# Introducing the World Uncertainty Index (WUI)

Brandon White – April 2020

***"Crises, like pandemics, don't break things in and of themselves; they show you what's already broken."*** – Patrick Wyman

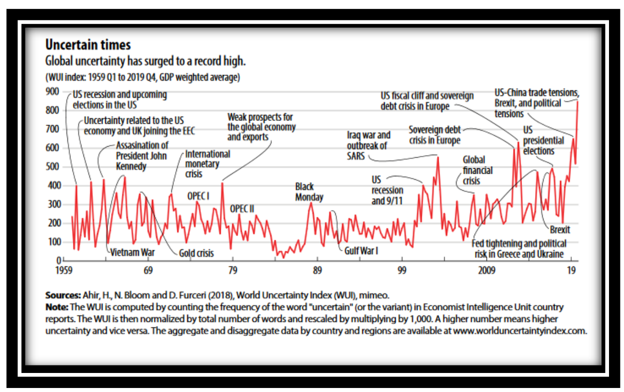
The world's current currency regime is a 45-year-old structure based on trading oil for USD. The petrodollar carry trade is what has supported the US bond market and the American military – and the illusion that the status quo is sustainable. What is happening now was unthinkable just a few years ago.

Understanding complex systems is something mankind has been refining for centuries. Until the late 19th century, it was as much a philosophical challenge as a mathematical one. Fundamentally, the reasons for studying complex systems are pragmatic (i.e. find a solution to a problem, avoid disaster or understand what went wrong). The modern secular approach to complex problems is now pervasive and almost exclusively the domain of mathematicians and scientists. This is especially true in the field of economics. Modern Monetary Theory is predicated on the application of advanced math as the foundation for how money is valued. Central banking is increasingly dictated by financial modelling – often utilizing highly sophisticated computer algorhithms. Financial dependency on computational modelling will only continue to grow as advances in machine learning and Distributed Ledger Technology (DLT) improve efficiencies and gain greater acceptance. This is the future of global trade settlement.

The irony with this future is that it is humans who will bring the greatest challenges. Economists have yet to conceive of a way to solve the uncertainty associated with the unpredictable nature in human behaviour – despite advances in Behavioural Economics. In short, there will always be uncertainty. There are many things beyond our control. Sometimes, things just don't appear to make any sense.

That doesn't mean central banks aren't trying to find solutions to these challenges.

The International Monetary Fund (IMF) released a new way to measure uncertainty in March of 2020. It is called the World Uncertainty Index (WUI) and it is an aggregate of the uncertainty sentiment contained within 60 years of central bank research papers, presentations and speeches. It literally counts the word 'uncertainty' and its equivalents. It studied 143 IMF member central banks. Why does it matter if central bankers are feeling uncertain about the world economy? It matters because they too have fears. What is their greatest fear? Many would argue that deflation is the thing they fear most. Maybe. It is certainly high up on their list of concerns. Carefully reading between the lines suggests there is something even more terrifying to them – a loss of faith in their reason to exist. Let me remind you that the Federal Reserve has a dual mandate of maintaining stable prices and low unemployment. Right now, we have neither.




It boils down to trust. Trust in central banking requires trust in the currency regime - money. What we consider to be money is increasingly being called into question. Central banking's role has become far more involved in global trade settlement and providing liquidity to the markets than it was in the last currency regime. Most trade settlement and liquidity before the 1950s was done through bilateral agreements.

The collapse of the USD-centric International Bullion Standard (i.e. the Bretton Woods Agreement) in 1971 lead to the currency regime we have today – pejoratively known as the US Petro-Dollar System. Since gold was still widely regarded as the ultimate form of money in the 1970s, the period was actually a deflationary event – not an inflationary event as it is so often incorrectly stated. We must view it through the correct lense.

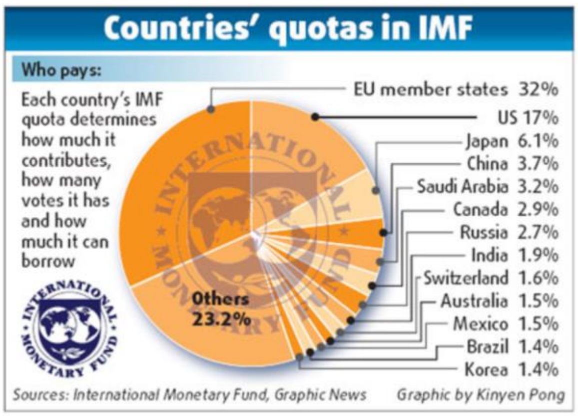
The post 2008 activity by central banks actively and publicly monetizing all types of assets – and at unprecedented levels – has now reached a crescendo with the latest round of monetization.

The monetary expansion this time is global and will require a global solution. The collective efforts of central banks and governments around the world over the last 12 years has lead to even greater distortions between real and nominal wealth. With so much direct intervention in the basic pricing of supply and demand fundamentals, how can they ever be known without a more stable denominator? The economic consequences of a loss of faith in the system itself require a solution. A solution was proposed in the early part of the 1940s that solves many of the systemic challenges we face today. Its successor was formally introduced to the IMF in 1969. Yet few seem to even acknowledge it exists.

It is called the Special Drawing Right (SDR). It is the second most significant international asset for adjusting and settling global trade between IMF members. It is also an interest bearing instrument. The SDR is listed on every IMF member's central bank balance sheet and is the unit of account for the bank they all share – the Bank for International Settlements (BIS). It was the dream of Lord Maynard Keynes to have a global international asset (currency) that offered much of the discipline found in a gold standard while allowing greater monetary flexibility – under central bank control. It is no accident that it was initially introduced on par with gold. The BIS has now begun openly discussing making this international asset available to global citizens through their own central banks. For the time being, it remains a type of money only available to IMF member banks and a few select institutions. The BIS proposal also recommended using DLT for reasons of efficiency, transparency and equitability. Interestingly, monetary gold remains an important and official component of the SDR.

A proposal was made in 2010 to alter the value of this currency unit – a review is held at the IMF every five years on the subject. The proposed alteration to the SDR was a more equitable solution to global trade settlement than the current USD centric system used today. As was expected, the US exercised its IMF veto right and denied the proposal. This happened again in 2015 when the Chinese Renminbi was added to the SDR basket. The response to the American's veto was staunch resistance and anger. Christine Lagarde, head of the IMF at the time, even proposed relocating the IMF headquarters to China. Strict policy written to contain American monetary power failed due to a failure in the IMFs internal democratic process – not because it isn't recognized as necessary. A global currency regime change is a complex process but the solution already exists. Its implementation is the real challenge.

The events of 2020 will have serious long term consequences that will accelerate the protracted global 'dedollarization' process. Trust in the current system is being tested in ways that even the best financial modelling and smartest machines struggle to address. Allowing structural change to happen will likely be imperfect due to systemic inconsistencies and differing objectives.




In conclusion, a currency regime change is underway and will affect how all assets will be valued globally. Real assets and consumer staples will continue to be a sound strategic way to preserve wealth. Properly structured derivatives with minimal counterparty risk will provide tremendous tactical opportunities but will be highly volatile until a solution becomes clear. Poorly structured derivatives with multiple levels of counterparty risk may not survive the transition.

We must acknowledge that the USD is nothing more than a complex oil derivative with multiple layers of increasingly malignant counterparty risk. What happens to the USD will impact all currencies, bonds, stocks and real assets around the world. Now is the time where generational wealth can be realized or lost. This applies to both nations and persons.

Said another way, the tools used to build homes in the 1940s, the 1970s and differ from the tools used today.

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