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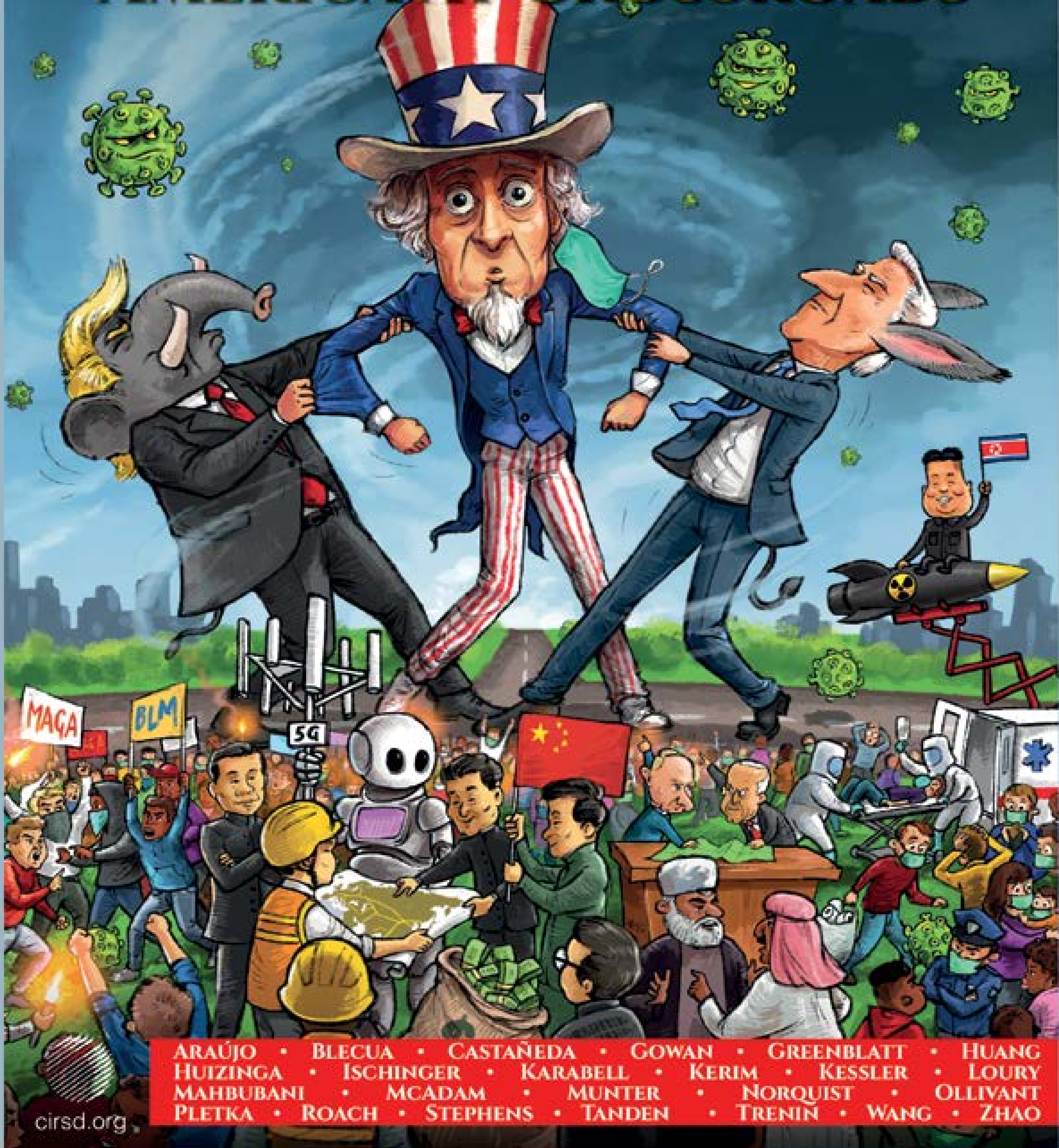
AMERICA AT CROSSROADS



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THE FALL OF THE ALMIGHTY DOLLAR

Stephen Roach

THE ERA of the American dollar's "exorbitant privilege" as the world's primary reserve currency is coming to an end. In the 1960s, then French finance minister Valery Giscard d'Estaing coined that phrase largely out of frustration, bemoaning an America that drew freely on the rest of the world to support its over-extended standard of living. For almost 60 years, the world complained but did nothing about it. Those days are over.

