

THE ECONOMIC TRANSITION PAPERS

RE-ENGINEERING THE DOLLAR



A PHILOSOPHY OF METRICS PUBLICATION



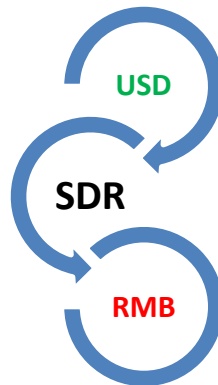
The Economic Transition Papers

Multilateral Stage One

E-Publication – 001

Re-Engineering the Dollar

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A [Philosophy of Metrics](#) Publication

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INTRODUCTION

Since 1944 the United States dollar has acted as the primary reserve currency in the global monetary system. This unipolar status has given the American economy advantage over all other countries, both developed and emerging. But this exorbitant privilege has also created imbalances between the national domestic monetary policies of the dollar at home in America, and the international monetary policies assigned to the USD as the international reserve currency. The balance of payments system and increasing account deficits of the United States are having a negative effect on the macroeconomic sustainability of the international monetary system and will require a new multilateral framework moving forward.

Through something called the Triffin Paradox, large imbalances in the system are created as more and more dollar based assets accumulate in the foreign reserve accounts of central banks around the world. These account imbalances are unsustainable and will require international coordination on monetary policy reform and the timely implementation of a new multilateral framework.

The expansion of USD assets has created an environment of speculation amongst precious metal dealers, as well as alternative economic analysts, who state that the dollar is heading for an inevitable collapse or severe devaluation. Though there is just cause for these speculations, a deeper understanding of the fundamentals and policies surrounding the economic transition reveals another, and more likely, outcome for the USD.

Based on the prominent position of the dollar in the current system, and the levels of external debt held in the foreign reserve accounts of the central banks, the USD will require some monetary re-engineering. This re-engineering will help achieve the defined goals of reducing and exchanging the dollar assets through substitution accounts and readjusting the exchange rate regime which has been in operation for over 40 years.

This series of publications, titled The Economic Transition Papers, will be segmented into 3 stages, being Multilateral Stage One, Multilateral Stage Two, and Multilateral Stage Three. Each segment will contain various publications dealing with specific aspects of the transition from a unipolar USD based financial system to a multipolar framework based on the Special Drawing Right (SDR) of the International Monetary Fund.

This first installment, E-Publication – 001, will deal specifically with the **Reengineering of the Dollar** and should bring a more fundamental understanding to the role which the USD will play in the coming years. It is important for factual information to be presented about aspects of the dollar's relationship with the external multilateral mandates. Lack of knowledge and understanding will only spread fear and confusion.

The alternative media has been promoting a false ideology of dollar collapse, while the mainstream media have failed at informing the larger population of the actual mechanisms and machinations of the economic transition. These papers will attempt to bridge the knowledge gap between both.

1 Historical USD Arrangement

a. The 1944 Bretton Woods Conference

One year before the end of World War Two the plans for reorganizing the international monetary framework for a post war economy were being developed at the Mount Washington Hotel in Bretton Woods, New Hampshire. Originally known as the United Nations Monetary and Financial Conference, the 3 week development session during the month of July was attended by 730 delegates from 44 allied nations.

The purpose of the conference was to regulate the international monetary and financial order after the conclusion of the war, and included western countries. China, the USSR, and India also attended, all of whom now make up the bulk of the BRICS countries, being Brazil, Russia, India, China and South Africa.

The fact that the world was still in open hostilities mattered little at that point, as the axis powers had already succumbed to the economic factors which were degrading their ability to wage and continue the intensity of war.

In the early years of hostilities the superior military qualities of the axis powers allowed for the successful realization of military strategies with large areas of Europe and South East Asia coming under the control of Germany and Japan. The gold reserves of these regions were looted and deposited in the accounts of the Bank for International Settlements.

The BIS was considered the facilitator of banking at a supra-national level, which allowed for the continuation of business and banking across the war borders. There was a supra-sovereign ease which facilitated the movement of assets looted from the occupied countries of Europe across borders. The lack of a regional supra-sovereign banking structure in the South Pacific made the movement of looted assets more challenging.

Much of the gold and other assets looted by the Japanese, including Chinese reserves, were hidden in the Philippines before the close of the war. This gold has come to be known as the Yamashita Gold and it is said that some of it has never been recovered.

These looted assets were used to support the Bretton Woods Agreement by reinforcing the treasuries of the 44 allied nations. This determined the structure of the global monetary system post 1944.

By 1942 the axis powers were deflating because of economic factors such as GDP and population numbers and their military superiority began to wane. As the war shifted it became

increasingly clear that the once powerful nations of Germany and Japan were now weakening, as if they had served their purpose, and the allied nations scheduled the Bretton Woods Conference to divide the spoils and build the new financial architecture.

The conference established the global institutions which exist today. The International Bank for Reconstruction and Development (now the World Bank) and the International Monetary Fund marked the end of financial war and economic nationalism. As we will review in the next section, economic nationalism took on a new face when the Bretton Woods Agreement ended in 1971.

The Bretton Woods Agreement created an adjustable fixed exchange rate system between the allied economies. This meant that currencies had to become convertible for trade related purposes and other current account transactions. Some of the exchange rates were not favorable to some countries balance of payments positions.

Balance of payments (BOP) is the method by which countries measure and track international monetary transactions for both private and public sectors. BOP determines the amount of money going in and out of a country. Received money is known as credit, and given or paid money is considered debit. Theoretically the balance of payments should be zero, which would happen if credits (assets) and debits (liabilities) were balanced. The deficit and surplus characteristics of the Bretton Woods Accord became more prevalent with each passing year.

The original intent of Bretton Woods was to structure a joint management system of the western political order by lowering barriers to trade and the movement of capital between industrial democratic nations. Each participant was assigned the responsibility of maintaining sustainable monetary policies which would effectively govern the system.

Economist John Maynard Keynes had originally recommended the use of a global currency called the bancor in place of the USD as reserve currency. Use of such a supra-sovereign asset would have lifted the reserve currency above the constraints and limitations of using a domestic currency such as the USD. For reasons unknown, the participants refused to accept the idea of the bancor and as such the USD was implemented as the reserve currency.

Unfortunately there were challenges right out of the gate as some of the core accords were not fully operational until December 1958, which is when all European currencies finally became convertible.

In addition, all member countries were required to subscribe to International Monetary Fund capital.

Also coming out of the Bretton Woods Conference was the demand to dissolve the Bank for International Settlements. It never happened, and the institution in essence became even more powerful in the years and decades after the war.

The Bretton Woods Accord can also be considered a gold exchange standard of sorts as the USD had a fixed exchange rate to gold of \$35.00 per ounce. This gold peg established confidence in setting the USD as the primary reserve currency which would be used to balance international trade.

This status assigned the USD an important role and required that each country would accumulate dollars in their foreign reserve accounts. Country “A” would sell their goods to country “B” in US dollars, and each country would then convert that payment back into the national currency.

Each country deposited gold and other assets on reserve with the Federal Reserve in the United States in order to support the arrangement as defined at Bretton Woods.

The arrangement gave America greater economic power and influence which contributed to the post war boom and growth of suburbia and the interstate system. All western allied participants of Bretton Woods experienced rapid infrastructure development which led to increasing expansion of the USD supply.

As the international reserve currency, demand for the national USD increased. This caused tension between the national monetary policies of the United States and the international monetary policies of the macro Bretton Woods Accord. The US was required to supply the world with extra dollars to meet the demands of the foreign exchange reserves, which caused an ever increasing trade deficit.

The problems of using one specific national currency as the international reserve currency is further defined in the Triffin Paradox. As the USD increased in the foreign reserve accounts the balance of payments for the United States became skewed and descended into the deficit end of the scale. This caused concern for member countries as the number of dollars in circulation soon exceeded the amount of gold backing them. It was becoming increasingly clear that the USD was overvalued. Between 1959 and 1969 France reduced its dollar reserves by exchanging them back for gold held on reserve at the peg of \$35.00 per ounce.

One solution offered at the time was to cut the deficit and raise interest rates. It would reduce the amount of dollars in the foreign reserve accounts and cause a flood of dollars to come back into the United States, leading to inflation and/or a possible recession.

The intent of the Bretton Woods System to ensure exchange rate stability, prevent competitive devaluations, and promote economic growth, began to transform. It became known as “America’s exorbitant privilege” as the rest of the world began to pay for the American dream.

