

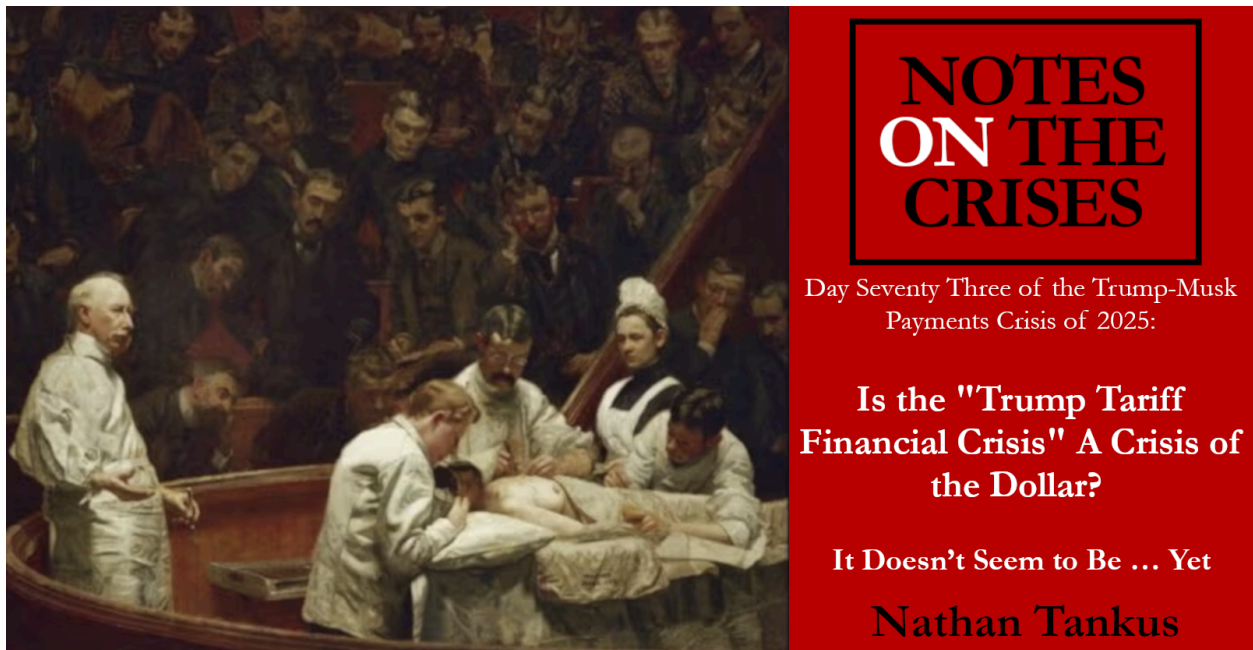
Is the Trump Tariff Financial Crisis A Crisis of the Dollar? It Doesn't Seem to Be ... Yet

Notes on the Crises

<https://www.crisisnotes.com/content/files/2025/04/is-the-trump-tariff-financial-crisis-a-crisis-of-the-dollar.pdf>

April 13th 2025 8:15 AM

By Nathan Tankus



For those just tuning in: I wrote a piece a day for the first three days of this week on what we should probably now term the “Trump Tariff Financial Crisis”. I am coming to you Sunday because, yes, I am a human and took much of the rest of the week off. I even slept at night! Three times in a row! Vanity Fair’s profile of Joe Weisenthal and Tracy Alloway a very bad sign, and very resonant to my experience this week: [“No! Sleep! For Bloomberg! How the Media Giant’s Joe Weisenthal and Tracy Alloway Survived a Manic Week”](#). Well, I did take about 16 hours to write this piece, but I did it at a slower pace with lots of breaks.

Part of why I didn’t feel urgency to have a piece out during the rest of the weekday was that I felt my first three pieces laid out most of the core elements of this crisis. I was confident they would serve as a good enough guide for readers regarding the rest of the week’s developments. The only missing piece was the international financial architecture part, which is the subject of today’s piece. This is certainly the most complicated part of what I have to cover and also the most opaque. In the future **I will try to break down this topic even more**: in part writing this piece has been an exercise in fully determining what I think by working through every logical angle I can come up with. This is the **outer edge** of our understanding of the global financial system. So this piece is an exercise in

“digestion” and will need to be “reprocessed” for public consumption in future pieces, and by others ([Hi Krugman!](#)). Skip to the conclusion if you just want my takeaway. First though, let’s recap where we’ve been.

