US DOLLAR THEATRICS: DEPRECIATING ACTS

© Leo Haviland, 646-295-8385 June 7, 2017

"Gonna leave this brokedown palace
On my hands and my knees I will roll, roll, roll". The Grateful Dead, "Brokedown Palace"

CONCLUSION AND OVERVIEW

The gradual depreciation of the broad real trade-weighted United States dollar ("TWD"; Federal Reserve Board, H.10 statistics; monthly average; March 1973=100) that began in December 2016/January 2017 at about 102.8 probably will continue for at least the next several months. Dollar cross rate patterns against assorted individual currencies (such as the Euro FX, Chinese renminbi, and Japanese Yen) are not necessarily the same. In principle and practice, the dollar may rally against one counterpart while getting feebler against another. Nevertheless, the similar weakness in recent months of the dollar's cross rate versus several key American trading partners manifests the widespread underpinnings of the growing overall dollar breakdown. Gold's bull climb since December 2016 roughly coincides with and reflects (confirms) the greenback's erosion.

****

Various entangled factors influence foreign exchange levels and patterns, with monetary policy of course being a key variable. Over the past few months and looking forward, underline the US Federal Reserve Board's willingness to tighten monetary policy by raising the Federal Funds rate; it also hints at the eventual reduction of its bloated balance sheet. Moreover, such Fed action and its forward guidance wordplay contrasts with the ongoing highly accommodative policy of many key central banks (such as the European Central Bank and Bank of Japan). Yet the dollar nevertheless has weakened. In this context, the TWD's slump over the past few months therefore portends future dollar depreciation. The Fed meets 6/13-14/17, 7/25-26/17, and 9/19-20/17.

Moreover, most believe that US real GDP growth will remain relatively strong. The dollar's downturn in New Year 2017 is ominous from this perspective as well.

****

The 1/20/17 inauguration of President Trump very closely connects in time with the TWD peak. Is this merely a coincidence? Probably not.

Comments during the 2016 election season and its aftermath by Trump and some members of the supporting cast allied with him indicate that he probably wanted some dollar depreciation to help boost US economic growth. Note their criticism of some key European trading partners and China. Isn't it unfair to the US if the Euro FX or Chinese renminbi are "excessively weak"?

But much more than a willingness by the Trump Administration to permit some dollar bearishness probably explains the dollar's decline in calendar 2017. After all, the US dollar rallied for several weeks after Trump's November 2016 victory.

America's notable political, economic, racial, religious, age, gender, and other divisions and related quarrels preceded Trump's political showmanship and electoral triumph. But such conflicts arguably have worsened since Trump took office.

Examine the ongoing intensity of the carnival of media coverage relating to such divisions, even after the contentious national election. Look at ferocious debates over Obamacare, fiscal priorities, immigration policy, and climate change. In Washington's political circus, note the significant disagreements in Congress on assorted key issues. The Republicans control the Presidency, House, and Senate, but they squabble. How likely will there be significant tax "reform" or substantial new infrastructure spending? The degree and scope of Russian involvement in American politics, including relationships with some people within or linked to the Trump Administration, capture headlines.

America's highly partisan budget battles likely will continue, and its existing long run debt problems will not magically evaporate. Moreover, marketplace wizards generally agree that the enactment of the President's budget plan (sketch) will widen the deficit dramatically relative to current trends. Of course other nations have big debt problems. Look at Japan's mammoth government debt, and see China corporate debt (and property, local government, and shadow banking issues). Yet America's increased indebtedness, particularly if Trump's vision becomes law, is "newer news" than what has been going on within Japanese and Chinese debt festivals.

In addition, US consumer indebtedness is not small, and it has been creeping higher in absolute terms. The New York Fed reported that total US indebtedness as of end first quarter 2017 was about $12.7 trillion. This placed overall household debt $50 billion above its prior peak of third quarter 2008, and 14.1 percent higher than the trough attained in 2Q13.

And very significantly, many people at home and abroad believe President Trump's leadership has been and likely will remain erratic. Compare his language and behavior with that of his predecessors.

Given the nation's significant political (and other interrelated cultural) conflicts and doubts regarding the quality and predictability of Presidential- and Congressional- leadership and action, and "all else equal", this makes the United States dollar (dollar-denominated assets) somewhat less attractive to hold. Widespread falling (low) public confidence in many US politicians, political processes, and political institutions eventually can generate falling confidence (and thus declines) in the dollar.