The French USD exchange for gold was being considered by other countries, which threatened the economic influence of the United States, and by 1971 the Bretton Woods Accord was unofficially ended.

b. The 1971 End of Bretton Woods

On August 15, 1971, President Richard Nixon went on live television and stated the following:

The third indispensable element in building the new prosperity is closely related to creating new jobs and halting inflation. We must protect the position of the American dollar as a pillar of monetary stability around the world. In the past 7 years, there has been an average of one international monetary crisis every year...

I have directed Secretary Connally to suspend temporarily the convertibility of the dollar into gold or other reserve assets, except in amounts and conditions determined to be in the interest of monetary stability and in the best interests of the United States.

Now, what is this action — which is very technical — what does it mean for you?

Let me lay to rest the bugaboo of what is called devaluation. If you want to buy a foreign car or take a trip abroad, market conditions may cause your dollar to buy slightly less. But if you are among the overwhelming majority of Americans who buy American-made products in America, your dollar will be worth just as much tomorrow as it is today.

The effect of this action, in other words, will be to stabilize the dollar.

Nixon effectively ended the dollars convertibility into gold and would eventually float the exchange rate. The overall purpose of this action was to depreciate other currencies against the dollar and allow for the continued expansion of USD in the foreign reserve accounts, avoiding the domestic hyperinflation that would have been created with such a large expansion of the US money supply.

Countries like China and Vietnam, with a currency pegged to the USD at a fixed rate, were forced to expand and depreciate their own money supply in order to maintain the peg against the USD. This is a method of exporting USD inflation into emerging markets.

Along with removing the gold convertibility, the US also put a freeze on wages and prices to circumvent inflation, as well as putting a 10% surcharge on imports. All of this was enacted to

prevent a run on the dollar and stabilize the domestic economy, along with decreasing unemployment and inflation rates.

In March 1973, the Bretton Woods fixed exchange rate system was replaced by a floating exchange rate regime. This new framework depreciated other currencies and caused increased inflation in other countries around the world.

Since 1973 there have been bouts of depreciation and appreciation between USD pairs with other currencies, such as the Japanese yen, which has caused instability in the exchange markets. This volatility has created imbalances that are difficult to measure but are no doubt substantial.

With no gold standard backing the USD the United States made arrangements with OPEC to secure energy sales in dollars. Although this had been happening since 1944, it was threatened when OPEC declared an embargo against the west over support for Israel in the Yom Kippur War.

The October 1973 embargo caused concern that global energy trade could be balanced in assets other than the USD, which could potentially lead to a run on the dollar. The United States, again under the presidency of Nixon, negotiated a deal with Saudi Arabia and other OPEC nations to secure oil sales in USD in return for the geopolitical and economic protection provided by the American military.

Many will remember the onset of increased inflation and oil price spikes in those early days of the 1970's. The end of the Vietnam War had much to do with the capitulation of the Vietnamese to allow energy sales in dollars. Based on the adjustable fixed peg of the USD/VND pair, this arrangement caused massive depreciation of the dong as dollars accumulated in the foreign reserve account of the State Bank of Vietnam.

c. Petro-Dollar Economics

With the creation of OPEC at the Baghdad Conference in September 1960, the coordination of energy and petroleum policies of the founding countries, Iran, Iraq, Kuwait, Saudi Arabia and Venezuela, were directed towards securing price stability and ensuring a profitable return on capital.

Nine additional countries subsequently joined OPEC throughout the 1960's and contributed to the broader global mandates of the petroleum market. Qatar, Indonesia, Libya, United Arab Emirates, Algeria, Nigeria, Ecuador, Angola and Gabon, all joined at a time of decolonization as the remnants of the British Empire and Ottoman Empire receded into the past.

By 1973 the deal between the United States and OPEC had been settled and the petroleum cartel was in control of energy prices on the world market. OPEC quickly began to broaden its mandates and in 1976 established the Fund for International Development which was meant to provide assistance to poorer nations. It likely had more to do with expanding market control to countries and regions which had undeveloped energy reserves.

With OPEC sales secured in USD all appeared well until late 1978, when the people of Iran began to protest the western installed government of Shah Muhammad Reza Pahlavi. A strike by anti-regime protestors effectively shut down Iranian commerce and industry, forcing the Shah's military government to seek assistance from western USD interests.

By February of 1979 the Iranian Revolution had removed the Shah from power and the Ayatollah Khomeini had taken governmental and military control of one of OPEC's founding members.

Iran did not immediately stop selling its oil for USD but did find alternative methods of exchanging those dollars instead of investing them back in the United States, as Saudi Arabia and other OPEC members had been doing.

It wasn't until the end of 2007 that Iran finally ended the denomination of its energy sales in USD. At which time they stated, that the USD was no longer a reliable currency and that oil exporters were losing profits due to the depreciating nature of the dollar. The Iranian Oil Minister recommended to other OPEC countries that the organization should denominate energy sales in a basket of currencies as opposed to the dollar, a currency which was susceptible to the weaknesses presented in the Triffin Paradox.

The supply from Iran was reduced because of the revolution in 1979, and by August of that year the great western oil shock was in full force with crude oil prices rising from \$15.85 per barrel to \$39.50 per barrel. Though the global supply had only decreased by about 4%, the panic had begun and would not trickle out until Saudi Arabia and other OPEC members increased production to make up the shortfall.

With Iran boxed in on one side by American ally Iraq, the Soviet Union invaded and occupied Afghanistan in December of 1979. This strategy to offset the petrodollar economics of the USD was supported by the larger geopolitical strategy of the USSR to create a buffer zone between borders with American allies.

The western promotion of war between Iraq and Iran had exerted immense pressure upon the region. When Saudi Arabia increased production of oil in the mid-80's, the price per barrel plummeted, which effectively pushed the Soviet Union closer to economic collapse. The

occupation of Afghanistan had buried them in a war of attrition against the western supported Mujahideen, who later reinvented themselves as the Taliban.

The history of the Middle East region and its resources would take thousands of pages, as would the petrodollar economics of continued warfare and civil unrest to secure energy sales in dollars. Such a geopolitical and socioeconomic exercise is outside of the scope of this publication. Needless to say, the region, and its oil, have played a dominant role in the agreement made between the United States and OPEC, as is evident in the constant rebalancing of power in the region.

The tectonic plate movement of geopolitics in reference to the petrodollar has caused a fracturing along regional lines which will require a new outlook and approach to solve. Ensuring the sale of energy in USD will come to an end as oil becomes denominated in a basket of currencies, something which was first recommended by Iran at the start of the financial crisis in 2007.

Any reversal of USD policy will mean dramatic geopolitical restructuring in the Middle East and amongst the OPEC members. Alliances will be adjusted and shifting economic mandates will require new energy policy frameworks as an alternative to the USD as reserve unit of account is implemented.

d. The Expansion of Credit

In the lead up to the financial crisis which began in 2007, the expansion of the money supply was a necessary component of the “exorbitant privilege” of the United States. As more dollars accumulated in the foreign reserve accounts, the ability for the US to run larger deficits increased.

Imports were in excess of exports, meaning under the BOP system the countries liabilities were increasing. The trading partners of the US recycled these “paid” dollars for Treasury Debt, which further accumulated in the foreign reserve accounts.

The amount dollars returning home were expanding the money supply and leading to domestic policies of easy credit. The capital flooding back into the country found its way into the security of government bonds, which served to push down interest rates.

With low interest rates the banking sector sought new ways of creating larger returns along with hedge funds and other investment institutions, both public and private. With the returns exceeding the borrowing costs, profitability increased.

After years of low inflation and stable growth had created an atmosphere of risk taking, the banks and hedge funds began to promote a systemic and irresponsible lending practice that led

to the rise of subprime mortgages and other high-risk credit instruments, such as auto loans and credit cards.

Many of the high-risk mortgages were packaged together as Collateralised Debt Obligations, or CDO's, and the expansion of the money supply continued. Investor demand for these securitised products increased as they provided higher returns at the same time as interest rates continued to decrease.

The real estate valuations increased as more and more people were qualifying for mortgages on homes which were once outside of their reach. As home values increased, the opportunity for second and third mortgages became available, allowing owners to access the low liquidity equity in their homes, and this new high liquidity capital increased consumer spending as sales of everything from televisions and off-road vehicles surged.

Other banks from around the world, especially in Europe, borrowed cheap American credit. This capital was then used to purchase questionable financial assets which would have otherwise been too risky. It was the perfect storm of easy credit and balance of payments deficits which developed into a swell of debt which created instability in the system.

