The Saturated Sponge

We think the unthinkable is upon us. For years, for decades, greenbacks have been piling up around the world, held by Central Banks, investors and businesses. The quantity is now well into the trillions. We (and many others) have often forecast indigestion, but, like a huge sponge, the global community has relentlessly absorbed all this paper. There has been an element of blackmail to this, basically revolving around the threat that countries must hold ever more dollars to avoid undermining the system. "It may be our dollar, but it's your problem!" as a former Treasury Secretary once said.

Moving in lockstep with the greenback glut has been a series of policies, advertised as being the right thing at the right time, but really designed to prop up confidence in fiat money and profligate nations. Anti-gold activities aside, we have had the huge hoaxes of Maastricht and Gramm-Rudman and their controlled budget deficits. Perhaps worse has been the mantra of globalization – the idea that the best of all possible worlds means floating exchange rates, uncontrolled flows of speculation and survival of the fittest. Be happy, don't worry. And now the big weak countries are advancing the idea that big strong countries limit surpluses to four per cent of GDP. Sure.

In short, as the dollar situation (and more recently the dollar/Euro situation) has intensified, policy makers have put the onus on strong, disciplined countries to support profligate ones, whereas during the sweep of history strong countries have always forced errant ones to smarten up. Blame the profligates if you want, but if you give a drunk endless cases of whiskey, what do you expect? We now have groups of alcoholics controlling the throttles of the world's money supply.

Pilots have a policy of waiting twelve hours between bottle and throttle, but most countries (big and small) today give it twelve minutes. And, like all addicts, they feel they have no choice.

Now the world is saturated with greenbacks to the point that most big Asian countries are intervening in the forex market to prevent further appreciation of their own currencies. So are many "emerging" countries (even South Africa), presumably because they want to continue emerging. In addition we would bet that Britain and Euroland, because of their own staggering problems, will resist any further appreciation in the Pound and the Euro. The big German car makers currently have a fat currency related edge on their Japanese and North American competitors and we doubt they'll let it go. After all, Germany is pretty well carrying Euroland at the moment and, more than anybody, they know the problems.

The surfeit of currencies and the cult of globalization have run their course. Decades of cosmetic measures have failed. Central Bankers and others now realize that no country can afford to have a strong currency, that all countries have to do a little (or a lot) of QE, intervention and protection. This is the clear legacy of killing Bretton Woods* and, recently, the clear message of commodity markets in general and precious metal markets in particular.

But it's a message investors are still unwilling to heed. The other day we listened in to the quarterly conference call of the world's fourth biggest gold mining company. There were only two meaningful questions during the Q & A period. That's right, two. Nobody cares – presumably they feel it's too late now to consider gold, the train has left the station.

That's rubbish. We have sweated this issue for decades, but now the easy ride lies ahead. Kicking and screaming, we are on the path to (partial)

* Bretton Woods was killed 40 years ago, but US suppression of the gold price started 50 years ago in what The Economist (January 1 '61) called "a defensive act of currency management."

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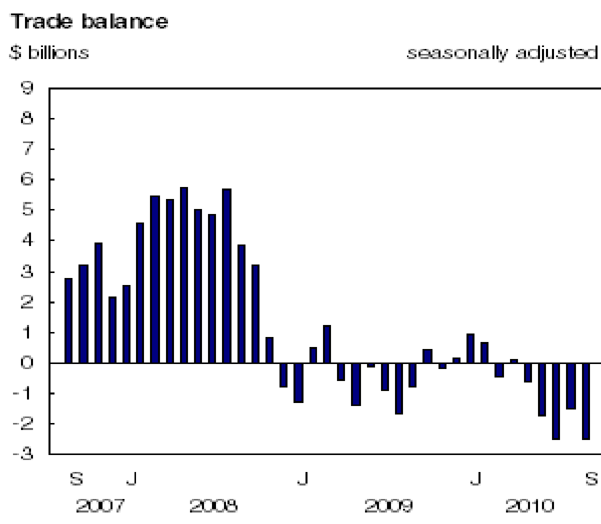
remonetization and nothing can stop it.**

But gold is small beer in the big picture. The big message to be gleaned from the end of this era is to recognize the need, the urgent need, to get out of paper and to pay attention to that huge reservoir of value contained in many stock markets. Whichever historical example you use, bad money has always led to hot stock markets. It will be a lot easier to buy good shares at 15 p/e today than at 40 p/e when the flight out of money is in full swing.

For Canadians the need may well be greater than in most countries. Canada is one of the few nations that has obediently subscribed to all the policies designed to prop up the greenback and Canada has done little or nothing to protect its own interests. We bought into the globalization scam hook line and sinker. We sold all our gold at pitiful prices, we have had Central Bank policies which have often been at odds with Canadian well-being and we have embraced floating exchange rates which have permitted speculators to drive the level of the loonie perhaps 20% higher than the level of general wage parity with the US. This has led to the closure of hundreds (thousands?) of factories and serious destruction of the Canadian tax base. And our $40 billion annual trade surplus has been replaced with a hefty trade deficit. We bought into the sub-prime fiasco and we helped bail out Detroit, after which we watched silently as the General pulled a profitable truck plant from Oshawa to the US.

With the exception of oil mines (tar sands) Canada's mining industry is not in great shape. Gold and copper production are well down over the past decade. Our current account deficit (mostly interest on past Eurodollar borrowings) just keeps growing as do federal and provincial budget deficits. GDP in Canada now means new condos, strip malls, government contracts, gourmet restaurants and Porsche dealerships. The term "wealth creation" has pretty well disappeared from our vocabulary.



Source: Statistics Canada 2010

When the speculators/investors long billions of loonies (under the illusion that Canada is a resources paradise) wake up, see the Canadian mess as it is and head for the exit we expect the loonie will be trashed.

Back to the unthinkable. The sponge is saturated. The jillions of bits of money, having spent the past several years surging and searching for a safe haven, have choked the system. A melt-down of the Southeast Asian variety is at hand, or rather, a melt-up in which gold, oil, stock markets and all sorts of things go up in terms of all currencies. Particularly the loonie; hell hath no fury…

** World Bank chief Robert Zoellick recently said "… markets are using gold as an alternative monetary asset today."

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