Time for the US to Fold Up Its Dollar Empire

Description

by Alasdair MacLeod via Goldmoney,

In this article I examine the current state of the fight for hegemonic control between America on the one side, and Russia and China on the other. It is being fought on two fronts. Ukraine, the one in plain sight, is about to endure a winter without power and adequate food potentially leading to a humanitarian crisis.

The other front is financial with America facing a coordinated attack by Russia and China on its dollar hegemony. The Russians are planning a replacement trade settlement currency, which if it succeeds, could unleash a flood of foreign-owned dollars onto the foreign exchanges.

We have no way of knowing how advanced this plan is, but the indications point perhaps to a gold-based digital currency. Moscow establishing a new gold exchange, Asian central banks accumulating additional gold reserves, and Saudi Arabia seeking non-dollar payments for oil sales are all circumstantial evidence.

As well as these plans, **there has been an underlying shift away from a long-term everything financial bubble,** with the prospect of higher interest rate levels in time. The reasons for foreign ownership of fiat dollars are diminishing, and a successful new Asian trade currency will only add to the dollar's woes.

Could this pressure compel America de-escalate Ukraine and sanctions against Russia? The argument to do so has become compelling. It is also a way to lower energy prices, giving central banks needed room for interest rate manoeuvre.

Russia is making the most of winter

The evidence that Russia is intent on breaking the will of the Ukrainian people is mounting. As the snow begins to settle, Russia is knocking out the power generation necessary to keep people warm and alive. It is a modern variation on the medieval siege. But instead of surrounding a city or castle and starving the residents into submission, by making conditions impossible they expect the

Ukrainians to leave.
Nearly eighty per cent of that unfortunate country's population is Ukrainian, as opposed to Russian. But that is based on officially recognised national boundaries and is not adjusted for the regions Russia gained in the East, including Crimea, in 2014 and subsequently. That leaves a potential refugee problem of 34 million Ukrainians fleeing impossible energy-starved living conditions with scarce food as the cruel winter grinds on.

It takes two sides to make a proxy war. You wouldn't believe it from the western media, but Putin has been careful to not escalate the situation into an official war and drawing NATO into direct confrontation. Instead, **he is using the Ukrainian constitution which protects ethnic Ukrainians, but not minorities including Russian speakers.** Effectively, they are denied human rights and gives Putin the excuse to rescue them.
This legal ethnicity in Ukraine's constitution is unusual today, a feature shared with Nazi Germany. It allows the Russian propaganda machine to accuse the Ukrainian regime of being a Nazi state. Russia's "special operations" were to rescue ethnic Russians in accordance with international law and explains why they have offered them Russian passports and safe passage from the Donbas and Kherson. Following acts such as the car bomb in Moscow which killed Darya Dugina, the daughter of a prominent Putin ally, and the bombing of the Kerch bridge Putin has accused Ukraine of terrorist acts for which Russia seeks retribution. Again, anti-terrorist activity is a device to avoid a declaration of war while justifying further action.
As the winter progresses, **34 million Ukrainians will therefore face the choice of becoming refuges or dying of cold and starvation**. Now that the snow has arrived, the Russians have started targeting Ukraine's energy supplies. The timing is no accident and the EU's leaders can now envisage the likely consequences. But in relying on NATO for their ultimate protection, the Brussels establishment does not see Nato's policy changes as its responsibility and so by going along with American's leadership they have neglected their own interests.
But the Americans now appear to understand the looming danger of winter with no power. Doubtless, this is what led William Burns, the CIA's director to meet his opposite Russian intelligence chief in Ankara two weeks ago. **The official story was that Burns was there to warn the Russians not to resort to nuclear weapons and to raise the issue of US prisoners**.[i] But there is little doubt that this back-channel meeting was to explore compromises before America finds itself a party to the cruel sacrifice of the Ukrainian population in a proxy war.