Already stressed by the impact of the COVID-19 pandemic, American living standards are about to be squeezed as never before. At the same time, an ever-shifting world is having serious second thoughts about the once widely accepted presumption of American exceptionalism. Currencies set the equilibrium between these two forces—domestic economic fundamentals and foreign perceptions of a nation's strength or weakness. The balance is now shifting. I look for a 35 percent plunge in the broad dollar index by the end of 2021.

AMERICA'S IMBALANCES

Three key forces are likely to be at work in prompting this seemingly shocking outcome—the first being an unprecedented deterioration in America's net domestic saving position, which is tightly connected to international capital flows and a nation's balance of payments with the rest of the world. The confluence of these factors leaves the value of the U.S. dollar with nowhere to go but down.

The seeds of this problem were sown by a profound shortfall in domestic U.S. saving that was glaringly apparent before the pandemic hit. In the first quarter of 2020, net national saving, which includes depreciation-adjusted saving of households, businesses, and the government sector, stood at just 2.9 percent of national income. No need to worry, goes the conventional excuse—America never saves. Think again. The net national saving rate actually averaged 7 percent average over the 45-year period from 1960 to 2005. And during the 1960s, long recognized as the strongest period of productivity-led U.S. economic growth in the post-World War II era, the net domestic saving rate averaged 11.5 percent.

Expressing these calculations in net terms is no trivial adjustment. Although gross domestic saving in the first quarter of 2020—at 18.9 percent of national income—was also below its 45-year norm of 21 percent from 1960 to 2005, the shortfall was not nearly as severe as that captured by the net measure. That reflects a very worrisome development: the difference between the gross and net measures of domestic saving are attributable to the rising depreciation of a worn-out capital stock. After decades of neglect, America is now saddled with a rapidly aging and increasingly obsolete stock of productive capital. That means that the bulk of its gross saving goes to replacing old capital rather than to building new capacity—the seed corn of economic growth. That seriously compounds the problem of a seemingly chronic deficiency in net saving.

Photo: Guliver Image/Getty Images

The Marriner S. Eccles Federal Reserve Board Building in Washington, DC, home of the Board of Governors of the U.S. Federal Reserve System

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Lacking in domestic net saving, and wanting to invest and grow, the United States has taken great advantage of the dollar's role as the world's primary reserve currency and drawn heavily on surplus savings from abroad to square the circle. But not without a price. In order to attract foreign capital, the United States has run a deficit in its current account—which is the broadest measure of trade because it includes investment—every year since 1982.

I look for a 35 percent plunge in the broad dollar index by the end of 2021.

COVID-19 and the economic crisis it has triggered is likely to stretch this tension between saving and the current-account to the breaking point. The culprit: exploding government budget deficits. According to the latest estimates of the bi-partisan Congressional Budget Office published in September 2020, the federal budget deficit is likely to soar to a peacetime record of 16 percent of gross domestic product in 2020, before hopefully receding to 8.6 percent in 2021.

A significant portion of the fiscal support has initially been saved by fear-driven, unemployed American workers. That tends to ameliorate some of the immediate pressures on overall national saving. However, the initial pandemic-related surge in personal saving reflected the impact of temporary income support measures—$1,200 checks to most Americans plus a sharp expansion of unemployment insurance benefits that has now expired. In the absence of such temporary support, the personal saving rate has already begun to decline—from 33.6 percent in April 2020 to 14.1 percent in August.

With the lasting surge in the federal government's deficit far outstripping the temporary increase in personal saving, intense downward pressure is now building on already sharply depressed domestic saving. Compared with the situation during the global financial crisis, when domestic saving was a net negative for the first time on record, averaging -1.7 percent of national income from the second quarter of 2008 to the second quarter of 2010, a much sharper drop into negative territory is now likely, possibly plunging into the unheard of -5 percent to -10 percent zone.

Indeed, in the second quarter of 2020, when COVID-19 hit full force, the net national saving rate quickly returned to negative territory, falling to -1.2 percent. Relative to the 2.9 percent positive rate of the first period of 2020, this 4.1 percentage point negative swing in the net domestic saving rate was the largest quarterly plunge on record. That could well be an ominous portent of what now lies ahead in an era of exploding federal budget deficits.