****

The rise and strength of a variety of "populist" banners and feuds with the "establishment" (elites) in the United States and elsewhere (notably Europe) reflect economic, political, and other cultural splits. First focus on the European scene and the Euro FX against the dollar cross rate. Worries about European populism and Eurozone breakup helped to weaken the Euro FX. It even slumped after the election of the populist Trump (11/9/16's interim top was 1.130; compare 5/3/16's 1.162 and 8/24/15's 1.171). Yet the Euro FX established a key bottom on 1/3/17 at 1.034, not long before Trump entered office. Notably, this rally has extended after populist leaders suffered defeats in Dutch (and especially) and French elections. The German establishment likely will retain power in its September 2014 vote.

The United Kingdom's Brexit vote reflected populist enthusiasm. Issues tied to Scotland and Northern Ireland's place in the UK were underscored. However, the British political arena thereafter (at least so far) did not produce a substantial changing of the guard. Despite some changing faces within the leadership, the overall establishment orientation (elite) has remained in place.

Two other key American trading partners, China and Japan, obviously have entrenched establishments; these are not currently endangered by populist turmoil. In North America, Canada is stable, although Mexico has significant internal friction.

Thus, in recent months, the victory of an apparently populist leader in America contrasts with the maintenance of power by the establishment in most key American trading partners. And the American President's rhetoric and actions (at least to some extent) not only are divisive, but also seem rather erratic and confused to many spectators. Since this picture parallels the weakening of the broad real trade-weighted dollar, it likely has encouraged that TWD depreciation.

****

Finally, let's briefly focus on America's role in the international economic and political theater. "America First!" and "Make America Great Again!" anthems inspire President Trump and many of his populist supporters. Yet such appealing slogans and dedicated audiences, as well as the related Presidential policies (attitudes) regarding trade (such as the Transpacific Partnership and NAFTA) and political alliances (such as NATO; retreat from the global climate change agreement) reflect the likelihood that America will become less involved internationally than previously.

This obviously in practice does not mean the United States, via its remarkable turn inward, necessarily will abandon or massively reduce its important role in the intertwined world economic and political scenes. Although America will not entirely depart from globalist (multilateral) doctrines practices, and although a large set of individually-negotiated arrangements with foreign counterparties are a form of multilateralism, America First is indeed a big and new deal. So perhaps a marginally declining American role on the international stage will be reflected by a marginally reduced inclination of persons to price transactions in dollars, or to hold onto dollar-denominated assets (including securities). Increased diversification away from (reduced demand for) the dollar may promote notable dollar weakness. In any case, the Administration's devoted quest to Make America Great thus may help to make the dollar less great.

THE BROAD REAL TRADE-WEIGHTED US DOLLAR: BREAKING DOWN

The Rolling Stones sing in "19^{th} Nervous Breakdown"
"You better stop, and look around,
Here it comes, here it comes, here it comes, here it comes
Here comes your nineteenth nervous breakdown."

****

The broad real trade-weighted US dollar ("TWD"; Federal Reserve Board, H.10 statistics; monthly average) appreciated about 28.0 percent and five and one-half years from its July 2011 major bottom around 80.3 to its twin peaks in December 2016 (102.84) and January 2017 (102.79) around 102.8. History suggests that the substantial extent and long duration of this bull charge, although not record-breaking, are consistent with the viewpoint that the December 2016/January 2017 elevation probably was a major TWD high.

The TWD's 2011-2017 bull move far exceeded its 15.1 percent and about one year ascent during the global economic disaster (April 2008 at 84.0 to March 2009's 96.7). The time taken and distance travelled by the TWD's climb from its 2011 record low depth rivaled the 34.2pc and over six and one-half years of the majestic July 1995 to February 2002 jump (84.0 to 112.8).

Though the July 2011 to December 2016/January 2017 dollar leap competed with the six and a half year duration of the glorious October 1978 to March 1985 appreciation, it was much less explosive (October 1978's 84.1 to March 1985's 128.4 equals 52.7 percent).

What about the duration of the TWD's bull move commencing in July 2011 in regard to prior major bear moves? The January 1973 to October 1978 slump (107.6 to 84.1) lasted nearly six years, about the same as the upward march beginning in July 2011. The TWD deteriorated just over six years from February 2002's 112.8 to 84.0 in April 2008. The gigantic tumble from March 1985's pinnacle at 128.4 to July 1995's bottom at 84.0 lasted over a decade. However, the greater part of that collapse took less than four years, reaching 89.8 in December 1988. Though it retraced slightly to June 1989's 96.2, the resumed bear move from then to July 1995's bottom ran six years.

