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Views and Analysis on the Economy and Precious Metals

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Why Politicians Are Good For Gold

Julian D.W. Phillips

After a long and lengthening political debacle on both sides of the Atlantic, the developed world remains embedded in a crisis that the political systems are unable, or unwilling, to resolve despite all the hopeful talks. The leaders of the developed world are capable, competent men who have what it takes to surmount the debt crises that are consuming confidence day by day. So why don't they?

Current Status

U.S.
Fitch Ratings gave the United States until 2013 to come up with a "credible plan" to tackle its ballooning budget deficit or risk a downgrade of the country's coveted, AAA rating. The ratings agency revised the outlook from stable to negative on the U.S. credit rating after a special congressional committee failed last week to agree on at least $1.2 trillion in deficit-reduction measures. The committee failure made it unlikely that any meaningful deficit plan will be adopted next year, increasing the fiscal burden on the next administration that will be elected in late 2012, Fitch said. Fitch said the chance of a downgrade is "slightly greater than 50%".

With unemployment still hovering close to 9.0%, it is likely that Federal Reserve policymakers will consider further monetary stimulus in an effort to give growth some support and to lower the risk of another US recession. While it may appear to be capable of stimulating growth, it will decrease the value of the U.S. dollar both internally and internationally.

Europe
The German bond auction, last week, and Italy's bond auction were poorly received with Italian 2-year bond yields rising to 7.8% from 3.45%. The I.M.F. is not in talks with Italy to provide financial assistance. It does not have the resources to do so either. This week, Italy had to pay 8% for its loans.

Belgium's credit rating by Standard and Poor's to AA from AA+. The Belgian government's capacity to prevent an increase in general government debt, which we consider to be already at high levels, is being constrained by rapid private sector deleveraging both in Belgium and among many of Belgium's key trading partners.

Standard & Poor's could change the outlook for France's triple-A rating to negative within the next 10 days. France's ratings outlook is currently stable with S&P, but there have been rumors for months of a possible downgrade by one or more of the ratings agencies.

Moody's said it could downgrade the subordinated debt of 87 banks across 15 European Union nations on concerns that governments would be too cash-strapped to bail out holders of riskier bank debt in times of stress. Most of the ratings to be reviewed were in Spain, Italy, Austria, and France. The review could lead to an average potential downgrade of subordinated debt by two notches, and junior subordinated debt and Tier 3 debt by one notch. Moody's believes that systemic support for subordinated debt in Europe is becoming ever more unpredictable due to a combination of anticipated changes in policy and financial constraints. Nations affected by review were listed as Austria (nine banks), Belgium (three), Cyprus (two), Finland (three), France (seven), Italy (17), Luxembourg (three), Netherlands (six), Norway (five), Poland (one), Portugal (two), Slovenia (two), Spain (21), Sweden (four) and Switzerland (two). Moody's also warned that the risk to ratings on subordinated

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Is Gold Bubbling Or Booming?

Richard Zimmerman

Precious metal prices appear to have entered a new stage. With increasing frequency, and regularity, the price of gold and silver has been swinging in volatile fashion. These volatile price swings have likely caused many individual investors to become reluctant, even fearful, of taking on fresh positions. After substantial runs to fresh highs, prices over the last week have whipped back and forth in a violent manner, making trouble for trend followers. How long might it be before these troubling times are over and a clear trend is re-established? Or better still, how far and in which direction must gold prices move before the market settles down and volatility softens?

Precious metals have always been considered to be welcome stores of value during uncertain times. That investors are facing uncertain times is demonstrable; just look at the price moves of almost any investment. Few are steady in the current

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environment. The customary pre and post Thanksgiving rally in stocks did not materialize, but the day after it sure did! America continues to react to happenings in Europe, and while the US dollar has recently strengthened in a flight to quality versus other currencies, it looks to be correcting amid an uptrend. What's next?

The national debt is now over 15 trillion dollars while the annual Gross Domestic Product is only $14 trillion. In other words the value of all the goods and services that generate income in America is now exceeded by the nation's debts. While the US dollar strengthens, it is because for now it is deemed the lesser of two evils. A stronger dollar weighs on commodity prices, especially gold.

