



Bottom Dollar

The art of Warsh, cosmic background inflation radiation, macro moves markets, ... and why not betting on long-term dollar debasement

Dylan Smith

Monologue

The Apprentice: Federal Reserve Special has wrapped up. Kevin Warsh was announced by President Trump as Jay Powell's successor as Chair of the Federal Reserve. The key news is that this is a market-friendly nomination of a well-credentialed candidate. We leave our commentary on the nuances of the appointment and on central bank independence to the Macro Monitor section (preview: a Chair with demonstrable political skill and some policy flexibility is not a bad thing).

At the time of publication, US government agencies are officially shut down pending a vote on a deal between Hill Democrats and the White House. Prediction markets put the most likely reopening day on Monday or Tuesday. We agree, but there is a small risk that it lasts longer.

Assuming the shutdown is very short, the top-of-mind issue for Chair-in-waiting Warsh may be the US dollar's recent weak run, and growing concerns that we're in an era of dollar debasement or outright global de-dollarization.

The first time I was asked whether the dollar was "toast" was in a Ghanaian taxi in 2017, when I was leading an investor trip to West Africa and more than a bit distracted by the lack of air conditioning and a string of cancelled appointments. After discovering I was an economist, the driver wanted to know how long it would be until the world ditched the dollar and returned to gold. I laughed him off; it seemed outlandish at the time.

I later learned that the driver was one of the many victims taken in by the [Menzgold Ponzi scheme](#). A foreshadowing of today's global market dynamics, perhaps?

I was reminded of this conversation this week by the many questions that echoed my taxi driver's. "How much longer does the dollar have?" "Is the dollar done?" "I don't buy de-dollarization, but maybe enough people do to create their own truth?"

It's a question worth asking. After all, imposing tariffs on your trading partners is supposed to appreciate your currency relative to theirs. And yet, since "Liberation Day," the dollar has gone in the opposite direction, down by ~11% since Donald Trump took office.

With that in mind, the long-term outlook for the dollar is the theme of the week, anchored by a chart-based deep dive in our Memo section.

To précis the conclusion, the numbers show unambiguously that the dollar is still clearly in a dominant position. Central banks, especially those in geopolitical competition with the US, have diversified reserve assets, but the dollar has retained its dominance elsewhere. Ironically, the arc of blockchain development is bending toward entrenching the dollar's centrality as the global unit of account.

In our view, the probability of the US fixing its unsustainable debt trajectory is higher than the probability of a viable alternative emerging to nudge the dollar off its perch.

One piece of dollar-related commentary I haven't seen much of is how a declining dollar magnifies tariff-related spikes in import costs for American producers and retailers, creating a near-term inflationary risk on top of the other pressures we're concerned about. As we highlight in the Macro Monitor section, this week's PPI data shows a worrying spike in costs in the domestic supply chain.

In fact, when you look at recent global geo-economic developments, it's hard not to see inflation lurking everywhere. We've noted that tariffs, quotas, and supply chain restructuring have already created a wedge between declining local Chinese producer prices and American import prices.

US-led Globalization was a *major* reason that inflation was low and stable for so long between the First Gulf War and the COVID-19 pandemic (I'd argue more so than central banking reforms that economists usually identify as the prime reason).

The new flavor of globalization that Mark Carney described in his famous Davos speech – great powers abusing their economic influence for short-term advantage, thereby forcing middle powers to form a latticework of bilateral mutual links when interests align – might have the opposite effect on inflation. Sure, some trade barriers come down (as in the EU-Mercosur deal or Canada's tariff agreement with China), but decentralization increases all sorts of costs – transport, supply chain efficiency, availability, and labor costs are all affected. This new multipolar form of globalization no longer pushes production forcefully to the most competitive global location.

The finer points of this world view are for another Monologue. I'm just pointing out the fact that it will likely create a new cosmic background radiation of mild but persistent inflationary pressure that the world is not quite used to.

That's not a huge problem, but it does mean that interest rates won't find their equilibrium in the extreme pre-COVID-19 lows. A federal funds rate above 3% and a steepish yield curve may be as good as it gets.

Good luck, Mr. Warsh.

Marginal Movers

Rising

- **Druck:** The Chair of the Federal Reserve and the Treasury Secretary are both close protégés of Stanley Druckenmiller, founder of hedge fund Duquesne Capital.
- **Prices:** An upside surprise to PPI sets the stage for rising inflation.

Falling

- **American exceptionalism:** Post-Davos, a feeling of middle-power solidarity is in the air. Plus, Europe is no longer underperforming on the economic margins or in markets.
- **The US dollar:** Down -0.6% this week, -1.4% this year, and -11.0% since January 2025. Related to the above.

Must-Reads

- **Why AI Won't Wipe out White Collar Jobs:** From the Economist, very highly recommended. We largely agree: "The AI office will look less like a robot and more like a cyborg, combining the best of human and computer capabilities: the Six Million Dollar Man rather than Terminator."
- **Dollarisation waves: new evidence from a comprehensive international bond database:** Timely new data on the US dollar's role in the global economy that ties in well with our Memo: "We find no monotonic dollarisation or de-dollarisation trend; instead, the dollar's share exhibits a wavelike pattern."

- **Lessons from Brexit on the Effects of Trade Disintegration**: From three Federal Reserve economists: "All told, the Brexit experience indicates that large trade policy shifts can influence economic outcomes gradually and manifest over long-time horizons."

Macro Monitor

The Art of Warsh

Kevin Warsh was announced by President Trump as Jay Powell's successor as Chair of the Federal Reserve on Friday. His appointment requires Senate ratification, and Senator Thom Tillis is still threatening to block it unless the Department of Justice drops its investigation into outgoing Chair Jay Powell. Fireworks are possible, but a deal and a smooth confirmation are more likely.

The appointment did not meaningfully shift market expectations of future interest rates in 2026/27, but the 10-year/2-year yield curve steepened by around 3 basis points this week due to Warsh's consistent position on shrinking the Fed's balance sheet.

So, what should we expect from Warsh? Scanning the reaction so far, the jury is out.

During and after his tenure as a Federal Reserve Governor during the Global Financial Crisis between 2006 and 2011, Warsh was among the most hawkish voices on the rate-setting Committee, although he never did dissent from the majority. Some are expecting a return to these hawkish instincts.

In the lead-up to Trump's decision on Chair Powell's replacement, Warsh has shifted in a starkly dovish direction, notably in a November 2015 Wall Street Journal op-ed titled "The Federal Reserve's Broken Leadership," in which he came out in favor of lower interest rates, a smaller balance sheet, and looser banking regulations.

Warsh's record hints that his policy views are sensitive to the politics of the day, while also showing a streak of independence in his character. Believe it or not, that's a good set of ingredients for running the Federal Reserve. Fed Chairs tend to become more independent once safely ensconced in their roles (cynically, because it is a power base rivalled only by the White House itself). Appointees from Greenspan to Powell, all close to their appointing presidents before taking the helm

at the Fed, have defied market concerns and wound up vociferous defenders of the institution's independence.

The Fed's mandate may be apolitical, but leading it requires great political savvy and subtlety. Alan Greenspan made sure he played regular tennis matches with leaders in Congress and the White House, and "technocratic" central bank leaders like Mark Carney and Mario Draghi have had success in electoral politics after leading central banks.

Perhaps a strong yet flexible political operator is exactly what the Federal Reserve needs at this point.

Fed Yawns...

Mr. Warsh is not in charge yet, and there was a rates decision this week. The rate-setting Committee, still led by Jay Powell, left its interest rate target range unchanged at 3.5%-3.75%, as was widely expected.

The meeting was a relative non-event. The Statement noted an improvement in the growth outlook and upgraded the language on the labor market to "showing signs of stabilization." The FOMC members were not scheduled to update their economic forecasts, and the press conference focused on the political and legal issues, which Powell declined to answer. He also declined to comment on dollar weakness or recent market events.

Forward markets moved very little in the wake of the decision. Traders aren't pricing in another 25 basis point cut until June (and one final cut after that toward the end of the year).

