12-14 December, 2014

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GCU Bulletin

Dear Reader,

The first victim of the financial crisis was Old Normal whom we had all known for years. As states started financing a highly developed commercially free market, her health deteriorated. After many setbacks due to extraordinary state interventions, she eventually succumbed, unable to keep up, exhausted and full of years. Old Normal is no longer among us, and believing that she will return if we just try hard enough is like crying next to the coffin. It wins sympathy, but it will not bring her back.

Getting into conflicts and conflict zones is often much easier than getting successfully out again. Increasing exchange rate volatility and monetary frictions due to single-minded decisions is the reality of today, and with Old Normal no longer here, now what? What shall become the New Normal? How shall we find common ground on a New Normal that provides the stability needed, resembles the realities and facts of the world as it is today, and is optimal for each participant?

When Old Normal was born, it was in order to provide ‘monetary stability’, ‘to protect the real producers of wealth, the investors and the working man’, where ‘the strength of a nation’s currency is based on that nation’s economy’ and ‘stability and equal treatment are in everybody’s interest’…

It does not take much more than common sense and a basic understanding of the landscape to realize that that there is no alternative to helping New Normal into the world.

In the words of US President Nixon, the father of Old Normal: ‘Stability and equal treatment are in everybody’s interest’. I leave you with this week’s eight selected highlights on exchange rates, money and monetary policy. (If you don’t recall the words from President Nixon’s TV-transmission on the event, you can see it here.)

Next time, I will introduce to you to the Trade-Weighted Equilibrium Exchange Rate System.

Best regards,
Jesper Toft

Read previous newsletters

Roubini: The return of currency wars

Central banks in China, South Korea, Taiwan, Singapore, and Thailand, fearful of losing competitiveness relative to Japan, are easing their own monetary policies – or will soon ease more. The European Central Bank and the central banks of Switzerland, Sweden, Norway, and a few Central European countries are likely to embrace quantitative easing or use other unconventional policies to prevent their currencies from appreciating.

Project Syndicate

Related: Geopolitical problems lead Roubini's list of top economic risks for 2015

Rising dollar major threat to global economy

The durability of the dollar isn’t a given, and pressure in the $12.3 trillion US Treasury market is causing alarm. A study by the Bank for International Settlements warns of the imbalance between dollar debt and dollar output, and that it could have a 'profound impact on the global economy'.

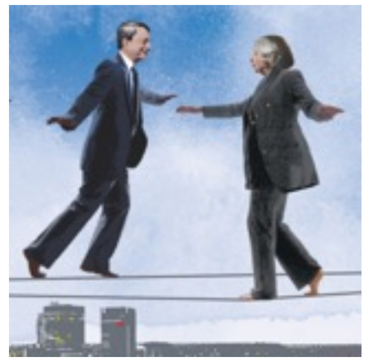
RT.com

Related:
WSJ - How the Rising Dollar Could Trigger the Next Global Financial Crisis
Reuters - Sudden swings expose fragility of financial markets

China knows that a global currency follows trade and is turning away from the dollar. There is a pattern forming on renminbi internationalisation. History suggests that global currencies have to be founded upon real trade and business, supported by liquid financial markets, efficient institutions and robust infrastructure. The last Chinese global currency standard served China for over half a millennium. Creating the next global currency will therefore not be a short-term journey.

- China: Turning away from the dollar
- China: Where trade and investment lead, a global currency follows
- China: Direct settlement with South Korea

Because they have no choice, central banks will stay easy in 2015



The world's central bankers could be forgiven for thinking that things are never going to get back to normal. More than six years after the financial crisis plunged the world into recession, monetary policy looks nothing like it did before those events.