Market participants might be surprised by gold's continuing weakness and some are likely questioning gold's safe haven status. However, the fundamentals of broad-based global physical demand remain very sound as evidenced by recent central bank gold buying data. Russia bought 19.5 metric tons of gold in October bringing their total gold reserves to 871.1 tons according to IMF data. Belarus increased its holdings by 1 ton; Colombia by 1.2 tons; Kazakhstan by 3.2 tons; and Mexico by 0.9 ton. Data also shows that Germany reduced reserves by 4.7 tons and Tajikistan cut reserves by 0.4 ton. If central banks are buying, what message does that convey?

Additionally SPDR Gold Trust, the world's largest gold-backed exchange-traded fund, reported a rise of 3.631 tons to 1,293.088 tons in its holdings. Commerzbank said recently that they expect to see gold trading at $1,800/oz by the end of the year. Barclays says it is sticking with a fairly bullish call for gold and says it sees the price at $1,875/oz in Q4, and according to Reuters. Deutsche Bank says they expect periods of risk aversion to remain through 2012 and their strongest conviction trade remains long precious metals and specifically gold.

Gold prices have corrected from record

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debt could extend outside the borders of the European Union.

Banks and ratings agencies are sounding their loudest warnings -the euro area risks unraveling unless its guardians quickly intensify efforts to beat the two-year sovereign debt crisis. European finance chiefs prepare to meet this week, yet again, but hopes are barely discernible. Moody's Investors Service said today the "rapid escalation" of the crisis threatens all of the region's sovereign ratings. Europe has accumulated too much public debt. It is in deep disagreement about the way forward. Its banks are short of capital and have difficulties funding. It has lost most of its internal growth dynamic. And bond investors have lost trust, draining away in droves and causing a liquidity crisis with the E.C.B. wishing to stick to its purity and Germany sticking to its guns.

So far, all we have are deepening sovereign and bank funding problems, governments being replaced, growth a lost dynamic, and despair the general currency. So it isn't too difficult to see a final EU crisis moment approaching in which markets cause asset prices to collapse, and there isn't sufficient public support to keep things afloat (never mind reform and regain market trust). And that moment, by all omens, may be neigh. So 2012 could, for all in the developed world, be another 2008 or 1998, as an E.U. disruption.

Why Politicians Cannot Get the Job Done

With the mental capacities, the power and control, why aren't politicians resolving financial crisis? This is an easy question to ask, but the answer is far from simple. Take the concept of democracy. This is a structure espoused as the answer to all ills, pushed forward by the developed world, in particular. What is democracy in the context of today's crises?

It's an institution that requires all people over a certain age (with very few exceptions) to state their support for a very few, selected individuals usually belonging to one of around three political parties to vote for one of this small number of choices that they feel will carry out their wishes as defined by the party's manifesto. Parties decide their manifesto ahead of elections that take place around five years at a time. Outside those elections, individuals have little or no choice in politics. Therefore politicians gear their actions to achieving the most popularity just ahead of those dates. This allows unpopular actions to be taken early in the term of elected politicians and for popularity to be garnered close to the elections. So the extent of the individual choice is very limited and occasional.

But something has gone very wrong with this system in the E.U. and the U.S.A. currently. The result of elections in so many developed world nations has left nations with such a fine balance of power on the political front that governments are not able to govern effectively. In the U.S. the Republicans and Democrats have managed to stalemate each other to the extent that they can get little governing done on the budget deficit. So strong are party politics, that the interests of the nation they govern have been sidelined. *Party politics have transcended national interests*. The same is true in the Eurozone, where government over-borrowing has been allowed against the European Union to which they swore allegiance. Even in the midst of the worst crisis the E.U. has faced, national politicians are failing to rise over national and party politics to save the Eurozone from individual or collective insolvency.

As one E.U. politician so aptly put it, "We know what to do, but the problem is getting re-elected after we've done it". So now we wait in this limbo of indecision, with little prospect of change coming. When will they act? Again democratic politics has a specific influence over their actions. When a politician acts to resolve a problem that requires unpopular measures, he rarely stays in power, victim of the unpopularity of voting support. When voters feel the pain of those problems, their attitudes change. Now their only hope is political action to remove that pain. Now unpopular measures are acceptable to the electorate, desperate to feel relief. In fact if these work, then the politician that imposes such measures is hailed a hero in his land and is likely to be re-elected.