My opening salvo was [“Trump’s “Liberation Day” and the Ongoing Stock Market Crash: The Key Lessons to Take into the Second Week of the Market Bloodbath”](#). I covered the basics of stock markets, that they actually close and thus the way foreign stock markets “preview” what will happen between 9:30 AM and 4:00 PM on U.S. (New York) stock exchanges. I covered the role of index providers and index funds in stock market dynamics today. I finished by covering exactly why the Trump tariffs were so disastrous and led to Covid March 2020 style supply chain paralysis.

I followed up from that on Tuesday with the piece [“The Stock Market is a Conventional Wisdom Processor: Why Trump’s Tariffs Crashed the Stock Market While the Trump Musk Payments Crisis Hasn’t \(Yet\)”](#). In that piece I recounted the history of the first week of the Trump-Musk Payments Crisis from the angle of my conscious attempt to get stock market participants to reprice financial markets with accurate information about the risks DOGE’s direct access to the Treasury’s internal payments system poses. Along the way I [exclusively reported the quotes of two former Senior advisors to the Treasury, Chastity Murphy and Anisha Steephen](#), on the extraordinary alarm that former and current treasury officials felt about DOGE’s [direct “read/write” access](#) to the Treasury’s payments system. They both even confirmed the importance *Notes on the Crises* had among high level current and former Treasury officials to understand what was going on.

Most importantly, that piece covered why I failed to crash the stock market by accurately spreading the word about the Trump-Musk Payments Crisis, and [why neither Bloomberg Oddlots hosts Joe Weisenthal or Tracy Alloway, or myself thought](#) I had much chance to succeed. The key idea is that the stock market is a “conventional wisdom processor”, while the extraordinary threat of the Treasury payments system issues were too technical to become conventional wisdom on wall street. Joe also pointed out, correctly, that stock markets have a very difficult time with risks that are so dramatic. They either don’t happen (and everything is fine!) or they do happen (and catastrophe results.) This is why the Trump Tariffs could only crash the stock market when “Liberation Day” happened. That fateful day, the “financial community” was repeatedly denied the “good news” that would allow some calm to return to financial markets.

Which leads to my third piece on Wednesday: [“104% China Tariffs Came into Effect at Midnight. We Instantly Entered this Crisis’s ‘Lehman Brothers’ Moment”](#). Trump’s eye-popping retaliatory tariffs on China, which actually came into effect at Midnight Wednesday, instantly solidified the financial market stresses into a full blown financial crisis. It is still unclear whether this will be much bigger than Fall 2008—but signs point to yes. What is of course unique about this crisis is that it is extraordinary volatility, comparable only to the Great Financial Crisis and March 2020, derived solely from the volatile, erratic and insane decisions of one man: President Donald Trump. The rest of that piece is devoted to the financial market infrastructure, the post 2008 financial regulatory environment, and the vulnerabilities left from a “lack” of monetary design which Trump’s incredible volatility is colliding with.

The only part of the international financial infrastructure I touched on in Wednesday’s piece was a general discussion of how scary it is that in this situation it's not at all clear that the Federal Reserve would provide central bank swap lines to foreign central banks. (That's what they did in 2008 and 2020.) I said there was going to be a hunger for dollars over time, and no “running from the dollar”.

We've clearly had some big dollar movements, **but I still think that last statement is true.** The former statement has shown no sign of being true yet, **and there are reasons to think it is outright wrong.** To understand why, we're going to have to unpack a lot of international financial dynamics I had no time to cover (or think about) Wednesday. In many ways, this discussion will have many familiar aspects from Wednesday's write up of hedge fund treasury securities holdings, hedged with "options". It's just now there's a whole new financial derivative at the center of the story: the **Foreign Exchange Swap.**

Before we dive in, I want to step back and make some general points about Financial Derivatives. To do so, I will return to a piece I wrote in May 2023 called ["The Utopian Vision of Financial Derivatives"](#). This piece is so important to understanding the topic here, that bear with me as I quote a large chunk of it:

Typically, finance is seen as the height of realism, while the demands of outsiders are cast in idealist (read: ill-thought out and unrealistic) terms. However, those who truly understand finance understand that **the financial system and its priests have utopias of their own, that they try to make a reality.** One of the deepest and most alluring utopias in the world of finance is a world without unwanted risks and uncertainties. In this utopia, no one takes on a risk without wanting to get a higher return. And any one who chooses to take on additional risk can afford to take that loss. It's a world where not only sufficient safe assets exist, the risk taking that does happen is contained, and does not have any systemic consequences. **Macroeconomic financial instability is, in other words, contracted away.**

How does this dream work? The key is financial derivatives. Through the lens of financial derivatives, no asset is unique. Rather than seeing assets as having unique risk (and uncertainty) profiles of their own, the financial market true believer sees a bundle of "risks", which can be mixed and matched. Have a commercial real estate loan with significant credit risk? Don't want to take any risk? Buy a **credit default swap**, essentially a kind of insurance against default, and now you have an asset without bearing the risk that your debtor will default! That will be someone else's problem if it happens.

