Confluence
INVESTMENT MANAGEMENT

Bi-Weekly Geopolitical Report

By Bill O'Grady

March 6, 2023

Enter the Petroyuan

In December, General Secretary Xi made a state visit to the Kingdom of Saudi Arabia (KSA) where he discussed the potential for trading oil in CNY. Although nothing formal was signed on this issue, Xi suggested that the KSA should trade oil and gas using the CNY for settlement. Talks between China and the KSA have been underway for some time, and there is a certain logic to making this change as China is the world's largest oil importer and the KSA is its largest supplier. For China, being able to buy oil with its own currency would reduce its need to acquire dollars to secure oil supplies. For the KSA, accepting payment in non-dollar currencies would improve ties between the two nations.

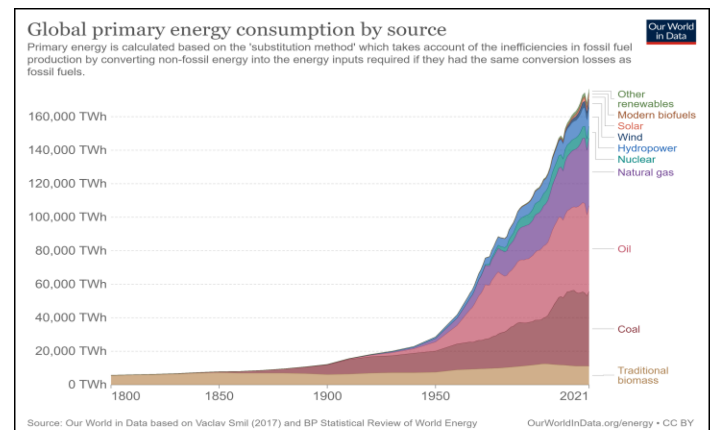
Accepting payment for oil in currencies other than the dollar would be a major change in practice and has raised concerns about the dollar's reserve status. This discussion has triggered sharp divisions between some of the brightest minds in finance. The potential for the emergence of a new payment system could bring notable changes to geopolitics and financial markets.

The dispersion of opinion on this issue is due, in part, to the "siloing" effect in academia and research. Few foreign exchange or international finance analysts have a deep understanding of the energy markets, while most oil and gas analysts are not experts in foreign exchange or international finance. This situation is unfortunate, because the experts on international finance tend to underestimate the critical nature of oil, while oil analysts miss the complexity of foreign exchange. We will attempt to, at least partially, bridge that gap in this report.

In this (rather lengthy) report, we will begin with a short history of the geopolitics of oil and its intersections with finance. This section will include a discussion of the sanction regimes implemented against Iran and Russia, which have raised concerns among other nations. Included is an examination of the basics of reserve currency economics. The next section will examine the emerging structure of the petroyuan system. Following that will be a framing of the debate on the threat of the emerging petroyuan: Is it a replacement of the dollar system, or not? We will close with the potential market ramifications of a parallel reserve currency regime.

The Geopolitics of Oil

For much of human history, the primary energy sources were human power, animal power, and biomass.



(Source: Our World in Data)

The industrial revolution, which began in earnest in about 1820, initially relied on coal. Oil drilling began in 1850 but it wasn't until the mid-20th century that oil and natural gas began to be used as substitutes for coal.

For the military and especially for naval power, however, oil began to supplant coal just before WWI. As First Lord of the Admiralty in 1911, Winston Churchill began to accelerate the Royal Navy's transition away from coal to petroleum as the power source of choice for naval vessels.

Oil has numerous advantages over coal. Oil and its derivatives have a higher energy to weight ratio, meaning that less oil delivers more power than coal. Coal-steamed vessels require extensive maintenance and are labor intensive since coal stoking was usually done by hand and the coal had to be transferred from remote bunkers as the coal stores onboard were depleted. An oil-powered vessel could run at full speed for long periods of time whereas coal ships could only go at full speed for a limited amount of time before the boilers would need to be cleaned. Oil-fired ships can be refueled at sea, allowing for longer voyages, while coal-fired ships had to be refueled in port.[1]

For Europe, the decision to switch to oil created a serious geopolitical problem. Although the continent has extensive coal reserves, it largely lacks oil. There is some oil found in Romania, and after oil prices spiked in the 1970s, the North Sea became a major area of production. However, with respect to the oil-extracting technology of the 19th century, Europe didn't have sizable oil resources. And so, for defense purposes, European nations moved to secure oil, and they did so through imperialism. Britain secured colonies in the Middle East and began developing oil fields in what is now Iran. The Dutch found oil in their colonies in Southeast Asia. Unfortunately, securing these oil resources required extended security measures and flows were vulnerable to interruption.

