

A Trade War Won't Be Good For The Dollar

Peter Schiff

On Wall Street, it's best not to think too hard or to look too closely into the mouths of gift horses. Since making predictions based on actual economic understanding is rare, analysts typically look to provide explanations after the fact. Within the financial services industry, currency traders are perhaps the greatest practitioners of this craft. While they often get the fundamentals completely wrong, it never seems to stop them from offering bizarre theories to explain currency movements.

After the Recession of 2001-2002, the dollar began an historic, nearly 40%, decline that bottomed out in early 2008. During that time, the falling dollar became a dominant topic in the financial world. While it was occurring, I argued that the sell-off was the result of the overly accommodating monetary policies of the Alan Greenspan-led Federal Reserve and the rapid increase of Federal debt under George W. Bush. Few currency traders agreed. Instead, most continually predicted that the slide would end long before it actually did. Their confidence may have been based on the fact that the Federal Reserve raised rates from 2003 to 2007. According to the textbooks, rising rates, which reward someone for holding a particular currency, are supposed to be a positive. Except, that time, they weren't. I argued that the rate increases were too mild to actually strengthen the dollar and too slow to deflate the growing bubbles in stocks and real estate. Eventually the dollar decline stopped, but it took the chaos of the 2008 financial crisis to bring it about.

After two and a half years of intense volatility that followed the aftermath of that crisis, the dollar settled into a long uptrend that began in April 2011 that has since added more than 30% to its value. When the rally started, traders attributed it to the first hints that the Fed would be winding down its Quantitative Easing bond buying program (which had been in effect since 2008). Even though those purchases didn't fully end until 2015, just the thought that the program would be slowing inspired traders to buy the dollar. When QE came to an end, their anticipation then shifted to the Fed's decision to lift interest rates from zero, a move that finally occurred in December 2015. Since then, they have attributed the rally to the rate hikes of 2017 and 2018 and the future hikes the Fed has said it intends to deliver this year and next.

But during the entire rally, interest rates have remained below even the official rate of inflation, and America's trade and budget deficits have kept expanding. Those factors should have dragged the dollar down. Instead, political troubles in the European Union and economic uncertainty in Asia, combined with massive central bank purchases of Treasury bonds, helped push up the dollar for unearned reasons. But as long as the trends conformed to their forecasts, no one questioned the causality.

When 2017 began, bullish consensus on the dollar was off the charts. Yet despite multiple rate hikes throughout the year, the dollar defied consensus and fell sharply, notching its first annual decline in five years, and its largest yearly drop in fourteen. But following its worst January since 1987, the dollar has since risen by about 7% from its February low. To explain the turnaround, traders are now making similarly bad arguments and are extrapolating continued gains into the future. Incredibly, included among their bullish arguments are soaring federal budget deficits and the prospects for a protracted trade war. But they are wrong that those factors will help the dollar.

Traditionally, rising government deficits have always been bearish for the dollar. That's because it was expected that the government would have to borrow to meet the shortfall. More borrowing leads to more debt issuance, which puts downward pressure on bond prices and the dollar, especially when the Fed increases the supply of dollars to purchase those bonds itself. But this time the markets think it will be different.

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The Fonzie—Ponzi Theory of Government Debt

Daniel Nevins



This post is excerpted from my book Economics for Independent Thinkers, although with some updating. It seems relevant after the CBO's latest long-term budget outlook, which in its optimistic "baseline scenario" called for America's net federal debt to double over the next 30 years, rising from 76% of GDP in 2017 to 152% in 2048.

Before reaching this chapter or even picking up this book, I imagine many of you were already loosely divided into the

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Valuing Gold In A World Awash With Dollars

Alasdair Macleod

Summary

In this article I point to the pressures on the Fed to moderate monetary policy, but that will only affect the timing of the next cyclical credit crisis. That is going to happen anyway, triggered by the Fed or even a foreign central bank. In the very short term, a tendency to moderate monetary policy might allow the gold price to recover from its recent battering.

Unlike the last credit crisis when the dollar rose sharply in a general panic for safety, on the next crisis, the dollar is likely to fall substantially. The reason is that foreign ownership of dollar investments (typically in US Treasuries) appears greatly overextended, and an additional \$4 trillion of liquidity is in the wrong (non-US) hands. This is likely to be unloaded during a general credit crisis, driving the dollar lower.