Still feel like you are taking on too much risk? Buy interest rate swaps, essentially types of insurance against the risk interest rates will change, and now you don't have interest rate risk! That derivatives pay out in specific circumstances make them contingent liabilities. Since every financial liability is someone else's financial asset, this makes them contingent assets to the holders. These contingent assets are supposed to offset the contingencies in the underlying securities. **The key word there is supposed to.** We'll return to this issue later.

This brings us right back to the issue of safe assets. Some readers may have predicted where this is going. In essence, this vision comes down to comparing **any given asset to a treasury bill, and then thinking through all the different financial derivatives that can be bought to turn any asset into a kind of treasury bill.** Mehrling, Pozsar et al. use the term **"quasi-treasury bill" for this type of asset**, which I think is apt. It serves the role of a safe asset, of a treasury bill, **until it suddenly can't anymore.** The key thing to understand is that in the full throated version of the utopian vision described here, with sufficient financial derivatives, **any financial asset can be transformed into a "synthetic" or "quasi" treasury bill.** The question is just the price you are paying on those

financial derivatives compared to the return the underlying asset is providing over and above the return on an actual treasury bill.

The true scope and power of this vision is easy to underestimate. Have a portfolio of long maturity risky commercial real estate loans? With interest rate swaps and credit default swaps, those are now quasi-treasury bills! In this vision, those risky commercial real estate loans are fundamentally just a treasury bill combined with interest rate risk and credit risk. **This vision can be taken further, a loan to a local government in another country and another currency is just foreign exchange risk, interest rate risk and credit risk. Buy a foreign exchange swap, an interest rate swap and a credit default swap and even that asset is now a quasi-treasury bill!** This is what I mean when I say this vision is utopian. Through this lens, **you can dream of a world where there's never any shortage of safe assets whatsoever.**

I know that was a lot to quote, thank you for bearing with me.

I promise that this is crucial to understand the international issues involved. That last paragraph particularly hits the important part: foreign institutional investors, Hedge Funds, Pension Funds and Insurance Companies among others, **have obligations in their domestic currencies but want to invest globally to get higher returns without taking on exchange rate risk.** They do this by entering into foreign exchange swaps. Since they are aiming for higher returns, they don't take out interest rate swaps or credit default swaps. Indeed, many buy stocks ergo they are not constructing "quasi treasury bills". However, a foreign hedge fund that both buys treasury securities, treasury options and forex swaps **is constructing "quasi treasury bills"**

I will get into more detail about how these swaps work when (if...) this crisis gets less acute, but in essence what they do is let, say, a Japanese pension fund get a foreign currency for Japanese Yen (i.e. "swapping" them) and then that Japanese pension fund promises to swap "the other way" (exchange foreign currency for Japanese yen). The key is this provides some degree of exchange rate certainty (you set the future "swap" price in advance). This in essence "funds" the Japanese pension's investments in dollar-denominated assets. In many ways, the global financial system runs on such arrangements. You can think of these as **"quasi-Yen U.S. investments" in the manner of Mehrling and Poszar et al.'s "quasi-treasury bill".**

This also centers the role of the dollar on a set of financial markets and arrangements that are **extremely obscure to the public** i.e. not trade arrangements. Hyun Shin, the head of the "monetary and economics department" at the [Bank of International Settlements](#), expressed the issues well in a March 2023 speech entitled ["The dollar-based financial system through the window of the FX swaps market"](#):

The international role of the dollar is often discussed in the **context of the current accounts of both advanced and emerging market economies and their accumulation of reserve assets.** Several contributions in this volume reflect this focus on the current account. **However, it is better to view the dollar's outside importance in global affairs as deriving more from its pre-eminent role as the funding currency of choice in global capital markets for banks and non-bank financial intermediaries (NBFIs), and the pivotal role of central bank dollar swap lines as a liquidity backstop in keeping the global financial system on an even keel**

[...]