We're now waiting for the pain to strike. You can be sure it will strike before the next U.S. Presidential elections. The skill of the President is to make sure the oppositions takes the blame. The skill of the oppositions is to make sure the President takes the blame. Both hope the electorates are gullible enough to support them and not to blame the system that rules them and to push for a change of system.

Contrast this with a system that believes it knows its people's wishes better than they do themselves, such as China. There the rule of government is almost complete, allowing them to manage the economy and monetary

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A Summary Of The Risks

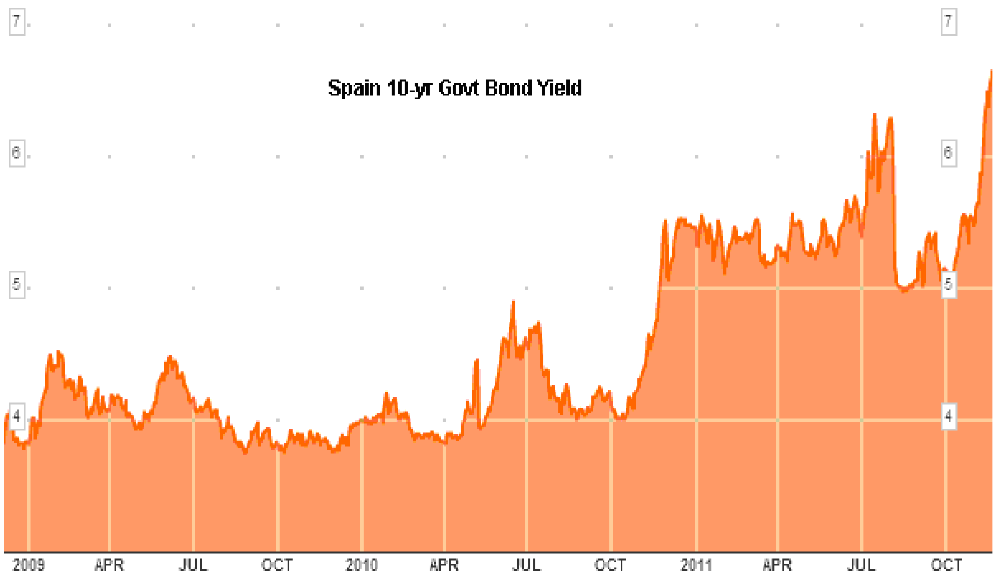
Steve Saville

The Risks

1. Europe's sovereign debt crisis

Of all the risks facing the global economy, the euro-zone's sovereign debt crisis has recently had the highest profile and the biggest effect on the financial markets. The most blatant outward signs of the crisis are the sharp rises in European government bond yields since early October and especially since early November.

Last week, the focal point was Spain. Due to a failed debt auction, the yield on the 10-year Spanish Government Bond surged to a new high.



2. As a percentage of GDP, Spain's government has a lot less debt than the US government. However, the market is saying that there is significant risk of a default by Spain's government and zero risk of a default by the US government. As explained before, the main reason for this apparent discrepancy is that the US government has at its beck and call a central bank that will always be willing and able to buy federal debt should the need arise. The Spanish government has no such unconditional support from a buyer with infinitely deep pockets.

Also of relevance is that while Spain's government has one of the lowest debt/GDP ratios in the developed world, the total amount of debt within the Spanish economy is comparatively high and the private sector is in big trouble due to the knock-on effects of last decade's real estate bubble. For example, the unemployment rate in Spain is around 22% and the unemployment rate for people in the 18-24 age group is around 45%. These are Great-Depression-like numbers.

3. The slowdown in China's economy could evolve into a collapse

Although the government's GDP numbers don't reflect it and will never reflect it, there is little doubt that China's economy is in recession. The latest piece of evidence in support of this view comes from HSBC's Purchasing Management Index for China, which declined from 51 in October to 48 in November (below 50 suggests economic contraction).

