Gold Stock Analyst
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Currency Wars & The Future of the International Monetary System

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International Monetary System Today Dominated by Currency Wars. Definition of a Currency War:

* Devaluation of one country's currency against that of another in order to increase exports and economic growth
* Important to place in historical and economic context in order to understand today's trends

Currency War I (1921-1936)

Began with massive war reparations and war debts
Weimar hyperinflation – 1921-1922
French devaluation and gold exchange standard – 1925
Fed policy blunders: Too loose 1927-28; too tight 1929-1931
English devalue in 1931 / U.S. devalues in1933
Tripartite Accord - 1936

Currency War II (1967-1987)

Bretton Woods prevails beginning in 1944
UK has massive overhang of Sterling claims from WWII
U.S. Policy of "Guns and Butter" begins in 1965
Bretton Woods begins to break down in 1967
London Gold Pool 1961-1968
Nixon Shock – 1971; Smithsonian Agreements
Inflation, recession, oil shocks 1973 - 1979
Volcker, Reagan and the return of "King Dollar" 1980-1984
Plaza Accord 1985 and Louvre Accord 1987

Currency War III (2010 -)

The Warning: Japan's Lost Decade and LTCM
The Prelude: Glass-Steagall, Swaps Repeal, VaR, Basel III
Chinese export model meets U.S. consumption model
Greenspan and Bernanke "puts"
The Depression of 2007 and the Panic of 2008
Aftermath: Debt, Depression and Deleveraging.....Again

Origins of a Currency War

Examining Growth – Fiscal Policy

Roots of Currency Wars are in debt, deleveraging, deflation
The debt overhang impedes growth for a decade or more

Fiscal Analysis

$$GDP = C + I + G + (X - M)$$

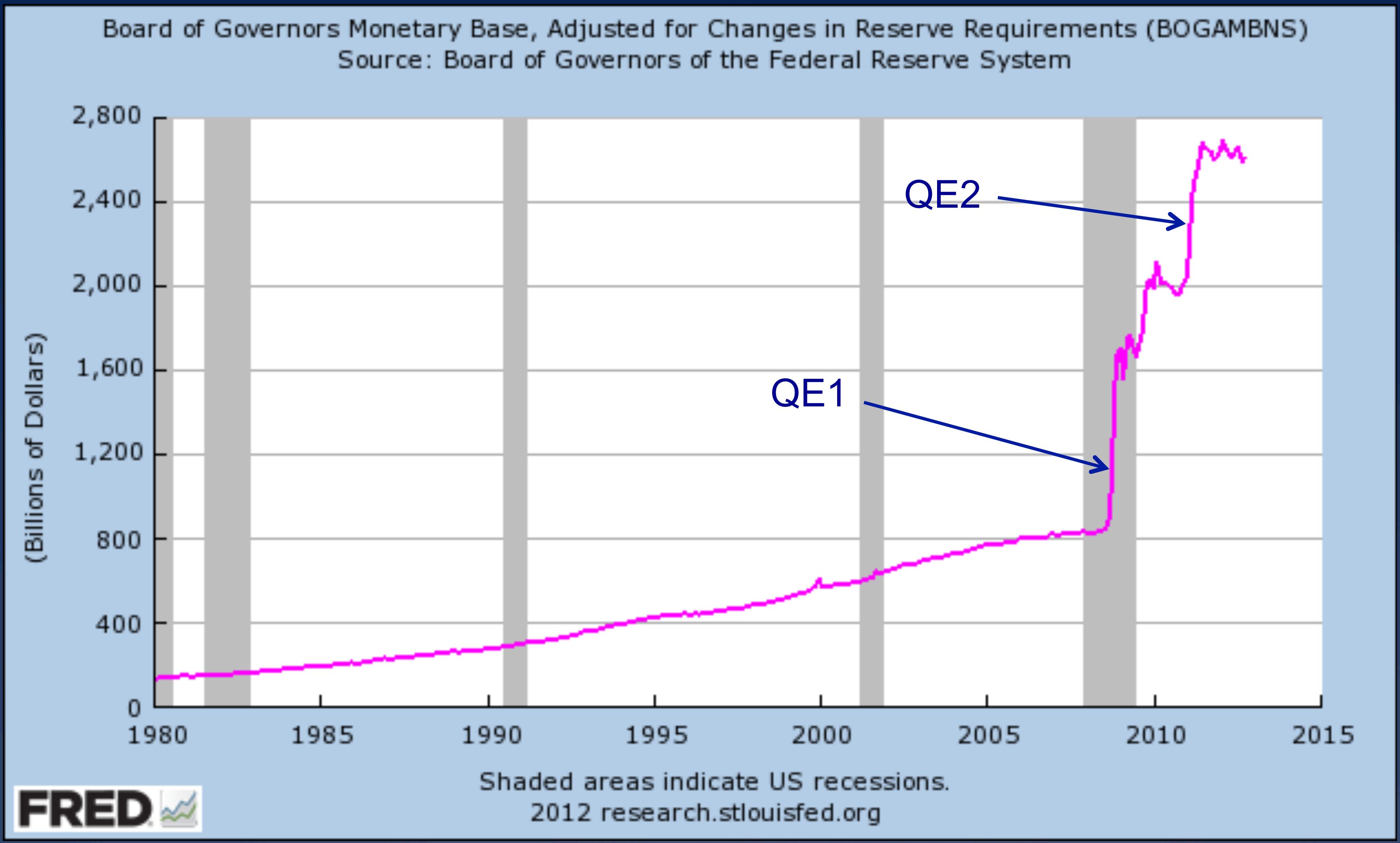
Origins of a Currency War
Monetary Drivers of Fed Policy