However, much more important than these “real economy” uses is **the hedging by non-bank financial firms (eg pension funds and insurance companies) that manage the exchange rate risk associated with their asset portfolio**. Take the case of a life insurer or pension fund who has obligations to policy holders or beneficiaries in euros, yen, sterling or Swiss francs. While these obligations are in domestic currency, the life insurer or pension fund typically holds **a globally diversified portfolio, much of it comprising dollar assets**. To **hedge the currency risk**, the life insurer or pension fund can enter an **FX swap with a global bank, in effect borrowing dollars while pledging domestic currency as collateral**.

The amounts involved in such hedging transactions are very large. **The outstanding obligations to pay US dollars in FX swaps/forwards, mostly very short term, amount to more than \$80 trillion**. This sum exceeds the stocks of dollar Treasury securities, repo and commercial paper combined. Such are the outstanding stocks. In terms of flows, the latest BIS Triennial survey found that **the churn of deals approached \$5 trillion per day in 2022, accounting for two thirds of daily global FX turnover**. [Emphasis Added, citations removed]

That was a lot and was not designed for public accessibility. Two things I'd note. First, readers should recall that “collateral” is something you pledge to get access to a loan. Creditors love to replace “collateral worthiness” for mere “credit worthiness” (read my 2020 [primer on collateral here](#)). The second thing to note is that “FX” is often used as a shorthand for “foreign exchange”. Finance has a funny evolution of shorthand. Foreign exchange became “forex” and in the acronym has become “FX”. “FE” just wouldn't cut it.

Anyway, in essence, Shin's first two paragraphs say what I said above. That last paragraph is the crucial new bit: this is a mind-boggingly large financial market. It's hard to even think about what **80 trillion dollars** of obligation to pay U.S. dollars even means. It shouldn't surprise us then, given the size of these numbers, that whatever is going on with the dollar is found in the “dollar swap market”.

In connection with these issues, a few anonymous sources have brought up the example of August 5th 2024, an intense but quickly forgotten burst of volatility in the foreign exchange currency and swap markets between Japan and other countries, but especially the U.S. To the people I talk to this episode provides the key model for understanding what's going on right now. As it happens, Hyun Shin **also** did an excellent interview with Joe and Tracy on the Oddlots [podcast on that early August 2024 hiccup](#) last year. Bear with me as I do another extended pull quote (it's just that kind of piece):

Hyun: But I think it's not really enough to explain why there was this much more broad based stress, especially in the equity markets. And I think here we have to think about the broader issues to do with how risk is managed, how risk management itself, risk management in the form of loss mitigation also generates some potential for amplification that could actually make things more volatile.

So let me explain what I mean by that. **So if I have a Value at Risk rule that says if my risk is triggered beyond this VaR level, then I cut my position, that means I sell, or if I'm lending, I cut my lines, etc., from the point of view of the borrower or from the**

point of view of the market as a whole that is something that would actually amplify whatever stress that was there in the first place.

If I'm a lender and I set margins, or if I'm a CCP — a central counterparty or an exchange — there is a margin that I ask for, the various contracts that I deal with, typically during stress periods, those margins go up. **So that's a kind of de-leveraging now, the way that we deal with risk is precisely to mitigate loss. And there is a spillover effect that goes to the broader market.**

And I wonder whether we should look back on the events of early August and if you like, apply that lens to the events back then. So if for example, I was not borrowing in and investing in technology stocks as you suggested, but it's just that within my firm there is a team that is doing a classical carry trade, but there is also a team that is leveraged the US tech stocks, but one team doesn't know what the other team is doing.

So let's say one pod doesn't know what the other pod is doing, but **from the firm's point of view, it looks as if in aggregate that there is a short yen position and the long position in technology stocks. And if that risk constraint is triggered somehow it's going to have a much broader implication, much broader repercussion through all of the holdings.**

Tracy: (18:49)