Domestically, in the next credit crisis the Fed is certain to support the banks, provide finance for a runaway government deficit and stabilise the private sector by injecting further liquidity into an economy already awash with dollars. Therefore, not only will the dollar fall on the foreign exchanges, but its purchasing power in the hands of American citizens seems certain to fall as well.

And finally, I demonstrate how fluctuations in the quantity of paper gold makes a nonsense of the conventional supply and demand approach to analysing and forecasting gold price trends. Futures and forward markets have deflected demand from physical metal, a situation that depends on confidence in the dollar as a stable currency being maintained. Only a marginal shift away from paper towards physical gold will undermine the whole paper-gold system.

The journey to the next credit crisis

Recently the gold price has depended on the dollar's cross-border flows. They in turn have been driven by market perceptions of increasing credit risks in emerging market currencies, and the

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two major camps of the public debt debate.

The first camp is already concerned and doesn't need my research to form an opinion. These people stress the math involved in borrowing—the idea that you get do extra stuff today, but you have to somehow pay for it in the future.

Meanwhile, those in the other camp ask, "So what?" They might argue that America will make good on its debt because "it always does." Or they'll point confidently to America's unique advantages as a military superpower, paragon of political stability, and steward of the world's predominant reserve currency. Confronted with the lessons of history, they'll say, "This time is different."

But what exactly is it that may or may not be different? It's important to draw a distinction between two types of debt limits:

- **The Fonzie–Ponzi transition.** At what point does it become virtually certain that a debt problem won't be resolved without a credit event?
- **The Keynesian endgame.** At what point does the ability to bear more debt break down completely and actually trigger the credit event or hyperinflationary money printing?

I'll explain Fonzie–Ponzi first. Charles Ponzi was the perpetrator of a pyramid scheme, soon to be called *Ponzi scheme*, that the *Boston Post* exposed in 1920. It's fair to say that Ponzi, who lived extravagantly while his scheme was underway, knew how to manipulate people. He shared that particular skill with Fonzie, although he was a scoundrel, whereas Fonzie was a well-liked sitcom character. If you watched enough *Happy Days* back in the day, you know that "The Fonz" had a keen understanding of human nature. You also know that impressing friends and foes with his unbounded confidence was a huge part of his alpha-male badassness.

I still remember watching the "Richie Fights Back" episode and puzzling over the revelation that Fonzie's tough-guy image was a confidence trick. Fonzie asks Richie, "In the entire time you've known me, have you *ever* seen me in a fight?" Richie's answer: "Well no, but that's just because the other guy always backs down first." In other words, it was no George Foreman–like string of knockouts that made Fonzie fearsome. It was attitude, reputation, and a commanding voice, along with a self-described "majestic bearing."

Fonzie soon became my word association for other confidence tricks. For example, paper currencies are Fonzies because their value rests entirely on confidence in the governments that back them.

And where do Ponzi schemes fit in?

Well, Ponzi schemes have characteristics that don't quite fit The Fonz. Namely, they need an endless supply of participants to sustain confidence and stay alive. Once the participant pool depletes as it eventually must, Ponzi schemes are revealed as scams. Whereas Fonzies can persist indefinitely (at least in theory), Ponzis must eventually collapse.

Ideally, public debt would always cruise along in Fonzie mode. Governments would rely on the confidence of their creditors, but without taking too many liberties with those creditors. But in reality, finances sometimes deteriorate and push public debt into Ponzi territory. The precise point where this transition occurs depends on the amount of austerity that's needed to put public debt ratios on a clear downward path, as well as the likely effects of that austerity. Instead of using numerical measures (for now), I'll say that restoring discipline at the Ponzi point would cause the economy to break down for an unusually long period, failing to create jobs or growth. The downturn may or may not meet the textbook definition of a depression, but it would lead to depression-like joblessness. Think of current circumstances in Greece, for example.

The Ponzi characteristics of the no growth, no jobs scenario are based on politics. Politicians are sure to second-guess austerity in a depression or depression-like economy. If they didn't, they'd be pilloried and voted out of office, replaced by populists and demagogues. Demagoguery thrives in difficult times—by whipping up a hurricane of discontent. And warnings of fiscal ruin at an indeterminate time in the future? They carry all the force of a gentle breeze. Political realities ensure that short-term thinking carries the day, whereas the Cassandras who insist on fiscal responsibility fade away.