Negotiations will not be a slam dunk

In the great game of geopolitical strategy, bringing the Americans to the negotiating table can be chalked up as a win for the Russians. But it is not just about a proxy war on Ukrainian soil. Both Russia and America have overriding objectives. The Russians want to secure their western borders, which means American military withdrawal from all border nations at the least — Lavrov has mentioned 300 miles being the missile range. **The US will undoubtedly resist these demands, because to give up effectively on its post-war role as the protector of Europe through NATO would be an open admission of defeat on the world stage.** It would mean the end of US global hegemony, which the Americans are desperately clinging on to. Furthermore, it is a defeat that would enhance Russia's power not just in the Western European arena, but through its partnership with China over the entire Eurasian continent.
From the US's point of view, negotiations with Russia will probably turn out to be an exercise in damage limitation — like the withdrawal from Afghanistan. She needs to get to the table before the situation deteriorates much further. And other than the Ukraine situation they have three pressing

problems to consider:

- There is little doubt that the EU's troubles will escalate this winter, with energy shortages, exorbitant food prices, and rocketing production cost likely to be the most severe test the EU has ever had to deal with. It comes at a time when the euro system faces instability which could take down major banks and expose the euro system itself as insolvent. Systemic risk would then almost certainly translate into an existential threat to the US banking system.
- The US is fighting not one but two new hegemons in Russia and China which have teamed up to form a new Asian-based world order with commodity and raw material suppliers worldwide. Purely on a population basis, a rapidly industrialising Asia with its associated interests in the Shanghai Cooperation Organisation, the Eurasian Economic Union, BRICS, the whole of Africa and large swathes of South America outnumber the North Americans, NATO members, Japan, South Korea, and some less certain US allies by at least six to one.
- The core of this Chinese-Russian partnership is determined to dispose of the dollar for trade settlement as far as possible. As one of the two parties behind the creation of the petrodollar, the Saudis are realigning themselves with the Asian trade bloc. Further moves in this direction are sure to undermine the dollar's hegemony, the principal source of America's power over other nations.

The EU dimension

You can tell that dissention is now evident in the EU, with the EU accusing the Americans of profiteering from the Ukraine war. This was from *Politico*earlier this week:
"The fact is, if you look at it soberly, the country that is most profiting from this war is the U.S. because they are selling more gas and at higher prices, and because they are selling more weapons," one senior official told *POLITICO*.[ii]
The article goes on:
"The explosive comments — backed in public and private by officials, diplomats, and ministers elsewhere — follow mounting anger in Europe over American subsidies that threaten to wreck European industry. The Kremlin is likely to welcome the poisoning of the atmosphere among Western allies. 'We are really at a historic juncture,' the senior EU official said, arguing that the double hit of trade disruption from U.S. subsidies and high energy prices risks turning public opinion against both the war effort and the transatlantic alliance. 'America needs to realize that public opinion is shifting in many EU countries.'"
Realistically, America can only keep its principal EU allies on side if it addresses these concerns. Attributed almost entirely to sanctions against Russia at America's behest and to Putin's reactions to them, rising prices are creating political pressures on the ground likely to force politicians to seek an early end to sanctions. In this respect, time is on Russia's side.

But it is not just in the EU that these pressures have arisen. The new global trend of rising prices is affecting the EU more than most, the European Central Bank having held its deposit rates in negative territory for a considerable period of time. Like other central bankers, **ECB officials failed to plan for an exit route from interest rate suppression and are more badly wrong-footed than most central banks**. It was a policy which encouraged commercial banks into risky territory.
Compressed lending margins forced major commercial banks to maintain profits by leveraging their balance sheets to record levels. The dead hand of negative rates, amounting to a tax on reserves held within the euro system was a burden on banks' performance. While the increase in rates has initially been a profit bonanza for the banks, they are now exposed to losses from declining asset values and

non-performing loans. And with the ECB's deposit rate still only 1.5% when official price inflation is running at over 10%, far higher interest rates are inevitable. Unless somehow price inflation can be brought down significantly, the consequences will be to create huge losses for the banks from financial assets both on-balance sheet and in the form of collateral — losses that will wipe out shareholders' capital.

The inflation problem is now manifest in an energy crisis arising from sanctions against Russia. To prevent the entire euro system being destabilised, the obvious short-term solution is to treaty with Russia. The removal of this source of rising prices would in turn reduce the outlook for euro interest rates, stabilising the entire euro system. We can be sure that the ECB and its network of national central banks will be pointing this out to their politicians.