Russia and the U.S. had indigenous oil supplies, putting Europe at a disadvantage. In WWI and WWII, the U.S. became the key supplier of oil to its European allies. It has been argued that Operation Barbarossa, when Nazi Germany invaded Russia, was driven, in part, by the need to secure oil in the Caucasus.

The Middle East has massive oil reserves. Both the British and French have attempted to secure these supplies, but the largest reserves, found in Saudi Arabia, were developed by American oil companies. In February 1945, President Roosevelt paid a personal visit to Ibn Saud, the founder of the KSA, and struck a deal — the U.S. would help develop Saudi oil in return for security support.

U.S. pressure to end European colonialism after WWII made Europe energy insecure. Europe's lack of oil and gas resources has been a perennial problem, and when consumers require a key resource, they usually attempt to directly secure it. If that isn't possible, the next option is to find multiple suppliers. The U.S. was willing to be a supplier of last resort for Europe and was open to the EU buying oil from the Middle East. Of course, by the early 1970s, the U.S. security commitment to the Middle East had steadily increased. What Washington consistently opposed was Europe becoming dependent on the Soviet

[1] For details on the transition of navies moving from coal to oil, see: Yergin, Daniel. (1991). *The Prize: The Epic Quest for Oil, Money, and Power*. New York, New York: Simon and Schuster, chapter 8.

Union, and then Russia, for oil. However, the Europeans, wanting to diversify their supply sources, mostly ignored America's concerns and expanded their energy imports from Russia.

Oil and the Dollar

Oil is perhaps the most critical commodity, but how a consumer pays for it is important as well. The British and the French would price their oil imports in their respective currencies when importing oil from their colonies, while the U.S., being a net exporter, would price oil in dollars. As European countries began losing their colonies, an increasing amount of oil began to be priced in dollars. After the U.S. exit from the Bretton Woods system, the dollar depreciated against most major currencies. Oil producers in the Middle East and Latin America mostly priced their oil in dollars, which was a legacy from U.S. firms developing oil production in these countries. Especially in the Middle East, though, the dollar depreciation was becoming an issue.

American support of Israel during the 1973 Yom Kippur War triggered an Arab oil embargo, sending prices sharply higher. At the same time, it's important to note that dollar weakness made the decision to support the embargo easier. Complicating matters was the fact that oil producers pricing their oil in USD had accumulated the U.S. currency. U.S. financial officials were worried that these oil producers would lend their dollars to European countries through the Eurodollar market, exacerbating U.S. inflation pressures. To prevent this outcome, Nixon's Treasury Secretary George Shultz, along with Henry Kissinger, reached an agreement with the KSA and other Middle Eastern oil producers where they would price their oil in dollars and then recycle those dollars into the U.S. Treasury market.[2] In return, the U.S. would provide military equipment, and, over time, outright security guarantees.

As more oil became priced in dollars, nations were forced to acquire dollars to secure oil purchases. Obviously, this arrangement benefits the U.S. since it can effectively print dollars for oil, within limits. The rest of the world doesn't have that privilege. Nevertheless, that privilege does come with some costs. For example, the U.S. has been called on to provide security in the Middle East. Although hinted at as early as the Roosevelt/Saud meetings in 1945, this arrangement was formalized by the Carter Doctrine, which stated:

An attempt by any outside force to gain control of the Persian Gulf region will be regarded as an assault on the vital interests of the United States of America, and such an assault will be repelled by any means necessary, including military force.[3]

During the Iran-Iraq War, the U.S. protected oil shipments from the region by reflagging foreign vessels as American to prevent the warring parties from interrupting oil flows. The U.S. led the international coalition to oust Iraqi troops from Kuwait in 1991, and implemented a no-fly zone over Iraq after the war. U.S. actions in Saudi Arabia led Osama bin Laden to directly attack America in 2001. In reaction to that attack, the U.S. invaded both Afghanistan and Iraq. The former was invaded because the Taliban-led government of Afghanistan wouldn't cooperate with the capture of bin Laden. Iraq was invaded on concerns that Saddam Hussein was developing weapons of mass destruction. U.S. involvement in the Middle

[2] Thompson, Helen. (2022). *Disorder: Hard Times in the 21st Century*. Oxford, U.K.: Oxford University Press, pages 105-06.