The United States, trapped in the paradox of having its domestic currency acting as the global reserve asset, could do little at this point but watch as the imbalances continued to grow in the system.

The only method available to the United States to reduce its balance of payments deficit, is to reduce the amount of USD accumulated in the foreign reserve accounts. This would result in a shortage of liquidity and a contraction of the money supply.

As such, an alternative source of global liquidity will be required. This source of liquidity would not be dependent on the domestic currency of any one country, and would allow for the expansion of the economy without the risks associated with running balance of payment deficits.

But back in the early days of 2007, the option for an alternate source of liquidity and unit of account to act as the global reserve asset was not available. The world could do nothing but watch as the debt imbalances in the system caused one of the largest financial contractions since the Great Depression.

2 The Financial Crisis of 2007 & 2008

a. Unsustainable Debt Loads

In the early stages of the financial crisis when the warning signs were building one on top of the other, I was facing a personal crisis of my own. As such, the leading economic events in 2007 passed me by without hardly a notice.

When the summer and fall of 2008 came and went it was clear to all but the ignorant that something of grave consequence was taking place in the United States. It was also clear that this series of events had the potential to spread around the world and cause a complete collapse of the global monetary system.

After a few bank failures and epic sized bailout packages of the remaining survivors, representatives and leading figures from the international institutions, such as the G20, United Nations, International Monetary Fund, and central banks began the process of engineering an alternative to the USD denominated system.

There was an immediate threat of the remaining unsustainable debt loads on the banks themselves, and the inevitable contraction of the money supply which would have normally followed such a large expansion of the money supply.

Deflation could not be allowed to happen until an alternative framework was in place, so the whole monetary system could shift from the unipolar USD foundations to the multilateral SDR foundations. Until such was ready, there needed to be a liquidity bridge of sorts which could hold back deflation until the system could be deflated carefully and with purpose.

b. Quantitative Easing and Liquidity Exchange

For our purposes here we will consider Quantitative Easing to be the exchange of low liquidity assets for high liquidity assets. Based on this definition we will define liquidity as the ease with which money can be used. As an example, the cash in your wallet and bank account are very liquid, as well as credit cards and lines of credit, which can be used rather quickly in the event you need too.

These are considered forms of high liquidity.

An example of low liquidity would be the equity in your home, or other investments and bonds. These assets are not so easy to liquidate into cash and use in the economy. We will mainly discuss low liquidity in terms of bonds and other securitized debts, such as CDO's, or Collateralized Debt Obligations, which we reviewed in Section 1(d) – The Expansion of Credit.

QE, or the swapping of assets, and in turn liquidity, where low liquidity bonds were exchanged for high liquidity assets, can be summarized as a liquidity swap. The Federal Reserve didn't print money or expand the money supply, because they only "created" money and used that high liquidity to exchange for low liquidity bonds from participating financial institutions which held the unsustainable debt from the expansion of credit.

As such, the balance sheet of the Fed was increased with the high liquidity cash, which was then exchanged for the low liquidity securities effectively changing the composition of the balance sheet. It was the low liquidity to high liquidity ratio that changed. The Fed reduced its newly created levels of high liquidity assets and increased its exposure to the low liquidity assets which had caused the financial crisis.

The QE "money", or high liquidity exchanges, replaced the low liquidity bonds held by hedge funds, sovereign wealth funds, high net worth investors, and the reserve accounts of central banks around the world. From there some of these high liquidity assets, or instruments, eventually made their way into the capital markets, such as the stock markets and commodity markets.

Back when the financial crisis hit in 2008 there was an overabundance of low liquidity assets sitting on the books of the large financial institutions. These banks and institutions were unable to unload those low liquidity assets into the regular money supply because there was already too much debt in the system.

Quantitative Easing was designed as a method of reducing the risk to these institutions, or transferring the risk back to the Federal Reserve and other central banks. It was something of a magic trick. The Fed simply gave high liquidity assets in exchange for the low liquidity assets held by the banks and institutions.

In turn, the banks and institutions were not allowed to liquidate those assets into the regular money supply, by way of loans and credit, places from which it could end up in our bank accounts and wallets.

QE, through the liquidity swap described above, has reduced the regular money supply which is why gold and silver have been coming down in the last few years. This is also why interest rates have been kept low. The central banks have been holding back rampant deflation by doing so.

As deflation settles in we will see substantial corrections to the capital and commodity markets, as well as stock markets. The script is already being presented through the media that when the next crisis hits the central banks will be unable to do anything to stave off the collapse, and other banks are insolvent.

Continuing to accumulate dollars in the foreign reserve accounts will only further increase the systemic imbalances inherent in the system and lead to additional debt cycles and volatility in the exchange rate markets.

The demand for an alternative to the USD was a direct result of the 2008 financial crisis, and based on the challenges of using a domestic currency as the global reserve currency, this alternative has taken on the definition of a multilateral monetary framework.

c. The Demand for the Multilateral

On March 23, 2008, the People's Bank of China published a statement by Governor Zhou Xiaochuan on methods which could be used to reform the international monetary system. The paper made very clear that China considers the imbalances in the dollar system to be the main cause of the financial crisis, and strongly suggested that the Bretton Woods system was no longer relevant, or able to correct the systemic imbalances which exist.

It was also made clear that there is a high level of risk for non-reserve currency issuing countries when they are required to hold on reserve the domestic currency of another country. The lack of direct control over the supply of this currency has contributed to the institutional and fundamental flaws in the USD system.

From the PBoC statement:

“The outbreak of the current crisis and its spillover in the world have confronted us with a long-existing but still unanswered question, i.e., what kind of international reserve currency do we need to secure global financial stability and facilitate world economic growth, which was one of the purposes for establishing the IMF? There were various institutional arrangements in an attempt to find a solution, including the Silver Standard, the Gold Standard, the Gold Exchange Standard and the Bretton Woods system. The above question, however, as the ongoing financial crisis demonstrates, is far from being solved, and has become even more severe due to the inherent weaknesses of the current international monetary system.”

Here we are informed of the inherent tendency of gold standards to cause deflationary pressure, while inflationary pressure is caused by the USD system, with no effective adjustment mechanism to address the imbalances.

The statement goes on to explain the nature of the imbalances:

“Issuing countries of reserve currencies are constantly confronted with the dilemma between achieving their domestic monetary policy goals and meeting other countries’ demand for reserve currencies. On the one hand, the monetary authorities cannot simply focus on domestic goals without carrying out their international responsibilities??On the other hand, they cannot pursue different domestic and international objectives at the same time. They may either fail to adequately meet the demand of a growing global economy for liquidity as they try to ease inflation pressures at home, or create excess liquidity in the global markets by overly stimulating domestic demand. The Triffin Dilemma, i.e., the issuing countries of reserve currencies cannot maintain the value of the reserve currencies while providing liquidity to the world, still exists.”

Zhou Xiaochuan references the Triffin Dilemma, or Paradox, which defines the systemic imbalances which are created by using one domestic currency as the primary reserve currency for international denomination and payments.

The creation of excess liquidity in the unipolar USD system has been the direct contributing factor of the imbalances and bubbles which have formed, leading to the 2008 crisis and the extension of that crisis which is unfolding in the year 2015, as a global deflationary event.

The USD imbalances have caused consistent account deficits, which in turn has led to unmanageable external debt. These inherent flaws in the system are not as visible because of the widespread use of the dollar denominated assets in international investment portfolios. The purchase of USD denominated financial products flow back into the United States as foreign exchange funds. This process has delayed and deflected the demand for corrections to the account imbalances.

As such, the system has been allowed to function under consistent account deficits which have led to the expansion of external debt. Persistent external debt has created depreciation pressure on the USD, causing the severe imbalances in the international monetary structure, and its trading systems, such as:

- a. Global Trade
- b. Credit Markets
- c. Forex Exchanges
- d. Inflation/Deflation
- e. Commodity Markets
- f. Capital Flows
- g. Geopolitical Power Shifts

The PBoC statement continues:

“When a national currency is used in pricing primary commodities, trade settlements and is adopted as a reserve currency globally, efforts of the monetary authority issuing such a currency to address its economic imbalances by adjusting exchange rate would be made in vain, as its currency serves as a benchmark for many other currencies. While benefiting from a widely accepted reserve currency, the globalization also suffers from the flaws of such a system. The frequency and increasing intensity of financial crises following the collapse of the Bretton Woods system suggests the costs of such a system to the world may have exceeded its benefits. The price is becoming increasingly higher, not only for the users, but also for the issuers of the reserve currencies. Although crisis may not necessarily be an intended result of the issuing authorities, it is an inevitable outcome of the institutional flaws.”

