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The Petrocurrency War. The Dollar versus the Yuan

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US Secretary of State Hillary Clinton in 2007 had supposedly asked ex-Australian Prime Minister Kevin Rudd "how do you get tough on your banker?" This was over concerns about China's growing power and hold on US finances and according to Wikileaks Rudd told Clinton to keep force as a last resort. ***Do the Chinese trust the Americans? As superpowers, both are wary of each other.*** *The business of America has always been business, not friendship or the interest of others in mind except their very own. That is understandable. About the American hubris- I once read somewhere that hubris was the downfall of a Greek hero in some classical tragedy.*

We are entering a new era- the era of a currency war that will test the might of the US economy and the dollar against the might of the Chinese economy and the yuan. The rope in the tug of war will be crude oil. The US economy based hegemony is being challenged by China and therefore it is naturally given that the US will try to maintain its global geopolitical and financial position. Between the giants, the global financial system could end up being completely redefined through a devastating war in the Middle East.

Some years ago I'd read a book "Petrodollar Warfare" by William Clark. The book was published in 2005 when the euro was a rising currency and China's yuan was a distant dream. **Clark had written that the rationale for intervening (in Iraq) was not just for control of oilfields, but also for the control of the means by which oil is traded in global markets.** Saddam was deposed by the US and its Arab allies (who held US$ as their reserve currencies) because he refused to sell oil in US$ alone. The same fate was meted to Libya's Gaddafi. Now Iran is in the American crosshairs not because it is purportedly developing a nuclear bomb which the CIA itself has denied but because it has been selling oil in several currencies from its Kish Island bourse. China is buying oil in international markets from countries that are willing to accept the yuan. *Based on the US Energy Information (EIA), China in 2013 became the number two oil importer at 6.2 million bbls/day (MMBOPD), just slightly behind that of the US at 6.6 MMBOPD.* Again, as per the EIA, China will become the largest importer of oil in 2014-15. Not only that but China's oil production from overseas equity shares through acquisitions increased from a meagre 150,000 BOPD in 2005 to 2.7 MMBOPD in 2013.

China has been importing 52% of its crude oil from the Middle East (including 10% from Iran and 20% from Saudi Arabia) while on the flip side the US has reduced its imports from Saudi Arabia to 16% while the imports from Canada have been steadily increasing over the years. In 2010 US oil production was 9.7 MMBOPD and consumption was 19.2 MMBOPD. That balance changed in 2014 as oil production increased to 13.4 MMBOPD due to shale oil while consumption has actually decreased to 18.7 MMBOPD due to alternate energy and fuel efficiency. Net imports, therefore, further decreased in 2014 by 1.3 MMBOPD (source: EIA)

For over 40 years the US$ has been enjoying an unprecedented and guaranteed position as the world's global currency reserve. In 1971, President Richard Nixon ordered the cancellation of the direct convertibility of the United States dollar to gold due to heavy inflation caused by the Vietnam war, trade deficit and the rising price of oil which made the dollar worth less than the price of gold used to back it from the Bretton Woods that all other currencies (including the British pound) to be indirectly linked to the gold standard wherein the Central Banks would trade gold among themselves at an agreed peg of US$35/ troy oz. *Immediately after this, Nixon negotiated with Saudi Arabia that all oil prices would, in future, be denominated in US$s thus delinking from the metallic yellow gold standard to the fluid black gold standard in return for arms sales and protection.* All thirteen OPEC countries including Iran adopted the sale of oil in US dollar. This allowed the US to export much of its inflation.

In January 2015, the Bank of International Settlements (BIS) issued a paper titled ***Global dollar credit: links to US monetary policy and leverage*** outlining *"that since the global financial crisis (of 2008), banks and bond investors have increased the outstanding US dollar credit to non-bank borrowers outside the United States from $6 trillion to $9 trillion (and up from $2 trillion in 2001). This increase due to quantitative easing (QE) by US Federal Reserve Bank has implications for understanding global liquidity and monetary policy transmission"*. The report explores the horrifying and addictive scale of global debt in US dollars. In layman language the debt is a direct result of the US printing of dollars since 2008.

According to SWIFT **(Society for Worldwide Interbank Financial Telecommunication)** China's yuan became one of the world's top five payment currencies in November 2014, overtaking the Canadian dollar and the Australian dollar. **Global yuan payments increased by 20.3 percent in value in December 2014.** CIPS **(China International Payments System)** will also put the yuan on a more even footing with other major global currencies like the U.S. dollar, yen, pound sterling and euro. It is possible that in a few short years the yuan will share the same position with the dollar as *the petrocurrency* with the price of oil being quoted in both yuan and dollar. **This will cause a massive migration of dollars to head back into the US from foreign countries and foreign investors resulting in hyperinflation.**

Having explained the impact the yuan in a few years and global debt addiction due to the US QE policies, we turn our attention to the new CIPS to be launched by end of 2015 as an alternative to SWIFT which links more than 9000 financial institutions in over 200 countries for facilitating global currency transactions**.**As per a Reuters report of 9 March 2015***"****the launch of the CIPS will remove one of the biggest hurdles to internationalizing the yuan and should greatly increase global usage of the Chinese currency by cutting transaction costs and processing times"*. Reuters mentioned that "CIPS will become the superhighway for the yuan".

Under above scenarios, the 40 years of political and economic marriage of convenience between Saudi Arabia and the US would likely change. **Iran could well emerge as the regional Middle East superpower and a close Chinese and Russian ally under the Shanghai Cooperation Organization (SCO) – a new OPEC with nuclear bombs as suggested in brevity by Professor David Wall in Matthew Brummer's Journal of International Affairs *The Shanghai Cooperation Organization and Iran: A Power-Full Union*. Could that well lead to World War 3 or history may refer to it as "the petrocurrency war"?**

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