Indeed, an ending of the sanctions would give stock markets and bond prices an almighty boost, at a time of growing concerns over a global recession. Let there be no doubt: the west's policies against Russia are nothing short of suicidal. And politicians in Brussels would be blind not to see it.

The conflict between the US and the two Asian hegemons is escalating

From Russia's point of view, America's precipitative withdrawal from Afghanistan and the replacement of an unpredictable President Trump with an aging Biden, known to the Russians through his background in US foreign affairs, confirmed that America's global influence was failing. For Russia, with Britain out of the EU it was a good time to escalate tensions between America and Western Europe to side-line America from Europe.

Putin has shown high level skills as a political operator — he had to have them in order to successfully navigate his way through the mess left by Yeltsin to a position of ultimate power. Before escalating the Ukraine situation, we can be certain he anticipated both American-led sanctions and calculated his response. **That the Americans have tentatively signalled that they are now prepared to negotiate confirms the success of Putin's Ukraine strategy.** Now, with the onset of winter he can afford to wait. And the longer he waits, the greater the squeeze on Ukraine and the EU.

America is fighting this power game on two fronts: Russia and China. She cannot be too aggressive against China because the US is still mightily dependent on its economy. The US is resorting to selective technology bans and not much else. Having exported manufacturing supply chains to China and Southeast Asia, large US corporations cannot afford to see their supply chains undermined by aggressive foreign policies. Already, intentionally or not China is putting the squeeze on US corporates with its covid lockdown policy.

We can never be entirely sure of Chinese intensions, particularly with the enigmatic President Xi. With protests at lockdowns, western media portrays Xi's administration as reverting almost to Maoist policies, a reversal of China's recent march into capitalism. The treatment of Uyghurs offends us. But reform of covid policies was known to be on its way, and on Tuesday the announcement was made by China's National Health Commission, giving new guidance to local administrations, which should ease lockdowns.

The underlying problem for China's government is that its economy is suffering a debt hangover from decades of overinvestment in domestic construction, secured by an exceptionally high savings rate. If the economy was left to its own devices, according to classical theory a debt crisis would destroy malinvestments and reallocate capital to more productive use. But with the large commercial banks under state control the policy will be more likely to ride through the transition of capital reallocation,

whatever the cost.
The effect of a credit crunch is to heighten the urgency for state directed investment into other areas, particularly integration with other Asian nations. While we must not forget that there are significant political and cultural differences between China and Russia, American hegemony and trade policies have only served to tighten the bonds between them, so cross-border investment is an obvious priority.
The immediate economic consequences are damaging for China, with an economy which has become ex-growth. While this is a negative factor for the whole region, it could hasten pan-Asian integration to limit economic damage, and to take nations such as India, the Africans and now the entire Middle East further away from US hegemonic control. American allies in Southeast Asia will also be re-examining their foreign policies.
Looking through the immediate prospects for a global recession, we can see that the old world of stagnating economies is being separated from a new world of industrialisation. Independent developing nations are being drawn into the progressive camp, leaving a rump of failing nations living in the past. So far, a confirmation of the end of US hegemony has been seen in the change of Saudi Arabia's trade policy, whereby it has realigned itself to Russia and China, confirming its intention to join the BRICS organisation. With other Arab states following the Saudi lead, this confirms that the Gulf states see their future being bound up with the Russian and Chinese partnership. This is likely to be followed by nations in South-East Asia, which at the moment are sitting on the fence. But Indonesia's recent hosting of the G20 meeting showed that **the hosts appeared to be more worried about upsetting the Russians and Chinese than the US-led western alliance.**
Member states of the European Union are beginning to face the same dilemma. They have gone along blindly with NATO policies without questioning them. The failure of NATO's wars in the Middle East and Afghanistan, and the consequences of the overthrow of Libya's Ghaddafi have all led to Europe's refugee problems. Now, the economic sacrifice of NATO alignment is plain to see. EU leaders are muttering darkly about how the Americans are profiting from Ukraine while Europe is paying the price.