The currencies of foreign countries are required to expand their own domestic currency supply in order to maintain the fixed exchange rate with the USD. As more USD accumulates in the foreign reserve accounts, the depreciation pressure on the domestic currency increases, eventually leading to dramatic devaluations.

The financial authorities in each of the participating countries are required to maintain the fixed rate by purchasing domestic currency when it's in excess supply and sell when it's in excess demand, in attempts to slow down this depreciation.

Countries with fixed exchange rate pegs to the USD are China, Hong Kong, Malaysia, Vietnam, and many more. All have had to depreciate their domestic currencies lower than the economic metrics of those economies would suggest. Most are so severely undervalued that when the USD exchange rate regime ultimately ends they will appreciate upward dramatically, as happened to the Swiss franc on January 15, 2015, when it ended the fixed rate with the euro, which was being depreciated because of its peg to the appreciating USD, and saw its value skyrocket 20% within hours.

The BRICS geopolitical and monetary union, Brazil, Russia, India, China, and South Africa, have put pressure back on the USD by limiting the amount of foreign exchange funds flowing back into the United States. This has been accomplished by purchasing less USD denominated assets and more RMB assets.

And again from the PBoC statement:

“The desirable goal of reforming the international monetary system, therefore, is to create an international reserve currency that is disconnected from individual nations and is able to remain stable in the long run, thus removing the inherent deficiencies caused by using credit-based national currencies.”

The demand for a multilateral monetary system is undeniable. The challenge presented to the international financial authorities, including domestic interests, was to design a framework which would address and correct the inherent imbalances in the USD system.

d. Reforming the International Monetary Institutions

The future of USD hegemony is not sustainable as the international monetary structure shifts to a multilateral global reserve asset system. This transition to the multilateral asset will fracture the existing International Currency System which is now composed of misaligned exchange rates.

The diversification which is at the core of the SDR composition will expand into other structures within the international monetary framework. The BRICS Development Bank and Asian Infrastructure Investment Bank are both strategies being utilized by the emerging economies to ensure that stability through diversification will function beyond the SDR and allow for a broader internationalization of the renminbi. This will be explained further in the next section.

3 Reengineering the Dollar

a. Why the USD will not Collapse

With so much fear mongering and predetermined analysis surrounding the so-called “demise, or death of the dollar”, it can be frustrating for the average person and investor to step back and reflect on the totality of what the multilateral effects will be on the American currency. What is certain amongst the international financial institutions and central banks is the reduction in reserve currency usage of the dollar.

This reduction will have an effect on the international valuation of the USD and the domestic economic performance of the United States, some of which will be positive and will lead to actual job creation growth.

There are multiple angles from which the macroeconomic analyst can view the transition away from the dollar as the primary reserve currency. The obvious and factual originating point of change comes with the reduction of liquidity in the USD asset market, and the rise of a multilateral source of international liquidity, in this case represented by the SDR of the International Monetary Fund.

This reduction will cause a depreciation of the dollars international value, and it’s from this point where diverging opinions and analysis literally baseline away from each other in opposite directions. One direction promotes the death of the dollar and the collapse of the American economy. I do not agree with this analysis and find it is based more on promotion of mass fear and less on economic fundamentals.

The second direction takes us into the more familiar territory of fact based analysis and the cause and effect of economic fundamentals.

A reduction in both the geopolitical and economic standing of the United States and its currency will initially lead to further weakness in the domestic economy. Some of this weakness has likely been experienced already, but to what extent is difficult to measure. A more sustained depreciation of the dollar will also be caused by this reduction.

b. Benefits of a Depreciating Dollar

This depreciation is not all bad, as it will make American made goods cheaper, leading to an increase in net exports. International investors, most visible in the large amounts of Chinese investors, have anticipated this depreciation and have already made large investments into US infrastructure and production capacity.

The depreciating dollar will have other broad effects on the overall economic performance of America. Some of these effects will include a decrease in international purchasing power of the dollar, rising commodity prices (this could potentially be offset as I will explain below), and upward pressure on interest rates (which is already visible in the discussions by the Federal Reserve to raise rates).

But most interesting of all the effects of a depreciating dollar will be the reduction of external debt. Whether this reduction of external debt will determine the need for a replacement of the USD as reserve currency with the SDR (as dollars in the foreign reserve accounts around the world will be reduced), or it is the need for a multilateral reserve currency which will dictate the need for a depreciation of the dollar, is somewhat irrelevant as the transition itself is happening regardless.

The international value of the dollar will have the following domestic effects, some can be considered positive while others are considered negative:

- Increase in domestic job creation based on increased production capacity and net exports
- Inability to continue raising the debt ceiling, which will rise to the surface again this October, the same month as the IMF meeting on the new SDR basket composition.
- Challenges with reducing budget deficits. (things such as military spending will need to be reduced)
- Stabilizing the growth of the federal government's long-term debt.

The global supply and demand for dollars, as represented in the size of the liquidity of the USD asset market, is directly connected with the buying and selling of USD denominated goods, services, and other financial assets, such as stocks and bonds.

This is where the world could see an increase in commodity prices, as explained above. When the dollar depreciates, we traditionally see an increase in the value of, say oil. This is because oil and other commodities are denominated in dollars. This increase in commodity prices can be offset, or eliminated altogether, by denominating commodities, along with goods, services, and other financial assets, in a multilateral reserve asset, as represented by the SDR.

The need for currency diversification for international investors will also increase with the depreciation of the dollar. With no direct access for retail investors to the SDR, the need for an investment safe haven based on the multilateral framework will be required.

e. Exchange Rate Adjustments

When domestic currencies around the world end pegs to the USD, there will be a need for a new exchange rate structure. For this section let's review one specific currency that has been depreciated outside of normal economic metrics and indicators.

Over the last year and half I have written a few pieces on the economic performance of Vietnam in the post war years, and the intent of the State Bank of Vietnam to revalue the domestic currency (dong or VND), as the world monetary system shifts from the unipolar USD framework to the multilateral SDR framework. This growth and potential appreciation of the Vietnamese currency is intertwined with the efforts to rebalance the global economy, as I will explain below.

Vietnam, as a member of ASEAN, has signed on to the AEC trade agreement which will come into effect on January 1, 2016. The AEC was thoroughly covered in the next section.

One of the most challenging aspects of the current unipolar (USD) monetary framework are the systemic imbalances which it creates. This is nowhere more noticeable than in the trade deficit, or balance of payments deficit, which the United States has developed. This imbalance continues to grow year after year, and because the dollar is the primary reserve currency, and used as an anchor and peg for other currencies, it forces other countries to continuously depreciate their own domestic currencies as a method of maintaining a peg to the dollar. This arrangement is an indirect method of the United States exporting its own domestic inflation overseas.

This structural flaw in the monetary system has increased the risk to global growth by expanding the imbalances themselves and corrupting the flow of capital which is associated with those imbalances. The world is implementing a solution to this problem by engineering a multilateral architecture which will revolve around the SDR of the International Monetary Fund as the primary reserve asset used in global commerce.

One segment of this multilateral shift has to do with using exchange rates as a method of correcting the imbalances. It has been determined that appreciating the domestic currencies of trade surplus countries is a viable rebalancing strategy. This is likely what is behind so much of the "global currency reset" talk and conspiracy which has built up online over the last 5 years. It is not a coincidence that talk of this sort began at the same time as 2010 IMF Quota and Governance Reforms and announcements from China on moving away from the USD towards a supra-sovereign (non-domestic) asset, such as the SDR, and discussions around the sovereign debts of historical bonds.

Trade surplus countries are those with a positive balance of trade, such as China, where exports exceed imports, leading to a net inflow of domestic currency from foreign markets. This is obviously opposite from trade deficit countries, such as the US, where imports exceed exports, leading to a net outflow of domestic currency into foreign markets.

That fact that the USD is the primary reserve asset has compounded the problem of this net outflow of domestic currency on countries like Vietnam, who have had to depreciate their own currency over the last 4 decades in order to maintain a peg with the dollar and build a trade exporting economy.

There are a few different ways of viewing trade exporting countries. One is by a percentage of Gross Domestic Product, and the other is strictly by volume, or dollar amount.