With unprecedented pressure on domestic saving likely to magnify America's need for surplus foreign capital, the current-account deficit should widen sharply. Since 1982, this broad measure of the U.S. external balance has recorded deficits averaging 2.7 percent of GDP; looking ahead, there is a distinct possibility that the United States current account deficit could break the previous record of -6.3 percent of GDP hit in the fourth quarter of 2005. Reserve currency or not, the dollar can hardly be expected to be spared under these circumstances.

A record shortfall of domestic saving and an unprecedented deterioration of the U.S. current account deficit are likely to be key in pushing the dollar sharply lower.

The Crumbling TINA Defense

A second factor at work is a likely repudiation of the so-called "TINA" defense of the dollar—that There Is No Alternative. That has long been the common refrain of currency speculators who smugly caution that betting against the almighty Teflon-like greenback is a fools' game.

That argument is very important in one critical sense: the U.S. dollar, like any foreign-exchange rate, is a relative price. As such, it encapsulates a broad constellation of a nation's value proposition—economic, financial, social, and political—as viewed against comparable characterizations of other nations. It follows that shifts in foreign-exchange rates capture changes in these relative comparisons—the United States versus the European Union, the United States versus Japan, the United States versus China, and so on.

My forecast of a 35 percent decline in the dollar is couched in terms of the comparison between the United States and the currencies of a broad basket of America's trading partners. Individual components in this basket are weighted by country-specific trade shares with the United States and expressed in real terms to capture shifting inflation differentials. As an economist, I care most about currency-related shifts in international competitiveness. The real effective exchange rate (REER), calculated monthly by the Bank for International Settlements, is particularly well suited for this task.

In dissecting the TINA critique of the weak-dollar forecast, it helps to start with the weighting structure embedded in the REER to get a sense of which of some 58 country-by-country relative comparisons might matter the most in pushing the Bank of International Settlements (BIS) construct of the broad dollar index sharply lower. Based on cross-border manufacturing trade flows, the BIS assigns the largest weights to China (23 percent), the

Eurozone (17 percent), Mexico (13 percent), Canada (12 percent), and Japan (7 percent). These five countries (or region, in the case of the Eurozone) account for 72 percent of the total trade weights in the broad U.S. dollar index. An additional 13 percent comes from countries six through ten: South Korea, the UK, Taiwan, India, and Switzerland. Weights of the top ten account for 85 percent of America's cross-border trade.

On this basis, the dollar can't go significantly lower without some combination of a strengthening in China's renminbi (RMB) and the euro. The currencies of America's USMCA partners (formerly NAFTA)—Mexico and Canada—also matter a good deal in that they account for 25 percent of U.S. manufacturing trade. Japan's yen is now of relatively little consequence to movements in the broad dollar index, given its sharply reduced trade weight.

The China call is especially contentious. From the trade war to the coronavirus war to the distinct possibility of a new Cold War, the American body politic now sees China as nothing short of an existential threat. The latest public opinion poll conducted by the Pew Research Center found that fully 73 percent of Americans viewed China in an "unfavorable" light in June 2020. That is up fully 26 percentage points from the pre-trade war readings of 2017 and, in fact, is the most negative assessment of American sentiment toward China since the inception of this Pew survey in 2005.

Notwithstanding these increasingly negative concerns of the American public, the broad renminbi index is up 53 percent from its December 2004 lows in real effective terms (BIS basis). As long as China stays the course of structural reform—shifting from manufacturing to services, from investment- and export-led growth to consumer-led growth—and embraces a further liberalization of its financial system, the case for further RMB currency appreciation remains compelling, even in the face an increasingly fraught relationship with the United States.

The call on the euro is also counterintuitive, especially for a broad consensus of congenital Eurosceptics like me. That goes back to my Morgan Stanley days when I argued repeatedly that an incomplete currency union—especially the lack of a pan-EU fiscal transfer mechanism—could not withstand the inevitable stress of asymmetrical shocks that typically arise in crises. Despite a strong political commitment to European unification as the antidote to a century of war and devastating bloodshed, there was always a critical leg missing from the EMU stool: fiscal union.