With austerity becoming a bad word in such challenging circumstances, debt resumes its climb toward a higher threshold, one that brings a more destructive outcome. That ultimate threshold—mainstreamers call it *debt*

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While it is well known that deficits are rising dramatically as a result of the recently passed tax cuts and spending increases, traders amazingly assume that the Fed will not need to accommodate the larger deficits with easier money. Instead they believe that the Fed will continue to tighten policy, raising rates through this year and next. They also believe that the Fed will actually tighten further by selling \$50 billion per month of its own inventory of Treasury bonds into the market (which the Fed has indicated it will do beginning in October of this year). By flooding the market with an unprecedented supply of treasuries, the thinking is that a dollar shortage will ensue. That is because the global dollar supply will be absorbed by the U.S. government, crowding other borrowers out of the market. The biggest losers are assumed to be emerging markets, where dollar funding plays a significant role in local finance. If you don't bother to actually think it through, such an idea may make sense. But it evaporates under closer scrutiny.

Since treasuries are merely interest-bearing dollars, as the supply of treasuries soars so does the supply of dollars. As investors loan dollars to the U.S. government, those dollars get spent right back into circulation, allowing the same dollars to purchase even more Treasuries. So the market will never run out of dollars, as the government will constantly spend whatever quantity it borrows back into circulation.

Even if the Fed manages to shrink its \$4.5 trillion balance sheet, the Federal Government's balance sheet will continue to swell. The world will be awash in dollars in one form or another. The Fed issues liabilities in the form of Federal Reserve Notes, which have no maturity and pay no interest. The U.S. government issues liabilities in the form of interest bearing Treasury debt of varying maturities. But the total dollar supply is actually the sum of all government liabilities, whether issued by the Fed or the Treasury. The only caveat is that one needs to believe the Fed would never allow the Treasury to default. My guess is that since the markets regard Treasuries as being risk free, that assumption has clearly been made.

But the larger issue is that as the deficits continue to grow they will cast an ever-larger shadow over the entire economy. More Federal red ink should force interest rates higher and may convince the Fed to abandon its plan to shrink its balance sheet (if the plan ever really gets underway in the first place). As the Fed monetizes the ballooning deficit, both the Fed's and the Treasury's balance sheets will expand in tandem. When that happened after the 2008 Crisis, the increasing dollar supply was offset by voracious demand from foreign banks, and markets remained optimistic about the Fed's ability to quickly turn off the monetary spigots when the economy got back on its feet. As a result, the dollar did not fall. But this time around, we may not be so lucky. If the Foreign banks stay away, if optimism on the economy fades, and if confidence in the Fed's ability to mop up the liquidity is lost, dollar demand may prove insufficient to meet a deluge of supply. In other words, the dollar will fall.

Traders are also betting a trade war will reduce U.S. trade deficits, which will be bullish for the dollar. It won't be. A reduction in the trade deficit may result from Americans buying less not selling more. A decline in imports may lead to a decrease in U.S. consumption, which would slow U.S. GDP growth, decrease employment, and lower tax receipts. This might lead to an increase in the U.S. government's budget deficit. In other words, a trade war may just move our red ink from one pocket to another. Also a slowing economy may force the Fed to cut rates rather than raise them, a development that few people now expect. As all surprises tend to do, this may shock the markets and could send the dollar tumbling.

But a bigger problem for the dollar may be that all of this trade tension may threaten the dollar's reserve currency status. China seems to be working feverishly to prepare for a world in which the dollar is not at the center. That would be the biggest blow the dollar could receive. While this is unlikely in the near term, if a trade war really gets ugly, anything is possible.

A trade war may also finally prompt China to do the smart thing and dump its trillion-plus holdings of U.S. treasuries. This would send long-term interest rates much higher, further slowing U.S. consumption and put pressure on U.S. asset prices. Many believe this nuclear option will never be tried, as it could lead to mutually assured destruction. But selling a portfolio of low yielding, dollar-denominated Treasuries near the major top of a 30-year bull market could be a great trade for China. And since most of China's Treasury holdings are short-term, there may be no need to sell. China merely may ask for their dollars back when they mature. So all the selling may be in the forex rather than the bond market.

However, there is no way for both China and the Fed to shrink their balance sheets simultaneously, especially if the U.S. government's balance sheet is also expanding. So if China pushes, the Fed may have to shove its shrinkage plans aside. With the Fed creating dollars not only to fund growing budget deficits, but to repay China, and with China dumping those dollars on the forex market, a dollar crisis could easily ensue.

But in the short run, dollar strength is causing paper FX losses for those who have invested in non-dollar assets.

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Fed's policy of normalising interest rates while other major central banks are still applying monetary stimulus. The result has been a stronger dollar on its trade-weighted basis and a weaker gold price.