In response to the slowing of the domestic economy and the economies to which they export a lot of goods,

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12 Eurozone Downgrade Shock Waves Could Slam Into US Economy

Daniel R. Amerman, CFA

Standard & Poor's missed the point when they "only" put 15 Eurozone nations on credit watch for possible near term downgrades. In this highly interconnected world - most of Europe can't be put on credit watch without putting much of the world on credit watch, with the United States being particularly vulnerable to global "contagion" risks.

Twelve possible implications for the United States are concisely explored herein. These "shock waves" include everything from the value of the dollar, to unemployment, gas prices, stock prices, derivatives, US bank stability, inflation, retirement investing, Federal Reserve reactions, the US deficit and credit rating, the potential criminal prosecution of S&P, and more.

Each potential "shock wave" assumes: a) that Eurozone leaders fail to credibly reach consensus; b) that this political breakdown does lead to an actual credit downgrade; c) that several European nations default on their debts; d) that there is least a partial collapse in the value of the euro; and e) that this all leads to a major downturn which materially reduces the size of the European economy. Those assumed events will not necessarily happen - much is still in play - but if even a partial Eurozone collapse does occur, then the resulting "shock waves" could rapidly change lives, standards of living, and investment values in the US and around the world.

1. US Dollar, Short Term

The US dollar's value as the world's reserve currency is likely to be substantially strengthened in the short term, as a panic-stricken globe seeks refuge from the euro collapse. The buying power of the US dollar may surge in this global rush for safety.

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system without oppositions and with only muted criticism. A look at the economy of the two tells its own tale. Nevertheless citizens in China place their trust is savings and in particular gold, not the government systems.

Why Gold Will Benefit From Political Impasse

With political considerations set far above financial ones, only the explosion of confidence in national money will swing political considerations behind financial ones. This seems and easy answer, but it isn't. The ailments of the financial system extend to its very structure: the banking system. The longer it takes to resolve the financial crises, the worse it gets. Once the decay in confidence has past a certain point, it's impossible to fix. Then there needs to be a restructuring of the system. The worse the level of confidence, the more radical the re-structuring needs to be. The more re-structuring there needs to be, the stronger the hold of government over its nation needs to be. That means there will need to be an overwhelming dominance of one party or another so as to avoid the current developed world impasses. To date, the performance of developed world political parties falls short of inspiring such support.

So what does an investor do?

In the developed world he can hop from one investment to another in the hope he has found some special formula that will save his wealth. Once this fails he may turn to another. For instance he may turn to U.S. Treasuries as the ultimate of liquid markets or cash (at the short end). But Treasury prices at all end of the Yield Curve have never been so high, so capital appreciation is not expected. Yield increases would mean falling prices and losses if one bought now. But this is the tree trunk of the fictional currency system, so there's nowhere else to turn.

Article by:
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A Summary Of The Risks

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Chinese factories have been reducing their labour costs by reducing wages and/or eliminating overtime work. Furthermore, workers who live from hand to mouth are not only seeing their incomes reduced, they are also seeing their costs of living rise thanks to the monetary inflation of the past few years. The deadly combination of a weak labour market and rising prices for the basic necessities of life is one of the inevitable effects of Keynesian economic policy.

And it isn't just the factory workers of China that are becoming increasingly disgruntled due to the economic contraction. In addition, there have recently been cases of irate purchasers of new apartments storming the offices of the associated property developers. The purchasers became irate after realising that property prices can go down as well as up.

Civil unrest will almost certainly intensify throughout China if the overall economy continues to stagnate or contract. This could prompt the central government to change tack and attempt to re-ignite the boom via accelerated credit expansion, but going down that path would lead to an even bigger inflation problem. A worsening of the inflation problem would, in turn, lead to greater civil unrest.

Interventionist economic policy always ends up putting the government "between a rock and a hard place" -- where, no matter what is done, it is no longer possible to maintain the illusion that things are going well. It looks like China's government is now in such a predicament.