[3] Source: State Department.

East has been costly and persistent, and the security guarantees, which protect oil flows for global consumption, are a serious burden.

The second issue is that the need to acquire dollars in a fiat currency environment requires the U.S. to accept current account deficits. The saving identity in macroeconomics is as follows:

$$0 = (I-S) + (G-Tx) + (X-M)$$

The first term in the equation (I-S) is the private sector saving balance. The second term (G-Tx) is the public sector saving balance and the third (X-M) is the foreign sector saving balance. To illustrate, if a nation runs a private sector surplus (S>I) and a balanced budget, it will need to run a trade surplus to balance the equation. Or a nation could have a balanced private sector and run a government surplus (Tx>G), which will also result in a current account surplus.

Essentially, since nations must acquire dollars, there is an incentive to over-save. The U.S., being the reserve currency provider, is forced to under-save by either running a private sector deficit (I>S), or a fiscal deficit. The U.S. is a mirror image of the rest of the world. This concept is important and often misunderstood. As the provider of the reserve currency, the reserve currency nation must offset global saving or dissaving. Under a fiat system, if the world is a net saver (and likely would be in a bid to acquire dollars for oil and other commodities), it will force foreign savings onto the U.S. economy. Using the above equation, that would mean the U.S. would run a current account deficit. To offset that deficit, it must either run a fiscal deficit or a private sector deficit (I>S).

It is also possible to acquire dollars via the capital account. In this circumstance, the U.S. could invest or loan dollars to a nation and they could use these dollars to buy oil or other items. This is similar to what the U.S. did with the Marshall Plan. The problem with this solution is that countries have limited ability to persistently attract investments or loans. Since the end of WWII, the most favored development model was export promotion, which relies on an importer of last resort, that being the U.S.

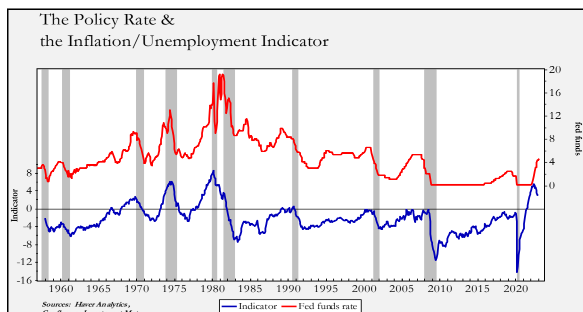
For the U.S., there are benefits and costs to persistent trade deficits and they are not equally distributed.[4] In general, the benefits of providing the reserve currency are lower inflation and interest rates and foreign support for fiscal deficits. The costs tend to be higher unemployment in import-competing industries. A tour of the American Rust Belt and the rise of populism show the costs of expanding globalization, which, put another way, are the costs of providing the reserve currency. On the other hand, the technology and finance sectors tended to benefit from the U.S. providing the reserve currency and reserve asset.

The Weaponization of the Dollar

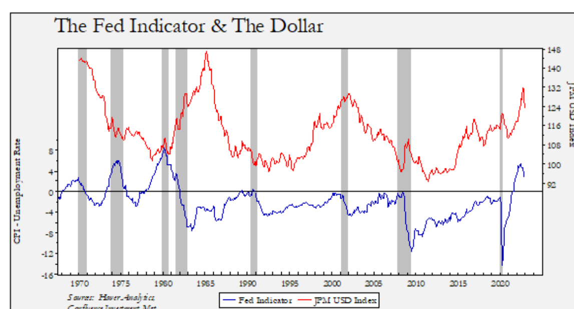
When Nixon ended U.S. participation in the Bretton Woods system, his primary goal was to allow U.S. policymakers to focus on domestic policy and to free them from the responsibility of maintaining the dollar system. From 1971 into the late 1970s, the dollar mostly depreciated. There were numerous reasons for this weakness. First, the U.S. faced a persistent inflation problem and seemed unwilling to enforce policy austerity to end the inflation cycle. Second, the dollar was arguably overvalued when Nixon ended Bretton Woods and some

[4] For a synopsis, see our *Bi-Weekly Geopolitical Report*, "The 2023 Geopolitical Outlook," Issue #1 (12/12/2022).

degree of depreciation was understandable. Even so, the persistence of the decline was problematic.



