The Rise and the Fall of the US Dollar? Fiat Currencies are "Terminal"

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We have watched, even marveled at how the U.S. dollar has strengthened since last September. All sorts of theories have been put forth as to "why". Some have proffered the dollar is the cleanest dirty shirt of the bunch. Others believe the interest rate differential is kicking in where dollars at least have a positive interest rate versus negative rates elsewhere.

Another theory and one which I have written about in the past and believe to be the main reason for dollar strength is the "margin call" aspect. In other words, the "carry trade" which was used to leverage all sorts of trades is unwinding and dollars are needed to pay back the loans. A synthetic dollar short being covered in other words.

Looking back to my writing yesterday regarding the impossibility in my mind of the Fed actually raising rates, the strong dollar also supports this argument. If the Fed were to raise rates, wouldn't this exacerbate an already immense currency cross problem with (for) the rest of the world? Wouldn't higher U.S. rates explode the dollar higher (short term) versus foreign currencies? The answer of course is yes, but with a stronger dollar comes other obvious problems.

The two biggest problems are

A. we still have a trade deficit of close to $500 billion per year, a stronger dollar will only exacerbate this AND destroy what little manufacturing we have left.

B. the very problems we just saw with a soaring Swiss franc will be seen in many multiples throughout the dollar lending market.

I might add, as the dollar moves higher and foreign currencies drop, more and much stronger inflation gets exported to foreign soil. High and rising inflation and its effects on living standards and the human psyche will create massive unrest across Europe and elsewhere.

This last point is an important one, foreigners who have borrowed in dollars have already seen their "loan balance" expand because the dollars cost more to pay back. Higher U.S. interest rates will only make matters worse. The strong dollar has had the effect of slowing the global economy as companies (and individuals) are cutting back (employment and consumption) to make ends meet.

The above is only half of the equation, the other half is described by Alan Greenspan himself. I personally watched Mr. Greenspan speak in New Orleans last October. He used the word “tinder” http://www.zerohedge.com/news/2015-03-09/alan-greenspan-warns-explosive-inflation-tinderbox-looking-spark for a coming inflation several times and spoke of the money supply and reserves of dollars that have been created and parked away on bank balance sheets. I could only think back to the Texas wildfire as he spoke of “tinder”. The amount of dollars created is like some nutcase piling dry leaves, branches and dead trees in a huge pile, then pouring gasoline on it …and thinking to himself, “this will keep me warm in winter”. In other words, the “fuel” is there and has already been created for a bonfire of inflation and the financial system blowing up on itself. But don’t worry, it will never catch fire?

Tying these two phenomena together, not enough dollars, yet too many, here is the likely scenario I can see unfolding.

The stronger dollar is putting pressure on the financial system all over the world, something (someone), somewhere is going to “fail”. Our financial system is so interconnected and over levered, it will only take one strategic institution’s failure to break the derivatives daisy chain.

Let’s call this the “spark”. This spark causes further failures which I am convinced will circle the globe in less than two days. The forest (economy and financial system) is very dry (weak, fragile), any spark (failure) will create an out of control forest fire which will not be put out until all the fuel is burned and blackened.

Please remember this, the dollar (and Treasuries) are now “backed” by the full faith and credit of the United States. This was not the case back in the 1930’s, dollars were backed by gold. The Treasury did not have enough gold to back all of the dollars but for a very large percentage of those outstanding. This is not even close to the case today. It remains to be seen if there is any gold at all left but, assuming the gold is left untouched, gold would need to be priced at $100,000+ per ounce to cover our debt and money supply. I bring this up because “gold will still be gold” no matter what happens financially. Hold this thought, it ties in with the final logic.

The stronger dollar is beginning to cause stress both financially and economically. It is not “official” yet but even with bogus reporting, the West is already in recession while the East is markedly slowing down. This brings up a few questions. With a slowing or declining economy, will the Treasury have the tax revenues to pay total interest and support all of the other largesse?

Of course not, we will just borrow whatever is necessary to keep going on down the road.

What about higher interest rates, will this exacerbate the problem?

Of course. Tax revenues will drop, “benefits” or spending will rise as will the deficit…and now the federal debt is almost double what it was last time around in 2008. Do you see where this leads? Is the “issuer” of dollars stronger, or weaker than it was in 2008? It’s OK, you can admit it. Weaker. In this scenario where a higher dollar (the spark) puts so much pressure on financial counterparties who are short the dollar, what will be the Feds reaction to derivatives or other sovereign currency crises? Does the Fed have to quintuple their balance sheet again? Or the federal debt double again? Or will another secret $16 trillion or a multiple thereof be lent out all over the world by necessity?

Looking at this in the real world, there have already been many markets thrown into upheaval. The two most important being the FOREX crosses and the oil market. Oil without a doubt is the largest and most all encompassing market on the planet with the exception of dollars themselves. Oil has crashed well over 50% in less than 6 months, dollars have risen 25% over this time frame.

Do you think that these percentages when applied to $10's of trillions might add up to a tad more than a tidy sum? Remember, derivatives is a zero sum game so anything "won" is also "lost". I believe the spark has already created a fire behind the scenes and some have already been consumed and are dead, but hidden. Can I know this for sure? No, but common sense and the amounts involved tell me this is 100% dead on! And there you have it folks, there are too may dollars outstanding …which were created by too much borrowing of dollars … This pushed asset values higher until the world reached debt saturation and led to assets being sold to pay back the debt, asset prices dropped which is causing a global margin call…this synthetic short has created dollar demand to pay these dollars back. In essence creating a dollar shortage. Are you still with me after that long and horrible string of sentences?

If you are, then here we are …facing the global margin call which can ONLY be met by central banks printing more dollars, euros, yen etc. because liquidity is again drying up. The alternative of course is to let the margin call run its course and take all banks, brokers and insurance companies down. Oh yes, don't forget the sovereign treasuries and central banks themselves. It is the solvency of these institution that will ultimately be challenged.

And no, I didn't forget I told you to "hold that thought" for the end. What I have described to you is the world running around and fetching as much wood and pouring as much gasoline on the pile as possible. The thought is this, without a spark this is harmless right? Without going into static electricity, spontaneous combustion, a "gun" or even a BIC lighter for that matter, is it even sane? Gold and silver do not and will not burn.

Whether it be a wildfire, a derivatives core meltdown, or even a central bank (like the Fed) or a sovereign treasury going upside down, gold will remain money and remain the benchmark against which currencies are measured. Fiat currencies by definition are "terminal" at their inception. The "deflation/inflation" debate is a moot point unless argued in terms of real money.

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Bill Holter writes and is partnered with Jim Sinclair at

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