When measured as a percentage of GDP, the following countries are all considered net trade exporters:

- Saudi Arabia at 14.11% of GDP
- Germany at 7.45% of GDP
- Vietnam at 5.42% of GDP
- Russia at 3.09% of GDP
- China at 2.02% of GDP

As opposed to the United States at -2.36% of GDP.

There are many more and this is only a short list for purposes of this publication.

When we view trade exporting data through straight volume in dollars we find that China is one of the largest, along with Saudi Arabia (because of petroleum products), and Vietnam actually falls to a net importer. But that is quickly changing.

In March of 2015, Vietnam's trade deficit was \$1.391B and in April of 2015 it had already reduced to \$600 million. This is a dramatic reduction in trade deficit in only one month. Though the trade deficit of Vietnam has been up and down for many years, this type of trade deficit decrease is symptomatic of the multilateral changes which are taking place in the world.

The American Chamber of Commerce predicts that Vietnam will soon become the largest Southeast Asian trade partner to the United States. The country, which is strategically located to serve as an effective export hub to reach other ASEAN markets, is emerging as a leader in low-cost manufacturing and sourcing of raw materials.

The labor costs in Vietnam are 50% of those in China, 40% of Thailand, and 40% of the Philippines, and its domestic workforce is growing by 1.5 million per year.

When the AEC comes into effect on January 1, 2016, Vietnam will see an increase in exports as its goods become accessible to the world's largest markets. The AEC ensures that there will be few tariffs and restrictions on Vietnamese exports. This, along with changes to domestic regulations making Vietnam more investor friendly, in terms of trade, will allow the country to become one of the wealthiest in Southeast Asia.

As Vietnam becomes a sustainable trade exporting country, or trade surplus economy, the exchange rate of its currency will be adjusted to facilitate the process of rebalancing the monetary framework internationally. In effect, reversing the USD inflation which has been built up in the domestic economy and currency of Vietnam.

As with all things there will be some challenges with this as well.

Though the appreciation of the domestic currencies of emerging economies is a viable strategy of rebalancing, it will have to be implemented parallel with the structural changes as designed in the multilateral framework.

The multilateral transition, and using the SDR as the primary reserve asset, will help reduce the effects of slowing domestic growth as surplus exporters adjust the exchange rates of their currencies. A peg to the SDR, as opposed to the domestic USD currency, will facilitate the transition for many economies, while ensuring a minimal amount of export loss.

One other method of addressing this issue is to allow economies to gradually shift from an export oriented model to a model with domestic sources of growth. This concept is further covered in the Appendix material at the end of this publication, called The Redback Revolution, which explores China's plans to move from the trade export based model to a trade services model.

One remaining issue with appreciating the domestic currency of Vietnam is accounting for the large money supply which has accumulated as a response to the USD forced imbalances. Based on the Open Market Operational functions of central banks, in this case the State Bank of Vietnam, the SBV can contract or expand the money supply by increasing or reducing the purchases of government securities, or bonds.

The SBV is unable to contract the money supply because that would mean purchasing less government bonds and ending the managed peg to the USD. The multilateral framework is not yet ready to support such a move by Vietnam, but could be by Jan 1, 2016, which is when both the AEC trade agreement and new SDR composition, which will include the Chinese currency, will come into effect.

The State Bank of Vietnam, or any other central banks, have the ability to bring money in and out of existence. As such, a method of reducing the money supply, once the VND ends the peg to the USD, could simply entail purchasing additional government bonds with the existing money supply, as opposed to creating new money supply. This would take money out of circulation.

The only thing preventing the SBV from contracting its money supply and appreciating its currency, is the managed peg to the dollar, which is increasing exactly the type of imbalances which have placed Vietnam in the situation to have to address the imbalances in the first place.

During this multilateral transition we will experience many forms of adjustment, some of which may not make sense initially, but will when contrasted against the larger process. Examples of this are the ending of the Swiss franc peg, and the recent move by Greece to make a debt payment to the IMF with SDR, which is in essence paying a debt to the IMF with the actual debt itself.

In such a crazy world, anything and everything is possible, including the appreciation of not just the Chinese renminbi, but also the Vietnamese dong. Especially if the VND gets pegged to the RMB, and the RMB to the SDR.

f. The USD and RMB Parallel Positioning

One of the biggest questions which we need to consider as the world moves closer to the full implementation of the multilateral financial system is when will the RMB end its managed peg to the USD? Now that the official request has been made to the International Monetary Fund, for the yuan to be included into the SDR basket composition, it is only a matter of time before the ending of the peg occurs.

There are a few time frames we are working with. One is the May meeting of the IMF where the first formal discussions around the new SDR composition will take place. The second is in October, which is when the new composition will be confirmed. Finally, the new basket will come into effect on January 1, 2016.

There are some key indicators and trends which we can use to build a case for the time frame of this event(s).

The official IMF transcript of a speech Christine Lagarde gave in China on March 24, 2015, will offer us our first clues. The excerpts below are from that speech, followed by my interpretations.

"The implementation of structural reforms as outlined in the 3rd Plenum Blueprint is underway. This should lead to slower, safer, and more sustainable growth--with a focus on innovation and entrepreneurship--which will be good for China and its people – and good for the world."

The market and financial reforms detailed back in 2013 have been discussed across many platforms. The consensus is that the financial reform component of the Plenum, which included the mechanism for exchange rate adjustments, was a reference to the widening of the exchange rate band with the USD that took place last year.

It is my contention that this segment of the Plenum is referring to a larger move in the exchange rate mechanism, as would be necessary for the RMB to be included in the SDR basket. Having the yuan remain pegged to the dollar would be pointless in the SDR framework, as it would not offer broader stability, which is the point of the inclusion in the first place.

Remarks from the International Monetary Fund would support the inclusion of the RMB in the SDR composition:

"I noted the impressive efforts made by the Chinese government to reform in three key areas in particular: cleaning up the house, by promoting good governance through strengthening the legal framework and the anti-corruption campaign; cleaning up the air, by curbing pollution and preserving the environment; and clearing the path to even more engagement with the world, through China's further participation in the multilateral dialogue and through more international investment and trade. I welcomed China's various initiatives in this area, including through the newly established Asian Infrastructure Investment Bank (AIIB)."

"I am very impressed by the rapid internationalization of Renminbi (RMB) in recent years. The authorities' commitment to accelerate reforms, particularly in the financial and external sectors, should further facilitate the international use of the RMB. The authorities have also expressed interest in having the RMB included in the SDR basket. We welcome and share this objective, and we will work closely with the Chinese authorities in this regard."

"During our meetings, we also discussed the delays in implementing the IMF's 2010 quota and governance reform. I share the authorities' view that every effort should continue to be undertaken to ensure that these reforms can be made effective as soon as possible."

The trend of information which we have been following for the last 15 months is now being validating almost daily as the official announcements and events play out as expected.

It is rudimentary to suggest that the country with the largest economy on Earth cannot keep its currency pegged to that of another. The price discovery which will take place in the opening days of the pegs end will see appreciations of the RMB. Some of the benefits of this upward

valuation will be realized as foreign funds are encouraged to enter China, there will be lower Chinese company operating costs, in the form of cheaper imports, and the Chinese will be able to purchase foreign assets cheaper.

The appreciation of the yuan will also slow economic growth within China, which is also something mentioned above by Lagarde in her speech.

To determine the timing of this event(s) we need to consider what other factors and systemic implementations align with the months of May and October.

First, there is the China International Payment System, or CIPS, which was originally scheduled to be operational in 2014, but was delayed due to technical difficulties. It is now stated that the CIPS system is ready to go, and is only going through final testing with 20 banking institutions, 13 of which are Chinese, and the remainder as foreign subsidiary banks. The new operational start date is in October, but it could be fully operational at any time.

This October time frame corresponds with the next fiscal crisis in America where the debt ceiling is reached and the Treasury runs out of money to fund the government. This could create an excellent pretext for the Chinese to end the peg. When a similar situation happened in October of 2013, the Chinese were very outspoken on the volatility in the USD.

It has been suggested that China may announce its actual gold reserves this spring, either April or May. This corresponds with the May time frame of the initial formal IMF discussion on the SDR basket changes.

So far, we have most key indicators pointing towards the October time frame, which corresponds with the final review and decision on the SDR composition.

But before making any final conclusions, we will need to take a closer look at the Chiang Mai Initiative Multilateralization and how China's trade partners will react to an end of the RMB/USD peg.

The CMIM is an agreement between ASEAN members to help provide assistance to countries experiencing balance of payments and short term liquidity difficulties. The agreement came into effect on July 17, 2014, around the same time the CIPS systems was to come online.

