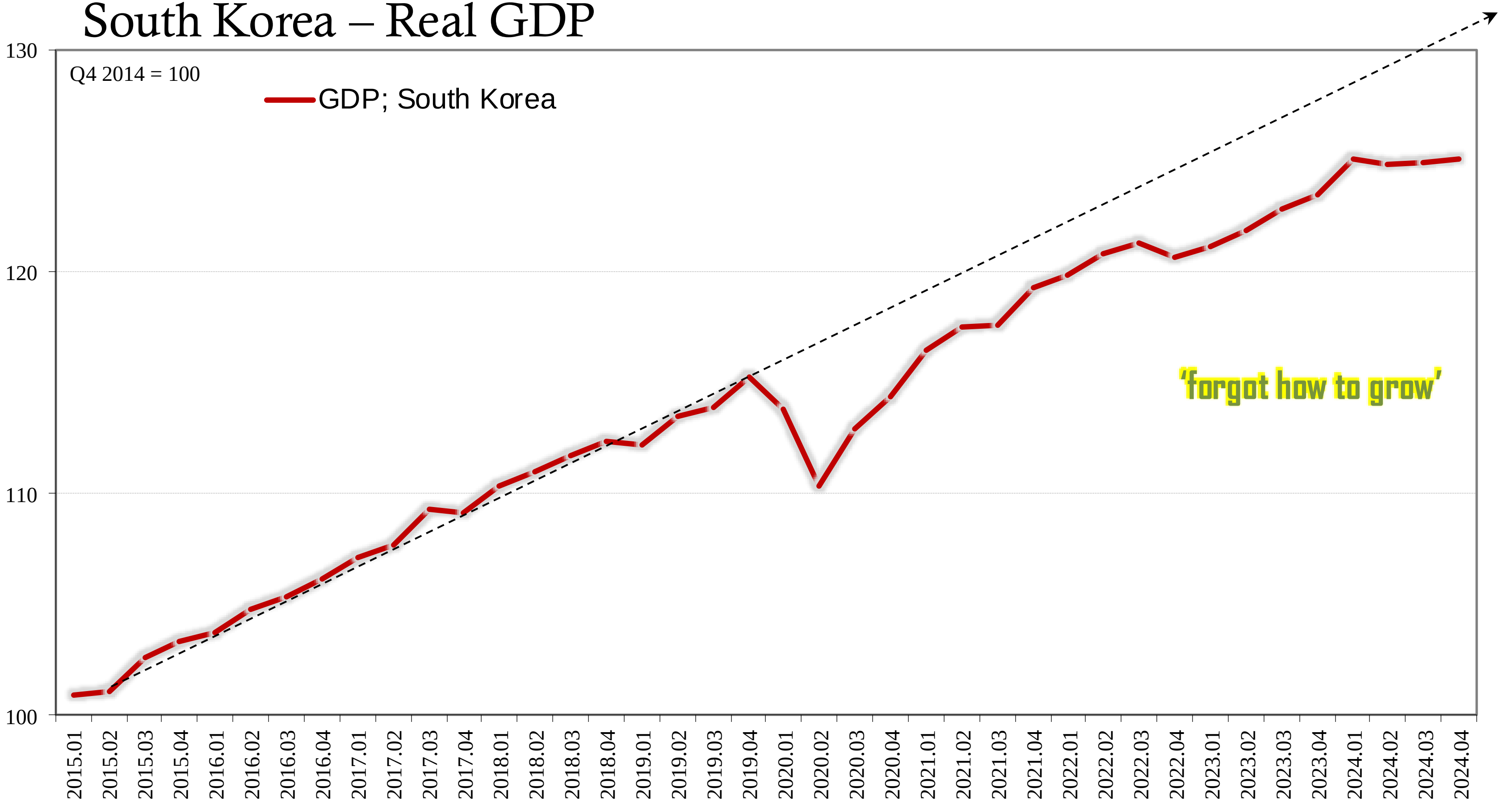
UK – Real GDP

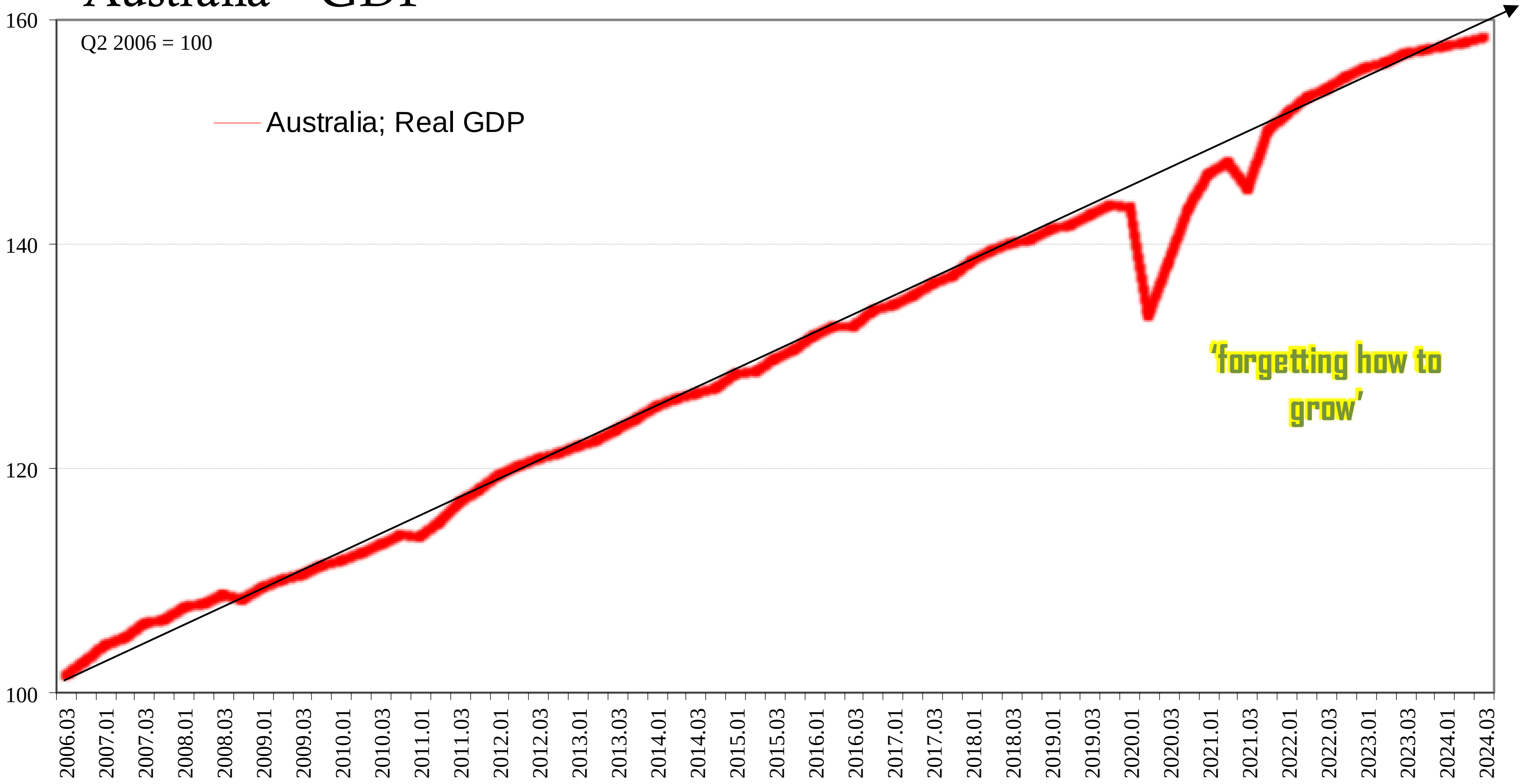