This is short-term. Long-term, there can be little doubt that the trend of a falling dollar measured in gold will continue, which has seen the dollar lose 97.5% of its purchasing power relative to gold over the last fifty years. We know this because it is official policy to maintain price inflation. While the long-term can take care of itself, we need to assess what is likely to happen in the next few years, particularly in the event of a mooted recession, and also the next credit and systemic crisis, which we know to be a periodic event.

Monetary policy now stands at a crossroads, with America's economy in the mature phase of the current credit cycle. The Fed plans to continue to reduce its balance sheet and to raise the Fed Funds Rate by at least one half of a per cent by the year end. At the same time there are concerns in some quarters that the economy is already being slowed by monetary tightening. Even President Trump has broken with convention and commented negatively about the Fed's tightening policy.

There appears to be similarities with the little-known minor recession of 1927, which turned out to not be a recession at all. Since the depression in 1920-21, the US economy had grown rapidly on the back of monetary expansion and technological innovation. By 1926, ordinary Americans were enjoying a standard of living undreamt of in the years following the Great War. There can be little doubt the economy was in its mature phase of the credit cycle and generally booming from 1925 onwards. A mild recession was then detected by the Fed in late 1926, so it made substantial open market purchases and eased the discount rate.

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The stock market was propelled into its final manic phase. The pause in the economy, for that was all it was, was subsequently attributed to Henry Ford switching production from the Model T to the Model A, necessitating the closure of his factories for several months.

Today's spanner in the works could turn out to be the disruption to trade from Trump's policy on trade tariffs. But we shouldn't take historical comparisons and their outcomes too literally, and there are few signs yet of some sort of economic pause. True, the growth in broad money supply has slowed to 3.8%, and the yield curve is deemed flat by historic standards. The combination of slow growth in money supply and a flat yield curve often presages a recession, but it should be borne in mind the US economy is already awash with deposit money.

It turned out that ninety-one years ago the Fed overreacted. So far today the Fed is sticking to its current monetary policy. But President Trump is kicking back. Undoubtedly, he will be supported by businesses addicted to cheap money and which want to see their profits bolstered by a weak dollar. It could become politically difficult for the Fed to continue on its course of gradual tightening.

If we see signs of the Fed succumbing to pressure to let up on monetary policy, we can expect the dollar to ease. Perhaps that time is approaching. However, the Fed cannot look at monetary policy in isolation, but in the context of a widening budget deficit. The Congressional Budget Office forecasts budget deficits increasing incrementally from \$804bn this year to \$1,526 in 2028 on current economic and fiscal policies. These deficits represent a significant increase of fiscal stimulus coinciding with a monetary policy that is coming under pressure to be eased.

Worse still, if President Trump follows through with his threats to impose import tariffs, the general price level will rise, which the Fed will find impossible to ignore.

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tolerance, whereas I'm joining the heterodox thinkers who call it the *Keynesian endgame*—is when investors refuse to lend more money, forcing default or hyperinflationary money printing. It then becomes obvious that the government's borrowing was a Ponzi scheme. It needed an endless supply of participants to stay alive, but the appetite for debt isn't endless.

The difference between the Ponzi point and the Keynesian endgame is crucial. At the Ponzi point, the game isn't over just yet, but it's a foregone (if not widely recognized) conclusion that you're on a path in that direction. The path is firmly established because measures to curb deficits would wreak havoc on the economy and change the political calculus about austerity.

Also, investors remain in the game at the Ponzi point, happy to hold government debt, in the same way that successful Ponzi schemers are able to find willing participants right up to the end. Large, developed nations, such as the United States and Japan, can sail right past their Ponzi points with nary a flutter in the financial markets. As I'll argue in a moment, Japan has already passed its Ponzi point.

Think of it this way:

You're swimming in the ocean on a perfect, sunny day, unaware of a riptide that's pulling you beyond a swimmable distance from shore. Once you realize what's happened, you'll struggle against the current and may pay for your mistake with your life if there's no help at hand. But the mistake was made earlier when you ignored the water conditions and drifted past your ability to swim back safely. Let's say it was halfway between the shoreline and where the rescue helicopter pulled you out that you unknowingly let yourself drift too far. That halfway spot was your Ponzi point.

In the swimming scenario, you should have turned around well before reaching the Ponzi point, even as there were no obvious signs of danger. By the same logic, governments should take action well before public debt rises to Ponzi levels, even though they, too, won't get a clear warning of the eventual catastrophe.