4. The US recession

It appears, to us, that the US economy has been in recession for much of this year. However, we don't know when the recession will officially be said to have begun. We can't even be sure that the recession of 2011 will ever be officially acknowledged. If forced to make a guess it would be that during the second or third quarters of next year, the National Bureau of Economic Research (NBER) will belatedly confirm that a US recession began during the third quarter of 2011.

It's possible that the current US recession will turn out to be mild, but for two reasons this is not the most probable outcome. First, the policies of the Fed and the government have got in the way of the economy's attempts to correct the problems that led to the 2007-2009 contraction. Of particular relevance, a lot of valuable resources have been channeled into the banking industry in an effort to keep alive badly managed and parasitical institutions. Second, the economies of China and most euro-zone countries are likely to perform poorly over the next 12 months, creating an external drag to go along with the internal drag.

The strong possibility that the US economy will remain in recession for at least a few more quarters is a big risk for the US stock market, because it means that 2012 earnings are likely to be a long way below the current forecasts of most analysts.

5. Egypt heating up, again

Many thousands of people flocked to Cairo's Tahrir Square over the past week to protest the slow pace at which the Supreme Council of Armed Forces (SCAF) says it will cede power to a civilian government. Clashes between the protestors and "security forces" led to the deaths of more than 40 protestors. SCAF apologised for these deaths, but refused to yield to the protestors' demand for a much quicker handover of power. This refusal makes it likely that protests will continue and tensions will escalate over the months ahead.

Elections for Egypt's Lower House of parliament are scheduled to commence this week. The problem, from the protestors' perspective, is that the elections will run for several months and even when they are complete the military will still be in charge. This is because the Lower House will have no real power anytime soon. Its primary role will be the writing of a constitution.

SCAF's current plan is for the transfer of power to a civilian authority to wait until after a president is elected, which won't happen any earlier than the second half of next year and will possibly not happen until 2013. Many

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2. Consumer Prices

The rapidly rising value of the US dollar would have the immediate effect of making almost all imports cheaper to buy, and so a trip down the aisles of Wal-mart may for a brief period become less expensive for the American consumer. The price decreases could be exacerbated by exporters from around the world engaging in vicious price competition within the US market, trying to keep their factories going and to offset the loss in consumption in Europe.

http://danielamerman.com/articles/2011/BrokenC.html

3. Unemployment

Because of the combination of the surge in the value of the US dollar and the reduction in the size of the European economy, US workers may face devastating job losses in two major categories: exports to other nations, and goods consumed in America.

American workers in export-driven industries will lose jobs because dollar-priced US goods will be more expensive for the rest of the world to buy. This decreasing competitiveness will be compounded by a drop in consumption in the huge European markets, resulting in less US exports. There is also the third danger of a drop in overall global consumption, as the result of exporting nations losing employment on a global basis.

In a global scramble to maintain employment even as consumption falls, the last thing workers want is to be handcuffed by having their products priced in the world's "reserve currency" - and that is the exact situation that American workers will be in.

The second major category of job losses will be found among the producers of goods consumed in the US. Because the dollar is more expensive, American workers will be undercut by other workers around the world, as imports grow cheaper and more difficult to compete with. These lower-cost goods mean that there may be a brief "Indian Summer" of lower prices for American consumers.

However, this will sadly likely be accompanied by a fundamental weakening of the US economy as unemployment surges, and fewer people can afford to make the purchases at all. Which then further reduces overall global consumption, intensifying the competition among exporters.

There may also then be increased "outsourcing" as American corporations seek to lower production costs by moving employment out of the US.

4. Gasoline & Energy

As a result of a likely depressed global economy leading to reduced energy usage, most nations are likely to see a declining cost of energy imports (with the exception of Europe, depending on how devastating the currency damage turns out to be). Because the US will benefit in this regard from the 1-2 combination of a higher valued currency and decreased global demand, the decline in the cost of energy may be particularly sharp in the United States, and could even briefly bring the cost of gasoline back down to under $2 a gallon. This cheaper energy will be an offsetting factor when it comes to global competitiveness for US firms, but likely not nearly enough to overcome the dollar's strength.

