

# GLOBAL MACRO INSIGHT

## "TRADE-WARS" AND THE VELOCITY OF DOLLARS

15 May 2019

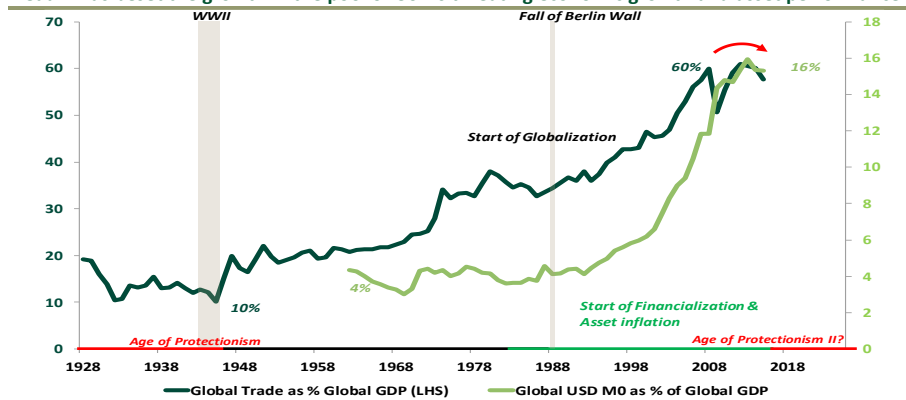


### Executive summary:

- Throughout history reserve currencies, like the USD at present, have been built on strong geopolitical and macroeconomic foundations. One of the biggest **macroeconomic tailwinds** over the past three decades has been a widening US trade deficit supplying ample liquidity to the global financial system. This growth in the pool of USD's kept interest rates low fuelling debt growth and asset inflation.
- The growth in the **pool of dollars** is being threaten by a couple of **structural forces** such as 1) threats from de-globalization (protectionism/populism) 2) slower pace of USD creation because of a shrinking US trade-deficit 3) the slowdown in the growth, leverage of the offshore USD banking system (Eurodollar system) and 4) subdued economic growth and global trade.
- As the saying goes **"if something cannot go on forever, it will stop"**. The macroeconomic tailwind arising from the growth in the USD monetary base is under threat, leaving the global economy and financial system vulnerable to tighter financial conditions.

**Investment implications:** We remain structural USD bulls supported by our view that USD creation is slowing down. However, we expect central bank balance sheets to become even more important role in the financial landscape to manage the changes in the quantum of USD in the global economy – leaving traditional signals like the yield curve, volatility and IR differentials difficult to interpret compared to previous cycle. We will continue to rely on the USD and our measurement of USD monetary base.

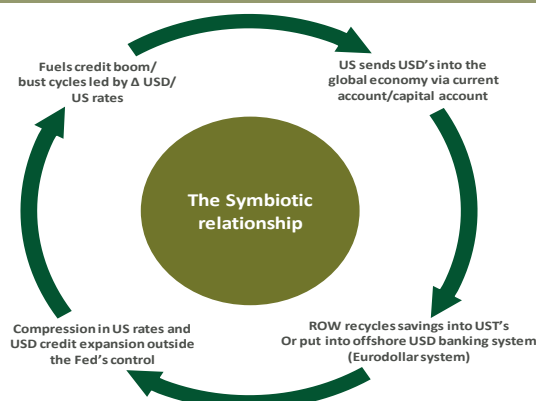
**Chart 1: For decades the pool of USD's lubricated the global economy and financial system. Now headwinds beset the growth in the pool of USD's threatening economic growth and asset performance.**