Now for my thoughts on the Ponzi point for today's large, developed countries. Smaller and emerging countries are different, because they often lose their creditors' confidence before the Ponzi point comes into play. Here's my theory for the big countries:

The Fonzie–Ponzi Theory

Government Debt (% GDP)	Fonzie or Ponzi?
Less than 100%	Fonzie
100% to 150%	In transition
More than 150%	Ponzi

Thresholds are notoriously inexact in economics, which is why I use big, round numbers. It's also why I've chosen a wide range for the transition from Fonzie to Ponzi. At some point between 100% and 150% debt-to-GDP, I think the sovereign debt of today's large, developed countries fundamentally changes. Bondholders who were merely perpetuating a confidence trick become participants in a Ponzi scheme.

My estimates are based on the research summarized earlier in this chapter, which I'll tie into the Fonzie–Ponzi theory in just a moment. I'll first add a few more qualifiers and then some data. Here are the qualifiers:

- **Assumptions behind my transition range.** I don't recommend a range of 100% to 150% for all times and places. It seems sensible, though, for countries with spending commitments extending far into the future without proper funding behind them or even honest accounting. That happens to be many of today's developed countries. My transition range is also more likely to apply to countries with heavy private sector borrowing.

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Of course, it is possible that the slowdown in money supply growth and a flattened yield curve as indicators of an approaching recession should be taken more seriously than today's full employment and above-target inflation figures. Or perhaps a full-blown credit liquidation crisis is already on its way without further monetary tightening, as various doomsters tell us. Therefore, it seems unarguable that whether the Fed loosens now and tightens later, or alternatively continues to gradually tighten, the US economy is heading for a cyclical credit crisis anyway, with only the timing being an issue. I am on record as having pencilled in a credit crisis towards the end of this year, possibly by mid-2019 at the latest, and I see no reason to change that opinion.

Of course, the trigger for the next credit crisis may emanate from the EU, China or Japan. Furthermore, memories of the Asian financial crisis in the late nineties when several currencies collapsed against the dollar still inform scholarly articles. All the signs of overheating economies in South-East Asia have indeed returned. Surely, say the financial experts, experience tells us that just the threat of a credit or systemic crisis will trigger a flight into the dollar, because everyone needs safe-haven dollars.

The current dollar rally appears to have been driven in part by this thinking. It accords with the dollar being regarded as the riskless standard for portfolios and businesses alike at a time of systemic crisis.

However, with respect to the dollar the situation is totally different from previous credit crises, particularly in the years running up to the last one in 2008-09. This is shown in Table 1, which highlights the cumulative capital flows in the credit cycle before the last credit crisis in 2008, compared with the flows since.

Table 1. USD Cumulative capital flows - \$billion	<i>2003-2008</i>	<i>2009-2017</i>
Net foreign investment in US\$ assets	5,344	8,971
Net US investment abroad	-788	-155
Balance of trade in goods and services	-4,094	-3,730
Net capital flows unaccounted for	462	5,086

In the previous credit cycle (2003-2008) the cumulative trade deficit was broadly matched by net foreign investment and the repatriation of capital by US residents. This is not the case during this cycle, which has seen additional capital inflows of some five trillion dollars. Supplemental to Table 1 is foreign investors' dollar liquidity, which Exhibit 19T in *US Portfolio Holdings of Foreign Securities as of June 2017* is recorded as an additional \$4.217 trillion, accounting for the bulk of the remainder of the inward capital flows.

These findings are central to how the dollar is likely to behave during the next credit crisis. It is a feature of any credit crisis that foreign currency exposure is liquidated where possible to provide support for domestic obligations. To some extent this is offset by the dollar's reserve currency status, making dollars the last foreign currency to be liquidated where more than one foreign currency is held by non-US entities.

The figures in Table 1 show that the common assumption a future credit crisis will trigger a buying stampede into the dollar is going to be wide of the mark.

Foreigners are already up to their eyeballs in dollars, and in a cyclical credit crisis are almost certain to be massive sellers. They have a \$4 trillion cash cushion available to unload before they even start on their US Treasuries.

Domestic impact of the next credit crisis

During a credit crisis we can expect the central banks to intervene both to support their domestic banking system and to coordinate rescue policies with each other. In addition, the Fed is certain to do whatever it takes to prevent widespread commercial bankruptcies and to ensure rapidly escalating fiscal shortfalls are covered. As a priority the rate of price inflation will be a distant second to saving the system. Initial easing of the dollar might be seen by the Fed as beneficial, reflationary at a time of escalating bankruptcies.