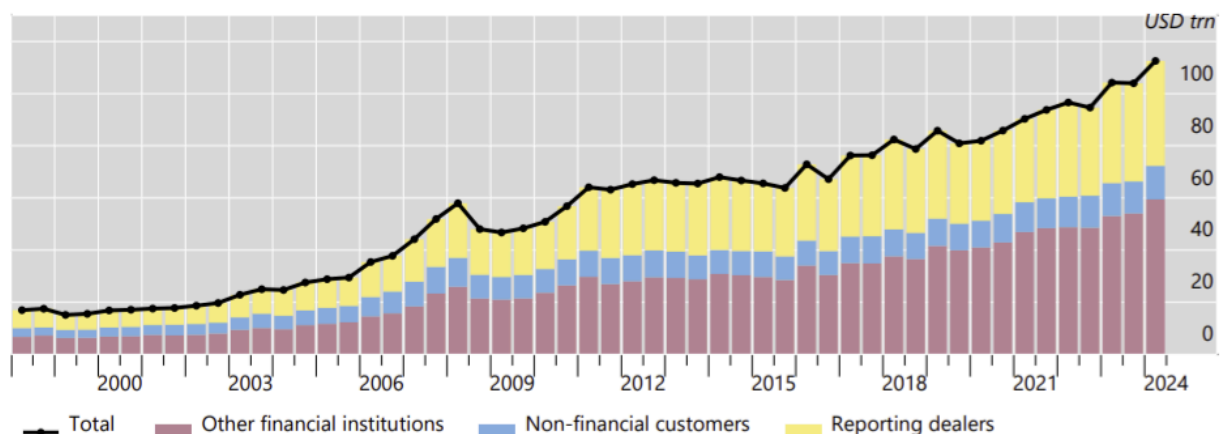
This kind of reminds me, there used to be that saying about [how] **'In a crisis, you sell what you can,' not necessarily what's most impacted.** So it might be that the most volatility is falling in the currency market and in the carry trade, but **the thing that you're selling to reduce your risk exposure is something totally different just because you can, or because it's easier to do in an extremely volatile environment.**

Hyun: (19:15)

And if you like, it's **the risk limits that are triggered.** And the way that risk limits work is if the **aggregate portfolio is suffering losses,** then the risk limits are **tightened for all the different assets that you own.** And I think something that we need to think about in terms of how we can mitigate some of these issues. [emphasis added]

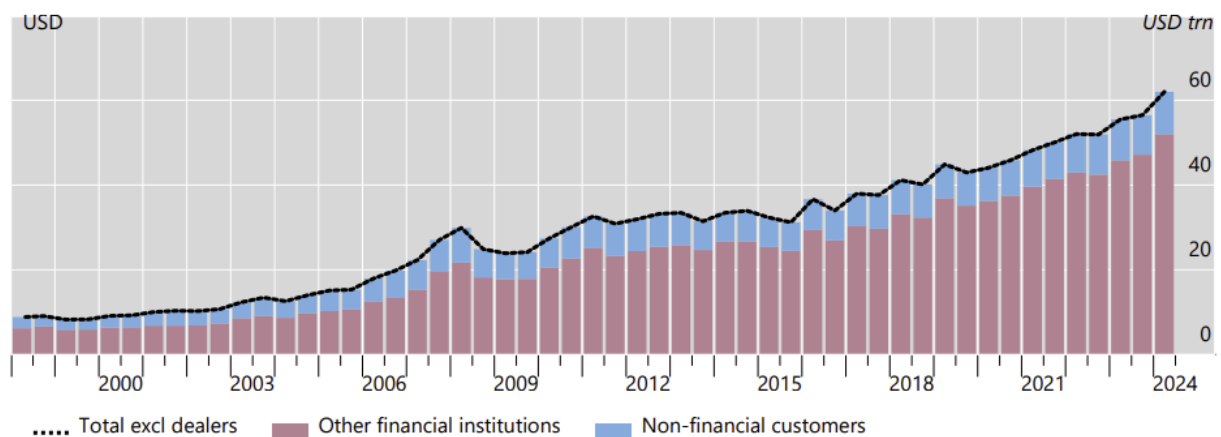
All of this should be, in some sense, familiar from Wednesday's piece. You have forced deleveraging leading to selling off of the "least affected" assets in the scramble for "cash" to pay down debts and meet other kinds of obligations. This "scramble for cash" and push to deleverage is fundamentally driven by the explosion of "risk" as measured by Value at Risk (VaR) models. Thus, underneath all the complication **is just the international version of domestic hedge fund deleveraging.** However we can't stop at this point. Because **the "international deleveraging" is running through the foreign exchange swap market and almost the entirety of global currency trading (by volume) runs through the swap markets** connecting Europe, major countries in Asia and the United States.

