Australian Dollar Impaired By The Greenback: The Threat Of A '*Mnuchin Shock*' In April 2020

Risk Management

Stirling Larkin, CIO

Maybe it is because Australia and America have been cut from the same cloth, that it is not coincidental that the vast majority of seismic shocks to the Australian economy and currency since Federation have egressed out of acute events that began in the United States.

One such abrupt blow erupted out of the ripple effects triggered by the Nixon Shock of 1971, which hit the Australian economy and then newly decimalised Australian Dollar at breakneck speed.

Right at the acme of Australian *Diggers* commitment to the War in Vietnam, US President Richard Nixon, on *Friday the Thirteenth* (13 August) 1971, announced the unilateral cancellation of the direct international convertibility of the United States Dollar to gold, in effect, ending the Bretton Woods backstop and this surprising move, came to be ominously known as the 'Nixon Shock'.

For Australia, this event stung on numerous fronts; it immediately hurt our gold reserves stored in Martin Place, Sydney, it placed a cloud over Australian mercantile pricing powers and more acutely, it was a slap across Australian's faces who had not only sent and lost more per capita young men to fight and die in Vietnam alongside US forces than any other allied nation, Australia herself had been supporting operations financially via state-sponsored nickel exports (for M16 ammunition), maritime supplies and innumerous other costly support channels.

But what Canberra and Australian financial practitioners learnt during these traumatic travails was the quip made by US Treasury Secretary, John Connally, who infamously told a group of European finance ministers in August 1971, that the US Dollar, "***is our currency, but your problem***".

Formerly Governor of Texas, and the man who sat in front of President Kennedy during his 1963 assassination, US Treasury Secretary Connally in August 1971 revealed Nixon's programme of raising the price of gold and formally devaluing the US Dollar, or Greenback and in so doing ended the gold standard entirely, a protocol installed by President Franklin D. Roosevelt in 1934 to buttress Dollar stability following the stalling post-Depression recoveries of the early 1930's.

What Connally conveyed to then Prime Minister William McMahon, Canberra and Martin Place (Reserve Bank HQ) was that colonial and satellite dependants of the former British Empire – Australia, Canada and in this context Britain herself following the Suez Canal crises of the 1950's – had to rethink their own monetary mechanisms, central banking regimes and sovereign solvencies and that Bretton Woods which was a legacy of World War Two's Marshall Plan, was finished.

Following the ***Corona Crunch*** of 2020's ***March Madness***, Australians once again are caught between the devil and the deep blue sea when deciding whether to reallocate towards the post 1971 safe harbour of the US Dollar herself or stay vested in domestically priced Australian asset classes.

Connally's forewarning, that the US Dollar is their currency but our problem remains material to the present day and current US Treasury Secretary Steven Mnuchin presents as a less dependable friend of US allies (such as Australia), than any before.

Even though Australia's Reserve Bank now enjoys a newly established swap-line with the US Federal Reserve in New York, the fragility of the AUD/USD exchange mechanism remains a first-order concern for Australian domiciled global investors.

These swap lines, which support US Dollar liquidity auctions by participating central banks, which now include the RBA, help ease funding strains in offshore US Dollar markets, designed to alleviate one factor boosting the Greenback during March Madness.

The immediate threat to Australians in April 2020 is that Treasury Secretary Mnuchin intervenes in US Dollar exchange markets, as per IMF guidelines, which suggests central banks and treasury's should confront, "*disorderly market conditions*" and despite the fact that US authorities have only intervened three times since 1995 with G7 partners, if Mnuchin was to do so during April 2020, this intervention would ricochet across Australian Dollar assets and potentially be comparable to a Nixon Shock in magnitude.

While other asset classes – equities, bonds and commodities – move at the speed of trust, foreign exchange, or Fx markets do not, they do not exhibit classic market microstructural architecture, no central limit order books (CLOB's) or equivalents and thus a ***Mnuchin Shock*** of 2020 would be a triple blow to Australians and the Australian Dollar.

As Francis Bacon taught us, "*hope is a good breakfast, but it is a bad supper*" and for Australian risk managers, defensive considerations must be urgently prioritised regarding Australian Dollar exposures towards the downside of the USD/AUD pairing.

In moments of extreme financial market volatility, the normal macroeconomic drivers of exchange rates take a back seat to the US Dollar's global role and recent Greenback appreciation has little to do with underlying macroeconomic fundamentals.

Rather, it reflects the structure of the international monetary system, for which the US Dollar still plays a central role and for Australians, once again, Connally's effrontery rings loud, that the US Dollar, "***is our currency, but your problem***". ■

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