Monetary Analysis

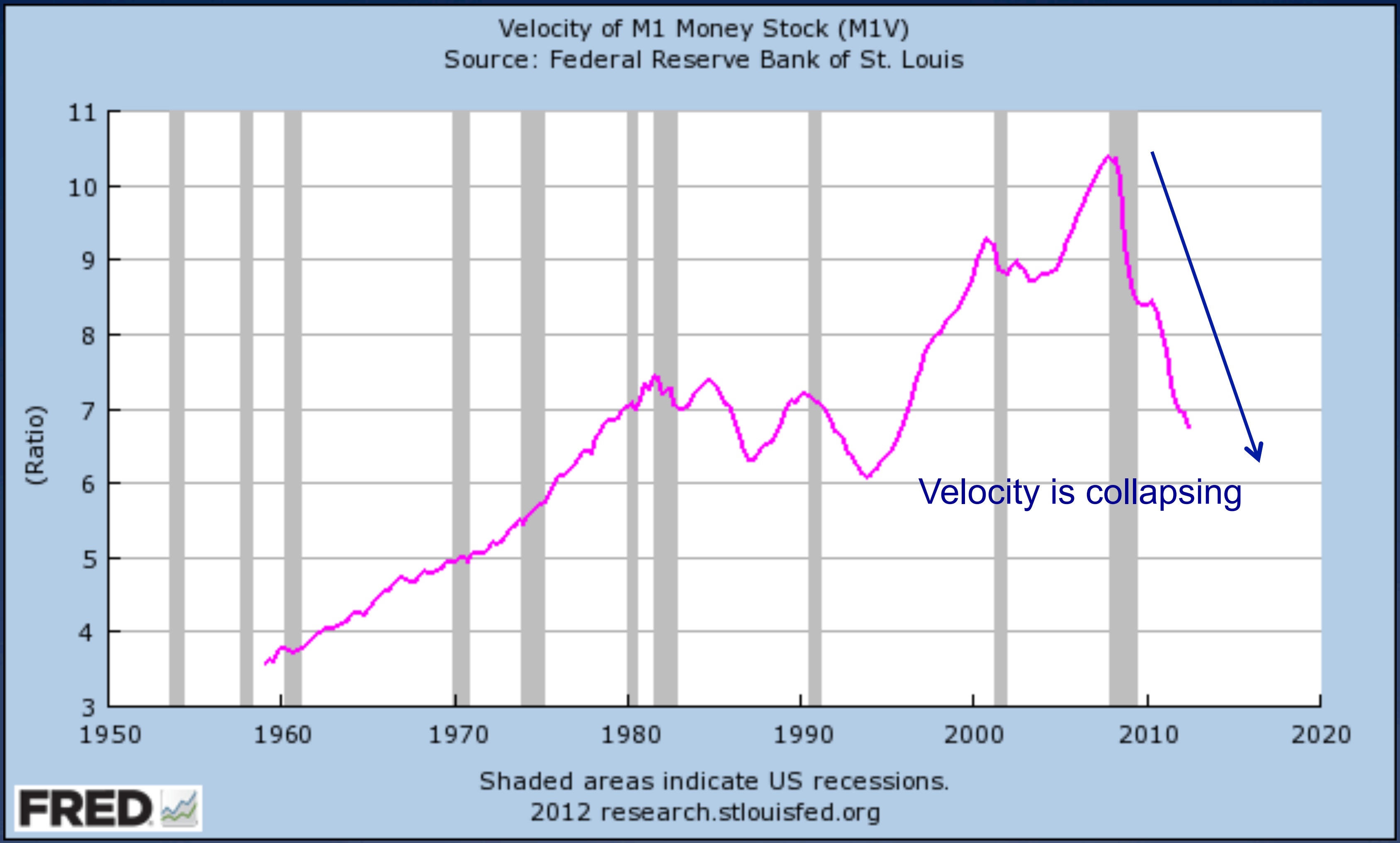
P•Q = Nominal GDP
Q = Real GDP
P = Inflation/Deflation
M = Money supply
V = Velocity of money

$$M \cdot V = P \cdot Q$$

Fed Expansion of U.S. Money Supply



Velocity of Money Both Volatile and Declining Sharply



Fed Must Bend the Velocity Curve

Changing Velocity is a Socio-Psychological Task

Primary Tools are:

Negative Real Interest Rates
e.g. Nominal Rates of 2% and Inflation of 4% =
Real Interest Rate of -2%

Inflation Expectations Shock
e.g. Expectations of 2% inflation and actual inflation of 4% causes an inflationary shock

Both Tools Require <u>4% Inflation</u>

How Does Fed Achieve 4% Inflation?