The dollar's hegemony is under threat as well

We know from official announcements that the Russian Chinese partnership, specifically through their membership of the Eurasian Economic Union, is planning to cobble together a new trade settlement currency. Due to currency sanctions against Russia, a sense of urgency has been imparted to the project, with other nations in Asia realising that retaining western currencies in their central bank reserves carries risk of sanctions. These risks are not merely restricted to the immobilisation of reserves in western currencies, but also restrict trade. The consequences of sanctions policy have been to force Asian governments to rethink about trade security as well.
At this stage, all we can do is to draw together some threads to determine the likely form of the new trade settlement currency Sergei Glazyev, the senior Russian official tasked with the project has proposed. An official statement dated 16 June from the committee which he chairs included the following statement:
"Sergei Glazyev informed about presenting in the near future the concept for forming the common EAEU exchange market, which, in particular, would involve the unification of exchanges' information systems and the nomination of prices in national currencies. "The agenda includes the transition to a new stable settlement currency based on a basket of national currencies and exchange-traded products, as well as the creation of our own stable pricing system. Such principles should be applied in work not only within the EAEU but also throughout the SCO," the EEC Minister concluded."

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The objective is for the dollar to be replaced as the settlement medium of intra-national trade. And the idea is that this new trade settlement currency will be open to be joined by other nations. If this project is successful, then the dollar will lose its status as the reserve currency for participating nations.

As described above, the project is impractical, appearing to be a political statement designed to gain early support for the project. Elsewhere, we see proposals to set up a new Moscow gold exchange, purportedly to replace access to the London bullion market now denied to Russia and its refiners. But again, we see that the moving light is the same Sergei Galzyev, this time telling us that the demand comes from Russia's bullion industry.

If it is to work, Glazyev's original proposal to Eurasian states cannot proceed. The inclusion of national currencies in some sort of daily fixing does n0t guarantee stability, and every time another SCO member decides to join a whole rebalancing exercise would have to take place. The same considerations apply to "exchange traded products", which from other statements we can take to refer to commodities traded between members of the scheme.

From being an inherently defensive move against US dollar hegemony, subsequent confirmation of Saudi intentions to switch payments from dollars to unspecified Asian currencies changes priorities. From convincing a coterie of Eurasian states, Glazyev's prize is to persuade the Saudis and other gulf energy suppliers as well to accept the new trade settlement medium. Only a gold-based currency fits the bill. With their Bedouin roots in physical coin, a gold-based trade settlement currency acceptable to the Saudis would have the added advantage of dealing a significant blow against the dollar.

The more one considers the situation, one can only conclude that gold is the logical basis for such as scheme, and Glazyev's involvement in the new Moscow gold exchange suggests he has reached a similar conclusion. **If that's the case, then it will be necessary to back a gold fixing scheme** in such a way that participants can confidently retain balances in the new currency, even though it will almost certainly be digital in form.

Assuming that the scheme progresses towards fruition with gold representing commodity-based transactions generally, the requirement for retaining dollar balances will fall away. The impact on the dollar has to be our next topic.

Foreign dollar balances are simply enormous

As illustrated by the chart above, foreign ownership of financial assets including bank deposits totals nearly $30 trillion, down over $4 trillion since last December. Some of this is due to fluctuations in portfolio valuations, but clearly the foreign appetite for holding dollars is waning. If the Russia/China Asian bloc comes up with a viable trade settlement currency, both official ownership and private sector

ownership of dollars will be less required, and ownership by foreigners will diminish further.
Dollars will be sold for other currencies, to purchase bullion, or to build stocks of durable commodities.
The global desire to sell dollars for other major fiat currencies was knocked on the head by currency sanctions against Russia. And we can be sure that the message about holding yen, euros, or sterling is widely received in all Asian nations.
Therefore, **US-led currency sanctions against Russia will probably backfire badly.** With the dollar being sold for bullion and commodities, the value of dollars relative to bullion and commodities will obviously decline. It will be a trend readily understood by foreign holders, likely to drive the dollar down more rapidly than might be expected.
It may be that the process has already started. So far this year, the dollar has gained against other major currencies due to the Fed having led other central banks into higher interest rates in an attempt to contain price inflation. Other central banks are now responding belatedly with their revised interest rate policies, and consequently the rising trend in the dollar's trade weighted index has broken down from its previous uptrend. The chart below illustrates the dollar's move so far.

