Strong USD weak CNY

Look for a moment at the deal struck between the US and China in the past decade. China has effectively agreed to hand over a thousand pairs of cotton underwear in exchange for an iPad 6 somewhere down the line.

Unfortunately, somewhere along the line, those thousand pairs of cotton underwear came to be worth a paltry half an iPad 6. The USD, that generally accepted accounting currency came to be not quite so generally accepted.

A whole bunch of shopping vouchers issued by the US treasury had been debased.

In the past decade, or more, the US had managed to keep economic growth humming at low inflation rates because the US was able to outsource its manufacturing to China. China as a willing accomplice was happy to provide vendor financing via the PBOC which bought US treasuries with its surplus USDs.

This trade dynamic was happily tolerated by all as it fueled China's growth and investment and accumulation of intellectual property. (Yes, mostly others'). The US was happy to live on credit as long as interest rates were low and collateral prices (read home prices) were rising. A key performance indicator of this policy was a rising current account and trade deficit which confirmed both hopes and fears.

This has come to an end. Negative savings rates in the US are no longer viable and therefore will rise. The trade deficit that the US runs with China and the rest of the world will shrink perhaps into the black.

A country that imports stuff, exports its currency. As the export of USD slows and contracts, the pressure will be on the USD to rise. The pressure on USD interest rates will also be to rise.

A decade of negative savings and wholesale export of USD has led to a weak USD. Yet no one has accused the US of being a currency manipulator. The weak USD has now resulted in pretty advantageous terms of trade. Also, US companies remain the strongest holders of patents, owner of trademarks and brands and holders of intellectual property.

The world has always had strong demand for US brands. For a long time these brands were made outside the US. This trend is reversing.

US exports have therefore rebounded and are likely to be the driver of growth going forward.

A country that exports stuff, imports currency. As the import of USD accelerates the pressure will be on the USD to rise. The pressure on USD interest rates will also be to rise.

The US policy of badgering the Chinese to let the CNY strengthen is not reasonable. If the Chinese float the CNY, the Americans may be in for a surprise.