South Korea – Real GDP



New Zealand – Real GDP

Australia – GDP



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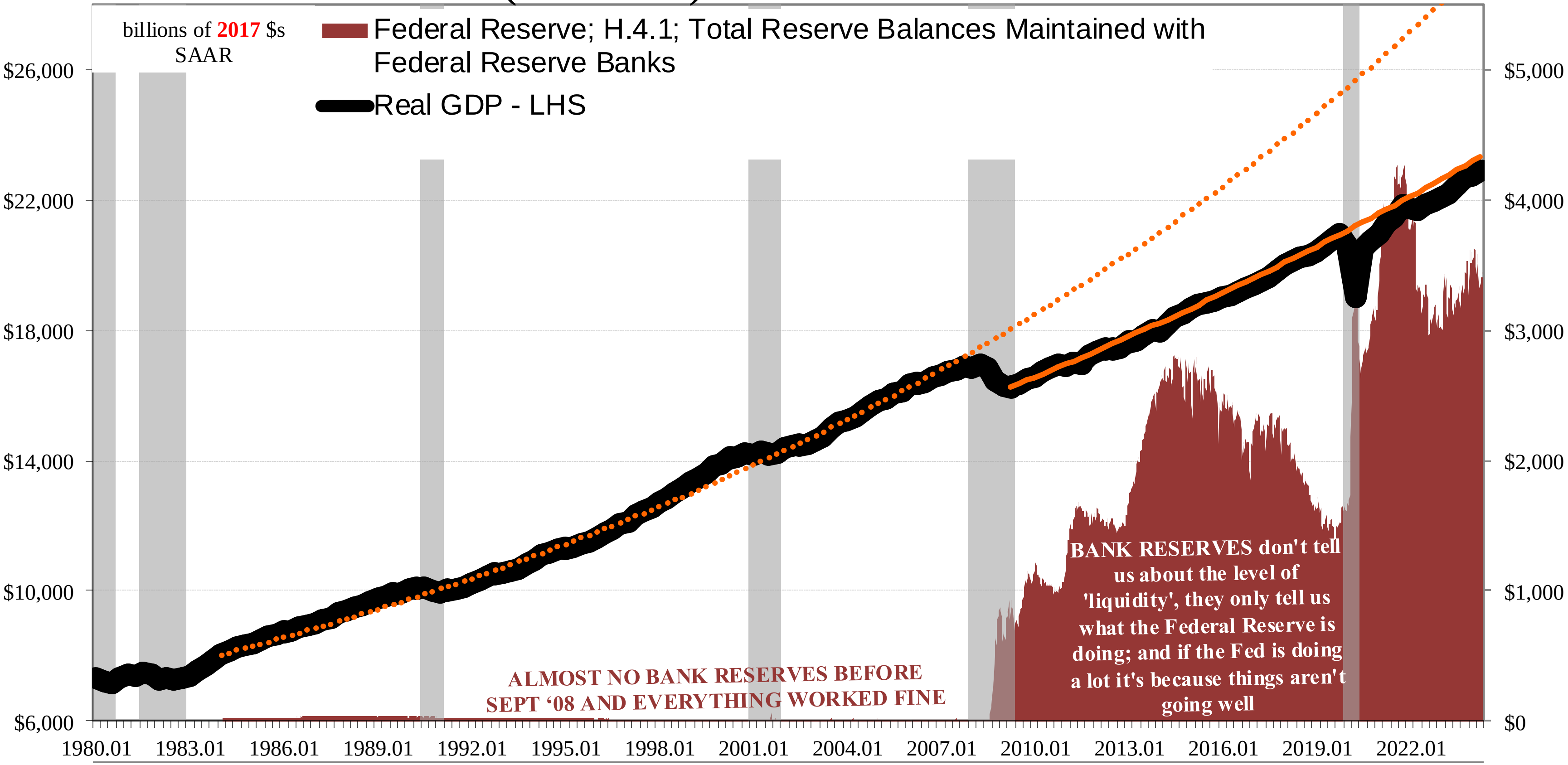