Outstanding swaps in all currencies stood at 113 trillion dollars in June 2024



Indeed, most foreign exchange swaps are **dollar exchange rate swaps**. As of June 2024, the total outstanding foreign exchange swaps according to Bank of International Settlements data was worth **113 trillion**. When you exclude dealers, i.e. focus just on their “financial” and “non-financial” customers, that amount becomes roughly **73 trillion**. The following graph ([graph sources here](#)) shows roughly **63 trillion of that involve dollars**. If this is roughly correct, then more than **80% of outstanding customer foreign exchange swaps** as of June 2024 were **dollar swaps**. Add in the dealers and we reach some truly astounding figures, both in percentage terms and in absolute dollar amounts.

US dollar swaps account for most of the outstanding customer total



In June 2024 outstanding fx dollar obligations was a truly astounding [99 trillion dollars](#). 99 trillion divided by 113 trillion outstanding means that **over 87% of outstanding forex swaps in the world involved dollars**. We are so, so, so, so far from the demise of the dollar.

Okay, the dollar is the core of this system, yet the dollar's exchange rate fell? How are we to understand this? Hyun Shin's argument in his March 2023 speech about the vulnerability of non-U.S. "advanced" economies to dollar liquidity needs was based on the presumption that foreign institutional investors would fight to maintain their institutional investments, and would only liquidate them in extreme scenarios that correlated with a deep global shortage of "dollar finance". It is in these circumstances that swap lines with the Federal Reserve become important. That's why it was so concerning that all the moves suggested that swap lines either wouldn't be used, or the Treasury would step in to force the Federal Reserve to terminate its swap line arrangements. This was my state of thinking as of Wednesday morning, while also knowing that foreign entities may be selling treasuries to cover liquidity strains and deal with their own risk model blowouts. So I knew that that was going on in addition to the domestic stress-based sell offs.

What has emerged since then is that the Trump Tariff Financial Crisis may have been extreme enough to get at least some foreign institutional investors to liquidate their holdings of U.S. dollar assets in order to deleverage. Thus dollar liquidity issues have not become extreme enough to require activating swap lines (i.e. lending dollars from the Federal Reserve to foreign central banks) because, when faced with increased difficulty and cost to holding U.S. dollar assets, some amount of foreign institutional investors would rather sell dollar assets and shrink their balance sheet. Let me be clear here, there are **no clear signs of divestment from (non-Chinese) foreign pension funds, insurance companies etc.** These discussions have started to happen, but **actions have not** (at least as far as can be divined). The extent to which there has been sell offs and deleveraging seems concentrated among hedge funds or other similarly situated non-bank financial institutions.



Anyway, remember [Fonzie from my last piece?](#) Well, here's a simplified way of thinking about what deleveraging looks like across borders, across currencies and with foreign exchange swaps. Let's check out what's going on with "Fonzie in Japan". Readers should keep in mind I'm skipping over, and simplifying, important accounting issues with Foreign Exchange swaps to convey the core dynamic.

Levered Fonzie in Japan

Assets	Liabilities
+U.S. Dollar Assets + Local Currency Assets +Offshore Non-Dollar Assets	+Local Currency Liabilities + Dollar Fx Swaps (USDA) +Offshore Non-Dollar FX Swaps
$\text{Leverage} = \text{Liabilities} / \text{Net Worth}$ $[\text{Net Worth} = \text{Assets} - \text{Liabilities}]$	

Fonzie in Japan Without Dollars	
Assets	Liabilities
+ Local Currency Assets +Offshore Non-Dollar Assets [same or more]	+ Local Currency Liabilities [less] +Offshore Non-Dollar FX Swaps [same or more]
Leverage= Liabilities/Net Worth [Net Worth= Assets-Liabilities]	

What is going on here is that, as the cost of financing what amounts to insurance protection against dollar exchange rate movements rises, and the general volatility of U.S. markets blows out internal risk models, the obvious takeaway is these positions are not worth the cost and to close them out. This seems to be happening on a large scale, which explains why the dollar exchange rate has sharply moved down amidst macroeconomic news that are conventionally associated with the dollar going up. This is precisely the kind of development which rips up “quasi-treasury bills” and **“quasi-Yen U.S. investments”**. To understand why, I have to briefly return to my [“The Utopian Vision of Financial Derivatives”](#):

In essence, what they [Mehrling, Poszar et al.] are saying is that the critical problem with “quasi-treasury bills” is that you can use financial derivatives for a lot of things, **but you can’t use them to insure yourself against a lack of liquidity. I.e. the risk that the asset will not be saleable (either outright or as collateral for a loan which assigns a favorable “collateral price” to the asset)** when you truly need to meet payment outflows. There is no private market for “liquidity swaps” and, even if there were, **how could the liquidity of the liquidity swap market be guaranteed?**

[..]