Compounding the dollar's problems are market suspicions that the Fed will be forced into a policy pivot as evidence of a recession mounts. While softening its line slightly the Fed still denies it, presumably for fear of encouraging yet higher consumer prices. Markets are betting that it is only a matter of time before the Fed is forced to call a halt to interest rate rises and reintroduce quantitative easing. The yield on the 10-year US Treasury note has fallen from 4.4% to 3.63%, while the CPI 'sincrease slowed to 7.7% in October.
Sanction-induced commodity and energy price rises have obscured a wider trend emerging from the end of the forty years of the financialisation of major western economies — the end of a prolonged everything bubble. Intractable government deficits are driving the debasement of currencies relative to the values of commodities. A new financial cold war between the hegemons is undermining the logic of supply chains across multiple jurisdictions. Just-in-time inventory management has become riskier. And while supply chain difficulties have lessened recently, the trade outlook has deteriorated, supply chain reform is on the cards, and commercial bank credit is long overdue its 10-year cyclical downturn.

Managing foreign dollar liquidation

Assuming that foreigners act as outright sellers on a net basis rather than merely hedging existing positions, the buyers will be either the Fed in the case of official institutions selling, or commercial banks.
When the Fed buys dollars, it reduces the liability side of its balance sheet, or redeploys repatriated dollars by buying assets. And since we are considering net selling by foreigners, those assets will be dollar-denominated assets in the domestic US economy. Whether the Fed reduces its balance sheet or buys domestic assets is a matter for economic and monetary policy.
Commercial banks will be acting principally for domestic US buyers, in which case there is no reduction in their aggregate deposit liabilities because the ownership of deposits merely changes. However, if they are not acting for domestic buyers but for themselves and deposits are being

withdrawn, then they must reduce their balance sheet assets to match. They can do this by selling financial assets if they have them on their balance sheet, or by calling in loans. However, we know from US Treasury TIC figures that commercial banks have limited foreign currency loan exposure (i.e. balance sheet assets —in June, it was $687bn[iv]) and with other currencies having been weak they are unlikely to have unhedged on-balance sheet foreign currency financial asset liabilities in any quantity. **Therefore, the bulk of private sector involvement is off-balance sheet and therefore the effect on outstanding commercial bank credit will be limited.**

It would therefore appear to be mainly a problem for the Fed, and the impact on the dollar of foreign selling will only be lessened through the expansion of the Fed's balance sheet. The chart below gives a clue of what the relevant impacts are likely to be.

We have ascertained that commercial banks will not be buying dollars from foreigners in sufficient amounts to affect their balance sheets materially. Instead, if foreigners decide the world is moving away from the dollar, the Fed's balance sheet currently standing at $8.6 trillion will be exposed to a contracting foreign dollar mountain of up to $30 trillion. There is a leverage factor in this which could be substantial.

A further problem for the monetary authorities is that they increasingly expect a recession, even though it appears to be slow in arriving. A recession is a contraction in commercial bank credit, against which the Fed would expect to compensate by the combination of an expansion of its balance sheet and the government increasing its budget deficit. **In other words, after fifty-one years of the dollar being totally fiat, and the dollar seeing demand on the basis that it is the only reserve currency,** the ending of that period at a time when the US economy is entering a recession is the worst combination of events possible.

This is probably the most compelling reason for the US Government to seek to de-escalate tensions over Ukraine and dismantle sanctions against Russia. It would or should have been on the CIA's William Burns's mind when he met his opposite Russian number in Ankara a fortnight ago.

[i] See https://www.reuters.com/world/russian-us-officials-holding-talks-turkey-kommersant-2022-11-14/

[ii] See https://www.politico.eu/article/vladimir-putin-war-europe-ukraine-gas-inflation-reduction-act-ira-joe-biden-rift-west-eu-accuses-us-of-profiting-from-war/

[iii] See https://eec.eaeunion.org/en/news/sergey-glazev-imeyushchiesya-rezervy-rosta-neobkhodimo-konvertirovat-v-narashchivanie-vnutrisoyuznoy/

[iv] Line 1 minus line 2 at https://ticdata.treasury.gov/resource-center/data-chart-center/tic/Documents/bctype.txt