- ✔ Cutting Interest Rates (2007)
- ✔ Quantitative Easing (2008)
- ✔ Communications Policy (2008)
- ✔ Currency Wars (2010)
- ✔ Operation Twist (2011)
- ✔ Nominal GDP Targets (2012)
- ✔ Try Harder (2013)

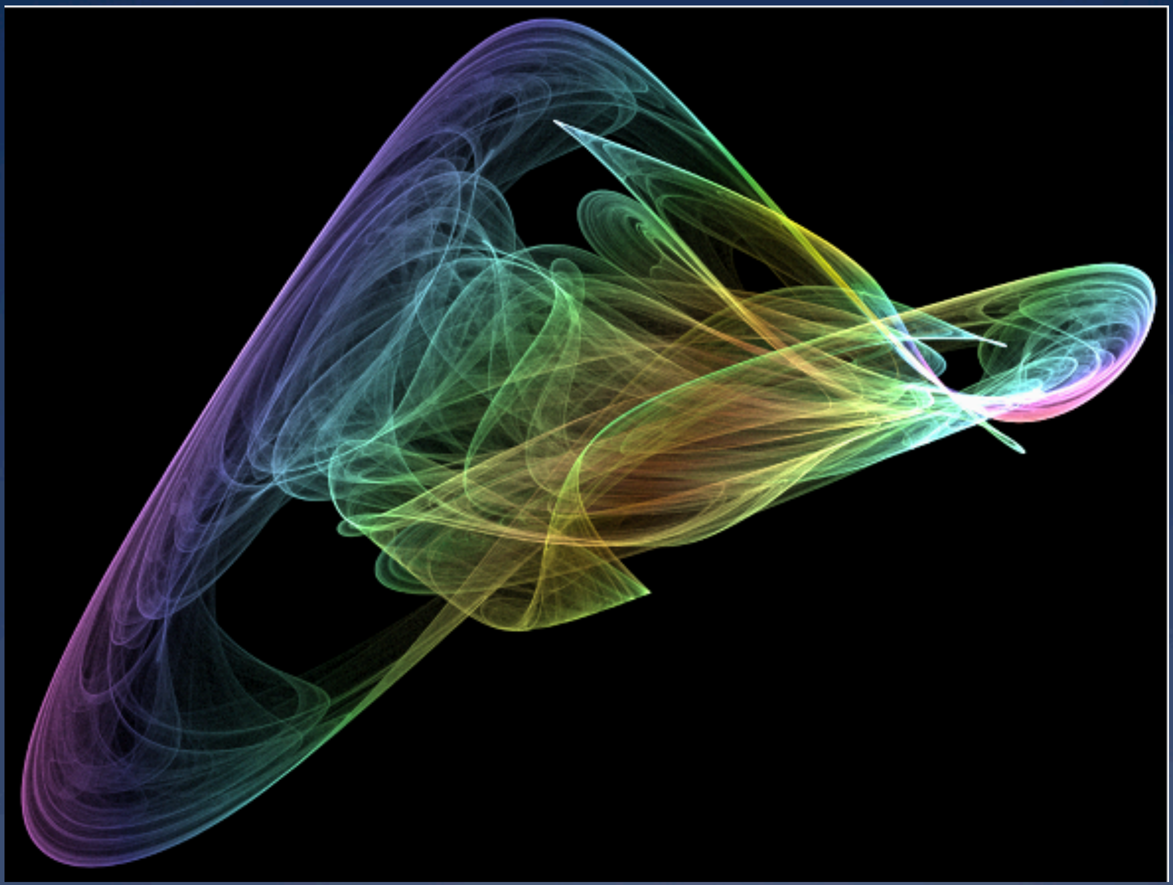
Monetary Math is Easy!

1 + 4 = 5

4 + 1 = 5

Nominal debt requires nominal GDP growth

What Could Possibly Go Wrong?



Fed Misapprehends the Statistical Properties of Risk in Currency and Capital Markets

Fed and other central banks persist in using equilibrium models

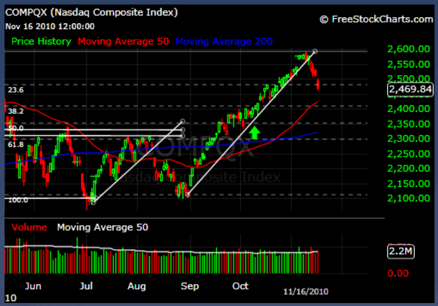
Evidence for complexity and non-equilibrium states is convincing

Are Capital Markets Complex Systems?