Source: DataStream, Nedbank CIB

- As **globalisation** accelerated post the fall of the Berlin-Wall a symbiotic relationship between the US and the rest of the world unfolded. As the US imported cheap goods and oil from the rest of the world the US trade deficit ballooned. This led to the growth in USD monetary base which grew fourfold as a percentage of Global GDP (**Chart 1**).
- The US and the rest of the world (ROW) benefited from this structural change in the monetary system. This **"exorbitant privilege"** by the US facilitated constitutently large trade-deficits, this is unfortunate also a **"exorbitant burden"** as in a single currency reserve system, the host country (US) must run deficits to supply the world with liquidity to grow, also known as the **"Triffin dilemma"**.
- The ROW, being e low-cost production countries (Asia) and oil producing nations (Petrodollar system) also channelled their excess USD earnings from exporting to the US into the US bond market compressing both the nominal interest rates and the risk premia.
- As a result, this fuelled the asset boom and the positive wealth effect led to more debt fuelled consumption. (Chart 2)**
- USD monetary base as a percentage of global GDP has lost momentum since 2014 and if the trade dispute becomes a permanent feature the growth in money supply of the last 30-years will be reversed.
- This slowdown in money/credit creation can only be averted by central banks adding to their balance sheets as there is not a lot of room on the interest rate front to move – hence traditional signals from the market may be distorted.

**Chart 2: How the USD is transmitted into the global economy and financial system.**



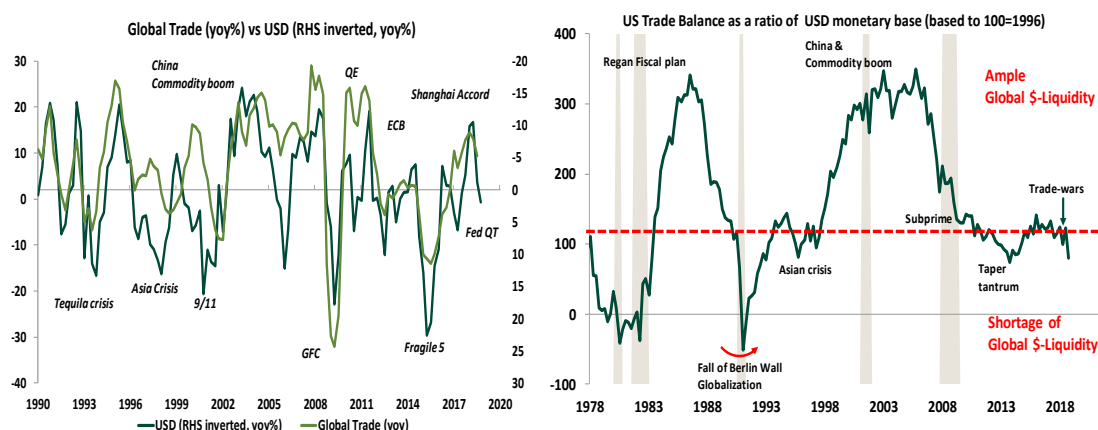
Source: Nedbank CIB

### ANALYST DETAILS

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**Chart 3: Global trade is one of the largest supplier of USD's into the global economy and financial system.**



Source: Shaded areas are US recession, DataStream, Nedbank CIB

- There are two main sources for the growth in the USD monetary base 1) the Fed's balance sheet and 2) the US trade deficit with the latter being the biggest source. Global trade is therefore a major provider of USD's into the global economy and financial system. A slowdown in global trade (lower velocity of money) results in less USD's being circulated into the world which leads to a stronger USD or tighter financial conditions, the opposite is true as well and is clearly demonstrated in the [Chart 3 \(LHS\)](#).
- US trade balance as a percentage of USD monetary base is rolling over.** Should the ratio continue to fall, this will lead to a stronger USD posing downside risks to the global economy and financial markets. ([Chart 3, RHS](#))
- The consensus is that should the trade wars accelerate it will be inflationary. We agree there obviously be a price shock on the back of the tariffs, but we do not expect an inflationary cycle, we expect the opposite. **As the USD monetary base contracts, it will slow down money/credit growth which is deflationary. This will favour bonds and other yielding assets over growth assets.**