... Bank of Canada yawns back

Not to be outdone, the Bank of Canada stood by its prior guidance and kept its policy rate unchanged at 2.25%. We'll probably be here for a while. With the economy broadly weak but not deteriorating and inflation benign, the bar to a change in either direction is fairly high.

On the one hand, higher tariffs, a deeper deterioration in the trade balance (data published on Thursday showed Canada's trade balance falling back into a significant deficit of CAD -2.2 billion in November), or a significant deterioration in the dollar (further harming Canadian export competitiveness) might prompt the Bank to cut.

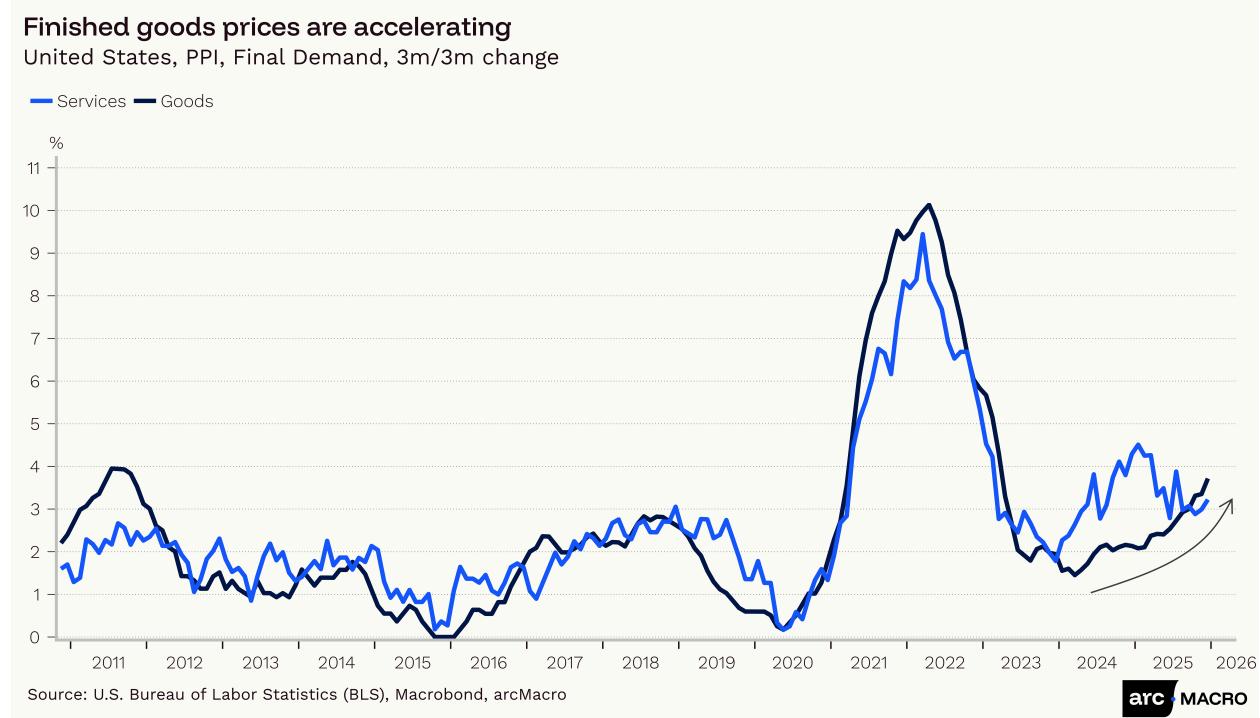
On the other hand, a new North American trade deal later this year could reduce uncertainty and spur domestic investment and growth, supported by Canada's efforts to diversify its trade and financing relations beyond the United States. If this proves inflationary, interest rates could rise.

Interestingly, the governor framed this point in language consistent with his predecessor-but-one Mark Carney's Davos speech: "The days of open rules-based trade with the United States are over [...] we'll be better off if we adjust than if we don't."

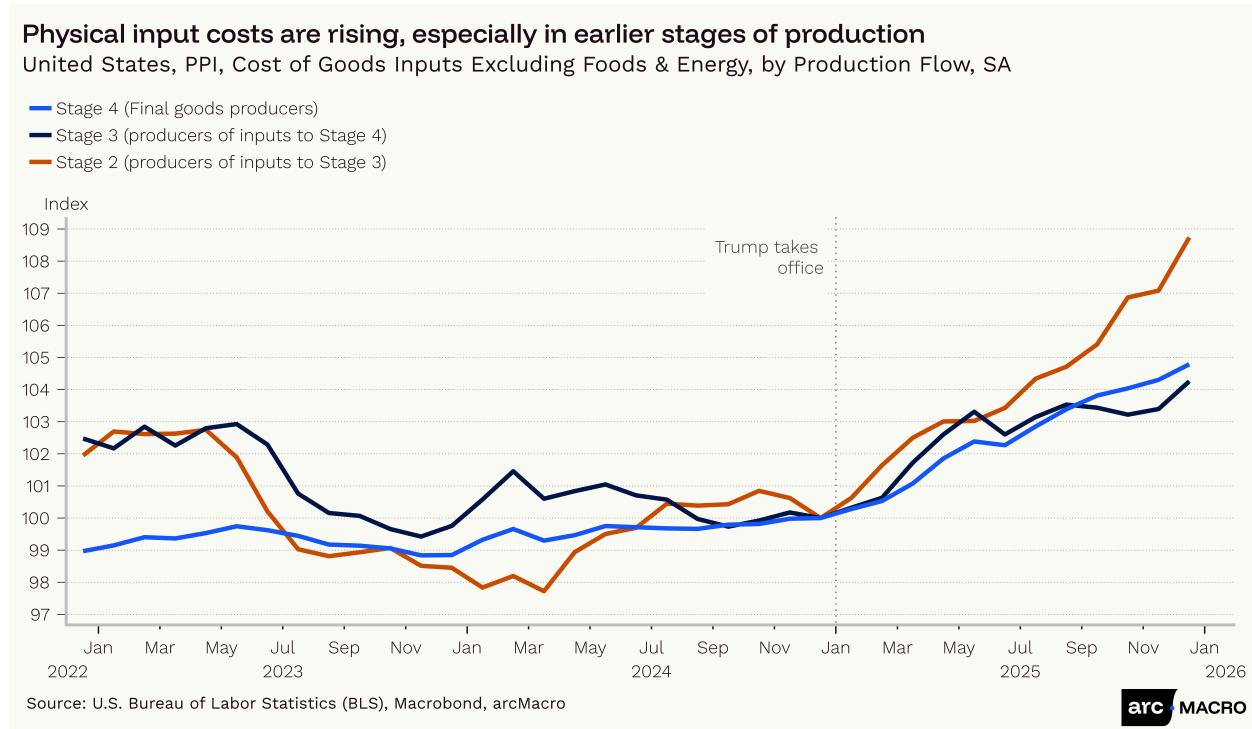
PPI Spike

Producer prices delivered a big upside surprise on Friday, jumping by +0.5% in December, compared to +0.2% in November (which is where forecasters had the December number). Finished goods inflation is running at 4% on a 3m/3m annualized basis.

As we've long argued, the first half of 2026 is when we will finally get the data to understand the true extent of tariff-related pass-through. To date, firms have been working through old inventory and absorbing costs wherever possible.



Particularly notable is what's happening along the supply chain. The chart below shows that "Stage 2" producers – who process raw materials for use by manufacturers of intermediate and final goods – are now experiencing significant cost pressures as tariffs on metals and other inputs bite. These producers experienced almost 10% inflation in 2025, all told. Our prior work on PPI transmission shows that most of it will pass through to final goods within six months.