5. US Financial Institutions

Up to this point, the markets have been focusing on the US financial institutions which have the greatest direct exposure to Europe and European banks. However, in the months following a potential Eurozone collapse, the secondary or ripple effects are likely to dwarf the first round of primary effects - and few major banks will be positioned to withstand it. After all, the US economy is still reeling from the last financial crisis, and there has been no real recovery to date.

A new second round of depression slamming into the global and US markets means a potentially massive increase in unemployment, with delinquencies soaring in all categories of consumer credit along with bankruptcies. There will also be dire financial implications for firms relying on exports or US consumer sales - and those two categories cover most of the private economy. This could all lead to a rapid increase in corporate loan losses. Most important of all could be the extraordinary effects upon the derivatives markets (see "Derivatives" below).

Over time, and as the interrelated negative effects compound upon each other, the direct and indirect effects of a Eurozone collapse are likely to be a "doomsday" event for the major US banks, absent another likely round of massive government interventions (see "US Deficit & Credit Rating" below).

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Gold bullion could 'easily' hit $2,000

Robert Miller

Richard Davis, manager of the BlackRock Commodities Income Investment Trust, tells Robert Miller why demand for commodities will remain strong and how gold bullion prices could 'easily go to $2,000'.

In recent months the commodities sector has certainly not looked like it was enjoying a so-called super cycle of soaring prices that was the investment scenario at the start of the year. And, given the slowdown in global economic activity in 2012, the prospects of further price increases in the raw materials used by industry would seem fairly remote.Think again.

The respected commodity research firm SEB said in its 2012 preview: “Over the next 12 months we expect oil, copper, nickel and gold prices to move higher, while agriculture is likely to soften further. There are of course risks of a double-dip recession in the US, a hard landing in China and the disintegration of the eurozone, though we regard them as less likely.”

Richard Davis, manager of the BlackRock Commodities Income Investment Trust, echoes SEB’s upbeat outlook. Speaking in the latest weekly Your Money Their Hands video he said: “At the moment, demand is reasonably weak, so I think that is a cause for concern. But, if we look longer term, demand growth is going to be strong and that will be driven by the likes of the Chinese economy. On the other side, supply growth will remain weak. That is good news for commodity prices going forward.”

The two commodities that attract the most investor attention – and indeed speculators – are oil and gold. The BlackRock portfolio under Mr Davis has taken a big position in oil, often referred to as “black gold”. “Long term,” he noted, “we think that the oil price has to remain above $100, and it has to be above that level in order to encourage new supplies to come on.”

And the gold outlook? Mr Davis pointed out that as an income fund manager, the shares of gold mining companies have not performed anything like as strongly as the bullion itself, so his exposure to the precious metal miners is quite small at less than 5pc. However, he believes that the outlook for gold bullion itself is very promising and that the price could “easily” touch $2,000 an ounce or even higher.

Article by: The Telegraph

A Summary Of The Risks

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Egyptians are worried that it will never happen.

The Muslim Brotherhood, the most important political party in post-Mubarak Egypt, chose not to get involved in last week's protests. This is no doubt because it is poised to do well in the coming elections and doesn't want to 'upset the apple cart'.

However, the Brotherhood's tactics could change if its current lack of open support for the protests leads to a significant reduction in its popularity or if there are further delays to the handover of power.

The upshot is that the political situation in Egypt remains unstable and stands a good chance of becoming even more so in the near future. This adds to the growing pile of risks that the global financial markets have to deal with.

6. Other problems/threats in the Middle East

The Middle East is never a bastion of stability, but right now it appears to be even less stable than usual. For example, in addition to Egypt's increasingly-volatile political situation:

- There is a realistic chance that protests against the Assad regime in Syria, which have prompted a draconian and deadly response from the regime, will evolve into a full-blown revolution. Given President Assad's apparent commitment to retain power regardless of the human cost, the death toll would be huge.

- There is the ever-present threat that Israel and/or the US will take military action to derail Iran's nuclear program. The closer Iran gets to the point where it is able to build a working nuclear weapon, the more likely an Israeli-US attack becomes.

The situation in the Middle East is the most plausible explanation for why oil has begun to diverge from the stock market (the oil market has recently been much stronger than the stock market).

