COMMENTARY

Is there risk of a cataclysm?
Changing perceptions of the dollar

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Introduction
President Obama’s printing of US dollars to tackle US economic woes is already a fact everybody knows. One year after the president’s election, it is time for us to assess what are the likely impacts such a strategy is having, say across the Pacific Ocean on the shores of Shanghai. In the early 1980s, even whilst walking leisurely along the Bund, I found ordinary Chinese eager to purchase any amount of US dollars with Mao-faced, Chinese renminbi. Even as late as the 1990s, when I embarked in search of a China entry strategy for a Swiss corporation (Foo, 2001), the US dollar was still a most desirable currency for the Chinese.

During November of 2009, I was back in the financial capital of China, Shanghai. Along the street, I found a sprouting of new schools. Enterprises set up to arm ordinary Chinese investors with technical approaches to investing including techniques for profiting from foreign-exchange markets. I was on a short visit to the forward-thinking Shanghai University of Finance and Economics. Mingling amongst the Chinese people (2008; International Monetary Fund (IMF), gross domestic product (GDP) per capita US$3,259; World Bank, US$3,264 (http://en.wikipedia.org/wiki/List_of_countries_by_-GDP_(nominal)_per_capita); higher on GDP, adjusted for purchasing power parity; IMF, US$5,970; World Bank, US$5,962 (http://en.wikipedia.org/wiki/List_of_countries_by_GDP_(PPP)_per_capita)), I found a deepening sense of reservation about the future of the greenback. No more dollars; they would rather keep the yuan. Surely, this aspect of Chinese financial behavior must be worth some further, deeper investigation for the bigger picture.

On the internet, I quickly found that the forecast of the Financial Forecast Center (http://forecasts.org) for the Chinese yuan to the US dollar provided a very different picture. It projected a flat-line curve in term of the forecasted values: 6.83 yuan to the dollar, for November 2009 until June 2010 (Figure 1). At that time, my bet was that in the next six months, if I wanted to exchange US dollars for yuan along the Bund, I would be offered less than the narrowly banded 6.83.

In other words, such a “stable” outlook on the internet forecast did not affect enhanced perceptions of the dollar as a much riskier currency, at least for the Chinese on the street. To survive in a period of treacherous global economics, engendered in large part by Wall Street, one has to be as street smart as the competition. This commentary has two roles. One, it is a document for gathering into one strand the various trends indicating the changing perceptions of risk regarding the US dollar. Two, the paper forewarns that these changing perceptions are highly suggestive that it is not impossible for a cataclysm to happen in the near future. Having seen the forecast of Chinese yuan to...
the dollar, we turn to look at the other two currencies associated with billion-sized populations: the euro and the rupee.

**Dollar, euro, and rupee**

In very sharp contrast to the “flat-line” forecast of the Chinese yuan to the US dollar, we get a far more realistic, $w$-shaped, wavy portrayal of expectations in the forecast of the US dollar to the euro (Figure 2).

The European economy as a whole is expected to show only a “[...] gradual recovery foreseen in 2010/11 [...]” (Source: Autumn Forecast 2009-11, European Commission, Economic and Financial Affairs). At the time I wrote this commentary, the OECD had just raised the expectation of recovery for its member states to 1.9 percent in 2010, and 2.5 percent in 2011. If these changes are incorporated into the above forecast, then the curve is likely to become more upward sloping.
Such gradualism in economic recovery contrasts sharply with China’s global, locomotive role. If China’s role, currently fueled by her internal fiscal measures, were reflected in Figure 1, then the Chinese yuan would be strongly buoyant against the US dollar at a rate that is a crescendo, and certainly not a monotone. In other words, if not controlled by authorities, the forecast would clearly be an upward-sloping curve.

What about the Indian rupee?
For several months following February 2009, the Indian rupee strengthened against the dollar (Figure 3). Is this surprising with the substantial outsourcing flows during the era of President Bush? Was the outsourcing of skilled jobs for very low-cost advantages the right strategy? Did it lead to the further weakening of the US dollar? From the perspective of US free-market economics, the answer is one thing; but if you draw from ancient Chinese wisdom, there has long been this proverb:

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<th>80% Correct +/-</th>
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Updated Saturday, November 14, 2009
Giving your son a skill is better than giving him one thousand pieces of gold.

