July 15, 2025

# Morning Briefing

## On The Dollar, BRICS & Hong Kong's Currency

**Executive Summary:** The BRICS has expanded well beyond the original four developing nations that the bloc was named for, but it hasn't gained might in the process. On the contrary, says William, bulking up has backfired, putting the BRICS' aspirations to rival the Group of Seven further from reach. … Also: The Hong Kong Monetary Authority has been struggling to keep the city's currency pegged to the US dollar amid China's deflation, Trump's trade wars, and the Fed's uncertain direction. Lately, it has been draining liquidity to shore up the currency—and hurting the local economy in the process. Are the peg's days numbered?

**Weekly Webcast.** If you missed Monday's live webcast, you can view a replay *here*.

**BRICS Paradox I: Paper Tiger.** President Donald Trump sure seems to have it out for the BRICS (Brazil, Russia, India, China, and South Africa)—the developing world's pitch to eclipse the Group of Seven. While Trump has railed against the bloc before, its plan to challenge the dollar's global dominance really has Trump World in a whirl.

Trump is threatening a *10% tariff* on BRICS nations for what he terms "anti-American" maneuvering. Last week, he singled out Brazil with a *50% levy* threat. One reason: Brazil is holding former President Jair Bolsonaro accountable for his *alleged involvement* in his supporters' attempted coup following his defeat in the 2022 presidential election. All this has India scrambling behind the scenes to *distance itself* from the BRICS' top agenda items.

Yet Trump might be wasting his time. The BRICS is proving to be more of a paper tiger than a successor to the world order—and doing so in real time. Let's take a look:

(1) *Muddy agenda*. Take last week's BRICS summit in Rio de Janeiro. News coverage focused mostly on the *absence* of Chinese leader Xi Jinping. But the discussion point that could matter more is *what wasn't present*: any hint of a vision for a geopolitical force supposedly on track to supplant US influence.

Xi's no-show exemplifies the problem. It suggests that China is putting less stock in the BRICS. Without China in the room, the BRICS has significantly less swagger on the world stage.

Russian President Vladimir Putin was missing, too. The optics of one of the original BRICS members being subject to an International Criminal Court *arrest warrant* is its own challenge. Yet in Rio, BRICS leaders validated concerns that the bloc is struggling to succeed even in areas of shared interest. It has yet to move beyond declarations to concrete steps that alter global dynamics.

One problem, critics argue, is that the long-hyped excitement over the BRICS went to the group's collective head.

(2) *How it started*. The original BRIC acronym was coined in 2001 by Jim O'Neill, then with Goldman Sachs. *O'Neill's thesis* was that these fast-growing, large-population nations would come to dominate world GDP and geopolitical influence in the not-so-distant future.

In 2009, Brazil, Russia, India, and China saw fit to hold a *summit meeting* in Yekaterinburg, Russia. By 2010, *South Africa* was added, representing the "S." In 2023, the BRICS added *six new members*: Egypt, Ethiopia, Indonesia, Iran, Saudi Arabia, and the United Arab Emirates. At present, BRICS leaders represent *about 40% of global GDP* and *49% of the world's population*.

**BRICS Paradox II: When Size Backfires.** The BRICS isn't stopping there, taking on a constellation of "*partner countries*." They include: Belarus, Bolivia, Cuba, Kazakhstan, Malaysia, Nigeria, Thailand, Uganda, Uzbekistan, and Vietnam. Yet this race to expand the group might actually be diluting its effectiveness against Western capitalism.

The core five members have yet to create anything approaching a free-trade zone. Along with decades-old border disputes, China and India are competing fiercely for influence among "Global South" nations. Russia's invasion of Ukraine is a controversy the BRICS could do without. And Brazil and South Africa worry that BRICS expansion might dilute their power.

Let's look at what's blocking the bloc's success and whether it might ever clear these hurdles to reach its goals:

(1) *Divides abound*. As new members arrive, *writes* Mariel Ferragamo at the Council on

Foreign Relations, “other major dividing lines include tensions between democracies and autocracies, and long-standing rivalries such as those between Saudi Arabia and Iran and between Egypt and Ethiopia.”

It’s become, as the *Financial Times* *argues* in a recent editorial, “a more diffuse and contradictory cluster” of nations—a giant island of misfit geopolitical toys.

By some measure, the grouping is indeed having a moment. In 2024, the BRICS+ beat the global annual growth average, growing 4% by the International Monetary Fund’s (IMF) numbers. This year, the IMF reckons the bloc will collectively *grow 3.4%* versus the global average of 2.8%.

(2) *The US quandary*. Yet size gets the BRICS only so far. In Rio, the grouping couldn’t even muster support for mentioning the US in its communique. It danced around Trump’s trade war, US support for Israel, and the recent bombings in Iran. The reason: Individually, each BRICS member relies more on exports to Trump’s economy than they like to acknowledge.