The upper line in the chart above shows the policy rate target (fed funds), while the lower line shows the difference between the yearly change in CPI less the unemployment rate. Federal Reserve monetary policy has tended to adhere to the Phillips Curve — the theory that there is a tradeoff between inflation and unemployment. The lower line is a rough depiction of the Phillips Curve. Although this theory is controversial, Federal Reserve policymakers have tended to hold to it mainly because they haven't found a workable alternative. From the late 1960s into the early 1980s, inflation rose above the unemployment rate. During this period, there was persistent dollar weakness.



The above chart replaces the JP Morgan dollar index for fed funds and shows the CPI/unemployment rate indicator on the lower line. In the 1970s, the persistence of the inflation rate running above unemployment suggested that policymakers were unwilling or unable to impose austerity on the U.S. economy. This lack of discipline led to persistent dollar weakness. The "Volcker Shock" was the outcome of the Fed implementing austerity; in other words, the Fed raised rates high enough to bring inflation below the unemployment rate. Note that this policy triggered a major bull market in the dollar. Subsequent Fed chairs have maintained the policy of keeping the rate of inflation below the unemployment rate. Whenever the inflation rate threatened to exceed the unemployment rate, policy was pre-emptively tightened.[5] It should be noted that the Fed had help in bringing down inflation in the early 1980s as supply side economic policies of deregulation and globalization expanded supply. However, the Fed's monetary policy did boost confidence in the dollar.

Since 1980, the dollar system has evolved. Because the U.S. was willing to run persistent current account deficits and absorb the world's excess saving, the dollar became the premier reserve currency and Treasury debt became the reserve asset. The American financial system expanded to facilitate this process. As dollars proliferated globally, the Eurodollar system expanded, and firms from around the world found they could borrow in dollars from foreign banks. But, in general, it was difficult to avoid "touching" the U.S. financial system if one uses dollars. The S.W.I.F.T. system created the operational messaging infrastructure to transact in dollars.[6] In other words, the "plumbing" of the dollar/Treasury system is the U.S. banking/financial system and the S.W.I.F.T messaging network.

Until 2012, the U.S. generally didn't use the dollar's reserve position as a weapon. But, in 2012, the Obama administration pressured

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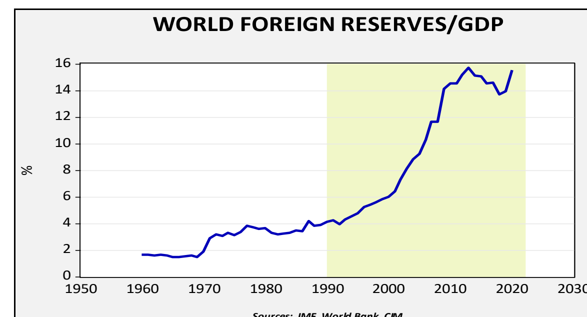
[5] Until recently, of course.

[6] For more details on S.W.I.F.T., see our *Weekly Geopolitical Report*, "Iran and S.W.I.F.T." (3/5/2012).

the S.W.I.F.T. network to exclude Iran in response to the country's nuclear program. Europeans, who imported oil from Iran, were furious and tried to build a competing payment system to evade the U.S. action. The alternative didn't catch on and Iran's exports plunged. By 2015, in a bid to end this particular sanction, Iran, the U.S., and several other nations signed the Joint Comprehensive Plan of Action, (JCPOA), which was designed to rein in Iran's nuclear program in exchange for sanctions relief. For the most part, foreign banks remained reluctant to engage with Iran, in part because the agreement was not a treaty and could be reversed by subsequent U.S. administrations, which is exactly what happened when the Trump administration returned to sanctions, effectively cutting off Iran from the dollar system.