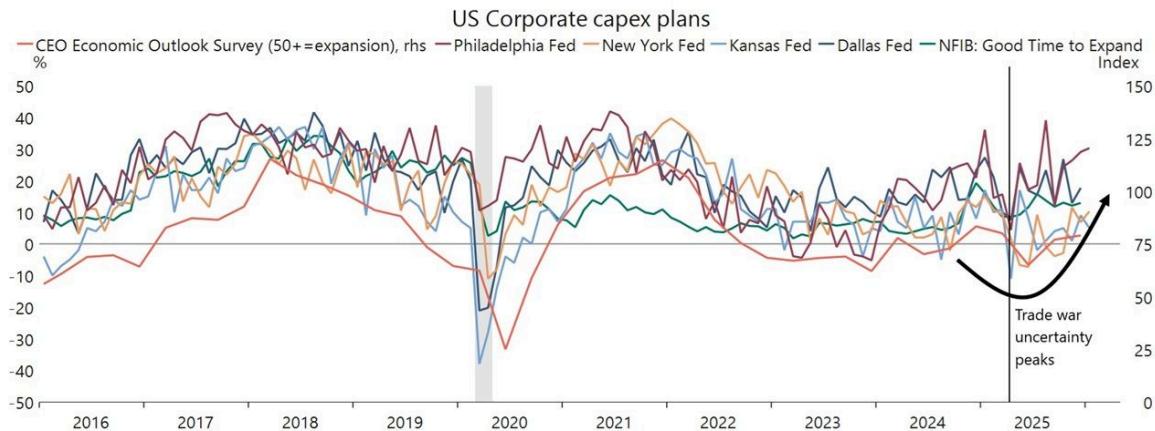


A durable theme?

Apollo Chief Economist Torsten Slok is arguing that a "capex boom" is underway. Perhaps if you squint, you can just pick it up in his survey data (?). We're not seeing it in hard data on orders for durable investment goods just yet, especially when you mentally adjust for inflation.

That's not to say it won't arrive soon, with "One Big Beautiful Bill" tax incentives hitting corporate income statements this quarter. Just not here in the data yet.

Capex boom started once trade war uncertainty abated



Capex is rising, but not yet a "boom" (and AI/tech not showing up like the '90s)
United States, Contributions to annual growth in non-transport durable goods orders

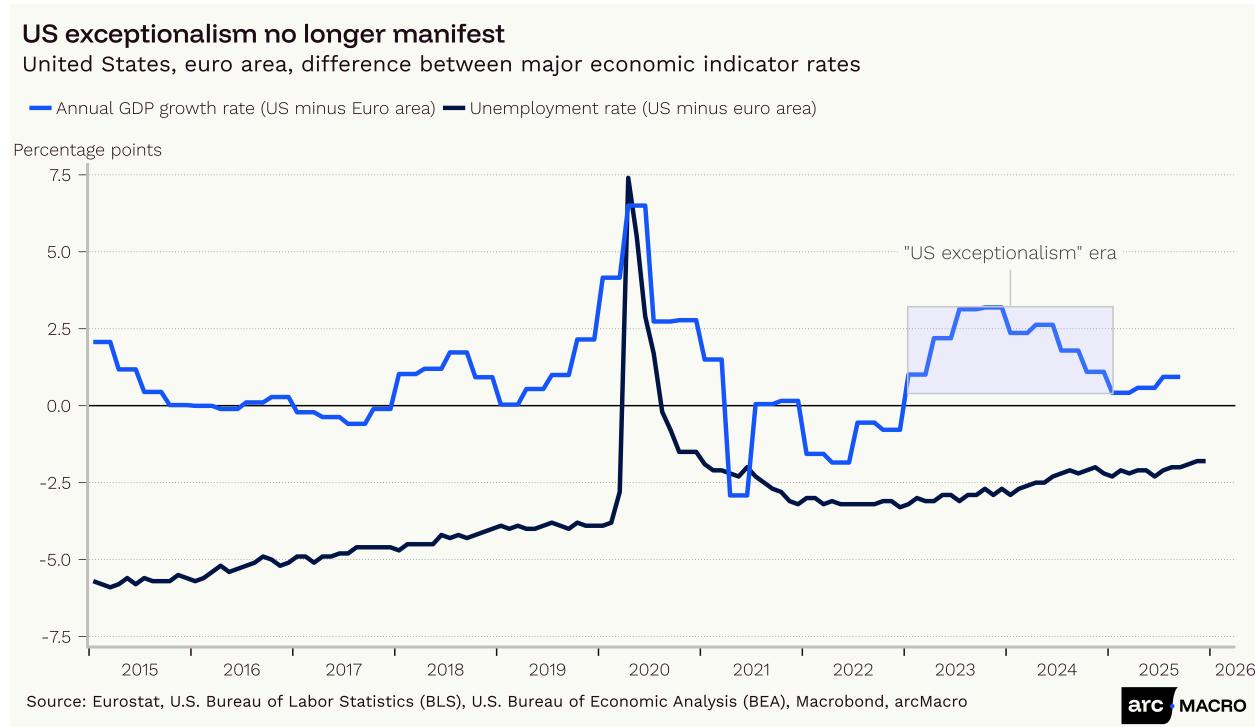
Computer & Electronic Products Electrical Equipment All other Durable goods orders, YoY



Euro trip

The euro area economy grew at a surprisingly robust +1.3% year-over-year rate in the final quarter of 2025, according to a "flash" estimate published on Friday.

Europe is playing “catch-up” to the US, with the difference between GDP growth across the Atlantic narrowing (even with robust US growth), alongside a longer-term trend of unemployment rate convergence.



See the appendix for arcMacro proprietary Factors and the Key Macroeconomic Indicators tracking chart.

Must-Watch

What we'll be keeping an eye on in the week ahead:

- *Shutdown resolution (US)*: Prediction markets expect this one to be behind us by Monday or Tuesday. Any longer, and markets might be affected.
- *US labor market data*: We're due a full slate of private and public data for January, covering hirings, firings, job growth, and unemployment. Highly market-sensitive in the context of a new Fed chair who has signaled a desire to ease rates further.
- *Central Bank meetings (UK and euro area)*: In the wake of the Fed and BoC this week, it looks likely that the Europeans will hold rates steady, especially with inflation stable or ticking up.

- *Winter Olympic Games*: Kicking off all over Northern Italy on Friday.

Market Monitor

Public markets

Macro themes were in the driving seat again this week, with the Fed news, dollar pressure, and gold volatility in the spotlight.

Reverse Bretton-Woods?

The US dollar started on the back foot this week, extending the prior Friday's weakness as hints that US officials were concerned over the sliding yen created rumors of a coordinated market intervention to use Greenbacks to stabilize the Japanese currency. In the event, that hint at potential action was enough to help the Yen more than regain the ground it lost last week and hit its strongest level since October. No official US action was taken. Still, the dollar remained volatile as the debate on "dollar debasement" took center stage, and Warsh's appointment led to a small rise on Friday to pare losses for the week.

Japanese Bond Breakfast

After last week's rout, Japan's long-term borrowing rates recovered to more normal territory, as low prices brought in buyers, helping this week's auction of 40-year paper go off without a hitch. Election-related volatility is creating buying opportunities amid what we believe is a structurally bullish long-run outlook for Japan.

Higher interest rates don't look too bad when you adjust for inflation

Japan, Real interest rates



Gold "toppy," industrial metals "poppy"

Gold briefly flirted with \$5,500 per ounce in intraday trading this week, before taking a nosedive on Friday in a clear pattern of top-of-the-market news sensitivity. Gold has now de-anchored itself from any standard valuation system, so we expect highly elevated volatility moving forward. Proceed with caution.

Industrial metals closed the week down, but we would be remiss not to point out that they're already up a handsome 12.5% in the last three months, driven by the AI-related capex, shortages in some markets, and a global demand upswing.

Private Markets

Unhedged by default

Since we're focused on the theme of dollar debasement this week, we thought we'd remind everyone that a majority of LP investors in private market funds are holding unhedged private market exposures.

This is a passive phenomenon; many LPs end up unhedged by default because of the operational challenges of hedging private exposures (e.g., uncertain cashflow timing, GP transparency) and its high cost.

For foreign funds expecting dollar-denominated returns, this is fine if you believe that recent pressure on the dollar is cyclical. However, if you buy into the structural case for dollar depreciation, some insurance might be in order.