7. Quantitative Easing

The Fed's Quantitative Easing (QE) was one of the reasons that the US economy's rebound from the 2007-2009 recession was so weak. QE, or money printing to use a more descriptive label, doesn't create new wealth. Rather, it surreptitiously redistributes existing wealth. Some people end up poorer and other people end up richer.

Importantly, the wealth transfer is inefficient and tends to benefit the least productive and least prudent people at the expense of the most productive and most prudent. It therefore doesn't only reallocate the pieces of the pie, it makes the overall pie smaller. QE is a seductive policy, though, because it usually makes things look better for a short while.

When a theory consistently fails in practice, a reasonable person will acknowledge the likelihood that the theory is wrong. However, it hasn't yet occurred to the Fed's leadership that QE theory (the theory that the economy can be helped by creating money out of nothing) is wrong. Consequently, there will very likely be more QE if the US economy gets worse and the stock market continues to trend downward.

The potential for a lot more QE is, in our opinion, the biggest risk facing the US economy. Moreover, this is a risk that will almost certainly materialise at some point. The only question is when.

Article by:
Steve Saville
28 November 2011
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6. Derivatives

A potential euro collapse threatens the possible near term annihilation of the financial system through both credit derivatives and interest rate derivatives losses. The near criminal insanity of investment bankers writing themselves massive bonus checks for effectively standing in a circle and making promises to each other that none of them have ever had the capital to back up (in the event of genuine systemic crisis), will be brought to the fore.

Absent massive government interventions, we may have a bankrupt financial system where none of the highly leveraged big players have any real capital remaining because their loan and investment portfolios went bad, but they still owe massive amounts of money to each other as counterparties on the hundreds of trillions of dollars in derivatives contracts.

The nominal sum of derivatives contracts outstanding is about $700 trillion, while the global GDP is estimated to be about $63 trillion. If the governments assume and honor the derivatives contracts, *then they could be on the line for a cumulative bailout that exceeds the size of the global economy* (though this would be reduced by the netting out of offsetting contracts). As a more likely alternative, there would be attempts at a legal "fix" of some sort, where governments use their lawmaking, regulatory and monetization powers to maintain a functional banking system, but would effectively set aside the rule of law (in one way or another) when it comes to derivatives contracts.

7. US Deficit & Credit Rating

If the Eurozone economy collapses, then coming into a presidential election year, the US government is likely to face a situation of soaring unemployment, a failing economy, and a bankrupt financial system. Given the political realities and the track record, the reaction of the US government is all too predictable:

- Spend federal money like there is no tomorrow in an attempt to boost employment levels;
- Run federal deficit spending up to all new levels as the money is spent but taxes aren't increased;
- Massively bailout the US financial industry;
- Bailout other US major corporations as needed; and
- Create trillions more dollars out of thin air to finance the above (see "Federal Reserve & Monetization" implications below).

This radical increase in the federal deficit accompanied by "printing" ever more money should "downgrade" both the US dollar and the entire US financial system as well as the US government. Whether or not subsequent rating downgrades occur is ultimately a political decision, and may have more to do with the outcome of the US Justice Department's (effectively) punitive investigation of Standard & Poor's that began shortly after S&P's previous US downgrade, rather than the actual facts of the situation.

The second half of this article contains Shock Waves 8-12. Topics include: Federal Reserve bailouts, long term US dollar effects; state and local government insolvencies; the potential criminal prosecution of Standard & Poor's; and implications for long-term investors. There is a linked resource exploring the redistribution of wealth within Europe itself.

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7 December 2011
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Is The US$ In Danger Of Losing Its Reserve Currency Status?

Steve Saville

A week seldom goes by without us reading somewhere that the US dollar is in danger of losing its reserve currency status. We are now going to argue that the US$ is actually in no such danger, because it can't lose what it doesn't have.

The US$ became the official "reserve currency" in 1944 as a result of the Bretton Woods agreement. Under this agreement, all the major currencies of the world were to have fixed rates of exchange against the US dollar. The idea was that participants in the Bretton Woods system would intervene in the foreign exchange market -- buying/selling their own currency or US$ reserves -- to keep the actual rate of exchange within 1% of the stipulated rate. For its part, the US agreed to make the dollar convertible into gold at the fixed rate of $35/ounce, although the conversion facility was only available to central banks and governments.