Russia's invasion of Ukraine led to sanctions of an unprecedented level. Never in the post-WWII world has a large economy seen such extensive sanctions. Perhaps even more interesting is that Moscow thought it was prepared for sanctions. It held $631 billion of foreign reserves with only 16% denominated in USD assets. It has $90 billion of gold reserves. It had also created a payment system as an alternative to S.W.I.F.T. called Mir. With Washington's coordination, though, most of the non-dollar reserves were frozen. Liquidating gold became nearly impossible because the "off ramp" for selling the gold touched the Western financial system. Although it may be possible for Russia to find a buyer for its gold, it will most likely suffer a discounted price. Russia has few alternatives, and it is difficult to hold CNY in reserves due to China's capital controls. With capital controls in place, there is no real reserve asset available that is denominated in CNY.

The U.S. and the West's financial sanctions on Russia became a cautionary tale for the rest of the world. Essentially, if a nation gets "offsides" the U.S., then Washington can cut off that nation from the dollar system, making trade difficult. Complicating matters is that the response from many nations after the Asian Financial Crisis (1995-98) was to build high levels of foreign reserves, mostly denominated in dollars and Treasuries. If those assets can be frozen on a whim, there isn't much value or safety in building those reserves. Even holding gold can be problematic if that asset can't be liquidated without touching the U.S. financial system.



The chart above shows global foreign reserves as a percentage of global GDP. Since the end of the Cold War, as globalization expanded, reserve accumulations rose and accelerated after 1998. The aforementioned Asian Financial Crisis led many Asian nations to accumulate foreign reserves in a bid to protect their economies from a repeat of the debt crisis that had plagued the region. If these reserves could suddenly be rendered valueless by U.S. unilateral action, what alternative protection could be created?

Enter the Petroyuan

China is in a tough position. It holds over $3.0 trillion in foreign exchange reserves, and although the composition is a state secret, the last official report in 2016

indicated that 59% of the reserves were in USD.

Such a large reserve position means that it would be next to impossible for China to diversify its holdings away from USD assets completely. Instead, we suspect Beijing wants to reduce the potential impact from U.S. (and Western) sanctions.

We see little enthusiasm from China to replace the dollar system. Beijing has no interest in opening its capital account or running persistently large current account deficits. Instead, it appears that China wants to create an alternative trade and reserve system that has the following characteristics:

1. Trade between like-minded nations will be denominated in local currencies. This exchange is particularly important with oil. However, trade limited to local currencies will tend to resemble barter. If an exporter accepts a minor currency, then it may only have value when buying imports from that country. The KSA has indicated it would be open to accepting currencies other than dollars for settlement. Being able to purchase oil in CNY would make China less vulnerable to sanctions.
2. Reserves could be held in commodities and liquified on Chinese exchanges. Such an arrangement would create an "offramp" for nations under sanctions that hold commodities but want to avoid the S.W.I.F.T. system.
3. The creation of a digital central bank currency shared among the BRIC nations would allow for electronic transfers of liquidity without touching the dollar system. This would protect participating countries from U.S. financial sanctions.

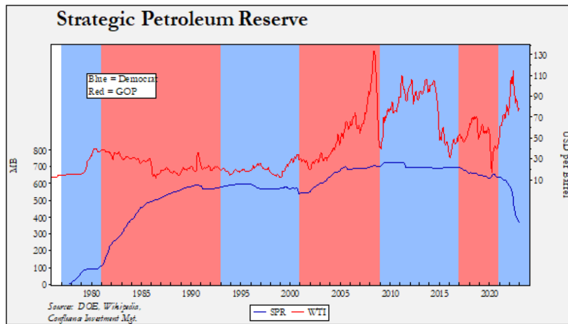
Pozsar/Gromen v. Pettis/Setser

The idea of a petroyuan has triggered strong responses from the financial community. Zoltan Pozsar and Luke Gromen argue that the petroyuan might be a viable alternative to the dollar system. Poszar is an analyst with Credit Suisse (CS, $3.03), and he is considered an expert on financial "plumbing." Luke Gromen is an independent financial analyst. Michael Pettis and Brad Setser believe that there is little chance the CNY will replace the dollar as the global reserve currency. Michael Pettis is a professor of finance at Guanghua School of Management at Peking University and a non-resident senior fellow at the Carnegie Endowment for International Peace. He has written several books and is considered an expert on the macroeconomics of trade and investment flows. Brad Setser is a senior fellow at the Council on Foreign Relations and is an expert on international financial flows.