Recall that the most essential thing that financial derivatives are supposed to do in this “extreme” example is preserve the security holder’s principal. In other words, a **“quasi treasury bill” functions like a real treasury bill when the value of the security**

combined with the value of the swaps stays the same. This means that when the actual underlying security takes a loss (either in market valuation or through a “credit event” i.e. default), **the swaps rise in value by an equal amount.**

As discussed earlier, while the model valuation of the swap may rise because e.g. interest rates actually rose, there is no guarantee **that the market value of the swap will fully rise to offset the loss on the underlying security.** Put simply, liquidity in the swap market is by no means guaranteed. However, this is not the worst of it. Even if the market value of the swap rises “fully”, it doesn’t necessarily **facilitate making payments.**

Go back to my last piece for [a basic discussion of liquidity](#). In the context of current events, a rise in the value of a dollar swap is supposed to offset a decline in the exchange rate of the dollar against the Yen. This is supposed to preserve the “principal” or the “acquisition price” of this “quasi-Yen U.S. investment”. If illiquidity and volatility in the swap market prevents that from happening, those foreign hedge funds will struggle to hold onto those dollar assets. This is especially the case because of the terms of those FX swaps.

Recall that FX swaps have collateral- the currency you “swapped” up front! They also have terms. Movements in exchange rates don’t affect the prices of the future “swap” i.e. repayment. But they **can affect collateral terms.** It is [convention in this newsletter](#) to refer to the valuation of collateral as the “collateral price”. You can “sell” assets for their “market price” or their “collateral price”. Instability often emerges when “market prices” have an immediate and direct impact on “collateral prices” (I wrote about this at length [in the Eurozone context in May 2020](#)). It is typical in the world of FX swaps to require additional collateral based on movements in some other underlying market. In essence, the terms of the dollar swap requires a certain “price” to be paid, and the terms allow for the “devaluation” of the current collateral and subsequently the sudden obligation to provide “more collateral”.

Meanwhile, even without the collateral issues the “maturity length” or time before a swap is “closed out” is far smaller than the “maturity length” of the asset holdings those fx swaps are partly financing. In other words, they are using dollar swaps to finance holdings of assets with much longer maturities. This is the meaning behind “shadow banking” (which you can read much more about in [my 2023 piece on Zoltan Pozsar and his early 2010s work](#).) To be “maturity matched” they would have to find lenders willing to provide forex swaps of 5 years, 10 years or more. Which brings me back, yet again, to my [“Utopian Vision”](#) piece:

In practice, even if you pursue the production of “quasi-treasury bills”, there are **all sorts of mismatches (large or small) that you take on in order to roughly get the safety you are looking for. And that works... until it doesn’t.** Complete and perfect collateral “matched book” trading rarely occurs. What gets called “matched book” in [practice involves](#) “significant **amounts of maturity**, credit, and collateral transformation, exposing them to interest rate, liquidity, and credit risk”. In other words, mismatches. [Emphasis added]

Issuing an obligation with “fragile” moneyness to finance asset holdings that you intend to hold far longer than the maturity date of those “shadow monies” works as long as that fragile moneyness holds up. FX swaps have been one of those shadow monies, and the sudden liquidation of large amounts of them may not literally be a “shadow money run” in the sense that people doubt counterparties holding up to FX swap terms. But nevertheless, the financial stress of this financial crisis is leading to those positions being liquidated. As we’ve discussed, deleveraging one place creates pressures for deleveraging across what we might call the “financial supply chain”.

Which brings us to the foreign exchange market itself. Lets say you google two currency pairs, like the United States Dollar (USD) and the Japanese Yen (JPY), along with the phrase “exchange rate”. The graph that will be staring back at you will be the exchange rate that emerges from the current buying and selling of Dollars and Yen. Much of the current talk of Dollar collapse, besides movements in the Treasury market, is the movement of the dollar against other currencies. This is based on the presumption that these markets are deep and liquid. That presumption [was only valid \(and not fully valid\) in a world before the global regulatory reforms](#) coming out of the Great Financial Crisis. If that presumption isn’t correct, then judgments based on spot dollar exchange rates will be mistaken.