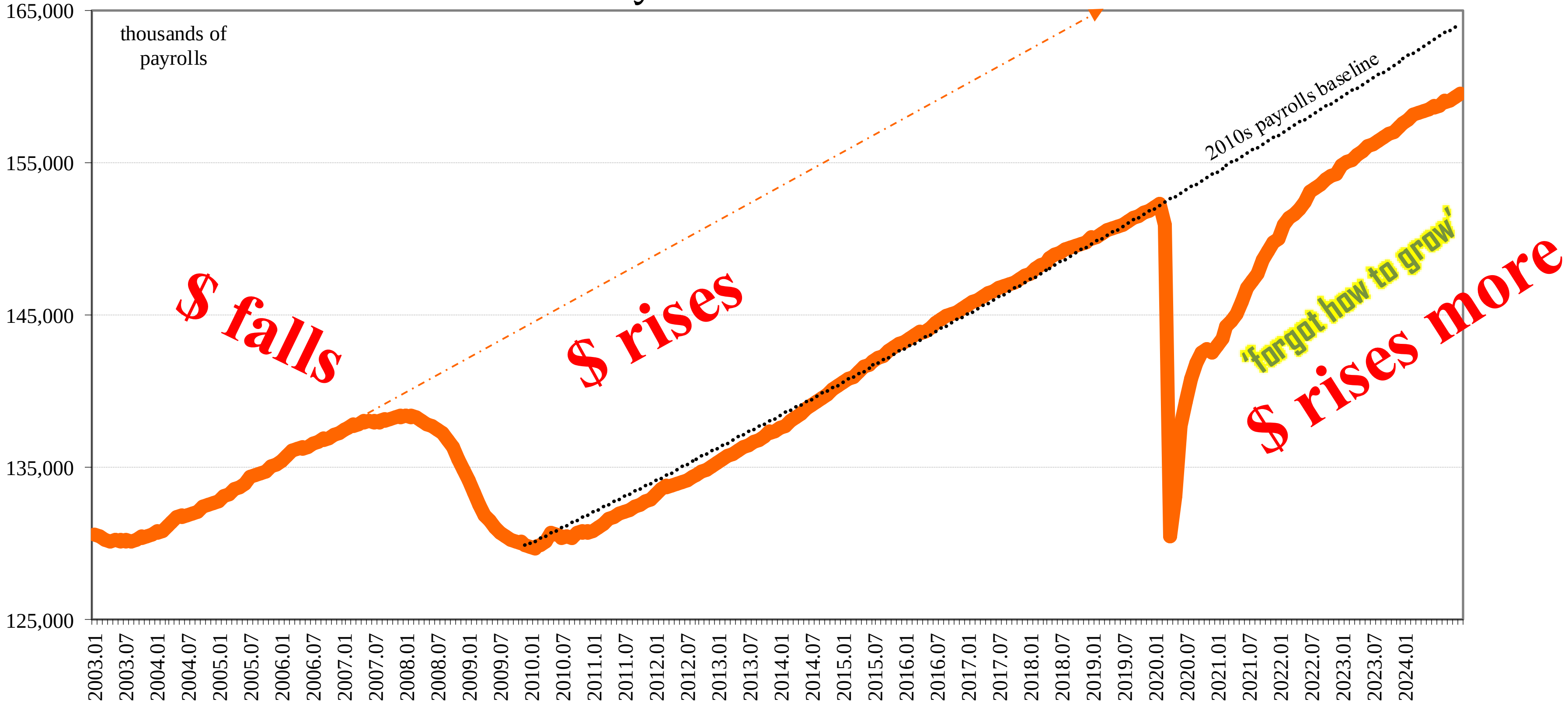
US – Real GDP (Problem)