**Chart 4: The USD is the only real-time barometer of USD monetary base expansion or contraction.**



Source: Bloomberg, Nedbank CIB

- Post the GFC the USD entered a bull trend for several reasons. 1) As the authorities clamped down on the Shadow Banking System which was USD based the total pool of USD credit contracted, 2) the US growth and interest rates remained above the rest of the developed world and 3) in 2014 the commodities entered a bear market and the falling petro-dollar balances led to a stronger dollar.
- Asset performance outside the US since 2014 has not been attractive and a stronger dollar from here would have the same result. The dollar has failed twice to break back into the long-term bear trend.
- Our thesis which we have held for years remains unchanged: the USD will remain strong as long as the growth in the pool of USD's remains lacklustre.**

## Key forecasts and target values

	Target values (period-end)				Broad trading range	
	3m	6m	12m	Year-end	High	Low
Fed funds	2.50	2.75	2.75	2.75	2.50	2.75
US 10-year bond yield	2.80	3.00	2.80	2.80	2.30	3.20
Repo rate	6.75	6.75	7.00	7.00	6.75	7.00
SA 10-year bond yield	9.20	9.50	9.40	9.40	8.60	9.70
R208 (%)	7.00	7.10	7.20	7.20	6.90	7.40
R186 (%)	8.90	9.20	9.10	9.10	8.30	9.40
R2048 (%)	10.00	10.20	10.30	10.30	9.50	10.50
EURUSD	1,12	1,10	1,14	1,14	1,14	1,10
USDZAR	14,10	14,50	14,10	14,10	14,50	14,10
EURZAR	15,79	15,95	16,07	16,07	16,07	15,79
GBPZAR	17,80	18.10	17.90	17.90	17,80	17,80
AUDZAR	9,90	10,15	10.00	10.00	10,15	9,90
Δ Global \$-Liquidity	↔	↓	↓	↓	-	-

### Nedbank CIB Markets Research/Nedbank Group Economics

	1Q19	2Q19	3Q19	4Q19	2019 Ave	2020 Ave
SA headline CPI	4.40	5.00	5.30	5.30	5.00	5.20
SA core inflation	4.40	4.40	4.40	4.40	4.50	4.50
SA GDP	1.60	1.70	2.10	2.30	1.3	1.8
Current account as a % of GDP					-3.4	-3.5

### South African Reserve Bank

	1Q19	2Q19	3Q19	4Q19	2019 Ave	2020 Ave
SA headline CPI	4.60	4.70	4.80	4.80	4.80	5.30
SA core inflation	4.80	5.00	5.10	5.30	5.00	5.10
SA GDP	-	-	-	-	1.70	2.00
Current account as a % of GDP	-	-	-	-	-3.7	-4.1

### National Treasury

	1Q19	2Q19	3Q19	4Q19	2019 Ave	2020 Ave
SA headline CPI	-	-	-	-	5.20	5.40
SA core inflation	-	-	-	-	-	-
SA GDP	-	-	-	-	1.5	1.70
Current account as a % of GDP	-	-	-	-	-3.4	-3.8