Under CMIM, a member country can draw up to 30% of its allocated quota amount under the agreement, without being subject to IMF conditions. The remaining amount, 70%, is required to be connected with an IMF program. The CMIM acts as a supplemental regional safety net to the IMF. As such, the CMIM cannot function without the IMF.

The Chiang Mai Initiative is one segment of the ASEAN Economic Community blueprint. For those who don't know, AEC is a game changer. Its mandates are nothing less than:

- Harmonization in payment and settlement system (CIPS)
- An Asian monetary union (with countries maintaining their domestic currencies)
- Single market for financial products
- Uniform exchange rates between ASEAN members

All phases of integration are scheduled to be completed and operational by Jan 1, 2016, the same date that the new SDR composition, with the RMB, will take effect.

International audit and financial advisory company Deloitte has published a document titled The ABC of AEC - To 2015 and Beyond. This document attempts to explain and direct the reader through the maze of AEC integration, and why it's important. The document opens with this:

"Across Southeast Asia, all the chatter around the ASEAN Economic Community (AEC) is focused on a single date: 31 December 2015. But the reality is that not everyone understands what that date means. What is it and why wait until then to do it? What will the impact be? Will we wake up to a different world on 1 January 2016?"

The obvious connection between the CMIM, and its IMF structure and mechanics, with the AEC, and its operational start date of Jan 1, 2015, along with the new SDR composition, is clear evidence for the reality of the macro multilateral framework which we have researched and presented here on this site.

The phased integration of AEC and the relationship between the IMF and CMIM make the 2010 IMF Quota and Governance Reforms all the more important. The AEC, and by default the CMIM, cannot function without the fair representation of China and other emerging economies on the Executive Board of the IMF. Not to mention that the quota amounts from both the IMF and CMIM will have to align at the 30%/70% ratio defined above.

But it doesn't end there.

With the regional exchange rate coordination, or uniform exchange rate between ASEAN members, we are likely to see most countries peg their domestic currencies to the Chinese yuan, as it will be the regional reserve currency which is in the SDR composition. This will position the AEC to avoid the inherent challenges in a regional currency like the euro, which it has publicly stated it does not want.

The uniform exchange rate structure will ensure that no opposing, or dual exchange rates are used within the monetary union. It is highly unlikely this means all currencies will be at parity,

but member countries could use the Shanghai Gold Exchange as a means of supporting the uniform structure, with predetermined rates set for each member country, based on similar weights as what will be used in the SDR composition.

This is the mechanism by which we are likely to see a revaluation of regional domestic currencies, such as the Vietnamese dong. We have reviewed the probability and intent of the State Bank of Vietnam to at some point end the dong's peg with the USD and peg to their largest trading partner, which is China.

We can see now that the mechanism which will be used for this revaluation is built within the structure and phase integration of the AEC implementation, which in turn is determined by the larger process of the RMB being given reserve status and included in the SDR composition. And the SDR is the reserve unit of account used by the IMF. The same IMF which supersedes the mandates and organizational flow of the CMIM, Chiang Mai Initiative.

Returning the time frame for the RMB to end the peg to the USD, we are still faced with the two possible dates of May and Oct, with the final results being in full effect on January 1, 2016.

It could really happen at any time in between May and Oct, but I will put forth one possibility which has begun to settle well on me, considering the careful action of China at every step of internationalizing the yuan.

It is possible that we could see China announce their full gold holdings in April or May, in time for the first formal meeting on the SDR, and perhaps even partially peg the RMB to gold, while at the same time widening the USD peg instead of removing it. This would allow the Chinese to feel their way through any possible market adjustments or fluctuations in the price of gold, and volatility with the dollar.

This would serve to apply more depreciation pressure on the USD in the lead up months to the US budget crisis and SDR confirmation meeting in October. At that time, China could fully sever the peg with the USD and allow the yuan to float freely and realize the price discovery appreciations which would have built up in the currency like a stored kinetic energy.

The other ASEAN members would follow and lead into the final implementation of the AEC blueprint by the end of the year, which is meant to correspond with the new SDR on January 1, 2016.

And let's not forget that the AIIB and BRICS Development Bank will also be fully operational at that time as well.

When faced with time frames of either May or Oct for the depeg to occur, it is my contention that it will happen piecemeal, with a possible widening of the peg range in May, followed by a

full ending of the peg in Oct. The official gold holdings and any partial support this may offer to the yuan could happen on either time frame, though I'm leaning towards sooner rather than later. What is certain is that we are going to wake up on the morning of January 1, 2016 living in a different world than the one we are living in today. This could very well be the last year of American hegemony.

g. SDR Basket Valuations

The SDR, or Special Drawing Right of the International Monetary Fund, will replace the US dollar as the reserve asset from which this much needed liquidity expansion will come from. The SDR is really three concepts consolidated into one asset.

Firstly, the SDR is a composite reserve asset which was created by the IMF, or the Fund as they call it, in 1969, just before the US dollar went off the gold standard. This is the official description of the SDR from the articles of the Fund.

Secondly, the SDR will act as a new class of reserve asset, becoming tradable as SDR denominated instruments issued by the Fund, or other investment vehicle or institutions backed by the Fund's members, which has been expanded to include the larger emerging markets, with the Chinese renminbi being added to the SDR composition basket by next year. This has been the purpose for the fast internationalization of the renminbi.

Thirdly, the SDR can act as a unit of account. This SDR will be used to price internationally traded assets, such as sovereign bonds, and goods, such as commodities, like oil and natural gas. It can also be used to peg currencies and to report balance of payment data.

Economic crises are used to further consolidate and integrate regions of the world. The 1998 financial crisis in Asia led to further regional integration, and the 2008 financial crisis was used to implement QE policies and integrate the liquidity framework for the MFS.

As such, today we find that the problems plaguing the international monetary system are as follows:

- Persistent Global Imbalances
- Large and Volatile Capital Flows
- Exchange Rate Fluctuations Which Are Disconnected from Economic Fundamentals, as visible in Vietnam.
- Insufficient Supply of Safe Global Assets. This is where the SDR bonds will replace the US bonds.

The above items, along with the coming deflation crisis, will be the pretext used to adjust the SDR as described above and begin expanding liquidity by way of SDR denominated financial instruments.

The ability of the SDR to bring further diversification and stability to the global financial system comes from its structure as a basket of currencies. The value is based on the weights of the currencies in the basket composition.

In 2011 the International Monetary Fund called for the replacement of the USD as the world's primary reserve currency. The SDR, which represents a potential claim on the currencies of IMF members, was considered to be the only viable alternative to the USD.

The SDR, through its structure as a basket of currencies, is able to contribute to the stabilization of the global financial system through currency diversification, and can be used as a less volatile alternative to the dollar.

Once established as the global reserve asset, the SDR will be freely converted into whatever currency a borrower member requires, at exchange rates which are based on the weighted composition of the reserve currencies which make up the basket.

Along with correcting global imbalances, the goal is also to have an international reserve asset for central banks which will better reflect the global economy, accounting for the growth in the emerging markets, such as China and India. The dollar, which is vulnerable to swings in the domestic economy and policy changes of the United States, does not meet the demands required of a reserve asset.

Along with a broader diversification of the SDR basket composition, the issuance of SDR-denominated bonds will also help to reduce central bank dependence on US Treasuries, which in turn will help limit the balance of payments deficit which the United States has been running for decades. The diversification of foreign reserve accounts based on the SDR will be more effective with a basket composition that is expanded from its current weighting.

With a change in global reserve currency, such assets as oil and gold will also be priced in SDR.

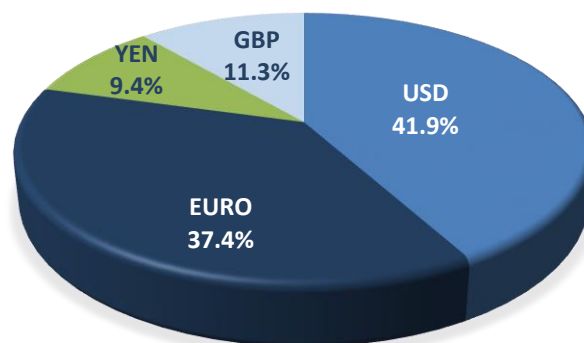
Over the next few years the financial world will see the creation of an additional \$2 trillion worth of SDR, bringing further diversification to the global monetary system.

In 1968 the United States supported the proposal made by the International Monetary Fund to create the new SDR international reserve asset. The purpose of the SDR (currency code XDR) was to reduce and eliminate the balance of payments deficits which America was building under the original Bretton Woods structure.