Recovery mode activated

News, reports, and data this week were all consistent with our broad view on PE from our Annual Outlook that those expecting a recovery in the industry will not be disappointed this time. For evidence, look no further than Blackstone's earnings call:

“We’re moving back towards more historic levels of activity [...] It helps, obviously, with transaction fees, it delivers returns ... And it gives the investors more capital in their pockets to redeploy.”

Related: European PE holding periods fall for the first time since 2020.

The Week in Markets

	Latest*	Change since last week (units)	Change since last week (%)	3-month change (units)	3-month change (%)	Year-to-date change (units)	Year-to-date change (%)
Equity							
S&P 500	6939	-24.4	-0.4	48.4	0.7	93.5	1.4
Information Technology			-0.8		-7.9		-1.7
Financials			-2.5		2.5		-2.6
Consumer Discretionary			0.7		1.3		1.7
Communication Services			1.1		8.5		5.7
Health Care			1.1		7.4		-0.2
Industrials			-1.6		6.7		6.6
Consumer Staples			0.9		9.0		7.5
Energy			3.1		16.5		14.4
Utilities			-2.0		-3.9		1.3
Real Estate			-2.4		2.4		2.7
Materials			2.6		13.1		8.6
Nasdaq Composite	23462	-14.1	-0.1	-497	-2.1	220	0.9
Dow Jones Industrial Average	48892	-261	-0.5	1260	2.6	829	1.7
Russell 2000	6496	-21.3	-0.3	320	5.2	328	5.3
Sovereign Fixed Income							
US: 2-year Treasury Note	3.52	0.01		-0.070		0.050	
US: 5-year Treasury Note	3.79	0.02		0.090		0.060	
US: 10-year Treasury Note	4.26	0.00		0.18		0.080	
FRA: 10-year OAT benchmark	3.43	-0.05		0.030		-0.13	
GER: 10-year Bund benchmark	2.85	0.07		0.22		0	
CHN: 10-year CGB benchmark	1.81	-0.01		-0.0096		-0.0361	
CAN: 10-year GoC benchmark	3.42	0.04		0.37		0	
Corporate Bond Spreads							
US: A-rated	63.6	-3.5		-7.0		-6.2	
US: BBB-rated	95.9	-3.2		-6.2		-8.6	
Leveraged Loan Spreads							
US: B-rated	418	3.7		18.3		26	
US: BB rated	266	1.22		5.23		10.1	
US: CCC-rated	1755	42.8		403		191	
Foreign Exchange Rates							
DXY US Dollar Index	97		-1.8		-2.2		-1.4
EUR/USD	1.2		1.1		2.9		1.9
USD/CAD	1.36		-1.3		-2.8		-1.0
USD/CNY	6.95		-0.1		-2.2		-0.7
USD/JPY	153		0.2		0.4		-2.1
GBP/USD	1.38		0.8		3.6		2.5
USD/CHF	0.768		-1.4		-3.3		-3.1
Commodities							
WTI Crude	65.5	2.06	3.5	5.36	8.9	8.12	14.2
Gold	4982	335	7.3	975	24.3	614	14.1
S&P GSCI Commodities			3.8		7.8		9.1
S&P GSCI Industrial Metals			2.0		12.5		5.3
S&P GSCI Agriculture			0.0		-5.3		-1.9

* Weekly closing value. Color indicates positive (green) or negative (red) change since prior week.

Source: S&P Global, Russell Investment Group, Nasdaq, U.S. Department of Treasury, Macrobond Financial AB, Central Bank of Germany (Deutsche Bundesbank), Bank of Canada, Intercontinental Exchange (ICE), International Monetary Fund (IMF), LBMA (London Bullion Market Association), Robert Shiller, Chicago Board Options Exchange (CBOE), U.S. Department of Labor, U.S. Bureau of Labor Statistics (BLS), Pitchbook | LCD, arcMacro



Memo

Debasement? I Wouldn't Buy that for a Dollar

Bottom line: The de-dollarization hypothesis does not stand up to serious analysis. Aside from diversification of some central bank reserve holdings, the importance of the dollar as a global safe asset, trade-indexing benchmark, and international settlement currency has not changed. That doesn't mean the dollar can't depreciate owing to cyclical headwinds, and those are blowing the dollar down toward the lower

end of its valuation band over the past 10 years, in our view.

What it means for businesses and investors: Make sure you know what you're betting on: *Dollar debasement is a long, slow, grinding process characterized by substitution away from dollars on all fronts. Cyclical dynamics play out rapidly and can also reverse rapidly. Plus, you should not ignore the possibility of a long-term fiscal fix in the US putting structural tailwinds behind the dollar.*

Another bad week for the US dollar (the DXY index is down -1.5% year-to-date and -11.0% since the start of 2025) has re-ignited global concerns that we're in a phase of "dollar debasement" - persistent loss of US\$ purchasing power due to structurally high US inflation or debt monetization - and "de-dollarization" - the abandonment of US\$ as the global reserve currency as a result.

True believers in the end of the dollar (and those worried about the rise of true believership) have shifted a sizable portion of their dollar-denominated assets into gold holdings, pushing its price past \$5,000 recently (with silver and other precious metals riding along in the sidecar).

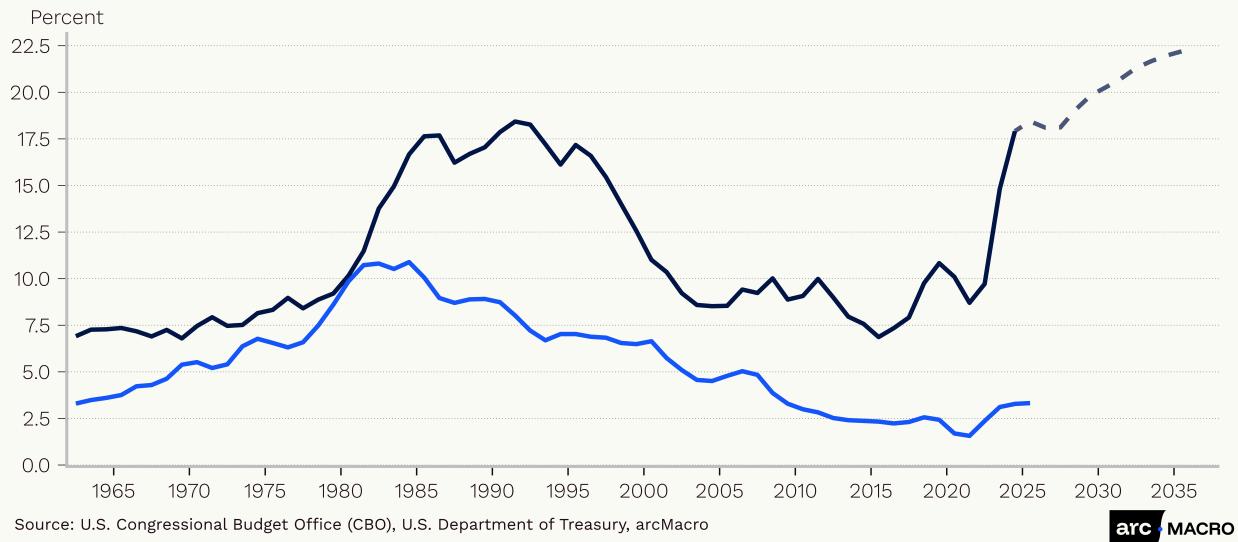
However, the de-dollarization theme does not withstand rigorous analysis. In rapid fire, eight charts will show us why.

Setting the record straight

1. The core of the problem is America's manifestly unsustainable fiscal position and the lack of serious action to address it, which is sparking fears of long-term US inflation and a corresponding slide in the value of the dollar.