The Pozsar/Gromen position is that countries aligned with China[7] are essentially securing oil supplies. China has been sensitive to the oil issue for a while. Helen Thompson has argued that Beijing saw the Bush administration's invasion of Iraq as clear evidence that the U.S. was deeply concerned about dwindling oil supplies. Although somewhat unrelated, we note that President Bush was also the only president to make large storage injections into the Strategic Petroleum Reserve when prices

[7] Our bloc analysis is a good reference point.

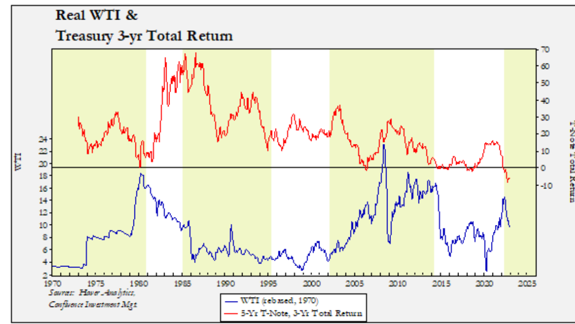
were rising. This policy tends to confirm his fears surrounding supply constraints.



The war was, in China's view, an American effort to ensure that Iraqi oil would be available to the U.S. and the West.[8] Although this position isn't widely held, we do note that at the time of the Iraq War, China lacked a "blue water" navy meaning its fleet could only operate in coastal waters. Over the past 20 years, China has rapidly built a large navy capable of ocean power projection. As Thompson explained, China was also fearful of a U.S. Navy blockade at the Straits of Malacca and other chokepoints in South Asia. [Its investment in Pakistan's Gwadar Port], which would allow it to offload oil just outside the Gulf of Oman, is one response to this worry.

Securing the physical oil is only one part of the process. For non-U.S. purchasers, securing financing is also important. Even if a nation wanted to use its own currency to buy oil, it would still need a way to avoid the U.S. banking/financial system. As we stated above, adopting a digital currency could work as a method to avoid the U.S. dollar banking system.

Luke Gromen argues that falling returns on Treasuries are leading oil producers to consider other payment arrangements. Although the following chart isn't from his work, we note that when three-year returns on the five-year T-Note have eased, oil prices have tended to increase.



On the chart above, dollar bear markets are highlighted in yellow-green. Although the correlation is far from perfect, the combination of high returns on Treasuries and a strong dollar tend to lead to lower oil prices (in deflated CPI terms) whereas weak Treasury returns and a bearish dollar lead to higher prices. Gromen suggests there is an emerging conflict between the dollar's role and U.S. domestic policy goals. Improving returns on Treasuries will, at some point, likely require monetary austerity. However, given the level of private and public sector debt in the U.S., Volcker-like austerity policies could result in a major financial crisis. He argues that, if forced to choose, the Fed will probably protect the domestic economy and may engage in yield-curve control. Such a policy would likely accelerate oil producers' preference for payment in other currencies or assets.

One unanswered question is why oil exporters would accept a currency other than dollars in the current situation. One could see a certain logic for the China/KSA oil trade. An oil exporter receiving CNY could recycle that liquidity into direct investment in China. For example, the Saudis could build oil storage in China. For other nations, though, the KSA would likely be reluctant to accept payment in their local currency. Gold might then become an alternative.

[8] Thompson, op. cit., p. 73.

Both Setser and Pettis suggest that this idea of replacing the dollar's reserve role is nonsense. Their argument is based on the correct observation that the dollar's preeminence is mostly due to open and transparent financial markets and the willingness to absorb the world's excess saving via deindustrialization. Further entrenching the dollar is the Fed's expansion of central bank currency swaps. Of course, not every nation gets access to the Fed's borrowing window, and for nations outside of that, the petroyuan system may be an alternative.

In fact, Pettis argues that the greatest threat to the dollar's reserve status is not from a competing currency. Instead, he opines that it might be U.S. policymakers who could decide that the cost of reserve status is too great and then implement capital controls. Setzer points out that Russia, China, and the KSA are current account surplus nations. For a fiat reserve system to work, somebody must run a current account deficit. Of course, in a non-fiat payment system, it is possible for that issue to be avoided because money is exogenous.

So, Who's Right?