On Thursday “Risk.Net” ran a headline [“FX liquidity ‘worse than Covid’ amid tariff volatility, dealers say”](#). There’s plenty of dense detail in this article, but the takeaway is that “intraday” (within one single day) volatility in the foreign exchange market went up “more than five fold” this week because of Trump’s Tariff announcements. This makes sense because the spot foreign exchange market is [not separate from the foreign exchange swap market](#). They are connected because an implicit exchange rate can be derived from how dollar swaps are trading. So when liquidity goes down in the dollar swap market, [that “spills over” onto the smaller spot](#) market.

Meanwhile, liquidity goes down when volatility goes up a lot and institutions, particularly large banks, pull away from the dollar swap market. Basically, the same thing that operates domestically also applies to the foreign exchange market. Liquidity constraints from both new liquidity requirements and new capital requirements [lead the foreign exchange “dealing desks” at these major bank-holding companies](#) to shrink their activities when these constraints start to “bind”. So the same VaR blowouts we talked about Wednesday do not just lead to pressure to sell assets, **they also directly drain liquidity from the currency markets**. It is truly astounding to get a handle on **all the knock on implications from Donald Trump’s volatility**.

This drain of liquidity is no idle matter. It is even key to the exchange rate dynamics between Europe and Japan. Roughly 18 months ago the Bank of International Settlements put out [some absolutely essential research](#) on the key role the largest U.S. banks play in the global forex swap market . As an aside, there’s a reason that I keep on bringing up the BIS so much. They are the core institution which takes these international financial architecture issues seriously and produces relevant and heavily empirical research on these topics. There’s a reason many people at the margins of economics have gravitated to the BIS of all the major official institutions.

Anyway, [the key point](#) from that research is:

US banks stand out as **pivotal FX swap intermediaries**. In particular, Japanese banks that swap out of yen and into euros, and euro area banks swapping in the other direction, **both transact via the US dollar mainly with US banks rather than with each other**.
[Emphasis added]

In other words, not only do European Banks and Japanese banks engage in dollar swaps to provide their customers with dollars, they **even enter dollar swaps to acquire Yen or Euros**. If this is truly the end of the dollar, Europe and Japan better get on building a much bigger and more reliable EUR/JPN swap market. That they rely on the U.S. for even this is a sign of how far we have to go before the “end of the dollar” talk becomes even a “concept of a plan”.

Which brings me to my final quote from Hyun Shin, this [one from the Bloomberg Odd Lots interview about the August 2024 financial stress episode](#) I quoted thousands of words ago:

This is why during financial stress periods these FX swap bases spike, and then there has to be central bank swap lines to quell [them], etc. But there's **nothing in principle that says it always has to go towards a dollar, right?** If your intention is to engage in a yen carry trade, but through using FX swaps **you could borrow yen and then acquire that yen obligation by going through the swap**.

And so **one telltale sign is what happened to the FX swap basis** during this recent episode. And in fact one of the interesting findings is **that the dollar FX basis versus the yen hardly budged. It's actually a very small movement which is very atypical of a financial stress event**.

To spell out what Hyun is saying: if institutions which are deleveraging are not all foreign institutions indebted in dollars but, instead, more and more U.S. institutions are, in effect, borrowing yen and euros to invest elsewhere- this could explain why exchange rate illiquidity is not leading to a (current) hunger for dollars and not leading to the kind of forex swap pricing (read distance between “bidding” and “asking” prices i.e. spreads) we typically associate with financial stress. In these circumstances the latest quote on dollar exchange rates are a lot less important than the degree of volatility in the foreign exchange markets themselves. Meanwhile the volatility of the “Chicago Board Option Exchange Volatility Index”, [discussed in Wednesday's piece](#), is a sufficient shorthand guide.

The conclusion of all this is that the dollar's movements recently are not a dollar crisis in the sense of a **collapse** of the dollar. Instead they are a “dollar fx swap crisis”, whose magnitude or duration is impossible to say. It could end up being an episode like August of last year... but that's quite unlikely. The questions about the dollar are longer term, though the dysfunction of the international financial architecture itself has solidified doubts which should be entering people's minds for other reasons. In particular, the [Trump-Musk Payments Crisis](#). But examining the future of the dollar of that lens will have to wait for another piece. This piece is already ****checks word count**. Eyebrows raise. Sympathy escalates** a horrific 5700 words or so. My apologies readers! I wrote this at the minimum level of complexity I could muster. It's just the most complex financial issue out there. It's a very bad sign you even desire to wrap your head around it.