* Diversity

* Connectedness

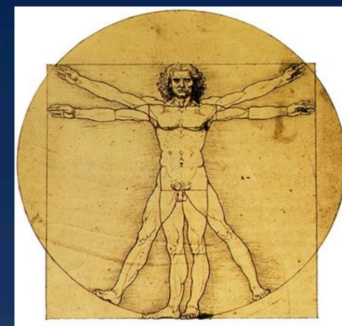
* Interaction



* Adaptability

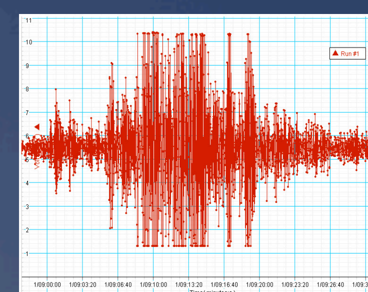
Characteristics of Complex Systems

- Emergent Properties



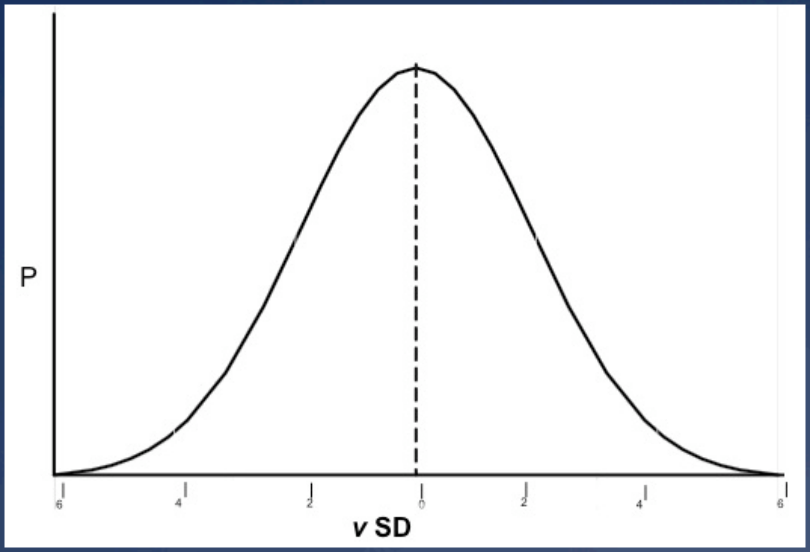
- Phase Transitions

- Critical State Dynamics

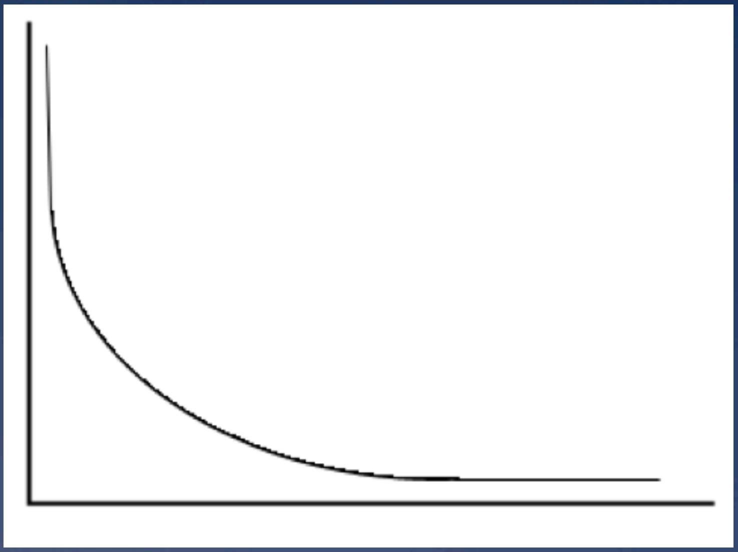


- Power Law Distribution

Comparison of Normally Distributed Events to Power Law Distribution, Bell Curve and Power Curve – Decay, Tails and Truncation



