Why US hard currency is worrying affluent Australians

In tightening the supply of the greenback to global central banks, the US Treasury has supplied the tinderbox for the next global markets crisis.

by **Stirling Larkin**

Whether by design or folly, President Donald Trump's US Treasury has again dangerously tightened the supply of US hard currency to global central banks and, in so doing, supplied the tinderbox for the next global markets crisis.

Every markets crisis since 1881 has been sparked by an acute contraction in the supply of credit and since 1944, global credit markets have inextricably been linked by a requirement of central banks to retain US dollar hard currency reserves.

With US 30-year Treasury yields rising half a per cent (or 50 basis points) this year and looking to break out above the technically significant 3.25 per cent level, Australian ultra high net worth global investors are increasingly focusing their attentions on the often overlooked CEEMEA – central and eastern Europe, Middle East and Africa. It's in these economies that US dollar liquidity crises have sparked three of the past six major global recessions and stock market crashes since the Nixon shock of August 1971.

The Nixon shock – which saw President Richard Nixon cancel the direct international convertibility guarantee of the US dollar for gold bullion – affected affluent Australians significantly. Set alongside the existing volatile transitory period caused by the "decimalisation" of the Australian dollar replacing the Australian pound in 1966, this ingrained a justified sense of paranoia regarding access to US dollar liquidity among Australian UHNW communities.

These fears also saw many affluent Australians transfer much of their wealth to what later became referred to as "Swiss bank accounts" during the late 1960s and throughout the 1970s, primarily in an attempt to safeguard not only their accrued wealth but also their liquidity in a future time of crisis.

Australia has shared an unusual parallel history and coaction with a key CEEMEA member – the Republic of Turkey.

Dollar reliance

Australia and Turkey have suffered parallel crises during near-identical windows of time, with the only identifiable common link being the reliance on US dollar liquidity reserves at their respective central banks.

Stoked by a concerning rise in domestic inflation, the fungibility of the newly decimalised Australian dollar after the Nixon shock and simultaneously rising unemployment under Prime Minister John Gorton's stewardship, the Australian economy slipped into a painful recession between October 1971 and March 1972.

It was thought that the Australian Reserve Bank struggled with "open market operations" during this time, given our sizeable gold bullion provisions and inadequate greenback currency reserves.

In combination, this resulted in an acute contraction in Australian bank-led credit.

At the same time Turkey, still struggling to recover from its first military coup in May 1960, saw the military intervene again in March 1971 to "restore order". This was after widespread unrest driven by soaring unemployment and a local currency unhinged to British pound reserves.

So much pressure was placed on the Turkish economy, which lapsed into recession, that kidnappings and bank robberies became commonplace until 1973, when Fahri Koruturk, a retired naval officer, was installed as president by the parliament.

Koruturk met with US Secretary of State Henry Kissinger in December 1973 and set a closer alignment between the Turkish lira and US dollar reserve system, before the Turkish invasion of Cyprus in July and August of 1974.

Since then, the Turkish economy has maintained an uneasy reliance on both foreign direct investment (FDI) and hard currency injections, not too dissimilar to the situation Australia has found itself in.

Timely question

But in late 2018, after beginning the year with a real growth rate of around 5 per cent, central bank reserves held at the US Federal Reserve have begun to shrink considerably and the timely question Australian UHNW investors are asking is "will Australia's dependence on US hard currency – which is now dangerously tightening – cause domestic contractions in Australian credit and economic terms of trade, as is being seen in Turkey and throughout CEEMEA?".

A hard currency liquidity crisis in Australia is obviously not entirely analogous to one seen in Turkey. But Australian investors are reaching a crossroads and need to make a choice. Are US yields rising because growth is accelerating, causing the expectation of high inflation which continues to propel the US's S&P500 and Australia's ASX200 higher? Or are rising US Treasury yields a sign of institutional investors growing more concerned that US government deficits are beginning to spiral out of control and a context as to why Trump's US Treasury is keeping a tight leash on US hard currency supplies?

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