The cost of carrying the debt is unprecedented, even with low average interest rates
 United States, Interest expenses, percentage of revenues

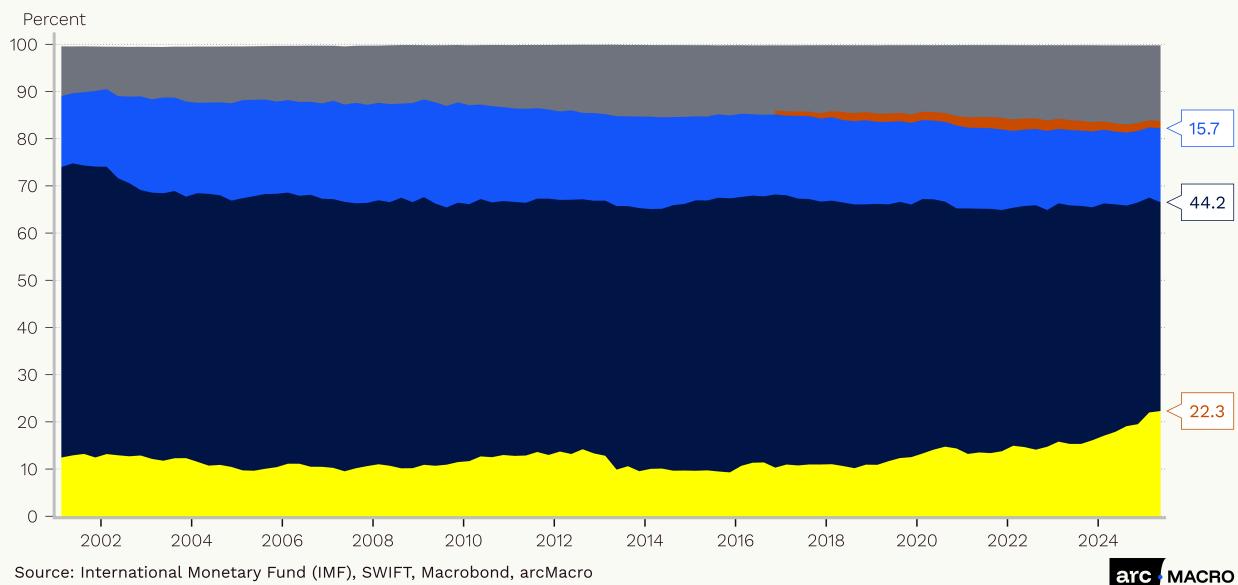
— Interest expenses, share of total revenues
 — Average interest rate on government financing



2. It is true that central banks are diversifying their reserves – especially those outside the US financial sphere of influence (Russia, China)...

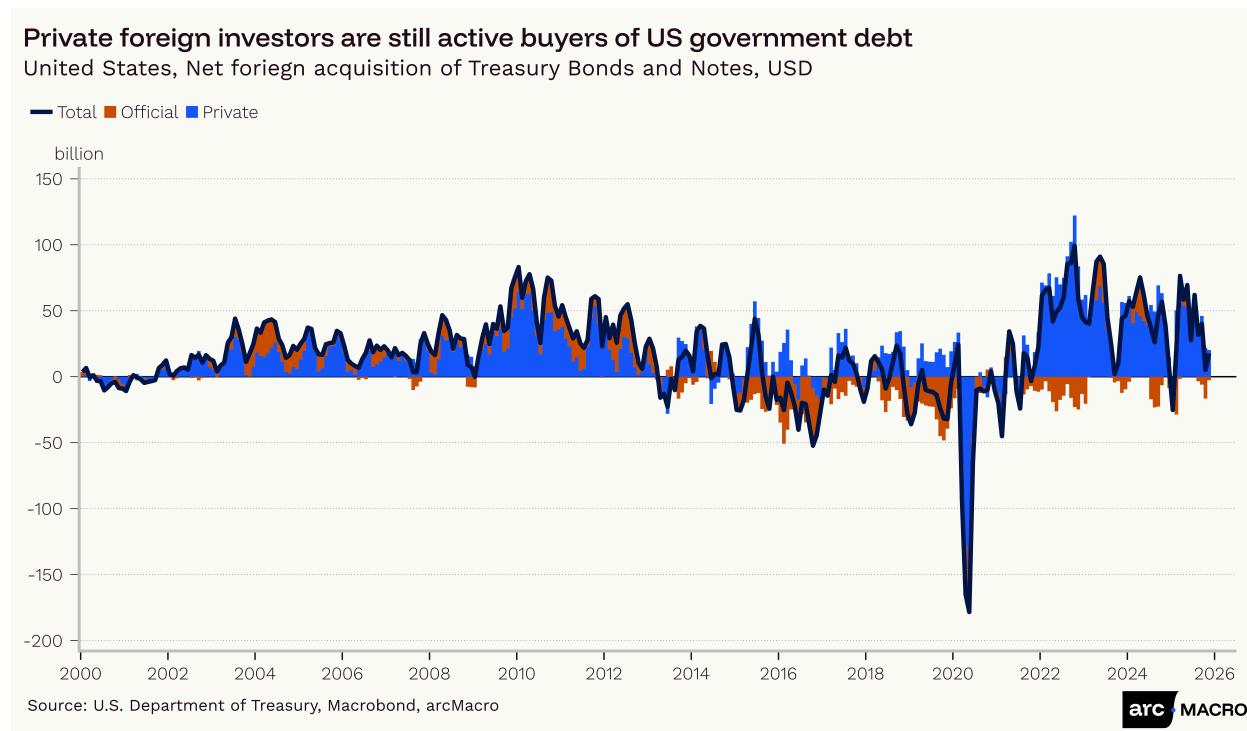
The gold rush has pushed official USD reserves below half the total
 World, Official Reserves, USD, as of Q2 2025

■ Other FX reserve currencies ■ Sterling ■ Remnimbi ■ Euro ■ US Dollars ■ Gold (market price)



3. ... but private investors have been more than happy to buy new Treasury

supply, stepping in to the tune of net purchases of \$50 billion per month even as official buyers have stepped back (including the Federal Reserve ending its Quantitative Easing program).



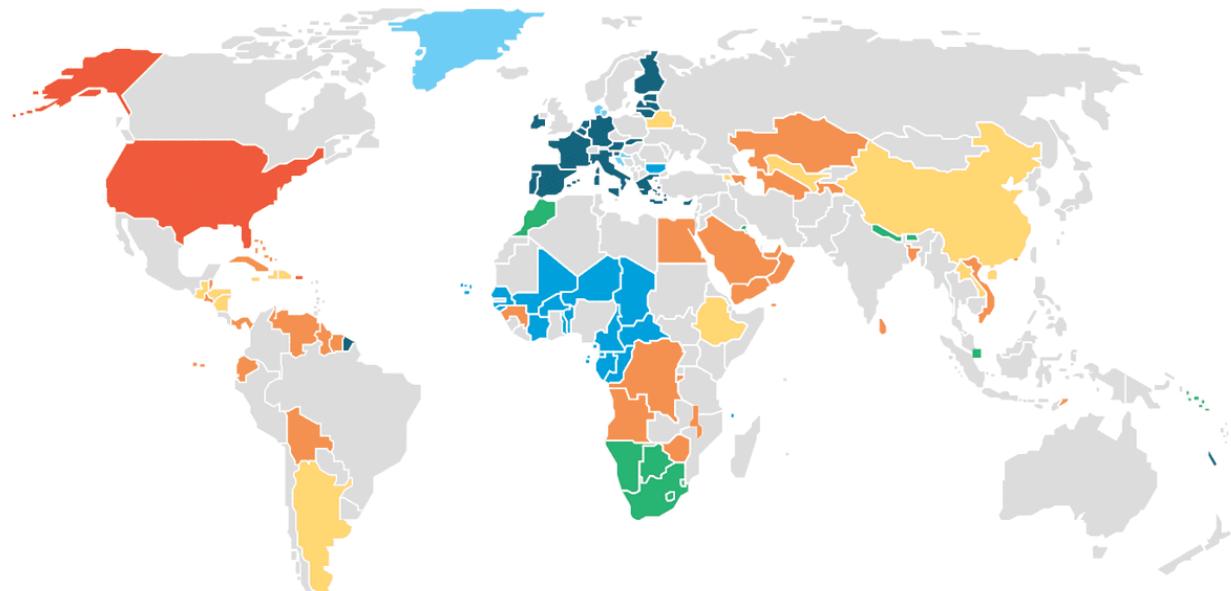
4. The US dollar remains the default peg for central banks looking for FX stability. Only the post-colonial francophone West African euro peg and a few regional fixes to local hegemons (Southern Africa to the rand, and Nepal/Bhutan to the Indian rupee) opt for a different currency.