The policy pursued by the Bush administration had benefited the Indian economy enormously. By such outsourcing, Indians have had the opportunity to upgrade their skills. Ultimately, the true driver behind the “power” of an economy has to be the skills of her people. The future strength of the rupee vis-à-vis the dollar has to involve such fundamental factors as the skills enhancement of India’s people made possible through the internet. It therefore is not so surprising for Berstein (2008), Chief Economist and Economic Advisor to US Vice President Joseph Biden, when presenting before the US House of Representatives on Challenges Facing American Workers, to state:

[...] There may be no more telling statistic [...] than the fact that the real wage for the median male was lower in 2007 than in 1973 [...]
Li (2008) predicted the rise of China with the demise of world capitalism. Events that are evolving suggest that there should be an eclipse of the US dollar with the emergence of Chinese capitalism. However, whilst China may dominate globally in hard manufacturing, India may yet outpace her with strengths in soft, knowledge-based skills. For this strategic advantage, India has to thank the British for introducing the English language to the “Mother” continent. Can the Chinese replicate the Indian facility with the English language? Initially, my thought was why not? But now, I realize it is a far more difficult goal to realize. Whatever the government may do to promote the use of English in China, everybody speaks primarily Chinese. After just a few years, even professors with PhD’s from the US lose their facility in spoken English. So, it is too early to rule out India from the competition for global domination. Perhaps conscious of China’s imposing a certain rigidity on the yuan, India has begun a process of internationalizing the rupee. So, in the future, these two currencies (rupee and yuan) are very likely to contend against each other in the foreign-exchange markets. Perhaps the dynamics of global competition may develop a complex triangulation – such as that of the Chinese historical novel, The Romance of the Three Kingdoms (Foo, 2005) – involving the euro, rupee, and yuan.

Having discussed the major currencies of billion-sized populations, we next look at two commodities, gold and oil.

Gold, oil, and the dollar
Perhaps nothing captures global risk trends better than the behavior of gold prices. It is widely known that the Chinese are collecting gold. Since very ancient times, people were known to hoard gold for reasons of security, as a hedge against paper currencies. Thus, the peaking of gold at a barrier-breaking price of US$1,000 per ounce and the subsequent hovering above it for such a sustained period is worrisome to many, including the Chinese people (Figure 4).

Everyone knows prices peak whenever the Chinese are targeting a specific commodity. This raises the question: are the Chinese securing against the risk of fiat money – specifically, the US greenback? Throughout the history of mankind, it is gold that has weeded out fiat money. Increasingly, the US dollar is perceived to have value only to the extent of the faith that people place in President Obama – or to be more precise, in how Obamanomics works out in the USA. For the Chinese, the color of gold has always symbolized wealth and prosperity. Also, gold literally is power: for the Emperor, the Son of Heaven, imperial power is donned in gold and thus projected like the rays of the sun.

When the Chinese first encountered the might of the USA, they attributed the word “gold” (金; pinyin, jin) to its currency (美元; pinyin, mei jin). As a motto, one might say the Chinese people’s perception of the then American dollar was “Good as gold.” It is for the same reason that, in the last two decades, the Chinese Government had been amassing wealth in US dollars. For the nineteenth century Manchu Chinese, America was named 美国 (mei guo; beautiful country): the “beautiful” country. Now that the US dollar has lost its luster, it is no longer shining like gold. The echoes of the streets are more likely 美元 (mei yuan). From the decreasing frequency with which the Chinese now unconsciously choose to call the dollar mei jin, one can guess how much faith they put in the dollar.

Intriguingly, rising gold prices have been accompanied by increases in the price of oil (Figure 5). While it is outside the scope of this paper to analyze the drivers behind rising oil prices, it is suggested that the concurrent forces of rising oil, gold, and other
currencies against the falling dollar are driving towards embedding the risk of a possible cataclysm in the global foreign-exchange market.

Next, we discuss the perception of dollar from a social perspective: what I shall call the “conversational” dollar.

Conversational dollar
Besides the issues already mentioned, there is a deeper problem with the US dollar as fiat currency: a fundamental issue in the perception of fairness. This is not spoken of by any

Figure 4.
Gold price trend
trained economist in China, but by a literal man on the street — a 40+ plus year-old driver. In a ride from the airport, the driver told me it would be grossly unfair if the Americans can always get away with fiat currency. Then he added, in words that I attempt to translate here:

To print every $1 US dollar (mei yuan not mei jin) probably costs the government less than 10 percent of its value. In other words, the US gets a 90 percent discount each time the dollar is utilized.

The other side of the coin is that the US dollar now actually has very little intrinsic value. Figure 6 shows our earlier and current discussion about Chinese perceptions of the US dollar. Recently, everyone in China, like others in the world, is placing a question mark (?) on the dollar.
This Chinese driver’s insight indirectly parallels Voltaire, the French enlightenment thinker who wrote exactly 180 years ago, “Paper money eventually returns to its intrinsic value of zero.” Voltaire is actually the pen name of François-Marie Arouet (1694-1778), who argued in the *Philosophical Dictionary*, with regard to China, that “[…] the constitution of their empire is in fact the best in the world […]” (http://chnm.gmu.edu/revolution/d/273/). And even more praises for the Chinese:

[...] the only one that has instituted prizes for virtue, while everywhere else the laws are restricted to punishing crime; the only one that has made its conquerors adopt its laws [...].

If only Voltaire had lived in this century and witnessed a flourishing China, he might well have advocated for the Chinese yuan not just as a reserve, but as the one global currency. Whether this will eventually happen in the future is clearly beyond the charts, and depends on the dynamics of the future global economy.