“While the *BRICS countries* are often perceived as a counterbalance to Western power, their economies remain linked to the United States in crucial ways,” notes Valentina Sader of the Atlantic Council.

All this suggests that the BRICS is unlikely to get its act together to threaten the dollar’s reserve-currency status, dethrone the IMF and World Bank, or even to forge a coherent intra-BRICS market that has the US looking over its shoulder. Trump might not need to do much to combat an entity that hasn’t proved it can shoot straight.

**Hong Kong’s Peg I: Under Strong Attack.** Hong Kong’s currency peg to the US dollar has survived multiple crises since 1983 and more speculative attacks than economic historians could count. Short-sellers of the Hong Kong dollar to the US dollar (HKD/USD) exchange rate—from *George Soros* in 1997 to *Kyle Bass* and *Bill Ackman* more recently—have learned that testing the Hong Kong Monetary Authority (HKMA) is the ultimate widow-maker trade.

Yet the latest attack is different. Since late June, the HKMA has fought to stem wild swings and keep the local currency within its *HK$7.75-HK$7.85* per US dollar band as Trump’s trade war whipsaws exchange rates and views on the direction of Federal Reserve policy vacillate.

This balancing act has grown more precarious for an economy caught between the US and China, as tariffs intensify global inflation risks. Hong Kong's overlords in Beijing are grappling with deflation, while the trajectory of the Fed, HKMA's other master, is hard to discern. Will the Fed's next move be to cut interest rates or to raise them?

Let's explore why speculators are targeting the peg now:

(1) *Tough balancing act*. Earlier this year, upward pressure on the currency had HKMA head Eddie Yue flooding the city's *$380 billion economy* with cash to *cap the exchange rate*. Now, to keep the dollar from falling too much, the HKMA is draining liquidity.

This is proving to be quite the conundrum. Yue's policy board is struggling to find a "Goldilocks zone" where it withdraws enough cash to defend the peg but not enough to undermine economic growth and Hong Kong stocks.

Take the city's battered property market, mired in a slump for years. As China's economy slows, rich mainlanders have fewer yuan to gorge on *Hong Kong real estate*. The more liquidity the HKMA withdraws to support the dollar, the stronger local headwinds become, making deep-pocketed local buyers scarcer.

(2) *Economic misalignments*. This tug of war raises fresh questions about whether the dollar peg's days are numbered. A cold look at the facts on the ground suggests that, *43 years on*, the peg no longer aligns with Hong Kong's economic priorities. Rarely has that been truer than now. And the costs of that misalignment are rising.

**Hong Kong's Peg II: What Comes Next?** In a sense, the city has exactly the wrong monetary policy framework that it needs right now. That framework should allow policy to respond to the local economy's needs, not the fast-shifting financial dynamics of the world's two biggest economies.

The most common suggestion is for Hong Kong to peg the dollar to a *basket of currencies* to spread out risk. Others argue the Hong Kong dollar should be linked to the Chinese yuan instead. Hong Kong is, after all, China's financial green zone. A *peg to the yuan* would reduce transaction costs for companies as ties deepen between Hong Kong and the mainland—and as increasing China-bound global investment flows through the city.

Ultimately, the call on whether to sever the peg—or reform the monetary system—will be made by officials in Beijing, not by Hong Kong Chief Executive John Lee's inner circle.

Chinese leader Xi Jinping is as change-averse as they come. And many Communist Party bigwigs see the peg as the embodiment of stability. It anchored the greater China region during the *1997 Asian financial crisis*, the 2008 global crisis, the 2013 Fed "taper tantrum," and today's US-China trade war.

Consider the following observations:

(1) *China's baggage*. Kiyong Seong of Societe Generale notes that a shift to a yuan peg "*will not be feasible*" until the yuan is fully convertible. That day might not come until Xi's government gets serious about repairing China's economic cracks, including a deepening property crisis and weak consumer demand.

One problem is how China is failing to emulate Hong Kong's vast success as a global financial center. Hong Kong's ease of doing business, low taxes, duty-free ports, free capital flows, and transparent rule of law have morphed it into a world-class investment destination.

Yet rather than learn from Hong Kong's laissez-faire ethos, Beijing is remaking the place in its image. Until 2020, Hong Kong routinely was named the "freest" economy by the Heritage Foundation. Today, Singapore holds the title. Hong Kong was *dropped from the index* owing to this Chinafication dynamic.

(2) *Carry-trade risks*. The trade war is making life uniquely difficult for the city—and for investors relying on the Hong Kong dollar "*carry trade*." The calculus involved in playing the gap between what traders pay when borrowing in Hong Kong and their profits from deploying that capital elsewhere is being upended because it's becoming harder for investors to limit risk.

(3) *Short-sellers circling.* In January, HKMA head Yue said there's "*no need to change*" the peg. Markets, though, seem to have a very different take on Hong Kong's ability to fend off the short-sellers this time.