Bell Curve



Power Curve

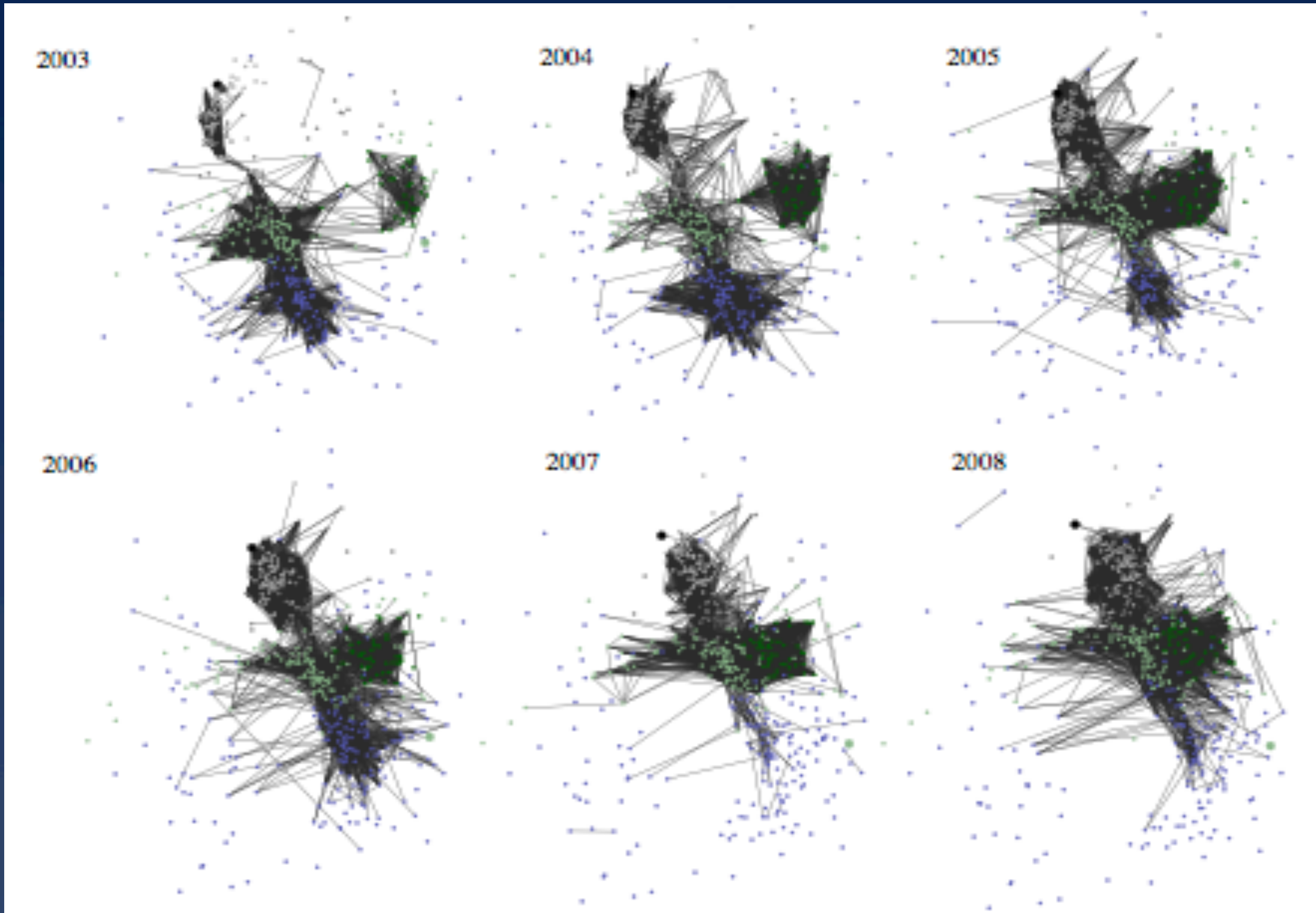
Sub-Critical and Critical States

Assume 100 People repudiate the dollar in each case
in total population of approximately 310,000,000 people.

T = Critical Threshold for each cohort

Case 1 **Sub-critical State**	**Case 2** **Critical State**
1,000 people / T= 500	1,000 people / T= 100
1 million people / T = 10,000	1 million people / T = 1,000
10 million people / T = 100,000	10 million people / T = 100,000
100 million people / T= 10 mil.	100 million people / T= 10 mil.
200 million people / T = 50 mil.	200 million people / T = 50 mil.

How Connected are we? How close to the Critical State?



1. Map of links between companies in 5 key economic sectors: technology (blue), oil (dark grey), other basic materials (light grey), finance linked to real estate (dark green) and other finance (light green). In 2003 the sectors are relatively distinct with real estate isolated; by 2008 they are tightly linked with finance at the centre.

Source: Professor Eve Mitleton-Kelly, London School of Economics. Used with permission.

Beyond the Collapse - The Future of the International Monetary System

Multiple Reserve Currencies

SDR's

Gold

Chaos

A World of Multiple Reserve Currencies

- Reprises 1920's and 1930's per Barry Eichengreen
- U.S. Dollar Declined from 70% to 60% of Global Reserves between 2000 and 2012
- Future Reserve Mix could be 35% USD, 35% EUR, 10% JPY, 20% GBP, CNY, CHF, CAD, AUD, other
- Dynamically unstable without an anchor
- Solves no problems, creates new one