Given the increase of debt in the economy since the Lehman crisis, the amount of rescue support required will almost certainly be far greater than anything seen before. The Lehman crisis involved writing open-ended cheques to a theoretical extent that I estimated at the time totalled some \$13 trillion.

The effect on domestic prices is likely to be severely inflationary following the next credit crisis, because the renewed flood of liquidity will be in addition to the increase in bank deposits since the last crisis. At the end of 2017, savings deposits plus checkable deposits plus currency in circulation totalled \$12.8 trillion, representing 66% of GDP. At the end of 2007, the last full year before the crisis, they totalled \$5.22 trillion, representing only 36% of GDP. If as a base case we assume that in the next credit crisis, monetary expansion to avoid widespread

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bankruptcies is at least as much again as occurred following Lehman, then we are likely to see cash plus savings deposits plus checkable deposits increase to a figure greater than GDP.

It is hard to see any policy alternative, other than just letting the whole system crash. Therefore, we can expect quantitative easing to return with a vengeance, not only to recapitalize the banks, but to cover escalating government deficits. As can be inferred from the money flows in Table 1 above, US national finances have been made perilous by relying on foreigners to finance budget deficits. They are less likely to buy Treasuries in a global credit crisis, because they already have too many and will want to sell their surplus dollars rather than invest them. The gold price will likely adjust to discount a veritable tsunami of dollars emanating from the Fed and from foreign holders at the same time.

The indications are that the history of our times will identify the next credit crisis as pay-back time for America's continual deficits and the illusion that foreigners will always finance them. While the Fed has no practical alternative to ensuring that dollar debt doesn't liquidate, the consequence can only be to collapse the dollar.

The last time a comparable dollar crisis occurred it led to the abandonment of the Bretton Woods system by President Nixon, when previously exported dollars were in such excess that their return caused the post-war monetary system to collapse. That led to the gold price rising from \$35 to a high of over \$800 in January 1980, an increase if replicated this time would take gold to over \$25,000.

The outlook for the gold price and why supply and demand statistics are useless

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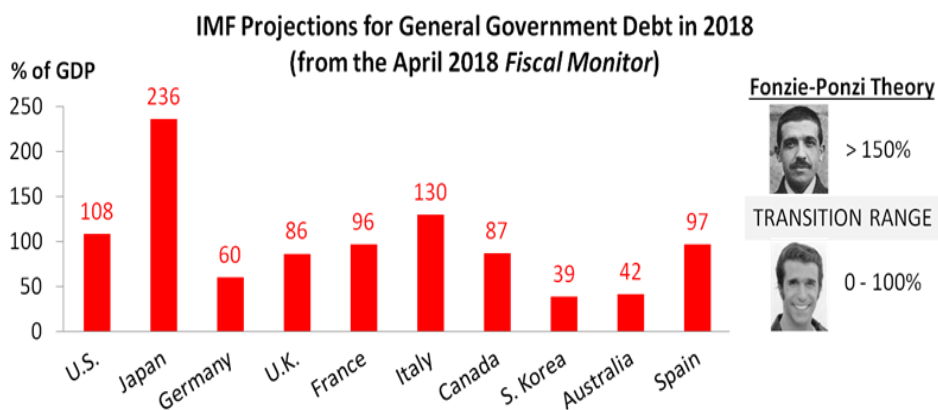
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The amount of private borrowing is important because it determines the capacity for new bank credit and, therefore, the likely effects of fiscal policy changes. If private debt capacity is high, banks can cushion fiscal restraint by expanding credit to the private sector. Conversely, low private debt capacity means fiscal restraint can more easily swing bank money creation into reverse (see this article), leading to the stagnant or negative growth that invariably coincides with a broad-based deleveraging.

- **Austerity versus anti-austerity.** I'm not making blanket recommendations for austerity policies—which may or may not be helpful, depending on the circumstances—nor is this a policy-oriented book in the first place. That said, I'll offer three brief policy conclusions. First, economic risks are lowest when governments stay well clear of their Ponzi points. Second, even though sovereign defaults are highly disruptive, debt restructuring is often the best option once the Ponzi point is breached. (If you're headed for default anyway, there may be a case to act quickly and restore public debt capacity to healthy levels.) Third, after a restructuring occurs, it's imperative to put public finances back on a sustainable path, one that remains below the Ponzi point. Of course, politicians often reach very different conclusions.
- **Fonzie–Ponzi versus Minsky.** The Fonzie–Ponzi theory is more lenient than Hyman Minsky's financial instability hypothesis. Minsky proposed a "Ponzi finance" threshold for private debt, but we can just as easily apply it to the public sector. He said that borrowing qualifies as Ponzi finance whenever fresh issuance is needed to fund interest on existing debt. According to the common assumption that America would miss interest payments without regular increases in the statutory debt limit, we long ago triggered Minsky's threshold.