CES – Establishment Survey



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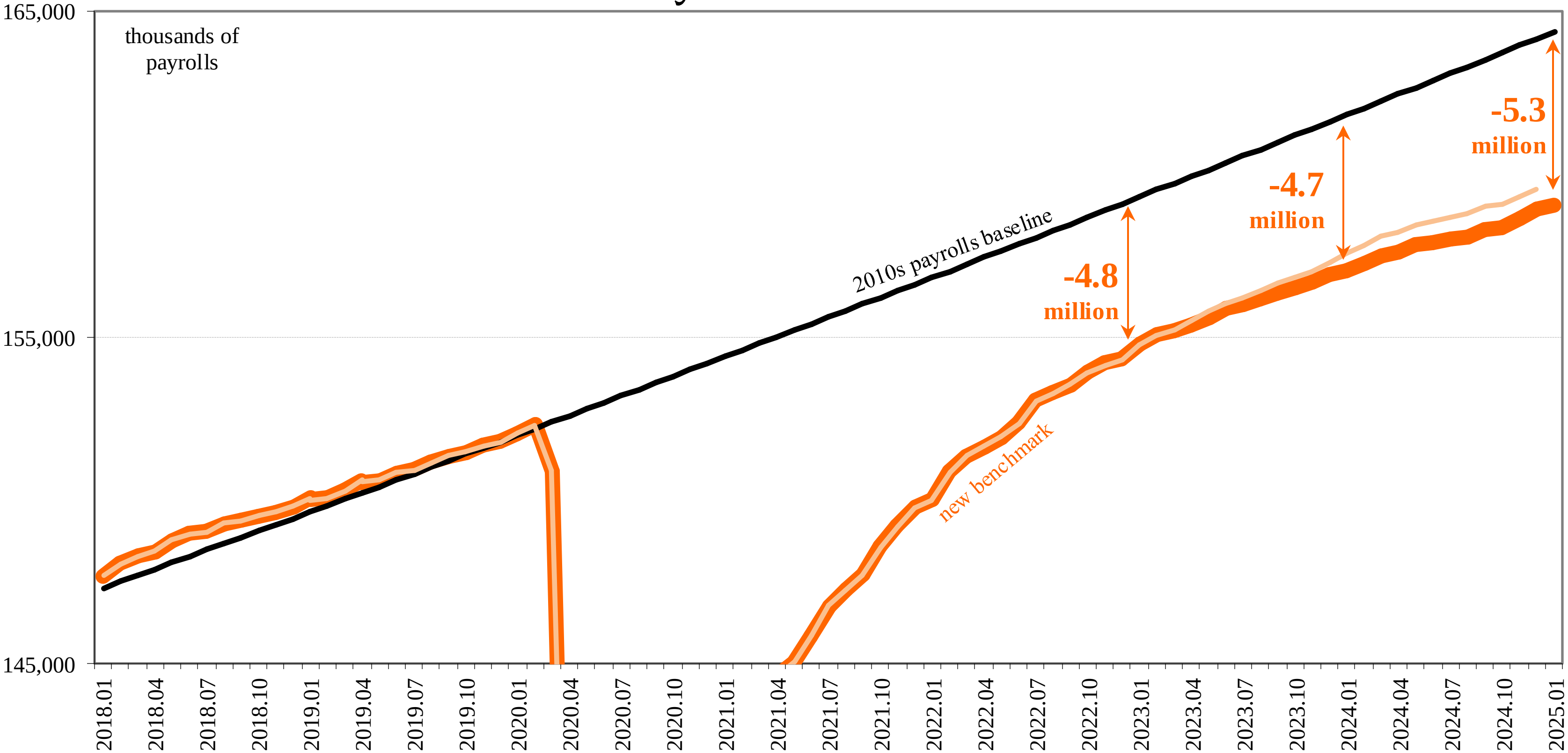

The EURODOLLAR WON'T BE ACCORD-ED

END

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