Currency pegs

United States
Currency pegged* to US dollar
Flexible† tie to US dollar

Euro zone
Currency pegged* to euro
Flexible† tie to euro

Pegged to a basket
of currencies or other
single currency



Sources: Christoph Fischer; IMF

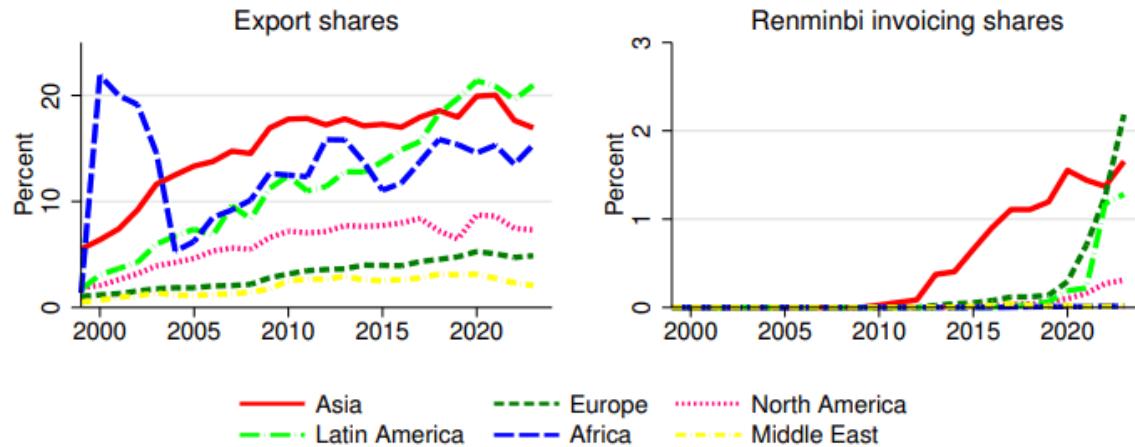
Economist.com

*Includes hard and soft pegs

†Looser (*crawling*) ties allowing for distinct monetary policy

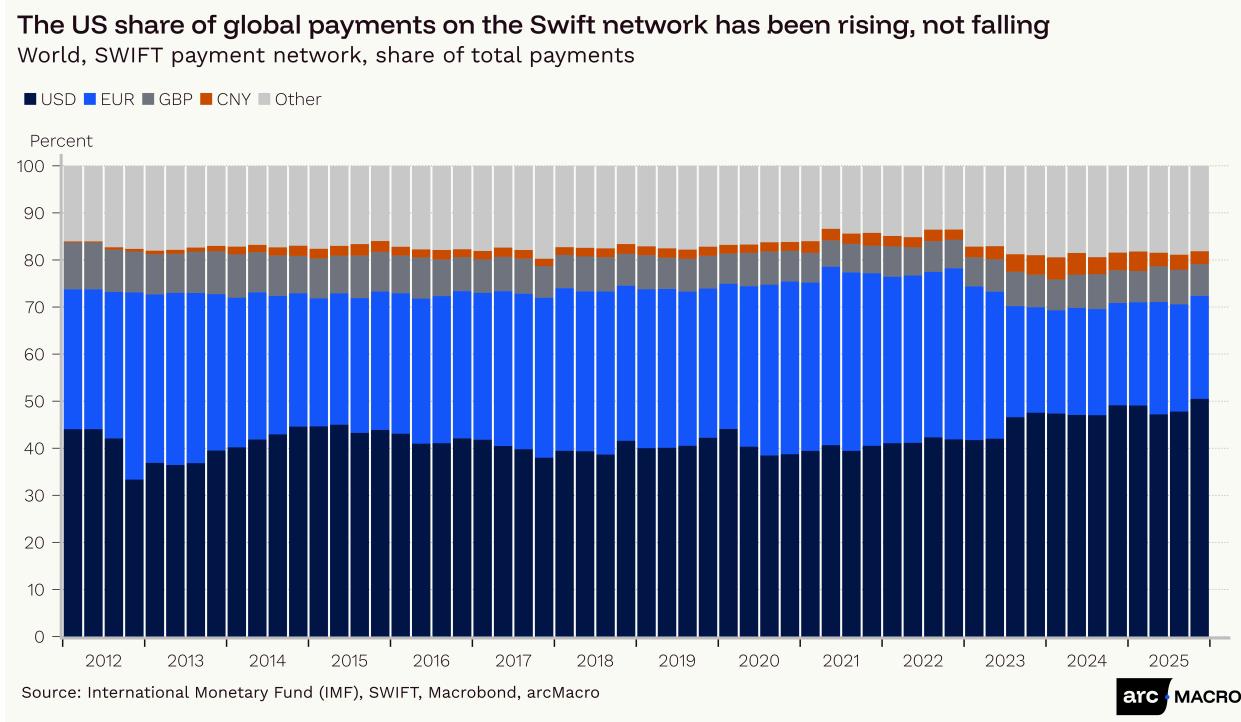
5. "Rival" currencies have so far failed to make inroads into the US dollar's role as the standard unit of account for global trade indexing. According to a recent [IMF paper](#), less than 2% of global exports to China are priced in renminbi.

Figure 5: Zooming in on exports to China and renminbi invoicing



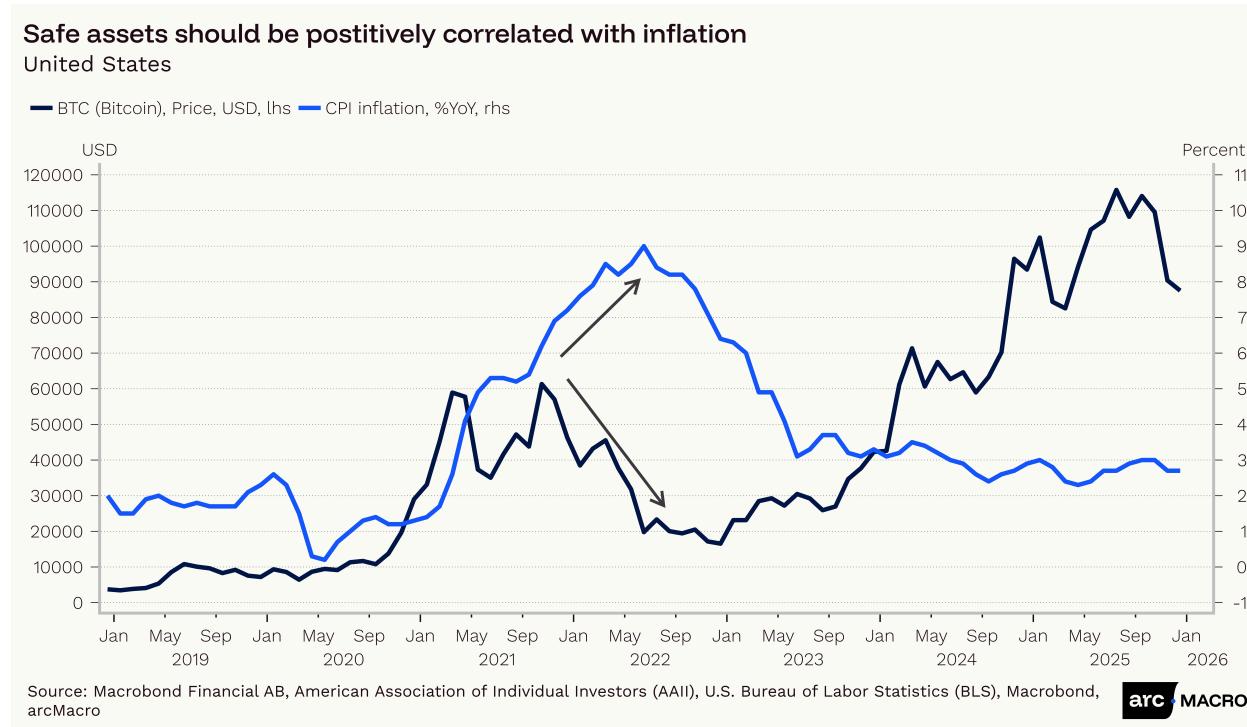
Note: The left panel depicts the share of a region's total exports that is destined to China. The data are from the IMF Direction of Trade Statistics; we only include countries for which we have renminbi invoicing currency information in our dataset. The right panel shows the share of a region's total exports that is invoiced in renminbi. We use the raw renminbi invoicing shares rather than inter/extrapolated data as in Figure 4. The large increase in Africa's share of exports to China in the early 2000s is due to Angola.

