Tuesday 10 November, 2015

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Dear Friends and Contacts of GCU,

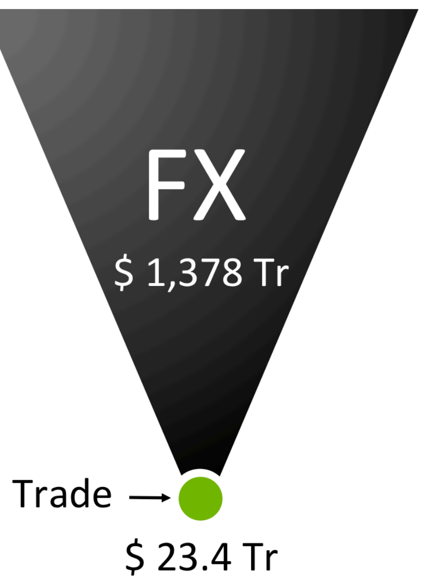
Let me ask you this simple question: *Did the underlying economic fundamentals between the US and the Eurozone change by 7% over the last three weeks?*

With no dramatic monetary events occurring over these past weeks, obviously the answer would be:
"No, the underlying economic fundamentals did not change 7% over the past three weeks."
But the EUR/USD exchange rate did change by that percentage within that period!
And that is the point in a nutshell: The current method of setting exchange rates is outdated and has a direct negative influence on global growth and economic integration.

The 1:52 element. To grasp the key aspect of this issue, you only need to understand the 1:52 element, which is the relation between global trade, amounting to $23,4 trillion *annually*, relative to trade in currencies, which amounts to approximately the same number – but that is looking at the *weekly* average only! So the volume of the foreign exchange market is the same in one week as all global trade of goods and services in one year.

In other words: One week per year the FX volume services global trade settlements, while for the remaining 51 weeks it does not.

Imagine FX as the cone on top of global trade. When the cone tilts to one side, it influences the small green circle of trade. The greater the cone becomes relative to the circle of trade, the greater the impact on the growth of trade and the greater problem it represents. (The proportions of the illustration are correct.)



The Fortune 500 and their average 7% profit. The average profit of Fortune 500 companies is around 7%. A vast majority of these companies are closely integrated into the global supply-chain and so exposed to disorderly exchange rate movements' percentage that is larger than their profit margin.
The inherent risk due to this outdated way of setting exchange rates is a hindrance to the development of trade and therefore to growth.

"Exchange rates should reflect economic fundamentals". Everyone seems to agree to that, but what is being done about it? This question is for the G20 meeting later this week, whose participants several times have assured us that they will "refrain from competitive devaluations." This is obviously better than the alternative, but in no way attempts to address the disorderly movements in exchange rates arising from an outdated system.

In the interest of best-achievable market-based exchange rate stability, may I suggest that you take a look at the Trade-Weighted Equilibrium Exchange Rate system from GCU - a practical approach to a multi-currency, arbitrage-free solution to this problem.

Best regards,
Jesper Toft

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