



# The End of Privilege

Unio Global Macro Council Outlook

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## A New Era

The American economics professor Kenneth Rogoff, co-author of a well-known text on debt 'This Time it's Different', has a new book out entitled 'Our Dollar, Your Problem'. The title is a play on a comment that the US Treasury Secretary, John Connally, made to his European counterparts in 1971, that the dollar 'is our currency but your problem' in the sense that the strength of the dollar and its growing role as the lynchpin of the global financial system, was simply something that other countries would have to contend with. Giscard d'Estaing, then French finance minister, referred to this as 'exorbitant privilege'.

The new Trump administration, and specifically the policies announced since late January, point to a more isolationist America, as well as a more selfish financial hegemon.

From the point of view of the dollar, at the start of this year it traded at historically, extremely expensive levels (compared to a basket of trade partner currencies), and it has simply dropped to 'over-valued'.

The risk from here is that a long period of trend dollar strength (going back to 2012), may now come to an end, as investors in particular begin to allocate away from US assets towards competing safe havens (core euro-zone bonds in the context of the Moody's US debt downgrade) and yielding assets in the case of EM debt, as well as structurally cheaper currencies like the Japanese yen.

The fundamental case for the dollar is not strong – it is expensive, undercut by growing fiscal imbalances, and it has been the beneficiary of massive asset flows, which are now ebbing.

There is now the negative catalyst of an administration that desires a weaker dollar, that is pursuing dollar negative policies (tariffs) and that questions the role of the US as the fulcrum of the financial system.

For instance, other central banks such as the ECB may start to question the role of the Federal Reserve as the financial system's crisis manager and provider of dollar swap lines.

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## Outlook

In the near term, with the weaker dollar becoming the consensus view amongst economists, there may be a near-term bounce in the dollar as the economic effect of tariffs on growth takes its toll on interest rate futures.

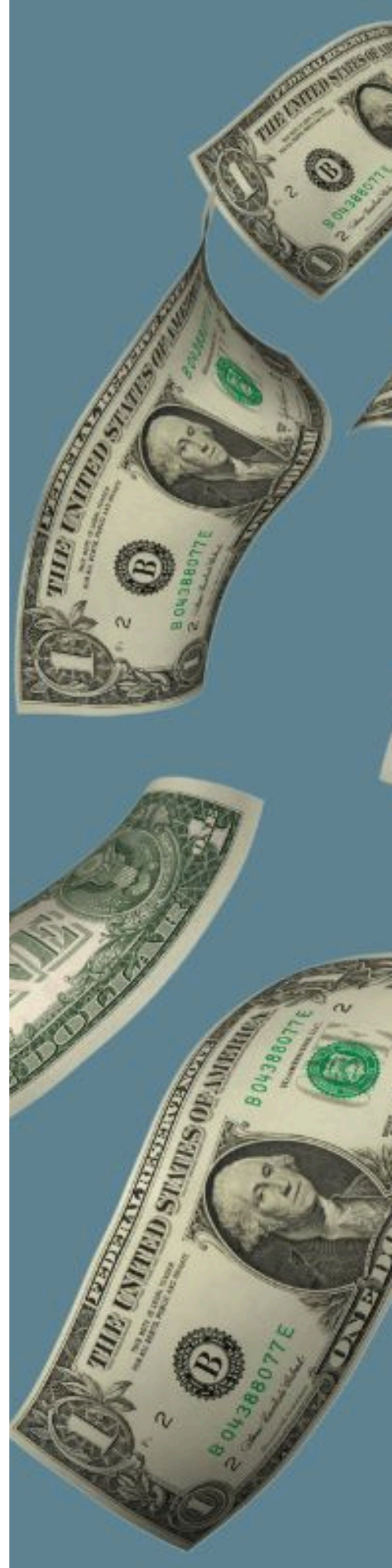
However, several factors will weigh on the dollar in the medium to long term: the retreat of the U.S. from financial diplomacy; a stated policy goal of weakening the dollar; the likelihood that European, Japanese, and other Asian investors will need to diversify away from U.S. assets; and the inevitable gravity of expensive valuations.

## Our View

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At Unio, we do not see a sharp drop in the dollar; rather, we are observing a steady rise in dollar hedging activity, greater demand for cheap currencies, increased flows to Europe and emerging market assets and potentially more FX volatility.

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