Perhaps both arguments have merit. Pozsar and Gromen are likely correct that a system of trade and financing that avoids the dollar will likely develop. The signal from the weaponization of the dollar, especially against a major economy like Russia's, isn't lost on lesser powers. At the same time, the emerging system will probably be much less efficient than the dollar system. For example, there is oil trading in CNY on China's oil exchange, but it isn't clear if one can hedge large positions or if a robust over-the-counter swaps market exists. Although the Saudis may accept payment in non-dollar currencies, it isn't obvious how far Riyadh will go with this policy. Accepting CNY might be ok, but the attractiveness of accepting frontier market currencies is probably low. At the same time, President Biden's snubbing of Crown Prince Salman didn't go unnoticed. The U.S./Saudi relationship is evolving, with Riyadh likely believing that it needs additional allies.

We suspect that the alternative system being developed will lack market depth and extensive derivative products, to say nothing about swaps availability and lending relations. If the dollar had not been weaponized, it is unlikely that the incentive to create an alternative would have been considered. So, in that regard, Pettis and Setser are probably right as well. To reiterate, the dollar system is efficient and robust; leaving or avoiding it leads to higher costs.

What is likely to develop is a dual system where the current dollar system will likely persist alongside this emerging petroyuan system. We would expect that the nations committed to the U.S.-led bloc will tend to ignore the non-dollar system. We note that a bill has been introduced in the U.S. Congress that would ban payments using the digital CNY. On the other hand, nations clearly on the outs with Washington will likely embrace the petroyuan. For Russia and Iran, the petroyuan would allow them to circumvent sanctions. For China and the KSA, the system would offer an outside payment mechanism if sanctions were applied.

For other nations, participating in both systems might be attractive. If gold were to become the reserve asset for the petroyuan system, holding both gold and Treasuries would allow participation in both systems. It might be possible for commodity producers to use China's futures exchanges to clear trades and acquire CNY.

Weaponizing the dollar was bound to trigger a reaction, and it appears that we are seeing that response emerge. The creation of a parallel reserve system to the dollar is an important development, but at the same time, the disadvantages and hurdles of the emerging petroyuan indicate that it probably won't dethrone the dollar.

Perhaps the best way to think about the rise of the petroyuan is to remember that during the Cold War the communist bloc was an alternative currency system. Because the ruble was not treated as a reserve asset, trade within the bloc was mostly barter. The Soviet Union did acquire dollars and "hard" European currencies through its commodity trade, but for the most part, the communist bloc was isolated from the dollar system. A parallel system would reduce dollar demand to some extent but not enough to fully replace the dollar.

Ramifications

The dollar's reserve currency status is a controversial issue. On the plus side, being the reserve currency allows the U.S. to import goods and services for promises to pay. *The Economist* magazine referred to this as "writing checks no one ever cashes." The U.S. can run large fiscal deficits, and in fact, the world needs the U.S. to do so in order to provide ample reserve assets. As we noted earlier, the dollar's reserve status does tend to bring lower interest rates and inflation, all else being equal.

However, as Michael Pettis correctly notes, the reserve status comes with costs. The rise of populism has been due, in part, to the costs of providing the reserve asset. For investors, any weakening of the dollar's reserve status merits concern, but we should acknowledge that there will be benefits from ending the dollar's reserve status as well.

All else being equal, if less trade is conducted in dollars, the U.S. would be forced to balance the saving identity internally. That might require more private saving, less private investment, higher taxes, or reduced fiscal spending. Reducing liquidity would likely lead to higher interest rates and weaken asset markets. The degree of impact probably would be affected by how broad the parallel system becomes.

If gold becomes the primary reserve asset of the petroyuan bloc, it should be bullish for the yellow metal. We are already seeing large gold purchases by the world's central banks. Although some of this buying is likely for diversification purposes, if gold becomes an important reserve asset again, central bank buying could be a permanent feature of the gold market. We note there is some academic research suggesting that nations that feel they may be on the outs, at some point, with the U.S. have been buyers of gold recently. Commodities, in general, would likely benefit.

It's probably worth noting that U.S. industrial policy, as evidenced by the Inflation Reduction Act and the CHIPS Act, is designed to bring investment to the U.S. ***We have noticed the lack of response from the Biden administration to the potential petroyuan threat***. It's possible that the rise of Jared Bernstein, who is on record as opposing the dollar's reserve status, may be a reason why Washington doesn't seem terribly concerned. As Pettis warns, it might be that the U.S. is rethinking its reserve status and may be more comfortable with allowing a challenge.

Bill O'Grady
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