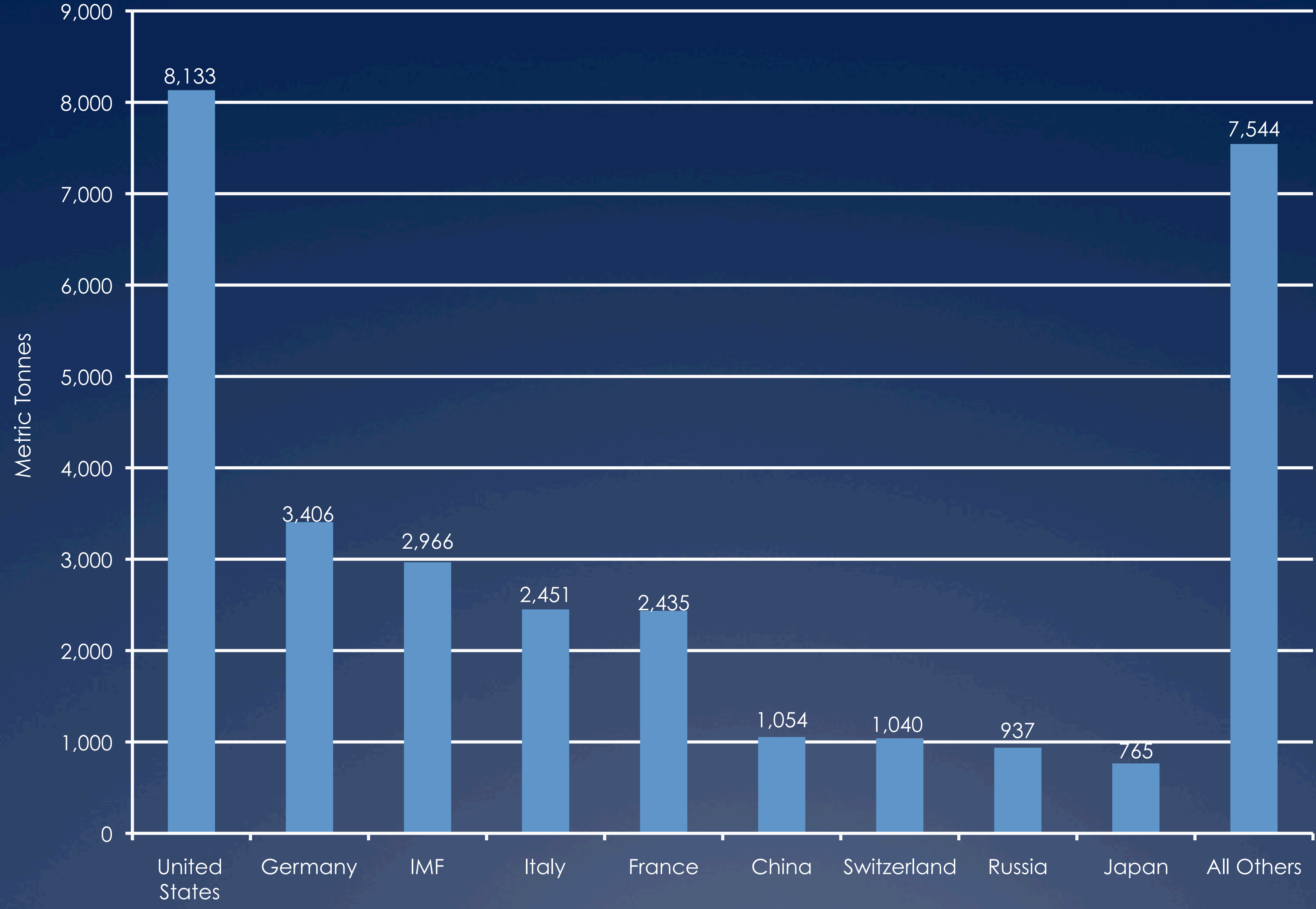
The SDR Solution

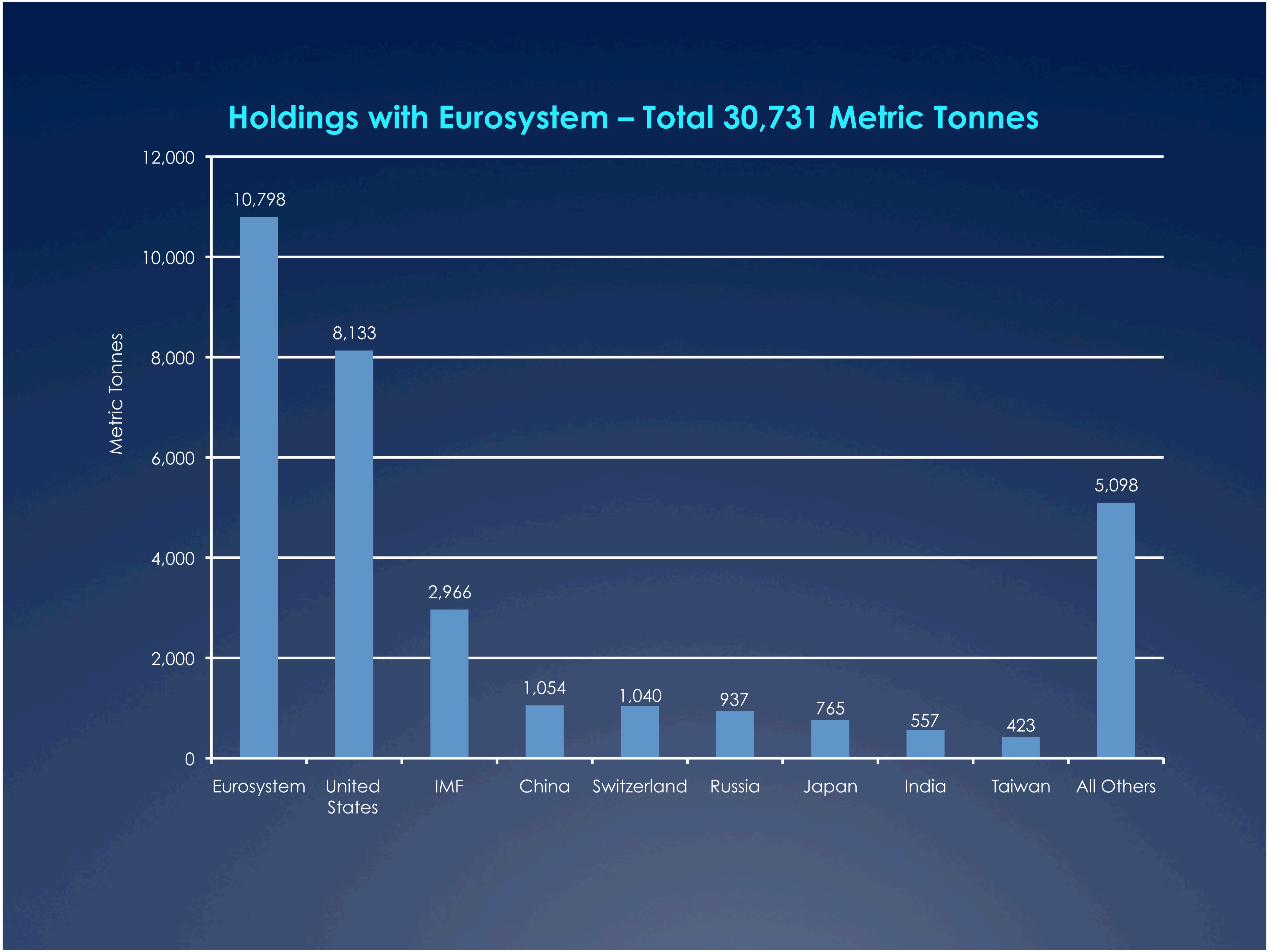
* Introduced 1969. Issued in 1972, 1981, 2009
* Obviated in 1980's by commercial banks
* Preferred path of the power elites
* Ten-year plan includes issuers, buyers, dealers, repo, derivatives and new allocations
* SDR's will not be local currency, but used for oil, global corporations, balance of payments
* Turns IMF into proto-world central bank with currency and expanded balance sheet