****

Calendar timing considerations also suggest the bull move in the broad real trade-weighted dollar (TWD) that commenced in July 2011 ended in December/January 2017 at 102.8. Why? Marketplace history is not marketplace destiny. However, several critical marketplace peaks in the broad real trade-weighted US dollar have occurred during the first quarter of a calendar year.

For example, recall the TWD's March 2009 major summit at 96.7. Other major TWD pinnacles include March 1985's stratospheric and record 128.4, February 2002's towering 112.8, and January 1973's monumental 107.6. In the context of the July 2011 bull move, note January 2016's important interim top at 100.9.

****

The broad real TWD's decline to date so far from its 102.8 summit thus far has been modest, about 3.4 percent to May 2017's 99.3 (May 2017 is the most recent month available with broad real TWD data). However, May 2017's 99.3 average falls beneath January 2016's noteworthy 100.9 top.

A five percent decline from 102.8 would push the TWD down to 97.7. A breakdown greater than five percent, and especially a decisive breach of important support around 96.0, would further confirm the TWD bear trend and probably would have significant implications for stock, interest rate, and commodity playgrounds.

Recall the March 2009 financial crisis high at 96.7. Also, after the significant interim top in January 2016, the TWD resumed its parade upward from 96.1 in April 2016. Though it is rather ancient history, also keep in mind June 1989's interim plateau at 96.2. Suppose a surveyor interprets TWD depreciation from February 2002's 112.8 to July 2011's 80.3 as constituting only one major bloody bear crash lasting over nine years. Thus from this vantage point, the rally from April 2008 to March 2009, though important, would be only a temporary retracement within that near-decade long span. The midpoint of the move from 112.8 to 80.3 is about 96.6.

A ten percent fall from 102.8 gives 97.7, 15pc 87.4, and 20pc 82.2.

****

The broad nominal TWD, unlike the broad real TWD, has daily data. Let's look at the H.10 statistics out to two decimal points. The broad nominal TWD peaked 12/28/16 at 129.08, almost matched by 1/3/17's 128.96. Its low since then is 6/2/17's (the most recent data point) 122.68. This is almost exactly five percent. Thus the broad real TWD's depreciation probably nowadays is near or entering a critical danger level. The nominal TWD is beneath its 1/20/16 top around

126.0. A ten percent stumble from 129.1 is about 116.2; a 15pc one equals 109.7, with a 20pc drop 103.3.

THE US DOLLAR: AT THE CROSSROADS

The blues icon, Robert Johnson, sings in "Crossroads":
"I went to the crossroads, fell down on my knees,
Asked the Lord above, have mercy, save poor Bob if you please…
…the sun goin' down…
You can run, tell my friend poor Willie Brown,
Lord, that I'm standin' at the crossroads, baby, I believe I'm sinkin' down".

****

Many countries want their currency to be relatively weak in the hope of thereby boosting and sustaining economic growth. However, even if there are currency wars, not everyone can depreciate at once.

****

The following table reviews the US dollar's depreciation in the cross rate context (such as dollar versus the Chinese renminbi) against its largest trading partners in recent months. Note the key timing points for the cross rate dollar tops (and further dollar weakness). The generally similar performance in direction and timing in late 2016/calendar 2017 for these assorted cross rates underlines the widespread (international) basis for the dollar depreciation.

The Federal Reserve's H.10 reveals the currency weights within the broad index of the foreign exchange value of the dollar. China has the lion's share, at 21.9 percent (compare 2000's 7.9pc), the Euro FX grabs 17.1pc. In North America, Canada captures 12.0 percent, Mexico 12.6pc. Japan owns a 6.3pc piece (it had 12.8pc in 2000, 20.7pc in 1986). These five largest US trading partners combined add up to almost seventy percent.

Notable Recent Currency Cross Rate Lows and Dates Relative to the US Dollar

Chinese Renminbi Made a key bottom on 12/28/16 around 6.965; subsequent lows as the renminbi rally continued were 3/10/17's 6.922 and 5/10/17's 6.908. China may be tightening its financial policy somewhat.

Euro FX Major bottom against the dollar at 1.034 on 1/3/17. The Euro FX bull move accelerated from 4/10/17's 1.057. The 1/3/17 low stands close to 3/13/15's trough at 1.046 and 12/3/15's 1.052 low.

Canadian Dollar The Canadian Dollar's cross rate major abyss was 1/20/16's 1.469 (the CD rallied up to 1.246 on 5/3/16). Recent Canadian Dollar cross rate lows against the US dollar remain well above that January 2016 trough. And note the dates of the late 2016 and calendar 2017 bottoms: 12/28/16's 1.360 and 5/5/17's 1.379.