Source: Nedbank CIB Markets Research, Nedbank Group Economics, SARB, NT

# 2019 Macro Calendar

JANUARY							FEBRUARY							MARCH							APRIL						
Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su
31	1	2	3	4	5	6	28	29	30	31	1	2	3	25	26	27	28	1	2	3	1	2	3	4	5	6	7
7	8	9	10	11	12	13	4	5	6	7	8	9	10	4	5	6	7	8	9	10	8	9	10	11	12	13	14
14	15	16	17	18	19	20	11	12	13	14	15	16	17	11	12	13	14	15	16	17	15	16	17	18	19	20	21
21	22	23	24	25	26	27	18	19	20	21	22	23	24	18	19	20	21	22	23	24	22	23	24	25	26	27	28
28	29	30	31	1	2	3	25	26	27	28	1	2	3	25	26	27	28	29	30	31	29	30	1	2	3	4	5
4	5	6	7	8	9	10	4	5	6	7	8	9	10	1	2	3	4	5	6	7	6	7	8	9	10	11	12
17th Jan: SA MPC 24th Jan: ECB meeting 22-25 Jan WEF Davos 30 Jan: Fed FOMC							7th Feb: BoE Meeting 7th Feb: SA SONA 13th-14th Feb: UK MPs to vote on Brexit 16th Feb: Nigeria election 20th Feb: SA budget							1st Mar: End of 90-day trade truce US-China 7th Mar: ECB Meeting 15th Mar: BoJ Meeting 20th Mar: FOMC Meeting 21st Mar: BoE Meeting 28th Mar: SARB Meeting							10th Apr: ECB Meeting 12-14th Apr: World Bank & IMF meet 17th Apr: Indonesia election 25th Apr: BoJ Meeting April/May: India election						
MAY							JUNE							JULY							AUGUST						
Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su
29	30	1	2	3	4	5	27	28	29	30	31	1	2	1	2	3	4	5	6	7	29	30	31	1	2	3	4
6	7	8	9	10	11	12	3	4	5	6	7	8	9	8	9	10	11	12	13	14	5	6	7	8	9	10	11
13	14	15	16	17	18	19	10	11	12	13	14	15	16	15	16	17	18	19	20	21	12	13	14	15	16	17	18
20	21	22	23	24	25	26	17	18	19	20	21	22	23	22	23	24	25	26	27	28	19	20	21	22	23	24	25
27	28	29	30	31	1	2	24	25	26	27	28	29	30	29	30	31	1	2	3	4	26	27	28	29	30	31	1
3	4	5	6	7	8	9	1	2	3	4	5	6	7	5	6	7	8	9	10	11	2	3	4	5	6	7	8
1st May: FOMC Meeting 2nd May: BoE Meeting 23-26th May: European Parliamentary election 26th May: Belgium election 08 May South African election							6th June: ECB Meeting 19th June: FOMC Meeting 20th June: BoE and BoJ Meeting 28-29th June: G20 Summit							18th July: SA MPC 25th July: ECB Meeting 30th July: BoJ Meeting 31st July: FOMC Meeting							1st August: BoE Meeting 25-27th Aug: G7 Summit						
SEPTEMBER							OCTOBER							NOVEMBER							DECEMBER						
Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su
26	27	28	29	30	31	1	30	1	2	3	4	5	6	28	29	30	31	1	2	3	25	26	27	28	29	30	1
2	3	4	5	6	7	8	7	8	9	10	11	12	13	4	5	6	7	8	9	10	2	3	4	5	6	7	8
9	10	11	12	13	14	15	14	15	16	17	18	19	20	11	12	13	14	15	16	17	9	10	11	12	13	14	15
16	17	18	19	20	21	22	21	22	23	24	25	26	27	18	19	20	21	22	23	24	16	17	18	19	20	21	22
23	24	25	26	27	28	29	28	29	30	31	1	2	3	25	26	27	28	29	30	1	23	24	25	26	27	28	29
30	1	2	3	4	5	6	4	5	6	7	8	9	10	2	3	4	5	6	7	8	30	31	1	2	3	4	5
12th Sep: ECB Meeting 18th Sep: FOMC Meeting 19th Sep: SA MPC 19th Sep: BoE and BoJ Meeting							18-20th Oct: World Bank and IMF meet 23rd Oct: SA MTBPS 24th Oct: ECB Meeting 27th Oct: Argentina election 30th Oct: FOMC Meeting 31st Oct: BoJ Meeting, End of term for ECG President (Draghi) and EC President (Juncker)							7 Nov: BoE Meeting 22 Nov: S&P/Fitch review SA credit rating							11th Dec: FOMC Meeting 12th Dec: ECB Meeting 19th Dec: BoJ Meeting						

	Central Bank Meeting
	World Summit/ IMF/ Trade war/ Political
	Election

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