A New Gold Standard

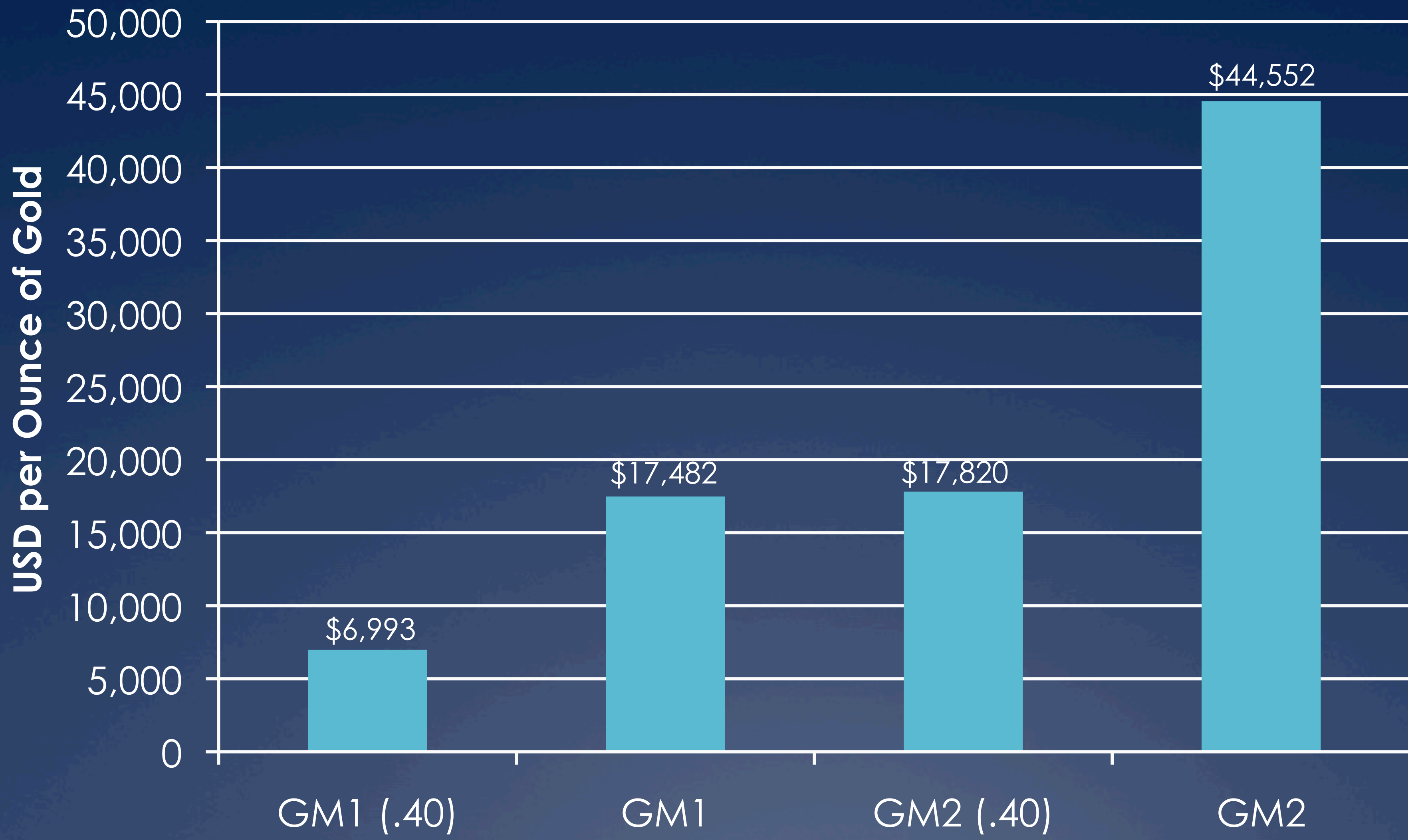
- What is a Gold Standard?
- What is the proper measure of Money?
- What is the proper reserve ratio?
- Which nations are included?