Bloomberg

See the results and documentation from our analysis of the potential benefit for Turkey, when using our Function instead of pricing in USD:

TURKISH TRADE VIA US DOLLAR TO: (2013)		ENGLAND (USD)	RUSSIA (USD)	CHINA (USD)	*Total* (USD)
Cost of risk TRY Exports using USD as intermediary currency		111.907.700	88.826.830	45.925.710	246.660.240
Cost of risk TRY Imports using USD as intermediary currency		199.092.600	795.738.300	783.769.700	1.778.600.600
Total		311.000.300	884.565.100	829.695.400	2.025.260.800
Cost of risk TRY Exports with GCU Split (50/50)		59.663.390	75.495.930	32.775.960	167.935.280
Cost of risk TRY Imports with GCU Split (50/50)		100.246.000	278.698.000	288.336.100	667.280.100
Total		159.909.400	354.194.000	321.112.100	835.215.500
Advantage from reduced risk/cost to Turkish trade using GCU Split (50/50) vs. pricing in USD		151.090.900	530.371.200	508.583.300	1.190.045.400
Total Trade		15.048.160.000	32.030.520.000	28.288.660.000	75.367.340.000
Saving as percentage of Total Trade		1,004049	1,655831	1,797834	0,015790
Saving using GCU Split compared to using USD in percentage		48,582230	59,958410	61,297590	0,587601
	USDTRY	GBPTRY	RUBTRY	CNYTRY	
Variance	0,011195	0,011921	0,012600	0,011123	
Standard error	0,105809	0,109182	0,112250	0,105466	
Trade (TRY export+import)	NA	15.048.160.000	32.030.520.000	28.288.660.000	
Total volatility in total trade - using USD (AC+BC)	NA	0,155890	0,195330	0,122976	
Total volatility in total trade - using GCU Split (AB)	NA	0,109182	0,112250	0,105466	
Reduction of volatility in percentage	NA	29,962100	42,533110	14,238050	
Trade-weighted volatility for Turkey, based on trade with GBP, CNY, RUB - using GCU Split	0,054546				
Trade-weighted volatility for Turkey, based on trade with GBP, CNY, RUB - using USD for pricing	0,105809				

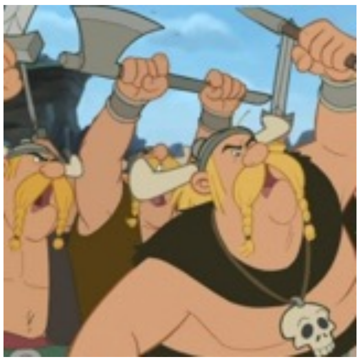
Savings using our Function vs. pricing in USD: **1.2 bn USD**
See results when pricing in Euro See documentation

European economy - a Greek tragedy

Greece is now in breach of its bailout agreement and seeking an extension while calling early presidential elections. Draghi is under pressure and is said to be planning QE early next year - although in conflict with several European central banks.

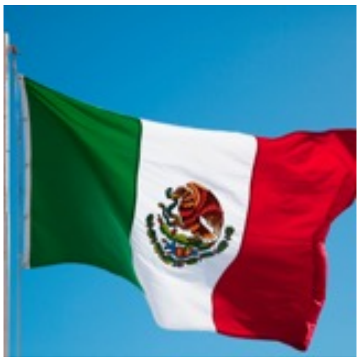
While the Eurozone should be wished the best of luck with the tasks ahead, it seems likely that it could '*all end in tears*'.

Draghi stimulus draws Danish pledge on limitless peg defense



As the ECB tries to pump liquidity into the euro area, Denmark is preparing its defense of a 30-year-old currency regime. The little nation on Europe's northern rim has resorted since 2012 to negative rates to fight back a capital influx into its AAA-rated market and sees no limit to how far it will go to defend the krone's peg to the euro.

Businessweek



Mexican central bank head says cautiously monitoring peso rate

Banco de Mexico is keeping its eye on the exchange rate, bank governor Agustin Carstens said Friday last, after the peso slumped to a fresh 2-1/2-year low against the U.S. dollar. 'We have to monitor (the exchange rate) with a lot of caution,' he commented as the central bank held borrowing costs steady but said the fall in the peso could add to inflation pressures.

Big News Network

Related: Mexico vows to sell dollars to halt peso's slide

Russia set to raise main lending rate

Since the incursion into Crimea, Russia's central bank governor Elvira Nabiullina has raised rates by 400 basis points and is now expected to raise them another 100 points. This is the result of Russia finding herself in the worst ruble rout since the 1998 default, with a weakening against the dollar of 24% since the last rate hike and with inflation on the rise.

Bloomberg
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Related: Medvedev alarmed at ruble harm as Russia asks companies for help

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