Initially the SDR valuation was equivalent to 0.888671 grams of fine gold, which was also the equivalent of \$1.00USD. After the collapse of Bretton Woods between the years 1971 and 1973 the SDR valuation was changed to the basket of currencies structure.

The basket valuation and weights went through several changes over the years, with adjustments made every 5 years. As of January 1, 2011, the SDR basket composition has been as follows:

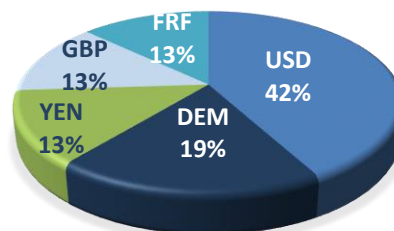
SDR BASKET COMPOSITION



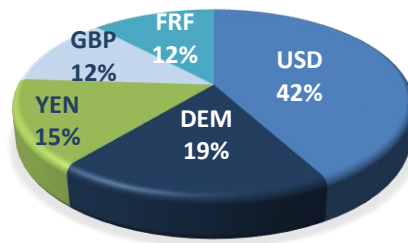
The SDR basket composition will once again be adjusted with the first formal meeting to review the weights taking place in May, 2015. The composition will be confirmed in October, 2015, with the changes taking effect on January 1, 2016.

Other historical compositions of the SDR are as follows:

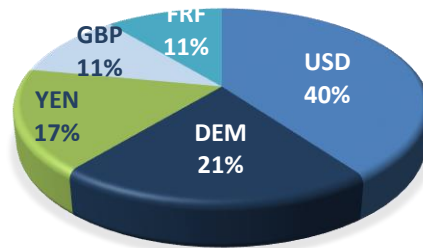
SDR BASKET COMPOSITION JAN, 1981 - DEC, 1985



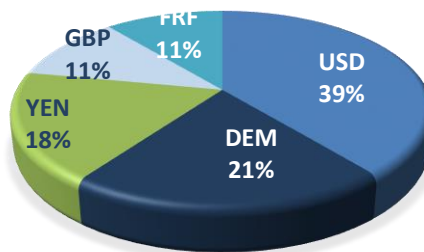
SDR BASKET COMPOSITION
JAN, 1986 - DEC, 1990



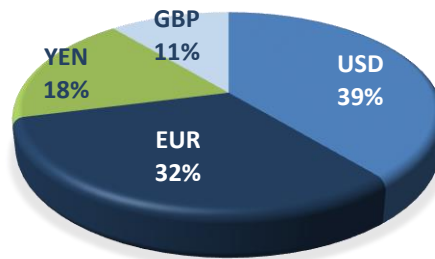
SDR BASKET COMPOSITION
JAN, 1991 - DEC, 1995



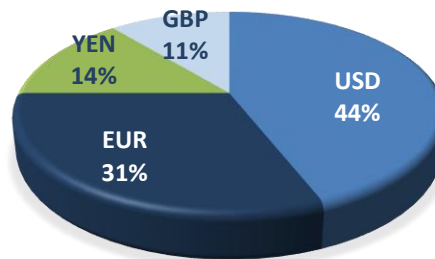
SDR BASKET COMPOSITION
JAN, 1996 - DEC, 1998



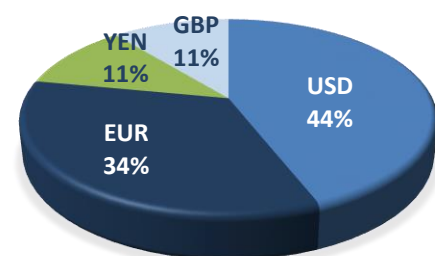
SDR BASKET COMPOSITION
JAN, 1999 - DEC, 2000



SDR BASKET COMPOSITION
JAN, 2001 - DEC, 2005



SDR BASKET COMPOSITION
JAN, 2006 - DEC, 2010



The upcoming SDR review will see the inclusion of the Chinese yuan, or RMB, in the basket composition. Both the IMF and China have been recently discussing this fact and have openly acknowledged that it will happen.

The renminbi has been dramatically internationalized since the last SDR review in 2010. The volume of international use of the Chinese currency has been expanded with the utilization of

Bi-Lateral Swap Agreements (BSA's) between the People's Bank of China and other central banks around the world, including the United Kingdom, Canada, Switzerland and Germany.

The RMB is not the 5th most traded currency in the world as of March, 2015, and will see additional increases in the coming months and years.

As explained previously, in 2009, as response to the financial crisis, Zhou Xiaochuan, Governor of the People's Bank of China, gave a speech titled "Reforming the International Monetary System". In that speech he emphasized the following:

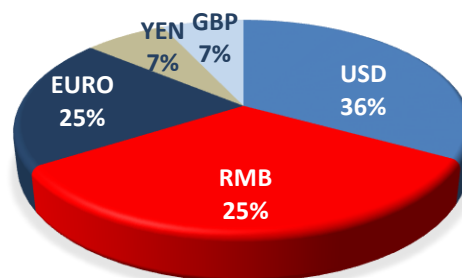
1. The need to create and utilize a supra-sovereign international reserve asset which is removed from the inherent deficiencies caused by the international use of national credit based currencies.
2. The potential of converting a percentage of foreign reserves into SDR.
3. Expanding the SDR to include, as a means of payment, currency of denomination for securities, commodity denomination, and elevation to the role as primary global reserve currency.

These mandates align with the statements from the International Monetary Fund in 2011 on the need for changes to the international reserve currency system.

There are several possible scenarios which changes to the SDR composition could encompass, with weights adjusted depending on what other currencies, or assets, are included in the basket.

One such scenario, which is virtually guaranteed, is the addition of the RMB. Possible weighting with this scenario could look like this:

SCENARIO#1 - SDR BASKET COMPOSITION

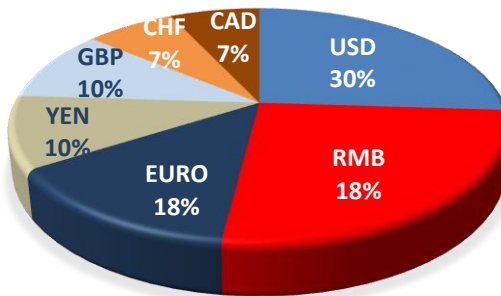


Another possible scenario would be to include, in addition to the RMB, the Canadian dollar (CAD) and the Swiss franc (CHF). Canadian dollars have slowly been accumulating in the foreign reserve account around the world, same as the Australian dollar, and the Swiss franc recently

end its peg to the euro, which could be in preparation for its inclusion into the SDR basket, as having a currency pegged to another currency in the basket would not create the necessary diversification and stability.

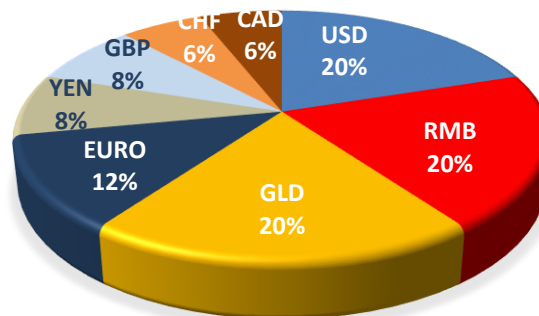
The Chinese renminbi would also have to end its managed peg to the USD in preparation for the SDR composition.

SCENARIO#2 - SDR BASKET COMPOSITION



A third possible scenario worth considering is that along with the currency composition above, gold could also be included into the SDR basket to bring additional stability outside of the currency class itself. We could also see, in place of gold being included directly into the basket, the currencies themselves partially supported by gold, much like the USD in the original Bretton Woods Agreement, and the initial structure of the SDR back in 1969.

SCENARIO#3 - SDR BASKET COMPOSITION



Conclusions

In this first installment of The Economic Transition Papers we have covered the history of the unipolar USD monetary framework and the systemic imbalances which have led to the call for an alternative multilateral framework based on the Special Drawing Right of the International Monetary Fund.

In the remainder of 2015, the international institutions and sovereign governments, and central banks, will continue to negotiate the full architecture of the multilateral system. How specific events and valuations will be determined will change from month to month, and year to year, as the international financial system continues to shift, and geopolitical considerations are leveraged.

At some point the reserve accumulation of USD will be reduced to allow for an increase in reserve accumulation of both the RMB and SDR. Many investors will look for alternative financial instruments which are not denominated in USD. The SDR is only available to sovereign governments and central banks, and select international institutions.