Now here's the data:



The chart shows the IMF's projected 2018 public debt ratios for the ten largest advanced economies, ordered from highest to lowest GDP. It shows three economies in the transition range and one full Ponzi, and these include the two largest economies and three of the largest six. Meanwhile, private debt has grown nearly as fast as public debt on a global basis. The Bank for International Settlements compiled data showing global borrowing by households and corporations jumping from 126% of global GDP in 1999 to 151% in 2008 and 159% at the end of 2017. That growth in the private debt burden—33% of GDP so far this millennium—has to eventually stall or reverse. Soaring private debt makes it even more important to heed the Ponzi point for public debt.

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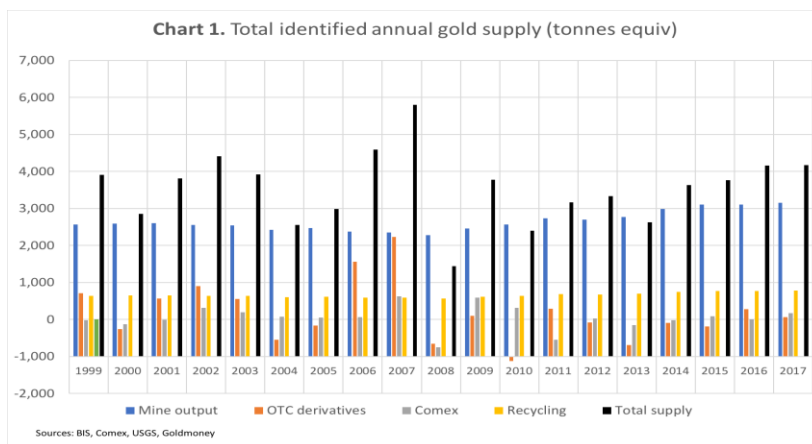
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The few specialists analysing monetary gold recognise that the only form of gold worth owning in the event of a systemic collapse of the fiat currency system is physical gold, or at the least, gold that is safely vaulted beyond the reach of the banking system. While this is unarguably true, so long as the current financial system of fiat currencies persists, the supply of non-physical forms of gold is bound to dominate the price.

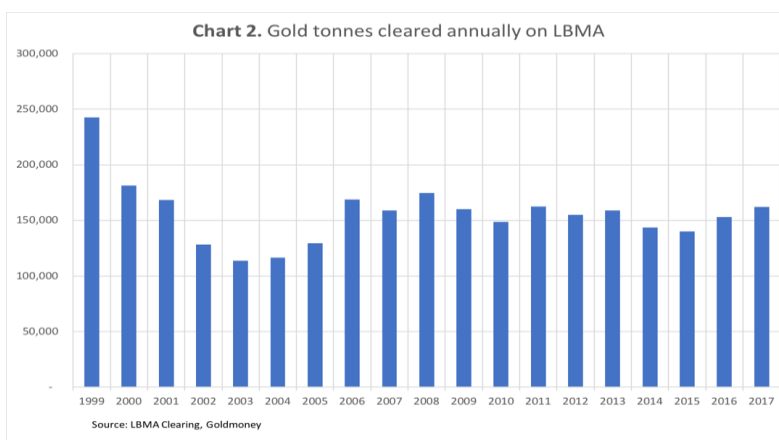
Traditionally, analysts of consumed commodities such as base metals talk about supply and demand in terms of mine output and user demand. However, nearly all the gold ever mined still exists. Some is monetary metal in the broadest sense, and probably more than as much again is classified as jewellery. Even here, the lines are blurred, because Asian buyers of jewellery see it as having a dual purpose, both as adornment and monetary savings.

Updating Goldmoney's 2012 estimate of above ground stocks gives us a figure of 172,975 tonnes as of 2017. Annual mine output currently amounts to approximately 3,000 tonnes per annum, and recycled scrap, counted as additional supply to the market, is perhaps a further 750 tonnes. These figures are dwarfed by the supply of paper gold. Chart 1 shows how the sum of mine output, scrap recycling, Comex futures and over-the-counter derivatives have varied from year to year.