Not anymore. An historic agreement reached on July 21 on a €750 billion

($858 billion) European Union recovery fund, dubbed Next Generation EU, changes that—with profound and lasting implications for an undervalued euro. I now have to concede that reports of the currency union's imminent demise have been greatly exaggerated. Time and again, especially over the past 10 years, Europe has risen to the occasion and avoided a catastrophic collapse of its seemingly dysfunctional currency union. From Mario Draghi's 2012 promise to do "whatever it takes" to save the euro from a sovereign debt crisis to the recent Angela Merkel-Emmanuel Macron commitment to address the coronavirus crisis, the great European experiment has endured extraordinary adversity. While Draghi's pledge solidified the European Central Bank's credibility as an unshakable guardian of the single currency, it did nothing to address the greater imperative: the need to trade national sovereignty for a pan-EU fiscal transfer mechanism. That has now finally been accomplished.

With China and the Eurozone accounting for 40 percent of U.S. trade, I would be the first to concede that the math of a U.S. dollar crash won't add up unless those two currencies rise significantly. And that is exactly what I now expect.

Of course, the deal is far from perfect. Significantly, it requires unanimous consent from the EU's 27 member states—always a nail-biter in today's highly charged and polarized political environment. And there was a major tug of war over the composition of the EU fund, which will comprise €390 billion in one-off COVID-19 relief grants and €360 billion in longer-duration loans. While the devil could lurk in the details, the bottom line is clear: the Next Generation EU plan will draw critical support from large-scale issuance of pan-EU sovereign bonds. That finally puts the EU on the map as the backer of a new risk-free asset in a world that up until now has only known only one: U.S. Treasuries. That is hardly a dollar-friendly development. The EMU stool finally has all three legs in place: a common currency, one central bank, and a credible commitment to a unified fiscal policy.

With China and the Eurozone accounting for 40 percent of U.S. trade, I would be the first to concede that the math of a U.S. dollar crash won't add up unless those two currencies rise significantly. And that is exactly what I now expect. Indeed, with both economies plagued by long standing current-account surpluses—albeit sharply reduced in China in recent years—currency appreciation is the classic cure for such imbalances.

Movements in other currencies should reinforce that outcome. That is especially true of the yen, which should draw support from Japan's relatively successful COVID-19 containment strategy. The recent resignation of Prime Minister Shinzo Abe, long associated with yen weakness under his Abenomics campaign of the past eight years, could well allow the Japanese currency to reverse course.

With America's share of reserves remaining well in excess of its share in world GDP and trade, the dollar's eventual demise as the world's dominant reserve currency might well be inevitable in an increasingly fragmented, multipolar world. The only real question is when—not if.

The same can be expected from America's continental trading partners, Mexico and Canada, both of whose currencies were hit especially hard earlier this year by the lethal combination of the coronavirus shock and a stunning collapse in world oil prices. The plunge in the peso was exaggerated by an unwinding of so-called carry trades during the near meltdown of the American equity market in late March. Barring a double-dip recession in the global economy, safe-haven plays into the dollar should unwind over the balance of 2020 and into 2021, reinforcing the negative case for the dollar. While crypto-currencies and gold should also benefit from dollar weakness, these markets are far too small to absorb major adjustments in world foreign exchange markets where daily turnover runs around $6.6 trillion.

Alas, the TINA argument doesn't stop there. The counter to the case for dollar weakness also rests on the dominant reserve status of the U.S. currency as the linchpin of world financial markets. All trading nations, goes the argument, have to hold the dollar as the price for doing business in an increasingly integrated dollar-based world economy.

Yet the U.S. dollar is now starting to look less like a monopoly as the currency of choice. China, long the major source of global commodity demand, has been successful in pushing for RMB-based invoicing of global comodities. More significantly, the dollar's share of official foreign-exchange reserves has declined from a little over 70 percent in 2000 to a little less than 60 percent today, according to the BIS.

While the dollar is not in imminent danger of losing its status as the world's leading reserve currency, the secular downtrend in its share of reserves could gather momentum in the years ahead. Indeed, with America's share of reserves remaining well in excess of its share in world GDP and trade, the dollar's eventual demise as the world's dominant reserve currency might well be inevitable in an increasingly fragmented, multipolar world. The only real question is when—not if. The 35 percent rout that I expect by the end of 2021 suggests that possibility may come into sharper focus sooner, rather than later.

Notwithstanding the longstanding hubris of American exceptionalism, no leading nation has ever devalued its way to sustained prosperity.

In short, if TINA is the dollar's only hope, look out below. Not only are America's saving and current-account problems about to come into play with a vengeance, but the rest of the world is starting to look less bad. Yes, a weaker dollar would boost U.S. competitiveness, but only for a while. Notwithstanding the longstanding hubris of American exceptionalism, no leading nation has ever devalued its way to sustained prosperity.