6. The dollar accounts for a dominant share of global payments using the SWIFT network (this does not capture other types of settlement, notably involving Russian trade banned from SWIFT).



7. There are no good alternatives to the dollar: the euro is too crisis-prone, China

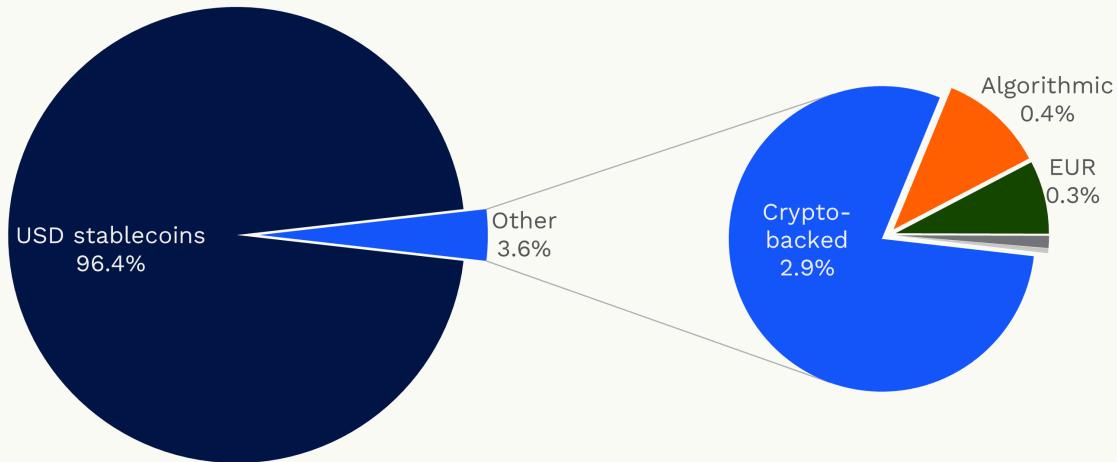
has not accrued enough trust on the world stage to force a switch, and cryptocurrencies are speculative assets that *lose* value during inflationary periods.



8. The arc of blockchain is bending toward the dollar: Stablecoins are overwhelmingly pegged to the dollar and backed by dollar-denominated assets.

Over 95% of stablecoins are backed by the US dollar
Global, Stablecoins by market capitalization, %

■ USD stablecoins ■ Crypto-backed ■ Algorithmic ■ EUR ■ Commodity-backed ■ JPY ■ TRY



Source: Coingecko, arcMacro

Still cyclical

Just because we don't think the dollar is losing its place as the world's reserve currency and trade denominator doesn't mean its value can't fluctuate.

It's not hard to attribute the dollar's recent decline in value to normal cyclical forces, largely driven by domestic policy decisions:

- Over the past six months, the US monetary policy stance has become more dovish than that of its peers. America's labor market has been gradually weakening, and the inflation outlook gradually worsening, both of which contribute to dollar weakness against regions such as the euro area, which are moving in the opposite direction.
- Concerns over Federal Reserve independence vis-à-vis the Trump administration are weighing on the dollar (the Supreme Court's decision on Governor Cook's dismissal and the first few Warsh meetings will either entrench or assuage these fears).
- Extreme levels of economic uncertainty are dollar-negative, and a [recent academic paper](#) shows that this factor has outweighed the traditional currency-strengthening effect of higher tariffs.

- Global spillovers from cyclical dynamics in other regions have affected the dollar's relative value, notably the potential unwinding of the Japanese carry trade and the improved performance of European and emerging-market economies.

Importantly, it's easy to imagine catalysts for any or all of these factors going into reverse. That's what makes them cyclical.

Even if you're still not convinced, and you think de-dollarization is underway, history suggests it will be a gradual, grinding process (e.g., the transition from GBP to USD). So if you're really thinking about long-term structural decline in America's role in the global financial system, you should be locking in 10- or 20-year bets on the dollar. Otherwise, you've made a category error, and you're thinking about cyclical valuation factors.

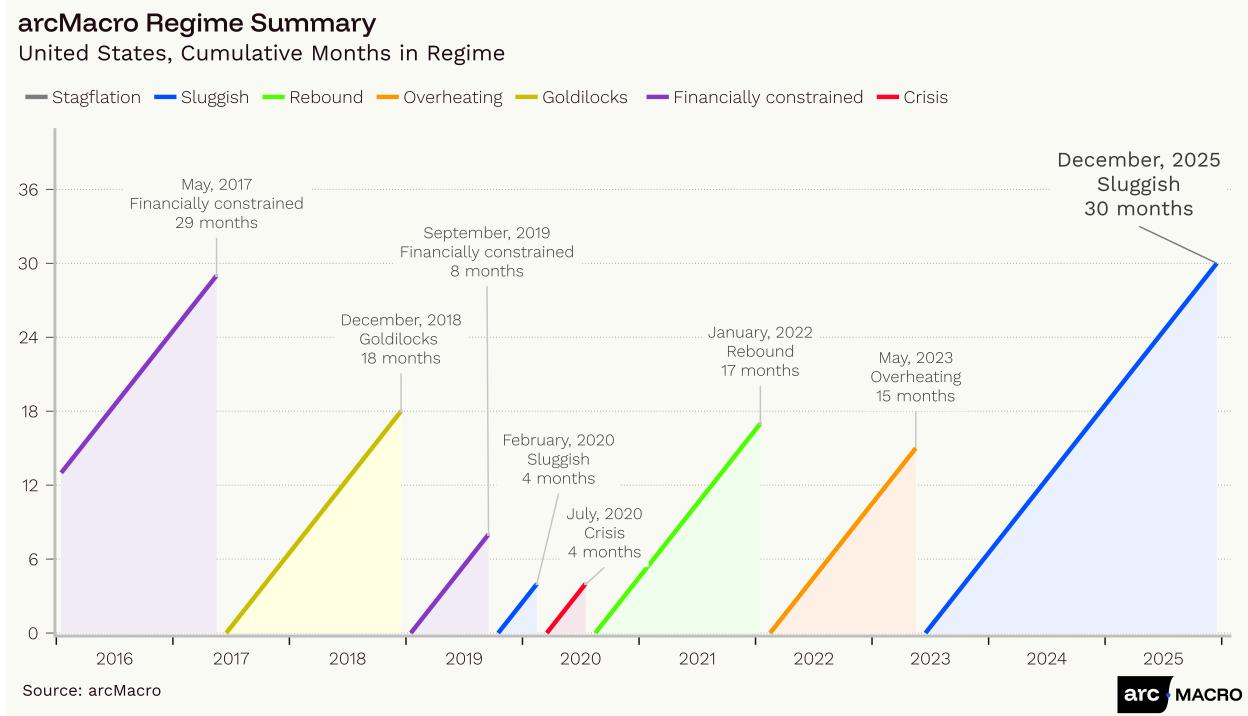
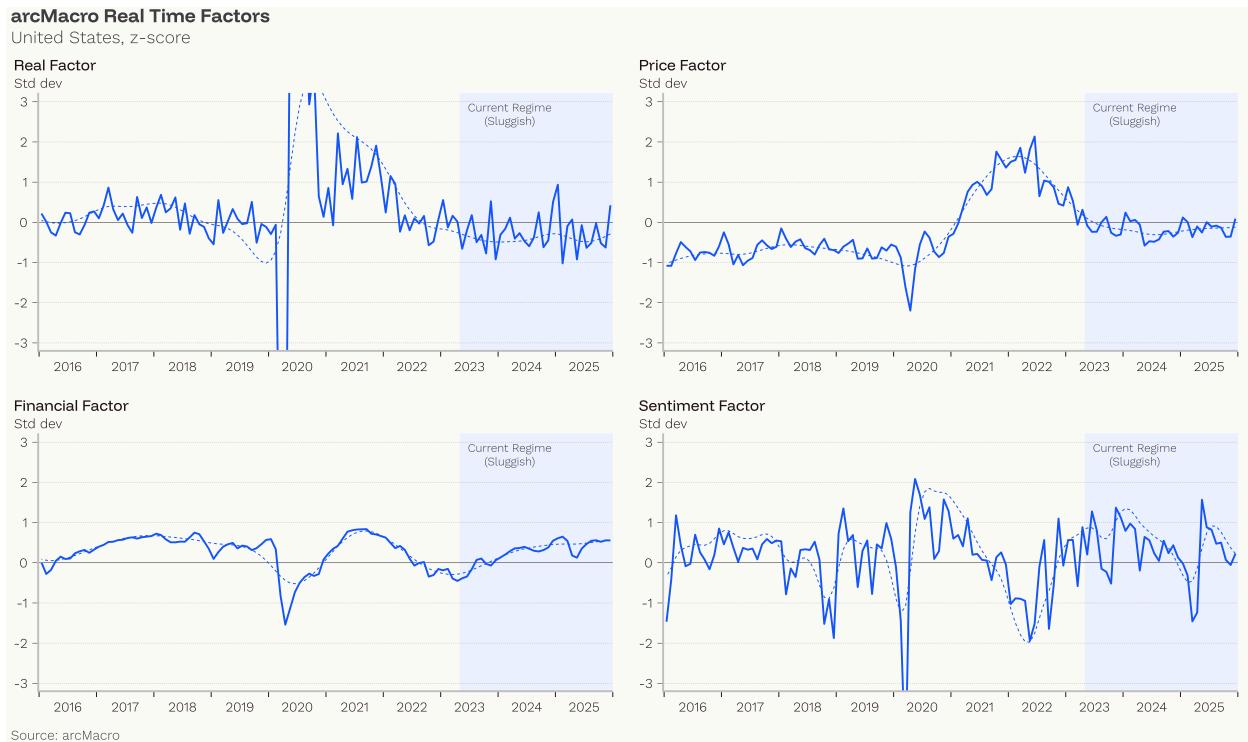
We'll end with the observation that bad news sells. While the "doomer" view on the dollar is not implausible, it's a very low-probability outcome. In our view, it's a genuine tail risk. We hear much less about the chances that Congress makes a genuine attempt to set the path of the Federal government on a more sustainable trajectory.