Add what to do about the peg to the long list of challenges confronting Xi in a year that probably can't end soon enough for China.

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## Calendars

**US: Tues:** Headline & Core CPI 0.3%m/m, 2.6%y/y & 0.3%m/m, 3.0%y/y; Empire State

Manufacturing Index -7.8; Barr; Bowman; Barkin; Collins; Logan. **Wed:** Industrial Production 0.1%; Capacity Utilization 77.4%; Headline & Core PPI 0.3% & 0.2%; MBA Mortgage Applications; Beige Book; Williams; Barr; Barkin. (Source: FX Street)

**Global:** **Tues:** Eurozone Industrial Production 0.6%m/m; Germany ZEW Economic Sentiment 37.8; Spain CPI 0.6%m/m & 2.2%y/y; Canada CPI 0.2%; EcoFin Meeting; Bailey. **Wed:** UK Headline & Core CPI 3.4% & 3.5%y/y; Italy CPI 0.2%m/m & 1.7%y/y; Germany Buba Monthly Report. (Source: FX Street)

## Strategy Indicators

**S&P 500/400/600 Forward Earnings** (*link*): During the July 11 week, forward earnings rose simultaneously for all three of these indexes for the sixth time in the seven weeks since May 30. LargeCap's forward earnings rose for an eighth straight week in its longest winning streak since December, and has posted gains in ten of the 11 weeks since it bottomed during the April 25 week. MidCap's rose for the seventh time in the eight weeks since it bottomed during the May 16 week. SmallCap's has risen for seven straight weeks since it bottomed during the May 23 week, and is now on the longest winning streak since it rose for nine straight weeks though June 17, 2022. LargeCap's forward earnings rose 0.3% w/w to its sixth straight record high. MidCap's rose 0.4% w/w to a 10-week high and is 1.9% below its record high during the April 4 week. SmallCap's rose 0.3% w/w to a 12-week high and is 13.4% below its June 2022 record. LargeCap's forward earnings is up 25.4% from its 54-week low during the week of February 1, 2023; MidCap's is just 7.1% above its 55-week low during the week of March 10, 2023; but SmallCap's has lagged considerably and is up just 1.5% from a very recent 42-month low during the May 23 week. These three indexes' forward earnings downtrends from mid-2022 to early 2023 and again during Trump's Tarriff Tantrum were relatively modest compared to their deep double-digit percentage declines during the Great Virus Crisis and the Great Financial Crisis. Here are the latest consensus earnings growth rates for 2024, 2025, and 2026: LargeCap (9.7%, 8.5%, 14.0%), MidCap (0.4, 1.9, 17.8), and SmallCap (-10.2, 1.9, 18.8).

**S&P 500/400/600 Valuation** (*link*): Valuations ticked down w/w for all three of these indexes during the July 11 week. LargeCap's forward P/E fell 0.1pt to 22.1 from a 30-week high of 22.2. It's now 0.2pt below its 43-month high of 22.3 during the December 6 week and 5.1pts above the seven-month low of 17.0 during the October 27, 2023 week. That compares to a 30-month low of 15.1 at the end of September 2022 and an 11-year low of 11.1 during March 2020. MidCap's forward P/E dropped 0.2pt w/w to 16.1 from a 23-week high of 16.3. It's now 1.0pt below its 40-month high of 17.1 during the November 29 week and 3.9pts above the 12-month low of 12.2 in October 2023. That compares to a record high of 22.9 in June 2020 when forward earnings was depressed, and an 11-year low of 10.7 in March 2020. SmallCap's forward P/E dropped 0.1pt w/w to 15.5 from a 20-week high of 15.6. It's 2.6pts above its 17-month low of 12.9 during the April 4 week and 4.9pts above its 14-year low of 10.6 in September 2022, but remains 1.4pts below its 41-month high of 17.1 during the November 29 week. That compares to a record high of 26.7 in early June 2020 when forward earnings was depressed, and a record low of 10.2 in November 2009 during the Great Financial Crisis. The forward P/Es for the SMidCaps have been mostly below LargeCap's since August 2018. MidCap's P/E is at a 27% discount to LargeCap's P/E, up from its 25-year-low 29% discount during the July 5, 2024 week. That compares to a 19% discount during the March 2, 2023 week, which matched its best reading since October 14, 2021. SmallCap's P/E is at a 29% discount to LargeCap's P/E, up from its nine-month-low 32% discount during the April 10 week. That compares to a 23% discount during the November 29 week, which was its best reading since the March 2, 2023 week. It's now 5ppts above its 24-year-low 34% discount during the July 5, 2024 week. SmallCap's P/E is now at a 4% discount to MidCap's, up from a 20-year low 10% discount in late 2021. Prior to that, from 2003 to 2018, SmallCap's P/E had been mostly above MidCap's, and both were above LargeCap's.

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