THE END OF AMERICAN EXCEPTIONALISM

A third leg to the stool of the case for a dollar crash is the very notion of American exceptionalism, itself. In recent years, the United Sates has all but abdicated its long standing role as a global leader. The Trump Administration has led the charge in pushing ahead on de-globalization, decoupling, and protectionism with a trade war against China. In contrast to Washington's mockery of globalists, other major powers are acting aggressively to fill the void.

China is an important case in point, with its Belt and Road Initiative and with its leadership in forming the Asian Infrastructure Investment Bank as an alternative to the World Bank's development funding platform. The contrast with the European Union is especially striking. The EU's latest efforts to address climate change are particularly noteworthy—not only framing the Next Generation EU plan to be compliant with the Paris Climate Agreement but also earmarking close to one-third of its broader budget package for green infrastructure and related spending initiatives. Trump has unfortunately gone in precisely the opposite direction, continuing to dismantle most of the environmental regulations put in place by the Obama Administration, to say nothing of having withdrawn from the Paris Climate Agreement in early 2017.

Moreover, America's COVID-19 containment has been an abysmal failure. Here as well, the contrast with the EU is compelling. Despite a recent resurgence in COVID-19 infection rates, the EU and its member states has repeatedly demonstrated a much deeper commitment to public-health policy and enforcement. And then, of course, there is the latest twist to America's original sin—a history of systemic racism and police violence that erupted with a vengeance in the summer of 2020, sparking a transformative wave of civil unrest. Against this background, especially when compared with other leading nations, it seems reasonable to conclude that the likelihood of hyperextended saving and current-account imbalances will finally have actionable consequences for the U.S. dollar. Exorbitant privilege needs to be earned, not taken for granted. The United States has squandered one of its most cherished advantages.

Could we actually be moving from an era of American to European exceptionalism? Those are tough words to swallow for a hardcore euroskeptic like me. Yet I have to concede that the EU's recent fiscal breakthrough drives an important wedge between an overvalued U.S. dollar and an undervalued euro.

Meanwhile, as the world's most unloved major currency, the euro may well be headed for an exceptional run of its own. That raises one of the most provocative questions of all: could we actually be moving from an era of American to European exceptionalism? Those are tough words to swallow for a hardcore euroskeptic like me. Yet I have to concede that the EU's recent fiscal breakthrough drives an important wedge between an overvalued U.S. dollar and an undervalued euro. Recent trading in foreign-exchange markets now seems to be catching on to this development.

But there is a long way to go. The trade-weighted euro, even after a bounce-back this summer, is still some 13 percent below its April 2008 high (BIS basis), underscoring the unmistakable upside for the most unloved currency in the world. At the same, the dollar index, despite its modest 5 percent weakening in the five months ending in September 2020, remains 27 percent above its July 2011 low. My prediction of a 35 percent drop in the broad dollar index is premised on the belief that this is just the beginning of a long-overdue realignment between the world's two major currencies—an undervalued euro and an overvalued dollar.

Adding up—deteriorating U.S. macro imbalances, a crumbling TINA defense, and the demise of American exceptionalism—there is a compelling case for a sharp 35 percent fall in the broad dollar index by the end of next year. Shocking as that may seem, such an outcome is not without historical precedent. The dollar's real effective exchange rate fell by 33 percent between 1970 and 1978, by 33 percent from 1985 to 1988, and again by 28 percent over the 2002-2011 interval. My forecast of a 35 percent drop between now and the end of 2021 is well within the range of these three earlier declines.

Adding up—deteriorating U.S. macro imbalances, a crumbling TINA defense, and the demise of American exceptionalism—there is a compelling case for a sharp 35 percent fall in the broad dollar index by the end of next year.

Foreign exchange markets currently appear to be only in the very early stages of catching on to such an outcome. Initially, as the pandemic broke out, the greenback was strong, benefiting from typical safe-haven demand long evident during periods of crisis. By BIS metrics, the broad dollar index rose almost 7 percent in real terms over the January to April period to a level that stood fully 33 percent above its July 2011 low. The small 5 percent slippage in the five months since April is only a small step in the direction that I envision over the next year and a half. As the economic crisis starts to stabilize, hopefully in late 2020 or in early 2021, the dollar's decline should intensify, easily testing its July 2011 lows.