Official Gold Holdings – Total 30,731 Metric Tonnes




Holdings with Eurosystem – Total 30,731 Metric Tonnes
Metric Tonnes
12,000
10,000
8,000
6,000
4,000
2,000
0
10,798
8,133
2,966
1,054
1,040
937
765
557
423
5,098
Eurosystem
United States
IMF
China
Switzerland
Russia
Japan
India
Taiwan
All Others

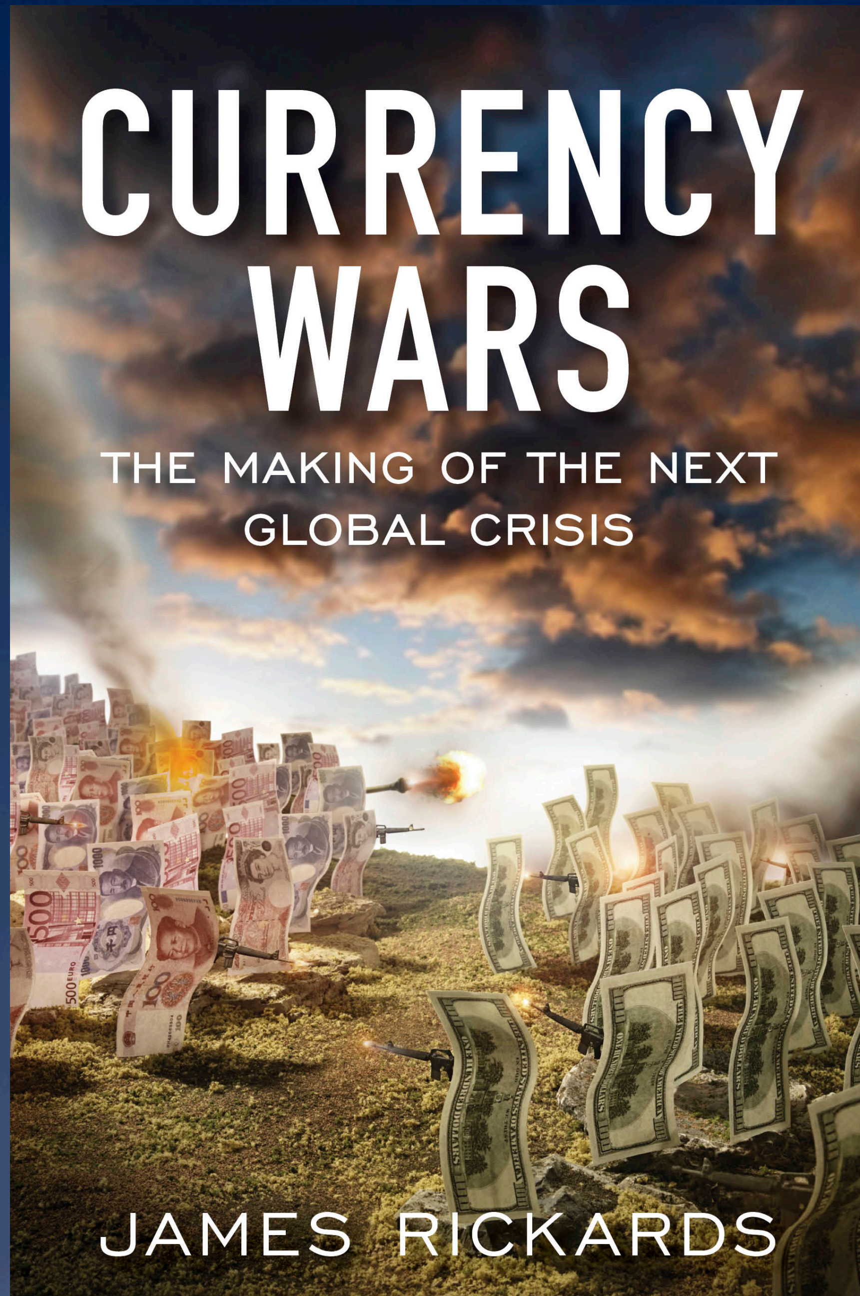
Gold Prices Based on Global Monetary Aggregates (US, ECB, China)



What Happens When Gold is the Numeraire?

The S&P500 Index in Gold Ounces

Chaos


CURRENCY WARS
THE MAKING OF THE NEXT GLOBAL CRISIS
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Thank you

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