The private retail investor has no access to the official SDR. SDR Future Pty. Ltd. has replicated the diversification and composition of the SDR basket in order to offer retail investors the world's first SDR service, the SDRF. Read more at www.sdrfuture.com

In the next installment of The Economic Transition Papers we will further explore the use of substitution accounts for exchange of USD bonds and the wider use of SDR denominated assets.



About the Author

JC Collins is a macroeconomic analyst and writer who has written extensively about the subjects presented in The Economic Transition Papers. On December 31, 2013, JC started a website called Philosophy of Metrics, where he produced essays on the multilateral transition, explaining how the international financial architecture will shift from the unipolar USD based framework to the SDR based framework.

Within the first 16 months the site has had over 2 million views and a readership which has spanned the globe.

JC Collins is also the co-founder of SDR Future Pty Ltd, offering a financial service strategy which replicates the stability and diversification of the Special Drawing Right (SDR) multilateral asset of the International Monetary Fund (IMF). The SDRF is the world's first full SDR service for retail investors.

More information can be found at the following sources:

www.philosophyofmetrics.com

www.sdrfuture.com

Appendix – Bonus Material

The Redback Revolution

How China Is About to Flip from Trade Exports to Trade Services

The Made in China label became a symbol of economic production lost in the western world alongside the rise of cheap labor and goods from the emerging economies. The cultural meme of "everything made in China" became common and could be heard at any given moment, anywhere in the developed world.

Whole industries and business models were built around the economic methodology of exporting cheap goods. Such as numerous chains of dollar stores, and brand name clothing outlets, which manufactured products in the Chinese provinces with the lowest labor costs, and then sold the goods at inflated prices to the developed world.

China now has the largest economy on Earth, and the monetary structure which made the USD the center of the solar system is shifting towards a multilateral framework. The Chinese currency, renminbi (RMB), or otherwise yuan, which is the unit of measurement, (such as the relationship between the British sterling and its unit of measurement the pound), will soon no longer be taking a subservient position against the American dollar.

The yuan, in both its on-shore and off-shore variations, has also been called the redback, drawing on the nickname of the USD, and its civil war version, the greenback. For years the redback has maintained a managed currency peg with the USD. This exchange rate regime has been managed by the Chinese government and the People's Bank of China at an undervalued false exchange rate.

Over the last 5 years the redback has become more widely used for global payments, financial investments, and reserve management. The large amount of Bilateral Swap Agreements, BSA's, and broader acceptance, has not yet been priced into the valuation. Nor has the growing status of the Chinese economy itself.

One of the main reasons for the internationalization of the RMB is directly related to the multilateral supra-sovereign reserve asset called the Special Drawing Right. The SDR is the unit of account used by the International Monetary Fund and is being re-worked as the global reserve unit of account which will replace the USD in the coming months and years.

The SDR basket is currently based on the valuations of the USD, the yen, pound, and euro. Every 5 years the basket is adjusted and currencies are included or removed. This the year the basket will again be adjusted and the reback will be added.

There are a number of reasons supporting this measure, but none more so than the need for stability in global liquidity. The growing sovereign debt crisis which is spreading from country to country will require large scale debt restructuring on a level that no one economy or domestic currency can handle effectively and efficiently.

The optimization of sovereign debt restructuring will take place through multiple methods, such as the SDRM process of the IMF, or Sovereign Debt Restructuring Mechanism. Other methods will be CAC's, or Collective Actions Clauses. The CAC process will be initially, and primarily, used as a method of incorporating into the issuance of RMB bonds - which will be used in a broader array of debt instruments and bank loans - the methods to address the sovereign debt issue. This process will be used in Greece and the Eurozone as the multilateral develops further into its broader global framework.

The RMB CAC and BSA dual machinations will build upward towards the SDRM and the utilization of SDR denominated bonds to address global liquidity concerns. These bonds will be issued through the BRICS Development Bank and other financial institutions as the process is expanded internationally.

The inclusion of the reback in the SDR basket is required to bring broader stability to the SDR before the debt restructuring can begin in both CAC and SDRM methods. This stability can only be realized if the RMB ends its managed peg to the USD and is allowed to free float on the forex markets.

The yuan is significantly undervalued and needs to be strengthened before its inclusion into the SDR basket. The initial IMF meeting to discuss the SDR is in May of this year, with the actual adjustments taking place in the fall months. This means that sometime in the next few months Chinese authorities will have to end the managed peg and allow the reback to become more market oriented.

There is a concern amongst economic analysts that China is headed for a "soft landing" or a "hard landing" as its credit markets contract and economic growth slows alongside the global deflation which is crawling its way through the sinuses of the existing international system. This line of thought continues into the managed float regime as conclusions are made and published that China will not allow the reback to float freely on the forex markets because it could lead to a devaluation.

This simply will not happen because the actual real world value of the RMB has not been priced into the managed regime. Once the managed peg is ended and the currency free floats, the yuan will experience strong real exchange rate appreciation as the existing BSA's and foreign reserve amounts increase dramatically alongside the further internationalization and inclusion into the SDR basket.

The argument which is made against the appreciation of the yuan is that it would destroy China's trade exporting economy. As such, it would further reduce economic growth and deepen the contraction of credit markets in the country.

What isn't widely accepted is that the appreciation of the RMB and a move away from the existing trade exporting model is exactly what China wants. Not only do they want it to happen, but they have taken strategic and necessary steps to ensure that it happens.

Over the last 10 to 15 years China has continued to modernize along with the flow of economic growth. At one point, China was building the equivalent of three Chicago's every year. The construction of these ghost cities, which have remained relatively empty, created a worldwide shortage of iron and rubber.

Many analysts assume that since these cities have sat empty all this time that it was a clear sign of a real estate bubble in China. But nothing could be further from the truth.

The engineering of the ghost cities were a part of the National New Urbanization Plan which intends to move 100 million people from the rural population into the cities by 2020. The intent is to increase the urban population of China by 60% and create a larger consumer class as the economy shifts away from the exporting model.

This will be the largest human migration in the history of the world. The economic strategies and cultural engineering used to accomplish it will be studied for generations to come.

China is about to create a middle class.

In its efforts to regain the superpower status which it had previously held three times in the last 2000 years - the Han Dynasty, the Tang Dynasty, and the Qing Dynasty - China has developed an urbanization plan which is meant to attract "elite human talent" to the "elite cities" which will be structured under strict population controls and citizenship will be based on a point system.

As the old world USD based system recedes into the shadows of yesterday, (like the British Empire before it) we can determine that the National New Urbanization Plan of China will

become, under the emerging multilateral framework, the Global Urbanization Plan of the United Nations.

For all the GDP growth and opportunity to modernize which the exporting model afforded China, it came with some increasingly apparent downfalls. First, the trade exporting model creates massive inequality within the population, which is being addressed by increasing the percentage of urban population and decreasing the percentage of rural population.

Secondly, it contributed directly and indirectly to under-consumption and over-investment. This will be reversed by shifting the Chinese economy from the existing trade exporting model to a trade services model.

The exporting model is self-explanatory but the trade services model may need some further review.

As the redback appreciates and is added to the SDR as one of the reserve currencies making up the basket, China will be looking at ways of expanding existing services and creating new ones. These services consist of financial services (think Eurozone bailout and McDonald's bonds), communications, transportation into international markets and regions, promoting tourism, and the exporting of media and traditional Chinese values and heritage.

Chinese economic strategists have set a target of reaching \$1 trillion of Trade Services by 2020, the same year in which the urbanization plan is set to include 60% of the population. This is a dramatic shift away from the policy of exporting goods which carried the growth of the Chinese economy for decades.

When China ends the managed peg to the USD, other ASEAN economies will follow. As a broadening of the, member countries such as Vietnam, Malaysia, and Indonesia, amongst others, will also end existing pegs and establish floating pegs with the RMB. The strong economies amongst the group will see currency appreciations alongside the redback.

The geopolitical tension which is taking place in the world is symptomatic of this transition away from the unipolar USD based system towards the framework and macroprudential policies of the multilateral SDR based system.

The USD, which has held the position of the Sun in the solar system since 1944, will soon be relegated to the position of a Jovian Giant, alongside the redback, as the SDR moves into the center position, from which all other currencies and commodities will both define, and maintain, their orbits.

The greenback, like the redback, are both about to go through some dramatic adjustments and re-engineering as the multilateral continues to emerge. - End