Three Implications

So what does this all mean? The coming plunge in the dollar will have three key implications: inflation, trade diversion, and external debt funding. Each will be discussed in turn. Firstly, it will eventually be *inflationary*—a welcome short-term buffer against deflation. However, in conjunction with what is likely to be a weak post-pandemic economic recovery, this is yet another reason to worry about an onset of stagflation—the tough combination of weak economic growth and rising inflation that wreaks havoc on financial markets.

Soaring deficits and debt could compound the problem. For now, no one is worried about them because of a conviction that benchmark policy interest rates will stay at zero forever. But with COVID-19 relief actions and a weak U.S. economy taking public debt to nearly 110 percent of GDP by 2025—up from 79 percent in 2019 and above the post-World War II record of 106 percent in 1946—something has to give.

History suggests that inflation may ultimately be the only way out. After World War II, the United States escaped from its public debts by reflation. Public debt fell by 0.9 percentage points a year from 1947 to 1957, while nominal GDP, helped by accelerating inflation, rose 7 percent annually. The ratio of debt-to-GDP soon plunged to 47 percent by

1957. Today, a comparable shrinkage in the debt ratio would occur if inflation moved back to 5 percent.

With rock-bottom interest rates, open-ended quantitative easing, and the massive debt overhang, inflation may well be the only way forward for America and other Western economies. Increasingly frothy equity and bond markets, priced under the presumption that inflation is effectively dead, will not take kindly to such an outcome.

The coming plunge in the dollar will have three key implications: inflation, trade diversion, and external debt funding.

Secondly, to the extent a weaker dollar is symptomatic of an U.S. exploding current-account deficit, look for a sharp widening of the trade deficit. Protectionist pressures on the largest piece of the country's multilateral shortfall with 102 nations—namely the Chinese bilateral imbalance—will backfire and divert trade to America's other trading partners.

This *trade diversion* is already under way. In 2019, in response to Trump's tariffs, America's bilateral goods trade deficit with China shrank to $346 billion—down from $419 billion in 2018. At the same time, the overall merchandise trade deficit came down just $25 billion in 2019, far less than the shrinkage of $73 billion in the bilateral trade deficit with China. Widening trade deficits with America's other trading partners—especially Mexico, Vietnam, Canada, Switzerland, and Ireland—were offsets to most of the narrowing of the China trade gap. To the extent these nations have higher cost structures than China, this trade diversion is the functional equivalent of a tax hike on long beleaguered American consumers.

Thirdly, who will buy the exploding issuance of U.S. debt? China has long been the largest foreign buyer of U.S. Treasuries. But in the face of an ever-escalating trade war and Washington's poorly timed wish for financial decoupling from China, it pays to ask whether China will sustain this role. At a minimum, there is good reason to wonder if there will be a significant shift in the terms that this *external funding* will now require.

This last question takes on added importance in the aftermath of the Federal Reserve's recent shifts in its monetary policy strategy. A tactical shift in the implementation of its price stability mandate—now aiming for an average 2 percent inflation target over an unspecified period of time—has effectively injected a low-interest rate bias into the currency calculus that was not evident under the Fed's prior policy framework. After years of inflation coming in below target, the U.S. central bank is now arguing that it makes sense to accommodate temporary above-target inflationary overshoots that would have once had actionable consequences for monetary policy.

This is likely to have new and important implications for the dollar. The current account adjustment mechanism forces the deficit nation to make concessions to its foreign lenders in order to attract the external capital required to compensate for the shortfall in domestic saving. Those concessions can take two forms—offering higher returns via increased interest rates and/ or cutting the foreign acquisition price of U.S. assets via a weaker dollar. The Fed's new policy approach effectively rules out the interest rate concession option and puts more pressure on a dollar concession as a result.

The Speed of Descent

The coming plunge of the dollar is likely to unfold surprisingly quickly. As we have found over the past several months, pandemic time runs at warp speed. That's true of the COVID-19 infection rate, as well as the unprecedented scientific efforts under way to find a vaccine. It is also true of transformational developments currently playing out in pandemic-affected economies. Just as a lockdown-induced recession brought global economic activity to a virtual standstill in a mere two months, the "sudden stop"—long associated with capital flight out of emerging markets—often exposes deep-rooted structural problems that can impair economic recovery. It can also spark abrupt asset-price movements in response to the unmasking of long-simmering imbalances.