**Dynamics behind the dollar**

Everyone knows the current exchange rate of the Chinese yuan to the US dollar to be unsustainable. Since we are discussing the yuan, it is useful to draw on timeless Chinese wisdom – the thinking of the Daoists. Given that exchange parity is “prescribed,” it hardly reflects what, for want of a better word, is the natural order of things. Things that are contrived and unnatural, in the scheme of the Dao, will never be everlasting. If anything else, this compounds the problem by deepening the undercurrent of concern about the dollar. Everyone now is beginning to hanker for stability, but we are living in the other extreme of insecure times.

Intriguingly, it was the highly numerate Sage-King Pacal Votan (603-683 AD) of the Mayan civilization who put a very precise date on the end of our present world cycle: December 21, 2012 (www.13moon.com/pacal%20link.htm). The careful reader will note that it is only the cycle that is ending; another will rise to take its place. Such films as *2012*, however, reinforce the popular consciousness of the coming of a cataclysmic time. In a way, the movie reflects our concern with having to live through uncertain, exceptionally risky times. Perhaps, it will be a little too challenging for governments,
even when acting in concert, to rein in, on a global basis, a mega socio-economic catastrophe – especially one triggered by the dollar.

What are some of the dynamics between China and the USA that eventually may drive down the dollar? First, it is a fact that payments by US firms to China for substantive goods are based on fiat, printed currency. As pointed out earlier and shown in Figure 7, this is simply unsustainable. The Chinese Government too must heed the growing concerns of the Chinese people about the weak and still weakening dollar in the global markets. The true value of US dollars for the Chinese is to be able to acquire real, productive assets in the USA. This means that the US Government has to be open to what China has been doing in developing her economy: welcoming foreign direct investment. Second, China is on a very fast on track to become an innovative society. Whilst the USA got entangled here and there in wars (thus, in the diagram, “One too many wars”) that caused her economy to bleed, the Chinese revitalized themselves by absorbing American ideas, MBAs, new technology, creativity, and now, trying to instill in their society the spirit of innovation. Why is China so reluctant to step forward and lead the world in economics? This brings us to the third reason: China still has a very poor western region to develop. Being conservative, the Chinese prefer to replicate the successful formulae of the past in developing the hinterland. Therefore, the central government has taken extra measures to avoid any dramatic rise of the yuan vis-à-vis the dollar. But the issue is: for how long can they do it?

Other factors favoring the Chinese in developing their economy rapidly include: optimism, vibrancy, youth, nationalism, and an emphasis on speed. In comparison and at the risk of over-generalization, in the USA, there is a sense of disillusionment about what the government can do. With the sub-prime crisis, there arose a feeling among working-class people of being “ripped off” by the “super rich.” Still, the American nation remains highly remarkable as a country where “fairness” or fair play is part of the national ethos. No nation in the world can compare to the Americans in terms of dynamism and “daring to be different.” It will, however, take much more than the American gung-ho attitude to restore confidence in the US dollar.

Risk of cataclysm
One of the most worrying indicators of the possibility of a cataclysmic event in the global foreign-exchange system is what Bloomberg reported on October 12, 2009: the US

![Figure 7. Some China-US socio-economic dynamics](image-url)
dollar’s share of world foreign-exchange reserves fell to a record low of 37 percent of new reserves (www.bloomberg.com/apps/news?pid=20601087&sid=aA6_py_71g_o). Yet an onward, continuous downtrend may be anticipated given the systemic pattern between the declining US dollar and rising gold, oil, as well as the major billion-population currencies of the Indian rupee and the euro (Figure 8). As explained earlier, if not for government controls, the Chinese yuan also would have risen against the US dollar.

The systemic matrix with the US dollar at its vortex makes it pertinent for us to look back at the trend of the dollar’s share of world foreign-exchange reserves. Since the beginning of the twenty-first century, taking a broad view of the trend of percentages (Figure 9), there has been a predictable, or at least extrapolated, decline from a high of 70 percent downwards towards 60 percent. The fear is what will happen when everybody, even the ordinary Chinese whom I have met in Shanghai, begins to lose confidence in the US dollar, seeing it as nothing but a fiat currency.

Graphically, we may anticipate that if the dollar’s pattern continues to fall within the range of 30-40 percent (or even dipping below) for future new world foreign-exchange reserves, then this may trigger a cataclysmic event. If there is anything that is beginning to characterize the twenty-first century’s global economy, it is uncertainty: events happening that cannot be explained and much less forecasted by “simple” economic theories. No mathematical modeling of quantifiable data could ever have predicted the timing, scale, and occurrence of the US sub-prime crisis (Foo, 2008). Still, there is no reason why we should not rely on a basis of evolving, globally interconnected trends to develop our foresight (Foo and Foo, 2003) in anticipating mega-events.

Figure 8.
Systemic matrix of US dollar with gold, oil, and currencies

+ 37% of new reserves, Bloomberg October 12th 2009
References


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http://blogs.moneyandmarkets.com/currency-corner/

Figure 9.
Dollar share of world foreign-exchange reserves

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