



# Black Swan Capital Currency Currents

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## Key News

- [Japan on the verge of a subprime housing crisis](#). (TimesOnline)
- [China's central bank renewed its call for a global currency](#). (Bloomberg)
- Global market [liquidity](#) is at its strongest level since November, according to an index updated today by the Bank of England. (Bloomberg)

## Quotable

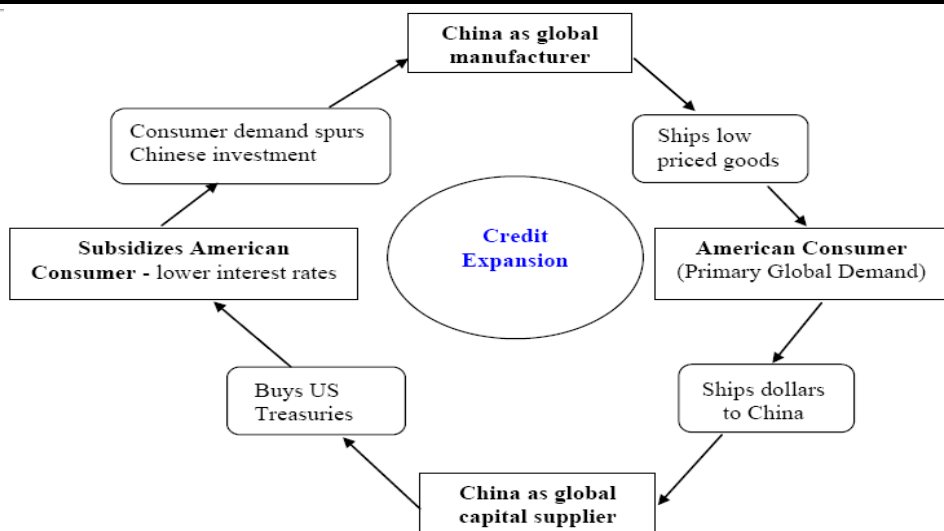
"Politics is the art of looking for trouble, finding it everywhere, diagnosing it incorrectly and applying the wrong remedies."

Groucho Marx

## FX Trading – Chinese train wreck?

China knows its symbiotic relationship with the US is over. You remember the one; it was based on US buying likely drunken sailors and China sending its sailors over to drop off container cartons of stuff, fill them with US paper, and ship them back to China, which many were shipped back to help keep this game alive. If you don't remember, below is a pictorial of this relationship that we put together a while back:

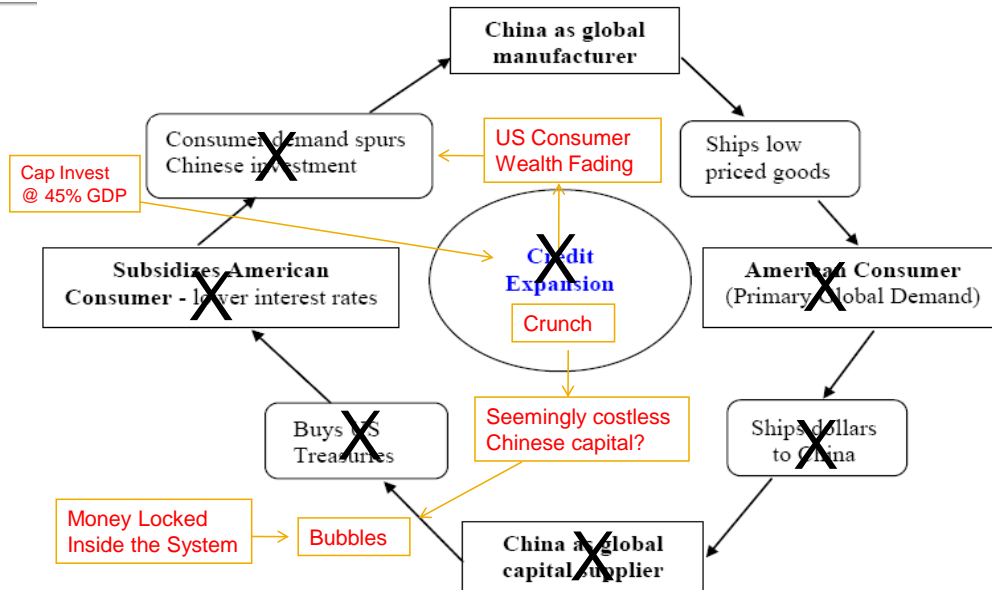
## US-China Symbiotic Relationship Single Currency Zone Argument



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This game is over, thanks to the credit crunch and a change in the consumption pattern in the US:

## US-China Symbiotic Relationship Game Over? *Single Currency Zone Argument*



In short, US savers aren't buying and China does not have the domestic demand to make up the slack. Thus, China's export machine is in big trouble, despite all efforts.

China is trying to force its trading partners in the region to take its products, while stepping up its consolidation of industry under government control and more vigorously limiting imports (as it always has; explicitly or implicitly through non-tariff trade barriers flying under the WTO radar screen). China justifies their new vigor on blocking imports (will still gladly take those who want to transfer technology as quid pro quo) with some good reason, the new "buy America" campaign in the US. Comparing US openness to Chinese openness is apples and oranges to start with, but no matter. These trade frictions are growing like green shoots.

Evidence China is trying to force its domestic adjustment (breakdown on the export model) on to others comes from the fact that we know China is shipping much less to the consumers of the US and Europe, yet they continue to record current account surplus, while many countries in the region have been racking up a negative string of current account numbers. And with all the belief that stimulus is working in China, why do they continue to import less and less?

For the record, we don't fault China's real concern about the dollar. All of us have watched a US government disgustingly out of control for years. But what interests us is

the dynamics of why such concern right now and call for a new currency order in the midst of global economic chaos.

I told the above story/tale to get to this point:

We think China is painfully aware of the potential train wreck their economy is facing if world demand does not rebound. They have only one way out—that is to export. And keep in mind, with their currency pegged to the lowly dollar, they believe they get increasing export competitiveness as the dollar falls; thus trash the dollar and push down the relative value of the yuan against all other players. Seems odd given their holding of all the dollar paper—but it is more important to export than grab return on their bond holdings, but when desperate we all do odd things.

It begs a couple of question:

- 1) Do currency values even matter regarding exports when there is no demand?
- 2) If the US currency is so awful, why continue to peg to it? (Officially China has a crawling peg system tied to some nebulous basket of currencies; but unofficially it does whatever it chooses with the yuan.)
- 3) Why not drop capital controls if they are such a “market-driven” economy?

Questions for another day I guess.

The key question we haven’t resolved at the moment: Does China believe jawboning on world reserve currency status will force US policymakers further down the path of “global stimulator of last resort,” part and parcel to an attempt to crank up the symbiotic relationship that once was? And are we already on that path?

If we are on the path of trying to revive the consumer-cum-stuff cycle, we don’t think it will work, but it will weaken the dollar in the meantime. If we are not on that path, China may become increasingly more belligerent both economically and politically, as the pressures grow internally, they already are (again, for the record, belligerence in the face of domestic turmoil is a game all governments play, not just China).

The upshot: Sooner or later we will pay the price by not letting the market naturally work its magic in the form of global rebalancing—too much Western consumption juxtaposed against too much Eastern production. Instead, our illustrious government thinkers continue to dump more debt into a system that was destabilized by debt in the first place (credit creation at the center of the first chart above). We think there will be a Chinese train wreck of some sorts. And we bet stocks won’t like it; and despite all ills, the buck is in for yet another major risk bid when it happens.

Have a great weekend.

Jack Crooks

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