Such is the case for a pandemic-stricken United States. The aggressive fiscal response to the COVID-19 shock is not without major consequences. Contrary to the widespread belief that budget deficits don't matter because near-zero interest rates temper any increases in debt-servicing costs, in the end there is no "magic money" of the free lunch. Yet that has recently become conventional wisdom in the brave new era of "modern monetary theory." Alas, that may be wishful thinking. In this time of pandemic, there is no conventional wisdom.

The U.S. Congress initially moved with uncharacteristic speed to provide relief amid a record-setting economic free-fall. As noted above, the Congressional Budget Office expects unprecedented federal budget deficits averaging more than 12 percent of GDP over 2020-2021. And, notwithstanding contentious U.S. political debate, additional fiscal measures are quite likely.

As noted above, with the net domestic saving rate having fallen to -1.2 percent in the second quarter of 2020, that process is now unfolding very quickly. In the COVID-19 era, the net national saving rate could well plunge as low as -5 percent to -10 percent over the next two to three years. That means today's saving-short U.S. economy could be headed for a significant partial liquidation of net saving. In and of itself, that poses perhaps the greatest challenge to the long-term growth prospects of the U.S. economy. With all this unfolding at warp speed, the coming plunge in the dollar is likely to come sooner rather than later.

Today's saving-short U.S. economy could be headed for a significant partial liquidation of net saving. In and of itself, that poses perhaps the greatest challenge to the long-term growth prospects of the U.S. economy. With all this unfolding at warp speed, the coming plunge in the dollar is likely to come sooner rather than later.

Election Wildcard?

Needless to say, the outcome of the November 2020 presidential election in the United States will have enormous consequences for America's position in the world. But will the verdict be enough to have a material impact on the bleak prospects for the U.S. dollar?

Clearly, many of the attributes of American exceptionalism have come under particularly intense pressure during the Trump Administration. But the pushback against globalization started long before Trump took office in January 2017. And even in the event of a victory by former Vice President Joe Biden, these forces are likely to endure long after the Trump presidency comes to an end. To be sure, a Biden Administration can be expected to be more supportive of alliance-driven multilateralism, re-engaging in frameworks and institutions long dominated by American global leadership—e.g. the Paris Climate Agreement, the Trans-Pacific Partnership, the World Trade Organization, and the World Health Organization. But will that be enough to reestablish America's once-unquestioned aura of global leadership?

To the extent that the anti-globalization backlash has coalesced around objections to trade liberalization and allegations of unfair trading practices, returning to a pre-Trump state of affairs is far more problematic. That is particularly the case when it comes to China, where public opinion polling underscores record levels of negative sentiment in most American demographic cohorts including age, education, and political party. While there is reason to suspect that the framework of engagement might change between the two nations—moving away from Twitter-driven bluster and across-the-board tariffs to issue-specific negotiations in areas such as intellectual property, market access, cyber security, and technology transfer—conflict with a rising China is likely to pose an enduring challenge for a Biden Administration.

At the same time, there is likely to be little relief from the macroeconomic imbalances that are pushing the dollar lower. Indeed, there is a good chance that the federal budget deficit is likely to be higher in the event of a Biden presidency, further depressing domestic saving and leading to an even deeper current account deficit. Downward pressure on the dollar will only intensify as a result.

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Normally, a central bank would lean against the confluence of fiscal stimulus and a sharply falling currency and boost policy interest rates. Yet with its new, more forgiving monetary policy strategy, the Federal Reserve is less likely to do so. Indeed, the inflationary consequences of a sharply falling dollar may well be even more consistent with the inflationary overshoot that the U.S. central bank is now seeking. Nor would a shift in the U.S. presidency have much of an impact on the case for currency appreciation in other nations—especially China and Europe.

If, on the other hand, Trump is re-elected, the baseline script outline above will remain largely intact. If there is one thing we have learned about the last four years, America's forty-fifth president never backs down from his core positions. Consequently, at this point in time—apart from fairly typical trading volatility before and immediately after the upcoming November election—the die is pretty much cast for a weaker dollar, irrespective of the political verdict.

I fully recognize that currency calls have long been among the trickiest macro forecasts of all. Former U.S. Federal Reserve Chairman Alan Greenspan famously put them on a par with coin tosses. Still, sometimes it pays to take a stab. For the reasons outlined above, this is one of those times.