With all the major currencies pegged to the US$ it made sense for most international trade to be conducted in dollars and for commodity prices to be quoted in dollars throughout the world.

In summary, the Bretton Woods agreement established a system of payments based on the US$, with all currencies defined in terms of the dollar and with the dollar defined in terms of gold. Under this system the US$ was the world's reserve currency, but gold was the ultimate monetary anchor.

For reasons that we won't regurgitate at this time, the Bretton Woods system was abandoned in the early 1970s in two stages. First, the US government "closed the gold window", meaning that the US reneged on its commitment to link the dollar to gold at the fixed rate of $35/ounce. Second, most central banks stopped trying to maintain fixed exchange rates. The result was an anchorless monetary system of free-floating currencies that persists to this day. Well over half of the world's currency reserves are still US$-denominated, but …

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this is not because the US$ is still the "reserve currency". The accumulation of US$ reserves over the past decade has mostly been associated with the mercantilist trade policies of China, Japan, and other Asian governments. This official-sector accumulation of dollars will continue as long as the political leaders of these countries believe that they can gain an economic advantage via a weaker currency. Refer to our article titled "Nobody wants a strong currency" for additional thoughts on this issue.

Also, a lot of international trade is still US$-denominated and commodity prices are still generally quoted in dollars throughout the world, but this happens for reasons of convenience and efficiency. It doesn't happen because the US$ has something called "reserve currency status". The fact is that the US$ is by far the most widely accepted currency in the world.
The upshot is that under the current monetary system there is no official reserve currency. It therefore isn't possible for the US$ to become less valuable as a consequence of losing "reserve currency status".

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The Outstanding Public Debt
National Debt:
15,058,558,802,767.63
The estimated population of the United States is **311,864,106**
US citizen's share of this debt is
$48,285.64
The National Debt has continued to increase an average of
$3.930000000 billion per day
Business, Government and Financial Debt exceeds
$100 Trillion

Is Gold Bubbling Or Booming?

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highs yet there is evidence of inflation clouds gathering. Food prices are up a full 13 percent this year. Inflation statistics however do not seem to verify this in CPI as a whole. It feels as though the foundations of future inflation have already been laid. There is still a piper to be paid for all of the money that was created as part of the stimulus efforts since 2008.

As for what is happening in Europe, two main potential outcomes exist: Either the euro zone splits apart or it binds closer together.

The euro may change its make up or face the emergence of a deeper political union in which a federal Europe takes control of national budgets - something that would lead to serious political, legal and financial consequences. With financial panic now threatening to move beyond Italy and Spain and into Belgium, France and Germany, the euro zone's paymaster, the pressure to arrive at a solution is at a new level of intensity.

The financial contagion in Europe is pushing already fragile global economies towards recessions, and increasing the risk of the world slipping into global recession is rising significantly.

Indeed, as analysts have warned for many months, there is a real risk of a global Depression given the scale of the debt levels in most western countries and the massive imbalances globally.

Although most of the focus has been on Europe in recent weeks, markets should cast an eye on the not-so-inconsequential matter of the appalling US fiscal position which could deliver further market volatility and see the US dollar come under pressure again. Washington's latest "Super committee" effort to come to grips with the mounting debt seems to have ended in failure when negotiators announced they could not reach a deal. This failure with cutting the US government's crushing $15 trillion debt looks set to support gold.

Summary

Gold and silver prices reflect market forces and what investors are experiencing right now are uncertain and unprecedented times. Precious metal prices have gone up substantially and the violent correction to prices is a result of that move. The longer term likely bodes well for another round of higher prices, but it will takes time for markets settle down and get accustomed to their new phase. It is easy for some talking heads to banter in the way they have always done - a really active market with fresh price highs is just a bubble waiting to burst or a story to take an alarmist view on. These sound bites might be good for the quick pace of daily news, but precious metals are unlikely to fade as fast as runway fashions or starlets. Remember to keep the macro view in mind - there is still a long road ahead for the global economy.

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