Mexican Peso The Peso crashed against the US dollar in the four weeks following Donald Trump's election victory. It was 18.16 on 11/9/16, plummeting to about 22.04 on 1/11/17. Since then the peso has had stellar appreciation, on 6/7/17 attaining a height neighboring its November 2016 level.

Japanese Yen Note the timing of the Yen's recent noteworthy lows against the US dollar in conjunction with those of other cross rates against the dollar. Recall the Yen lows on 12/15/16 at around Y118.7, 1/3/17 at Y118.6, and 5/10/17 at Y114.4. The Yen also remains significantly stronger than its major low at Y125.9 on 6/5/15.

The widely-watched British Pound is 3.7pc of the TWD; its appreciation increased from 1/16/17's 1.200 low. The Swiss Franc weighs about 2.0pc within the dollar index. Note the SF's 12/15/16 bottom at 1.034 (adjacent to 11/27/15's 1.033 depth and 1/29/16's 1.026 low), and its further strengthening from 5/10/17's 1.010.

Round one in the colorful French Presidential election fight was 4/23/17. The second round on 5/7/17 produced a smashing victory for the (remaining) establishment candidate against the right-wing populist contender (National Front). Note the general weakness in the US dollar against various currencies in spring 2017, and particularly since around the early May 2017 outcome of the second round of the French election.

Political and economic pressures from populism remain in Europe (see Italy, for example). However, in Holland's March 2017 election, the Dutch prime minister's establishment party decisively defeated populists. Germany's national election is 9/24/17. Although the current center-right and center-left parties closely contest the election, most pundits believe these establishment parties will beat populist (or extreme or radical) groups.

The advances made in the past few months by the Eurozone establishment in maintaining power contrasts with the increasing conflict (disorder, divisions) on the US national scene.

****

Gold's rally in recent months parallels the broad real trade-weighted dollar's (TWD) weakness, as well as the dollar's growing feebleness from its cross rate perspective. After steadily slithering lower from its 7/6/16 top around $1378, gold bottomed at $1124 on 12/15/16 (which in turn was above 12/3/15's major low at $1046). Note the higher lows on 3/10/17 ($1195) and 5/11/17 (right after the French election, at $1217).

****

Convergence/divergence (lead/lag) relationships between intertwined marketplace playgrounds such as the trade-weighted dollar and **commodities "in general"** (or sectors such as the petroleum and base metals complexes) of course can persist, evolve, break down, or transform. In any case, the retreat in the TWD since its end 2016/early 2017 peak links to (probably confirms) bear moves in commodities in general (use the broad S&P Goldman Sachs Commodity Index, the "GSCI", as a benchmark) and the petroleum and base metals arenas in particular.

Recall the highs in the broad GSCI (which is heavily petroleum-weighted) on 2/13/17 at 409 and 4/12/17 at 403. Though NYMEX crude oil (nearest futures continuation) peaked 1/3/17 at $55.24, its second top, on 2/23/17 at $54.94, roughly coincided with February 2017's broad GSCI peak. The London Metal Exchange's base metals index ("LMEX") established an important top on 2/13/17 at 2926. The $53.76 NYMEX crude oil top occurred on 4/12/17, right in tune with that in the GSCI. After the GSCI decayed to 361 (5/5/17; crude oil trough that day as well, at $43.76), the GSCI rallied, aided by signs that OPEC and non-OPEC oil producers would extend their crude oil output restraint agreement. Indeed, on 5/25/17, OPEC and non-OPEC petroleum ministers renewed their output reduction deal through March 2018. However, NYMEX crude oil did not race to a new high relative to its prior tops of calendar 2017. Instead, it has cratered from its 5/25/17 high at $52.00. The GSCI's 5/25/17 high at 395 hovered under its February and April 2017 tops.

****

For further marketplace analysis on currency, commodity, interest rate, and stock marketplaces, see essays such as "Ticket to Ride: US Corporate Profits and S+P 500 Trends" (5/17/17); "Marketplace Volatility: Calm Before the Storm" (5/8/17); "The Oil Battlefield: Evolution, Relationships, and Prices" (4/10/17); "Eurozone Under Siege: Currency Trends and Politics" (3/10/17); "Easing Comes, Easing Goes: US Government Interest Rates" (3/13/17); "Rhetoric and Global Currency Trends" (2/13/17); "Gold and Goldilocks: 2017 Marketplaces" (1/10/17).

****