This will require a major renegotiation of the American social contract and is seemingly out of reach for now. But it would only take an election or two (and perhaps the threat of a market rout) to galvanize a new Congress to take on the challenge.

Maybe this is also a low-probability outcome, but is it really much less likely than a credible global alternative to the dollar emerging? We think the opposite.

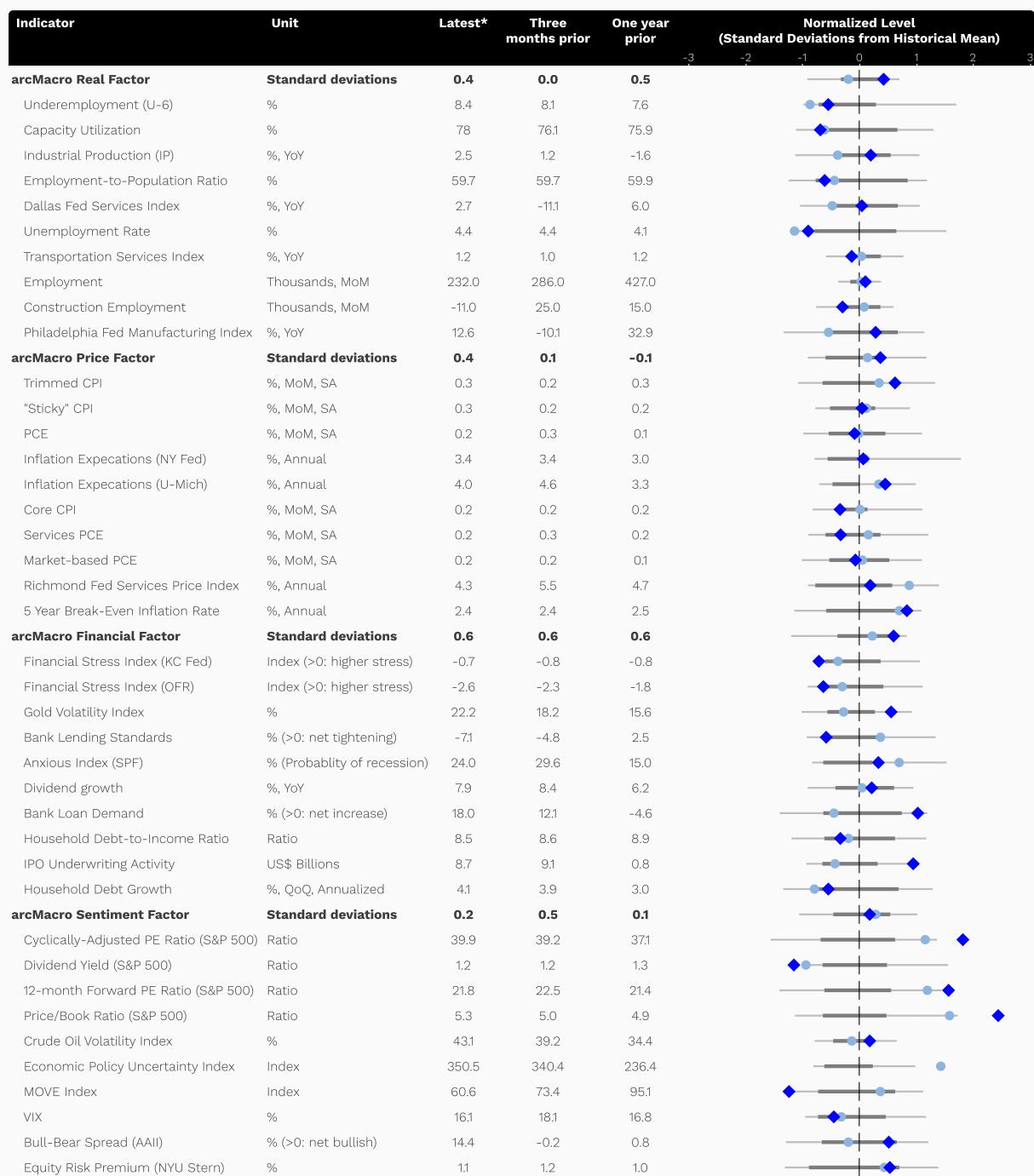
Appendix

Proprietary Factor and Regime Model and Key Macro Indicators



arcMacro Factor Input Monitor

Top 10 inputs by factor loading



■ 10th-90th Percentile ■ 25th to 75th Percentile ● Mean of past 5 years ♦ Latest Value

Source: arcMacro, BLS, Fed, Dallas Fed, DOT, Philadelphia Fed, Cleveland Fed, Atlanta Fed, BEA, New York Fed, University of Michigan, Richmond Fed, Macrobond, Kansas City Fed, The Office of Financial Research (OFR), CBOE, S&P Global, SIFMA, Robert Shiller, Economic Policy Uncertainty, ICE BofAML, LJKmfa, AAII

*Most recent published data point. Time period and frequency do not necessarily align.