Total changes in annual supply are substantial, hitting a peak in 2007 of 5,800 tonnes, falling to 1,445 tonnes in 2008, following a contraction in OTC derivatives and outstanding Comex contracts in the wake of Lehman's collapse that September. The expansion of supply last year was recorded at 4,168 tonnes.

Even these figures fail to capture the full picture on two counts. The four categories of supply in Chart 1 aren't the only ones, and more importantly, they are only year-end snapshots. Supply is a continual process, with every transaction a record of both supply and demand. One should add up all the daily turnover volumes on futures exchanges for a start. The London Bullion Market provides this information on a daily settlement basis for the forward market, which forms the bulk of OTC derivatives in the Bank for International Settlements statistics. This is shown in Chart 2.



Compared with changes in supply on a year-end basis, the totals dwarf mine supply, and they do not even include intra-day buying and selling. It shows how misleading statistics based on mine output and recycled scrap alone are for discussing gold prices.

We cannot know how the ever-elastic paper supply to satisfy demand without moving the gold price might expand or contract in future.

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A Trade War Won't Be Good For The Dollar

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It is also pushing down the local currency prices as well, especially in emerging markets that are hit extra hard by the dollar's rise. (Many of these countries have issued dollar-based bonds and have gotten squeezed as a rising dollar makes the debt more difficult to service).

Dollar strength also pushed down gold and commodity prices, compounding the problem for those who have invested under the assumption that the dollar will fall.

But the stories that traders tell themselves in order to justify price movements (that are fundamentally unjustifiable) can fall apart very quickly. New stories can replace the old ones.

The next one may even be closer to the truth. If so, investors would be well-served to look for signs that the Fed is not nearly as hawkish as it likes to pretend.

Article by:
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July 22, 2018
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Valuing Gold In A World Awash With Dollars

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We can only be certain that it will disappear entirely if paper currencies become worthless and so we can presume a falling dollar will gradually undermine the whole paper pyramid. Until that time, it is only clear why the Svengalis operating in the paper gold markets have been able to suppress demand for physical gold by inflating paper supply to many multiples of the physical.

It also explains why the combined demand for physical gold from Asian markets can consistently exceed mine supply without the price being unduly affected. It is, however, a situation that cannot continue indefinitely. Paper markets for gold only work so long as participants do not demand delivery of physical bullion. The bullion banks strongly resist this, not only in the paper markets but also, reportedly, some German and Swiss banks are today refusing to return physical gold held by their clients in supposedly allocated accounts.

Investors simply hoping for a profitable trade on the price of gold do not appear to understand that gold is money, not a speculative investment. They are likely to find that as the purchasing power of the dollar declines with increasing rapidity it is never worth selling gold, or any other asset including cryptocurrency for that matter, to book profits in a declining fiat currency.

Gold is and always has been the non-speculative hold-it-until-you-are-ready-to-spend-it money, whose purchasing power gently increases over time. It is monetary calm while everything else is in flux and deserves a premium value for that quality alone.

Conclusion

We cannot be sure what form the next credit crisis will take, but we can be certain it will happen, because it is a cyclical event created by central bank monetary policy. Once that fundamental point is grasped, it follows that the severity of the crisis is proportional to the monetary distortions that precede it. The next credit crisis will almost certainly dwarf anything seen so far in the fiat currency era.

Following the next credit crisis, the suppression of the gold price by expanding the quantity of paper derivatives will become less effective at controlling the price when the purchasing power of the dollar deteriorates under the sheer weight of its increased quantity.

The price of gold can be expected to rise significantly higher when measured against fiat currencies. How much depends on the degree and the rate at which fiat currencies lose purchasing power. To understand this properly it helps to reapply the pricing relationship between gold and fiat currencies when fiat currencies were defined by their weight in gold. That is to say, gold is the objective money and fiat currency bears the subjective price. This turns \$1230 per ounce into 25 milligrams of gold per dollar. We may have to get used to it and be ready to price the dollar in micrograms as well.

Article by:
Alasdair Macleod
July 26, 2018
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The Outstanding Public Debt

National Debt:

21,296,800,376,948

The estimated population of the United States is 328,227,564

US citizen's share of this debt is
\$64,883.00

The National Debt has continued to increase an average of
\$3.8 billion per day

Business, Government, Financial and Unfunded Liabilities Debt exceeds
\$100 Trillion

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